

**BUY**

TP: Rs 1,160 | ▲ 28%

**CIPLA**

| Pharmaceuticals

| 26 January 2022

## Growth led by India business

- Q3 sales growth modest at 6% YoY led by US and India formulations. API sales declined due to slowdown in orders from developed markets
- EBITDA margin remained healthy at 22.5% despite RM cost pressure and higher freight charges
- We roll over to FY24E valuations but retain our TP at Rs 1,160 with a reduced multiple of 16x EV/EBITDA (vs. 17x). Reiterate BUY

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**Strong traction in US business:** Cipla reported modest 6% YoY sales growth in Q3FY22 with strong tractions in India formulations, US generics and branded portfolio in Africa. Contribution from the Covid-19 portfolio, however, declined by 17% QoQ and 10% YoY. US business reaches its highest revenues at US\$ 150 mn with momentum in the core portfolio, especially respiratory and other products. The company's Rx share in Albuterol and Arformoterol was at 15.9% and 26.8% in 3QFY22 respectively.

**'One India' India strategy delivers strong growth:** India business grew 13% YoY led by sustained momentum across core therapies and traction in flagship brands, while contribution from the Covid portfolio remained modest. Order flow in the trade generics prescription (GRx) business remained healthy across therapies and regions. Cipla's consumer business witnessed steady growth with strong traction in core and transitioned brands. Lower order flow from developed markets affected API sales (-25% YoY).

**Inline EBITDA margin despite headwinds:** Cipla reported an EBITDA margin of 22.5% (-135bps YoY) despite raw material and freight cost headwinds, as these were partly offset by benefits from increased sales in complex and chronic launches. Gross margin came at 60.9% (-55bps YoY, -40bps QoQ) due to the cost inflation as well as certain provisions for inventory and lower contribution of Covid products. Management expects the gross margin to improve as complex launches will benefit with favourable product mix going forward.

**Maintain BUY with TP of Rs 1,160:** With a strong India franchise, rich US pipeline and low risk of price erosion in the US, Cipla is poised to leverage the network reach of the robust core portfolio to launch major generics. In our view, operating leverage in the US business will be a key margin driver for FY22-E-24E. We reiterate BUY and retain our TP at Rs 1,160 as we roll forward to FY24E EBITDA while lowering our target multiple from 17x to 16x EV/EBITDA (implied P/E of 26x) in light of the slowdown in API sales, lower Covid contribution and cost headwinds.

## Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	CIPLA IN/Rs 906
Market cap	US\$ 9.8bn
Free float	63%
3M ADV	US\$ 28.9mn
52wk high/low	Rs 1,005/Rs 738
Promoter/FPI/DII	36%/25%/21%

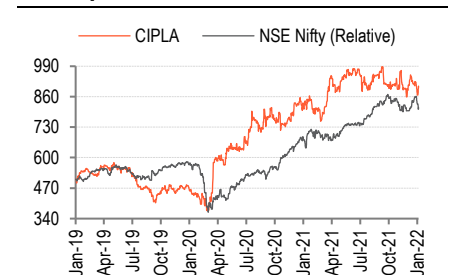
Source: NSE | Price as of 25 Jan 2022

## Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	1,90,682	2,15,698	2,34,785
EBITDA (Rs mn)	41,611	47,567	50,362
Adj. net profit (Rs mn)	23,135	27,604	29,768
Adj. EPS (Rs)	28.7	34.3	36.9
Consensus EPS (Rs)	28.7	35.1	41.7
Adj. ROAE (%)	13.5	14.2	13.6
Adj. P/E (x)	31.5	26.4	24.5
EV/EBITDA (x)	17.8	15.2	13.9
Adj. EPS growth (%)	57.3	19.3	7.8

Source: Company, Bloomberg, BOBCAPS Research

## Stock performance



Source: NSE



## Earnings call highlights

- **India formulations growth led by 'One India' model:** India formulations grew 13% YoY in Q3FY22 led by sustained momentum across core therapies and traction in flagship brands, while contribution from the Covid portfolio remained modest. Traction in the trade generics Rx remained healthy across therapies and regions. Cipla's consumer business saw steady growth with strong traction in core and transitioned brands.

EBITDA margin in branded sales is the highest among the India formulation verticals of CIPLA, while trade generics is marginally lower. Both margins are, however, higher than Cipla's blended average EBITDA margin. Management expects the consumer healthcare business to achieve operating breakeven in FY22E.

- **SAGA:** Private business in South Africa (SA) grew 16% YoY in local currency (ZAR) in 3QFY22. Secondary sales are however continued to grow in line with the market led by nine new launches.
- **US generics:** Cipla reported US\$ 150 mn in Q3 revenue from the US market due to robust momentum in core formulations and strong traction in the respiratory portfolio. Its Rx share in Albuterol and Arformoterol stood at 15.9% and 26.8% respectively – among the highest in recent quarters.
- **EMs:** CIPLA's strong growth in direct-to-market (DTM) portfolio maintained with a steady double-digit uptick in secondary sales. Cipla filed two respiratory products in Europe in 3QFY22.
- **Covid-19 contribution:** Contribution from Covid products declined by 10% YoY and 17% QoQ.
- **API:** Order flow from developed markets in the API business witnessed a momentary slowdown due to overstocking in channel networks. EMs maintained normal transaction flow and the order book is robust in medium-term.
- **New approvals:** Cipla received its first 505 (b)(2) approval for Lanerotide injection; this expands the peptide portfolio in the US, which is planned as a key franchise along with the inhaler portfolio.
- **R&D investments:** R&D investments stands at Rs 2.6bn in 3QFY22. Spending on priority development projects is on track and management guided that upper limit of the R&D expense to be 7-7.5% of annual sales. R&D spend will be higher in FY23E as some clinical trials to commence.
- **Net cash balance since Dec'21:** Growth in operating profit and prudent working capital management support a continued, healthy net cash-positive position as of Dec'21, despite strategic inventory buildup to maintain adequate supply. TTM ROIC of 21.2% continues to track above the long-term sustainable range.

**Fig 1 – Quarterly performance**

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
<b>Net Sales</b>	<b>54,789</b>	<b>51,687</b>	<b>6.0</b>	<b>55,198</b>	<b>(0.7)</b>	<b>1,65,030</b>	<b>1,45,531</b>	<b>13.4</b>
<b>EBITDA</b>	<b>12,310</b>	<b>12,309</b>	<b>0.0</b>	<b>12,262</b>	<b>0.4</b>	<b>38,031</b>	<b>34,561</b>	<b>10.0</b>
Depreciation	2,475	2,484	-	2,531	-	7,616	7,825	-
<b>EBIT</b>	<b>9,835</b>	<b>9,825</b>	<b>0.1</b>	<b>9,731</b>	<b>1.1</b>	<b>30,414</b>	<b>26,736</b>	<b>-</b>
Interest	207	479	-	380	-	883	1,333	-
Other Income	913	869	-	607	-	2,169	2,059	-
<b>PBT</b>	<b>10,541</b>	<b>10,215</b>	<b>3.2</b>	<b>9,958</b>	<b>5.9</b>	<b>31,701</b>	<b>27,462</b>	<b>15.4</b>
Less: Taxation	2,952	2,690	-	2,838	-	8,627	7,605	-
Less: Minority Interest	304	44	-	6	-	281	(56)	-
<b>Recurring PAT</b>	<b>7,286</b>	<b>7,481</b>	<b>(2.6)</b>	<b>7,114</b>	<b>2.4</b>	<b>22,793</b>	<b>19,913</b>	<b>14.5</b>
Exceptional items	0	0	-	0	-	(1,246)	0	-
<b>Reported PAT</b>	<b>7,286</b>	<b>7,481</b>	<b>(2.6)</b>	<b>7,114</b>	<b>2.4</b>	<b>21,547</b>	<b>19,913</b>	<b>8.2</b>
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
Gross Margin	60.9	61.4	(55)	61.3	(41)	61.5	62.0	(48)
EBITDA Margin	22.5	23.8	(135)	22.2	25	23.0	23.7	(70)
Tax / PBT	28.0	26.3	-	28.5	-	27.2	27.7	-
NPM	13.3	14.5	(118)	12.9	41	13.8	13.7	-
<b>EPS (Rs)</b>	<b>9.0</b>	<b>9.3</b>	<b>-</b>	<b>8.8</b>	<b>-</b>	<b>28.3</b>	<b>24.7</b>	<b>-</b>

Source: Company, BOBCAPS Research

**Fig 2 – Segmental performance**

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
<b>Formulations</b>	<b>52,720</b>	<b>49,180</b>	<b>7.2</b>	<b>52,860</b>	<b>(0.3)</b>	<b>1,57,250</b>	<b>1,37,760</b>	<b>14.1</b>
India	25,180	22,310	12.9	24,160	4.2	76,440	59,290	28.9
North America	11,240	10,330	8.8	10,550	6.5	32,170	30,890	4.1
SAGA	8,920	9,130	(2.3)	9,940	(10.3)	27,230	25,990	4.8
International	7,380	7,410	(0.4)	8,210	(10.1)	21,410	21,590	(0.8)
APIs	1,500	2,010	(25.4)	1,720	(12.8)	6,240	5,740	8.7
Other Op. income	569	467	21.8	618	(7.9)	1,541	1,991	(22.6)
<b>Net Sales</b>	<b>54,789</b>	<b>51,657</b>	<b>6.1</b>	<b>55,198</b>	<b>(0.7)</b>	<b>1,65,031</b>	<b>1,45,491</b>	<b>13.4</b>
USD/INR	75	74	2.0	74	1.2	74	74	0.4
US sales in US\$ terms	150	141	6.7	142	5.3	433	417	3.8

Source: Company, BOBCAPS Research

## Valuation methodology

We like Cipla for its strong India franchise, rich US pipeline and low risk of price erosion in the US market (top 3 products contribute more than 25% of US sales). Contribution from partner products is decreasing while DTM portfolio revenue is growing with every approval of complex generics. In our view, operating leverage in the US business would be a key margin driver for the next two years.

We believe Cipla’s future investments will have a sharper focus on opportunities in high-value/complex assets. Management plans to drive sales growth while maintaining EBITDA margins at current levels. With approval of NDA product Lanerotide, pipeline of peptide injectables, clinical trials of high-value inhalers, CIPLA plan to improve the quality of US revenues through differentiated portfolio, product development capabilities and derisking of the supply chain across key global markets.

As per management, Cipla’s near-term priorities include (1) continued execution on demand levers, (2) improvement in manpower productivity, (3) active advancement on innovative consumer-centric products to accelerate its global consumer wellness franchise, (4) sustained leadership and growth in respiratory categories such as Albuterol/Revlimid, (5) monitoring of key filings and acceleration of its global lung leadership aspirations, and (6) maximising the value opportunity in US complex generics with steady launches.

We reiterate BUY and retain our TP at Rs 1,160 as we roll over to FY24E valuations while lowering our target multiple from 17x to 16x EV/EBITDA (implied P/E of 26x) due to slowdown in API sales, lower Covid contribution and cost headwinds. Our target multiple is at the midpoint of the stock’s 10-year historical band (12-22x).

**Fig 3 – Revised estimates**

(Rs mn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Sales	217.0	236.2	259.9	216.3	235.7	259.2	0.3	0.2	0.3
EBITDA	47.6	50.4	56.9	47.6	50.4	56.9	(0.0)	(0.0)	0.0
EBITDA margin (%)	21.9	21.3	21.9	22.0	21.4	22.0	(7bps)	(5bps)	(6bps)
EPS (Rs)	34.3	36.9	44.6	34.2	36.9	44.6	0.1	0.1	0.1

Source: BOBCAPS Research

**Fig 4 – Key assumptions**

Revenues (Rs bn)	FY21	FY22E	FY23E	FY24E
India	77.4	92.8	104.0	77.4
North America	40.8	44.5	47.6	40.8
SAGA	34.5	36.4	38.3	34.5
International	28.3	31.2	33.4	28.3
API	8.0	8.8	9.7	8.0
OOI	1.7	2.0	1.9	1.7

Source: Company, BOBCAPS Research

**Fig 5 – Peer comparison**

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY21-24E (%)	ROE (%)		ROIC (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
Aurobindo	ARBP IN	BUY	886	6.1	14.1	13.4	22.1	23.2	8.5
Cipla	CIPLA IN	BUY	1,160	11.0	13.6	14.5	24.0	29.7	16.0
Dr. Reddy's	DRRD IN	BUY	5,500	14.6	17.7	17.7	25.2	32.1	14.0
Lupin	LPC IN	HOLD	1,045	19.0	12.9	15.1	19.4	22.6	11.6
Sun Pharma	SUNP IN	BUY	955	13.5	15.4	15.4	27.5	30.1	18.4

Source: BOBCAPS Research

### Key risks

- **Poor US execution:** We expect the US market to contribute meaningfully to profitability in the coming years. Any delay in ramp-up of key launches such as Advair Diskus can potentially erode EPS.
- **Reduction in Global Access funding:** A decline in the tender-facing Global Access business due to challenges in the funding environment would pose a risk to our estimates.
- **Regulatory issues:** Failure to get clearance on plants under USFDA observations would affect growth.
- **Drug prices:** Weak drug price hikes in South Africa are another key downside risk.

### Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.5	2,181	2,800	BUY
Alembic Pharma	ALPM IN	2.0	758	980	BUY
Alkem Labs	ALKEM IN	5.5	3,454	4,250	HOLD
Aurobindo Pharma	ARBP IN	4.8	617	886	BUY
Cipla	CIPLA IN	9.8	906	1,160	BUY
Divi's Labs	DIVI IN	14.4	4,049	5,540	HOLD
Dr Reddy's Labs	DRRD IN	9.8	4,403	5,500	BUY
Eris Lifesciences	ERIS IN	1.3	725	975	BUY
Laurus Labs	LAURUS IN	3.4	475	715	BUY
Lupin	LPC IN	5.5	916	1,045	HOLD
Sun Pharma	SUNP IN	25.9	808	955	BUY

Source: BOBCAPS Research, NSE | Price as of 25 Jan 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Total revenue</b>	<b>1,70,577</b>	<b>1,90,682</b>	<b>2,15,698</b>	<b>2,34,785</b>	<b>2,58,411</b>
EBITDA	31,317	41,611	47,567	50,362	56,938
Depreciation	11,760	10,677	13,195	13,867	14,539
EBIT	19,557	30,934	34,371	36,494	42,399
Net interest inc./(exp.)	(1,972)	(1,607)	(625)	(390)	(244)
Other inc./(exp.)	3,442	2,660	3,810	4,397	6,822
Exceptional items	0	0	0	0	0
EBT	21,027	31,987	37,557	40,501	48,977
Income taxes	6,312	8,888	9,952	10,733	12,979
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	5	(36)	0	0	0
<b>Reported net profit</b>	<b>14,710</b>	<b>23,135</b>	<b>27,604</b>	<b>29,768</b>	<b>35,998</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>14,710</b>	<b>23,135</b>	<b>27,604</b>	<b>29,768</b>	<b>35,998</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	22,818	20,668	29,272	31,909	35,113
Other current liabilities	10,604	14,709	12,821	13,976	15,380
Provisions	10,815	11,945	13,507	14,724	16,202
Debt funds	28,160	15,375	9,609	6,006	3,754
Other liabilities	0	0	0	0	0
Equity capital	1,613	1,613	1,613	1,613	1,613
Reserves & surplus	1,60,215	1,84,062	2,07,634	2,33,370	2,65,336
Shareholders' fund	1,61,827	1,85,675	2,09,247	2,34,983	2,66,949
<b>Total liab. and equities</b>	<b>2,34,224</b>	<b>2,48,372</b>	<b>2,74,456</b>	<b>3,01,597</b>	<b>3,37,398</b>
Cash and cash eq.	10,039	14,012	20,536	47,487	81,876
Accounts receivables	38,910	34,457	43,908	47,863	52,670
Inventories	43,776	46,692	58,543	63,818	70,227
Other current assets	21,715	21,267	29,916	32,611	35,886
Investments	15,953	28,318	28,318	28,318	28,318
Net fixed assets	51,281	49,563	44,367	38,500	31,960
CWIP	8,245	9,689	9,689	9,689	9,689
Intangible assets	44,305	44,375	39,180	33,312	26,773
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>2,34,224</b>	<b>2,48,372</b>	<b>2,74,456</b>	<b>3,01,597</b>	<b>3,37,398</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Cash flow from operations</b>	<b>33,111</b>	<b>40,491</b>	<b>19,750</b>	<b>37,110</b>	<b>42,378</b>
Capital expenditures	(9,259)	(7,180)	(8,000)	(8,000)	(8,000)
Change in investments	9,586	(12,365)	0	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>327</b>	<b>(19,545)</b>	<b>(8,000)</b>	<b>(8,000)</b>	<b>(8,000)</b>
Equities issued/Others	1	0	0	0	0
Debt raised/repaid	(15,001)	(12,785)	(5,766)	(3,603)	(2,252)
Interest expenses	(1,972)	(1,607)	(625)	(390)	(244)
Dividends paid	(2,419)	(4,032)	(4,032)	(4,032)	(4,032)
Other financing cash flows	(10,198)	1,452	5,195	5,867	6,539
<b>Cash flow from financing</b>	<b>(29,589)</b>	<b>(16,972)</b>	<b>(5,227)</b>	<b>(2,159)</b>	<b>11</b>
<b>Chg in cash &amp; cash eq.</b>	<b>3,850</b>	<b>3,974</b>	<b>6,523</b>	<b>26,951</b>	<b>34,389</b>
<b>Closing cash &amp; cash eq.</b>	<b>10,038</b>	<b>14,013</b>	<b>20,536</b>	<b>47,487</b>	<b>81,876</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	18.3	28.7	34.3	36.9	44.7
Adjusted EPS	18.3	28.7	34.3	36.9	44.7
Dividend per share	3.0	5.0	5.0	5.0	5.0
Book value per share	197.1	227.1	256.3	288.2	327.9

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	4.4	3.9	3.4	3.0	2.6
EV/EBITDA	23.9	17.8	15.2	13.9	12.0
Adjusted P/E	49.6	31.5	26.4	24.5	20.3
P/BV	4.6	4.0	3.5	3.1	2.8

### DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	70.0	72.3	73.5	73.5	73.5
Interest burden (PBT/EBIT)	107.5	103.4	109.3	111.0	115.5
EBIT margin (EBIT/Revenue)	11.5	16.2	15.9	15.5	16.4
Asset turnover (Rev./Avg TA)	21.9	24.4	25.7	25.5	25.3
Leverage (Avg TA/Avg Equity)	1.2	1.1	1.1	1.0	1.0
<b>Adjusted ROAE</b>	<b>9.5</b>	<b>13.5</b>	<b>14.2</b>	<b>13.6</b>	<b>14.5</b>

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	8.7	11.8	13.1	8.8	10.1
EBITDA	29.3	32.9	14.3	5.9	13.1
Adjusted EPS	120.3	57.3	19.3	7.8	20.9
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	18.4	21.8	22.1	21.5	22.0
EBIT margin	11.5	16.2	15.9	15.5	16.4
Adjusted profit margin	8.6	12.1	12.8	12.7	13.9
Adjusted ROAE	9.5	13.5	14.2	13.6	14.5
ROCE	11.8	17.2	18.2	17.8	19.2
<b>Working capital days (days)</b>					
Receivables	85	67	75	75	75
Inventory	96	90	100	100	100
Payables	50	40	50	50	50
<b>Ratios (x)</b>					
Gross asset turnover	1.2	1.2	1.3	1.4	1.5
Current ratio	2.6	2.5	2.8	3.2	3.6
Net interest coverage ratio	9.9	19.2	55.0	93.5	173.8
<b>Adjusted debt/equity</b>	<b>0.1</b>	<b>(0.1)</b>	<b>(0.2)</b>	<b>(0.3)</b>	<b>(0.4)</b>

Source: Company, BOBCAPS Research | Note: TA = Total Assets

## Disclaimer

### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

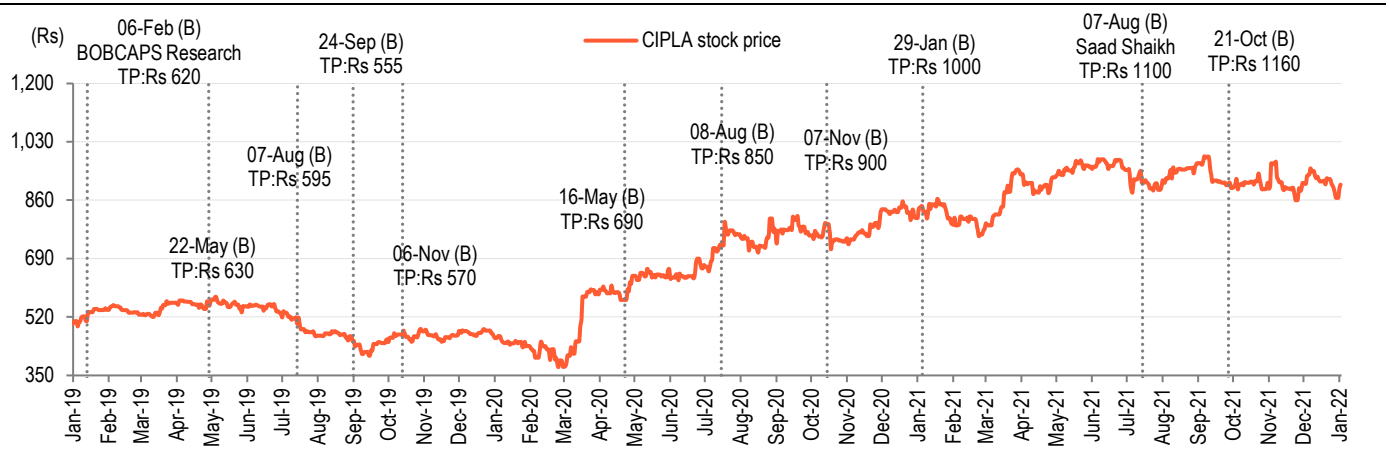
**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

### Ratings and Target Price (3-year history): CIPLA (CIPLA IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

### Rating distribution

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