

Cipla Ltd

HOLD
CMP Rs303
TP Rs312

06 May 2011

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Quarter below expectation, no near term triggers

Cipla reported disappointing Q4FY11 results with OPM contracting 212bps on back of higher contribution from the low-margin ARV business. Further, Cipla's FY12 guidance is also not encouraging especially on the margins front in spite of the fact that 10% of sales is expected to come from Indore SEZ. The stock has under performed the broader market by ~7% in last 3 months. We have revised downwards our FY12 earning estimates by 9% to factor in lower OPM. We continue to maintain our Hold rating with a reduced target price of Rs312 (earlier Rs331) based on June'12E earnings.

Sales growth surprises but the mix disappoints

Cipla reported net sales of Rs16,152mn up 22.6% which surprised positively primarily driven by the exports. However 60% of the export growth came from the ARV segment which disappointed as the same was at the cost of the margins. Domestic business grew by strong 14.7% driven by field force expansion and product launches.

Margins under pressure

The company reported OPM of 18.1% (lowest in last 3 years) as against our estimates of 19.9% on account of higher raw-material cost. The higher raw-material cost was on back of increasing contribution from the ARV segment. We estimate the ARV segment to have margins in high single digit.

Key call takeaways

1) The company has guided for 10-12% revenue growth and 18-20% OPM for FY12. 2) Indore SEZ is expected to contribute 10% of the total sales in FY12 from current 4% in Q4FY11. Further, US FDA inspection of the facility is still pending 3) On the domestic front Cipla now has strong field force of 6,000 MR and plans to enter new TA (oncology and CNS) 4) DEPB income was at Rs600mn for FY11 5) The low-margin ARV business contributed 30% (22% earlier) to the total exports for the quarter. 6) For FY11 the debt was at Rs3,500mn and cash at Rs2,500mn.

KEY FINANCIALS (Rs mn)

	FY09	FY10	FY11E	FY12E	FY13E
Total Revenue	51,786	55,133	62,109	71,627	82,867
YoY Gr.(%)	23.2	6.5	12.7	15.3	15.7
Op. Profit	9,487	12,183	13,155	15,075	17,746
OPM (%)	18.3	22.1	21.2	21.0	21.4
Adj. Net Profit	7,769	9,864	9,689	11,035	12,373
YoY Gr.(%)	11.0	27.0	(1.8)	13.9	12.1

KEY RATIOS

Dil. EPS (Rs)	9.7	12.3	12.1	13.7	15.4
ROCE (%)	18.9	21.7	18.4	18.8	19.3
RoE (%)	19.2	19.2	15.5	15.8	15.8
PER (x)	31.2	24.7	25.1	22.0	19.7
EV/ Net Sales (x)	4.9	4.4	3.9	3.4	2.9
EV/EBDITA (x)	26.4	19.7	18.2	15.9	13.4

QUARTERLY SNAPSHOT (Rs mn)

	Quarter Ended		
	Sep-10	Dec-10	March-11
Net Revenue	16,154	15,537	16,152
YoY Gr.(%)	12.0	8.0	22.6
Op. Profit	3,516	3,182	3,021
OPM(%)	21.8	20.5	18.1
Adj.Net Profit	2,506	2,327	2,140
YoY Gr. (%)	(9.5)	(24..7)	(1.0)

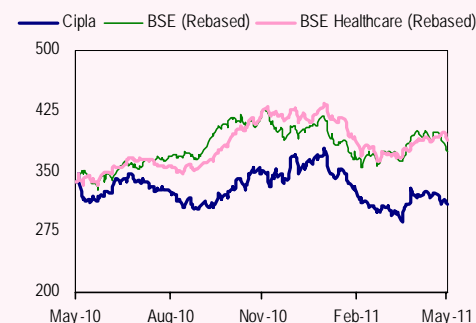
STOCK DATA

Market cap	Rs240bn
Book Value per share	Rs92
Shares O/S (F.V. Rs2)	803mn
Free Float	63.2%
Avg. Trade Value (6 months)	Rs499mn
52 week High/Low	Rs381/300
Bloomberg Code	CIPLA IN
Reuters Code	CIPL.BO

PERFORMANCE (%)

	1M	3M	12M
Absolute	(4.0)	(7.8)	(12.1)
Relative	3.9	(6.6)	(18.0)

RELATIVE PERFORMANCE



Outlook and Valuation

We have revised downward our FY12 earning estimates to factor in OPM of 21.0% (still higher than the guidance) from earlier 22.8%. We now expect net sales and earnings to clock CAGR of 15.5% and 12.6% respectively over FY11-13E. We have valued the stock at 22x June'12E earnings and continue to maintain HOLD rating on the stock with a reduced target price of Rs312. Key long term trigger for the stock going ahead would be approval of combination inhalers in EU.

Exhibit 1 - Earnings Summary (Rs mn)

March Ended	Q4FY10	Q4FY11	% Ch YoY	Q3FY11	% Ch QoQ	FY10	FY11	Ch YoY	PINC Comments
Gross Sales	13,290	16,272	22.4	15,158	7.4	54,116	61,726	14.1	Strong domestic and export formulations led the growth
Excise Duty	115	120	3.8	144	(16.9)	522	487	(6.6)	
<i>Excise duty rate</i>	<i>0.9</i>	<i>0.7</i>	<i>-13 bps</i>	<i>0.9</i>	<i>-21 bps</i>	<i>1.0</i>	<i>0.8</i>	<i>-17 bps</i>	
Net Sales	13,175	16,152	22.6	15,014	7.6	53,594	61,238	14.3	
Other Operating Income	572	540	(5.6)	523	3.2	2,719	1,941	(28.6)	
Net Revenues	13,747	16,692	21.4	15,537	7.4	56,314	63,180	12.2	
Expenditure	10,967	13,671	24.7	12,355	10.7	42,718	49,815	16.6	
EBITDA	2,780	3,021	8.7	3,182	(5.1)	13,596	13,365	(1.7)	Margins impacted by High raw-material cost on back of increasing contribution from low-margin ARV segment
<i>EBITDA Margins (%)</i>	<i>20.2</i>	<i>18.1</i>	<i>-212 bps</i>	<i>20.5</i>	<i>-238 bps</i>	<i>24.1</i>	<i>21.2</i>	<i>-299 bps</i>	
EBITDA (ex tech fees)	2,208	2,481	12.4	2,659	(6.7)	10,877	11,423	5.0	
<i>EBITDA - excl technology income (%)</i>	<i>16.8</i>	<i>15.4</i>	<i>-140 bps</i>	<i>17.7</i>	<i>-235 bps</i>	<i>20.3</i>	<i>18.7</i>	<i>-164 bps</i>	
Interest	5	18	293.5	29	(38.2)	237	51	(78.3)	
Depreciation	495	697	40.8	653	6.8	1,878	2,536	35.0	Rise on the back of commissioning of the Indore SEZ
Other income	1,401	204	(85.5)	257	(20.8)	1,833	794	(56.7)	Last quarter consisted sale of i-pill for Rs950mn
Forex gain/(loss)	(200)	-	(100.0)	-	-	(635)	10	(101.6)	
PBT	3,481	2,510	(27.9)	2,757	(9.0)	12,679	11,581	(8.7)	
Tax	726	370	(49.0)	430	(14.0)	2,485	1,910	(23.1)	Lower tax rate for the quarter
<i>Tax rate (%)</i>	<i>20.9</i>	<i>14.7</i>	<i>-611 bps</i>	<i>15.6</i>	<i>-86 bps</i>	<i>19.6</i>	<i>16.5</i>	<i>-311 bps</i>	
Reported profit	2,755	2,140	(22.3)	2,327	(8.0)	10,194	9,671	(5.1)	
Adjustments	594	-	(100.0)	-	-	(635)	8	(101.3)	
Recurring profit	2,162	2,140	(1.0)	2,327	(8.0)	10,829	9,663	(10.8)	
<i>Net margin (%)</i>	<i>16.4</i>	<i>13.2</i>	<i>-316 bps</i>	<i>15.5</i>	<i>-225 bps</i>	<i>20.2</i>	<i>15.8</i>	<i>-443 bps</i>	

Source: PINC Research, Company

Exhibit 2 - Expenditure Break-up (Rs mn)

Year to 31 March	Q4FY10	Q4FY11	% Ch YoY	Q3FY11	% Ch QoQ	FY10	FY11	Ch YoY	PINC Comments
Net Sales	13,175	16,152	22.6	15,014	7.6	53,594	61,238	14.3	
Consumption of Raw Materials	6,108	7,998	30.9	6,958	14.9	24,706	29,146	18.0	On back of increasing contribution of low-margin ARV segment
<i>% of Net sales</i>	<i>46.4</i>	<i>49.5</i>	<i>315 bps</i>	<i>46.3</i>	<i>317 bps</i>	<i>46.1</i>	<i>47.6</i>	<i>150 bps</i>	
Staff Cost	999	1,308	30.9	1,351	(3.2)	3,711	5,410	45.8	Addition of Indore SEZ
<i>% of Net sales</i>	<i>7.6</i>	<i>8.1</i>	<i>52 bps</i>	<i>9.0</i>	<i>-90 bps</i>	<i>6.9</i>	<i>8.8</i>	<i>191 bps</i>	
Other Expenses	3,860	4,365	13.1	4,046	7.9	14,301	15,260	6.7	On account of Indore SEZ and higher selling expenses
<i>% of Net sales</i>	<i>29.3</i>	<i>27.0</i>	<i>-227 bps</i>	<i>26.9</i>	<i>8 bps</i>	<i>26.7</i>	<i>24.9</i>	<i>-176 bps</i>	
Total Expenditure	10,967	13,671	24.7	12,355	10.7	42,718	49,815	16.6	
<i>% of Net sales</i>	<i>83.2</i>	<i>84.6</i>	<i>140 bps</i>	<i>82.3</i>	<i>235 bps</i>	<i>79.7</i>	<i>81.3</i>	<i>164 bps</i>	

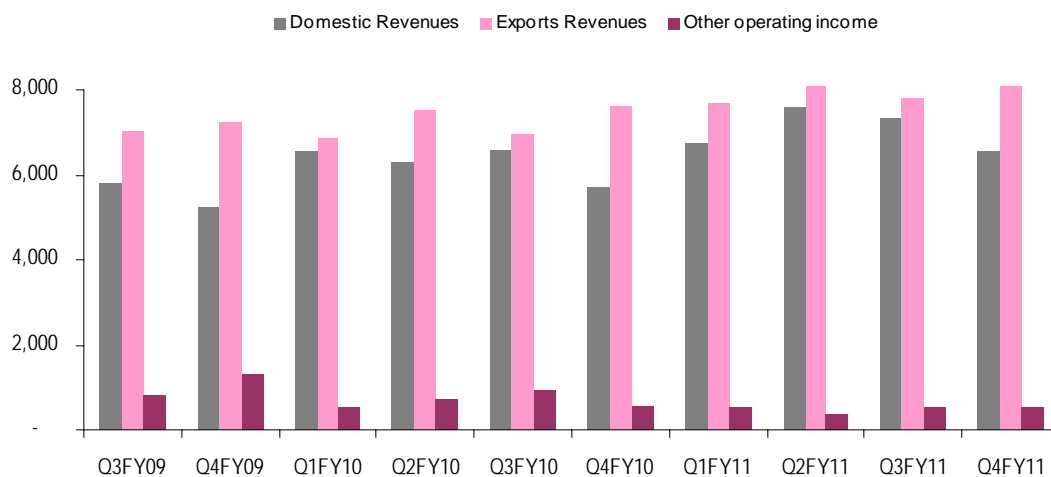
Source: PINC Research, Company

Exhibit 3 - Geographic Revenue Mix (Rs mn)

Year to 31 March	Q4FY10	Q4FY11	% Ch YoY	Q3FY11	% Ch QoQ	FY10	FY11	Change YoY	PINC Comments
Domestic	5,688	6,522	14.7	7,340	(11.1)	25,111	28,178	12.2	Driven by field force expansion and product launches
<i>% of Total Revenues</i>	<i>41.0</i>	<i>38.8</i>	<i>-223 bps</i>	<i>46.8</i>	<i>-801 bps</i>	<i>44.2</i>	<i>44.3</i>	<i>8 bps</i>	
Exports	7,602	9,750	28.2	7,818	24.7	29,005	33,548	15.7	Driven by ARV segment which contributed 30% of export sales
<i>% of Total Revenues</i>	<i>54.8</i>	<i>58.0</i>	<i>315 bps</i>	<i>49.9</i>	<i>814 bps</i>	<i>51.0</i>	<i>52.7</i>	<i>166 bps</i>	
Formulations	6,139	7,428	21.0	6,432	15.5	23,205	26,756	15.3	
APIs	1,463	2,322	58.7	1,386	67.5	5,800	6,792	17.1	Lumpy business
Sales	13,290	16,272	22.4	15,158	7.4	54,116	61,726	14.1	
Other operating income	572	540	(5.6)	523	3.2	2,719	1,941	(28.6)	Expected to remain subdued
<i>% of Total Revenues</i>	<i>4.1</i>	<i>3.2</i>	<i>-92 bps</i>	<i>3.3</i>	<i>-13 bps</i>	<i>4.8</i>	<i>3.0</i>	<i>-174 bps</i>	
Total Revenues	13,862	16,812	21.3	15,681	7.2	56,835	63,667	12.0	

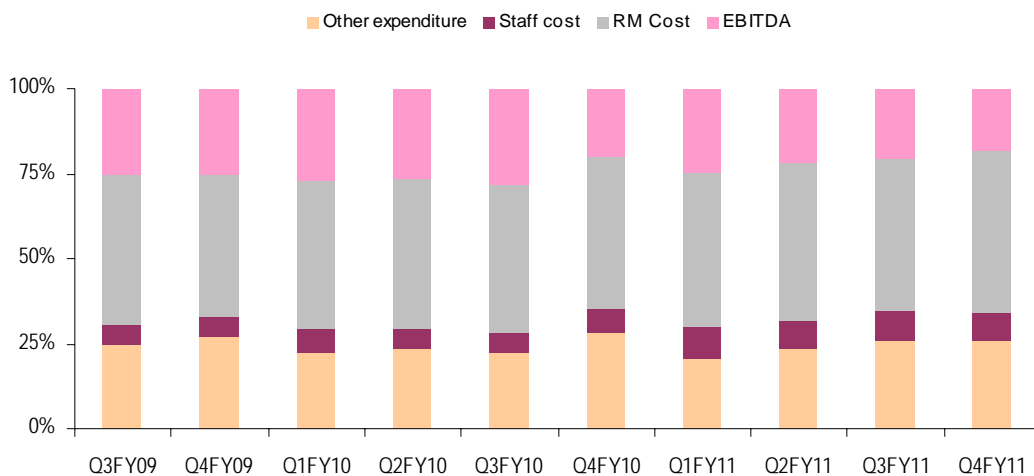
Source: PINC Research, Company

Exhibit 4 - Revenue Classification (Rs mn)



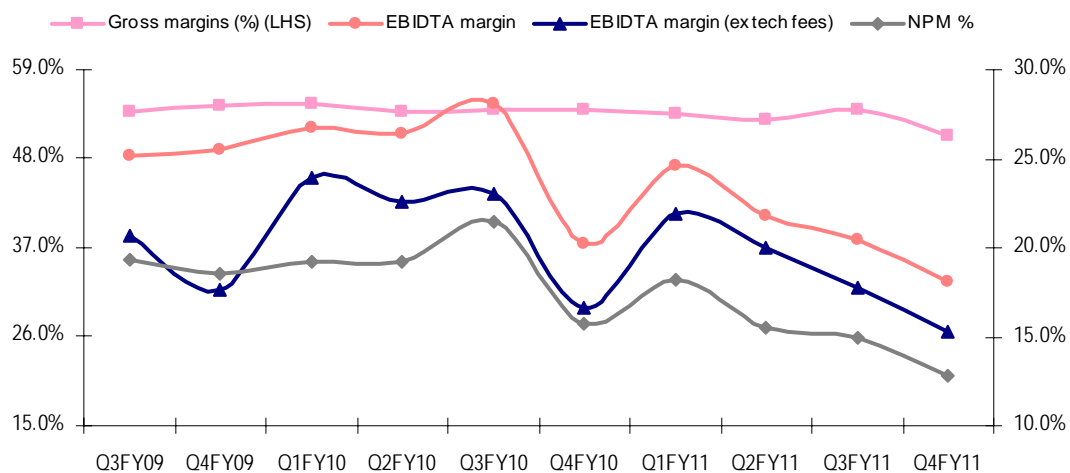
Source: PINC Research, Company

Exhibit 5 - Operating Expenses and Profit break-up



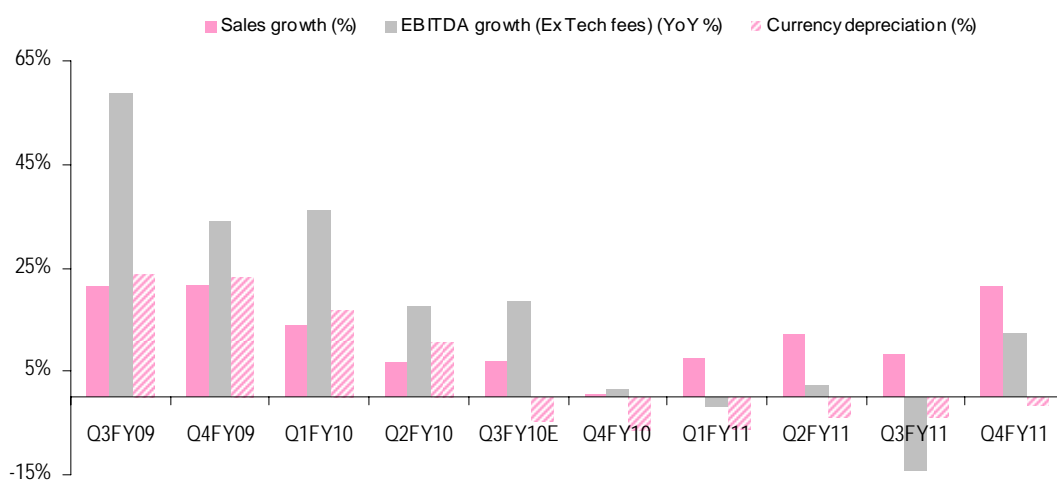
Source: PINC Research, Company

Exhibit 6 - Margin Movement



Source: PINC Research, Company

Exhibit 7 - Sales and EBITDA Growth v/s Currency Depreciation



Source: PINC Research, Company

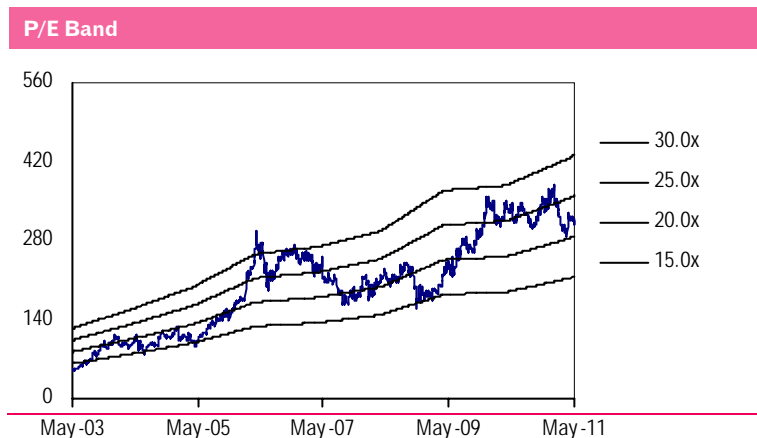
Year Ended March (Figures in Rs mn)

Income Statement	FY09	FY10	FY11E	FY12E	FY13E
Net sales	49,608	53,595	60,879	70,336	81,575
Other operating income	2,178	1,538	1,230	1,292	1,292
Total Revenues	51,786	55,133	62,109	71,627	82,867
Growth (%)	23.2	6.5	12.7	15.3	15.7
EBITDA	9,487	12,183	13,155	15,075	17,746
Growth (%)	12.2	28.4	8.0	14.6	17.7
Depreciation	1,518	1,653	2,570	2,866	3,548
Other Income	1,375	1,999	1,236	1,254	1,274
EBIT	9,343	12,529	11,822	13,464	15,472
Interest Paid	329	230	6	6	6
PBT (before E/o items)	9,014	12,299	11,815	13,458	15,466
Tax Provision	1,245	2,435	2,127	2,422	3,093
E/o income/(loss)	-	950	-	-	-
Net Profit	7,769	10,814	9,689	11,035	12,373
Adjusted Net Profit	7,769	9,864	9,689	11,035	12,373
Growth (%)	11.0	27.0	(1.8)	13.9	12.1
Diluted EPS (Rs)	9.7	12.3	12.1	13.7	15.4
Diluted EPS Growth (%)	11.3	26.6	(1.8)	13.9	12.1

Cash Flow Statement	FY09	FY10	FY11E	FY12E	FY13E
PBIT	7,990	10,530	10,585	12,209	14,198
Depreciation	1,518	1,653	2,570	2,866	3,548
Total Tax Paid	(1,245)	(2,435)	(2,127)	(2,422)	(3,093)
Chg in working capital	(5,565)	(1,396)	(1,820)	(2,098)	(233)
Other operating activities	1,045	1,769	1,230	1,248	1,268
Cash flow from oper (a)	3,743	10,120	10,438	11,803	15,687
Capital Expenditure	(6,247)	(5,219)	(6,500)	(6,500)	(6,500)
Chg in investments	134	(1,663)	(1,104)	790	(2,020)
Other investing activities	-	-	-	-	-
Cash flow from inv.(b)	(6,113)	(6,882)	(7,604)	(5,710)	(8,519)
Free cash flow (a+b)	(2,370)	3,238	2,834	6,093	7,168
Equity raised/(repaid)	-	6,691	-	-	-
Debt raised/(repaid)	3,998	(9,352)	-	-	-
Change in Minority Int	4	5	6	6	7
Dividend (incl. Tax)	(2,278)	(2,885)	(2,834)	(3,228)	(3,619)
Other financing activities	(1,165)	(1,165)	(1,165)	(1,165)	(1,165)
Cash flow from fin. (c)	559	(6,706)	(3,993)	(4,386)	(4,777)
Net chg in cash (a+b+c)	(1,811)	(3,468)	(1,159)	1,707	2,391

Balance Sheet	FY09	FY10	FY11E	FY12E	FY13E
Equity Share Capital	1,555	1,606	1,606	1,606	1,606
Reserves & surplus	41,923	57,500	64,355	72,162	80,916
Shareholders' funds	43,478	59,106	65,961	73,768	82,522
Minorities interests	-	-	-	-	-
Total Debt	9,402	51	51	51	51
Capital Employed	52,880	59,156	66,011	73,819	82,573
Net fixed assets	23,588	26,954	30,884	37,384	43,884
Cash & Cash Eq.	534	621	500	500	500
Net Other current assets	29,600	30,909	32,850	34,948	35,181
Investments	801	2,464	3,568	2,778	4,799
Net Deferred tax Assets	(1,642)	(1,792)	(1,792)	(1,792)	(1,792)
Total Assets	52,881	59,156	66,011	73,819	82,573

Key Ratios	FY09	FY10	FY11E	FY12E	FY13E
OPM (%)	18.3	22.1	21.2	21.0	21.4
Net Margin (%)	15.7	18.4	15.9	15.7	15.2
Div. Yield (%)	0.8	1.0	1.0	1.1	1.3
Net debt/Equity (x)	0.2	(0.1)	(0.0)	0.0	0.1
Net Working Capital (days)	208.6	204.6	193.1	178.1	155.0
ROCE (%)	18.9	21.7	18.4	18.8	19.3
RoE (%)	19.2	19.2	15.5	15.8	15.8
EV/Net Sales (x)	4.9	4.4	3.9	3.4	2.9
EV/EBITDA (x)	26.4	19.7	18.2	15.9	13.4
PER (x)	31.2	24.7	25.1	22.0	19.7
PCE (x)	25.3	21.1	19.8	17.5	15.3
Price/Book (x)	5.4	4.1	3.7	3.3	2.9



Key Assumptions	FY09	FY10	FY11E	FY12E	FY13E
Formulation Export Growth (% yoy)	34.5	7.6	15.0	18.0	20.0
Bulk Export Growth (% yoy)	7.8	-1.2	14.0	12.0	12.0
Domestic Formulation Growth (% yoy)	12.8	12.4	12.0	13.9	13.0
Domestic Bulk Growth (% yoy)	65.6	-72.2	10.0	10.0	5.0
Capital expenditure	6,247	5,219	6,500	6,500	6,500
Gross margins (%)	54.7	55.5	54.0	53.7	54.1
EBITDA margins (%)	18.4	22.1	21.2	21.0	21.4

T E A M

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