Indiabulls

CIPLA LIMITED
RESEARCH

EQUITY RESEARCH December 15, 2008

RESULTS REVIEW

Share Data

Market Cap	Rs. 139.8 bn
Price	Rs. 179.85
BSE Sensex	9,832.39
Reuters	CIPL.BO
Bloomberg	CIPLA IN
Avg. Volume (52 Week)	0.4 mn
52-Week High/Low	Rs. 244 / 146
Shares Outstanding	777.3 mn

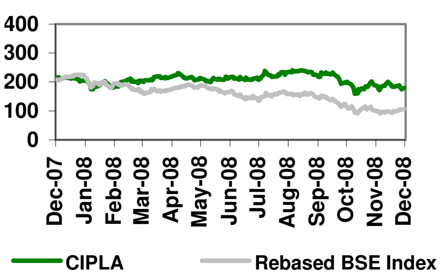
Valuation Ratios

Year to 31 March	2009E	2010E
EPS (Rs.)	6.9	10.4
EPS Growth (%)	(23.1)%	50.5%
PER (x)	26.0x	17.2x
EV/ Sales (x)	2.9x	2.5x
EV/ EBITDA (x)	13.2x	11.9x

Shareholding Pattern (%)

Promoters	39
FIIs	16
Institutions	16
Public & Others	28

Relative Performance



Cipla Limited **Buy**

Pricing pressure unlikely to play out

Cipla Limited (Cipla) posted better-than-expected results for Q2'09. The Sales swelled by 23.3% yoy to Rs. 13.5 billion on the strength of an upsurge in both domestic and export sales. Furthermore, the EBITDA margin rose by 289 bps yoy to 23.3% due to depreciation of the rupee and an improved product mix. Meanwhile, our DCF valuation provides a fair price of Rs. 207, indicating a significant upside from the current levels. Thus, we upgrade our rating on the stock to a Buy.

Robust revenues expansion: We have revised our net sales upwards by 3.2% to 19.4% for FY09E and by 1.2% to 16.6% for FY10E. We believe that the Company is well poised to leverage its position as the second largest manufacturer globally in the rapidly growing, high-value aerosol segment, ahead of the Montreal protocol deadline. Cipla is also investing heavily into R&D, enabling its upward movement in the value chain, as is evident from the Company's endeavour to steadily transition its product portfolio to include higher-value products such as HFAs and biosimilars. The capacity addition at Sikkim and Indore affirm the scalability of Cipla's operations, necessary to bolster its sales volume.

Operating margins to stay firm: We have adjusted our operating margin upwards by 2.3% to 21.9% for FY09E and by 1.3% to 20.9% for FY10E. We believe that the global pricing pressure anticipated by Cipla in H2'09 may not hurt the margins as the Company progressively moves away from segments that have been experiencing price erosion. While we project that the margins would drop in FY10E as overheads mount due to capacity additions, FY11E onwards we expect the margins to revert and stay firm at around 21% on the back of better operational leverage in newer capacities.

Key Figures

Quarterly Data	Q2'08	Q1'09	Q2'09	YoY%	QoQ%
(Figures in Rs. mn, except per share data)					
Sales	10,984	12,071	13,547	23.3%	12.2%
EBITDA	2,240	2,701	3,155	40.8%	16.8%
Adjusted Net Profit	1,906	1,400	1,514	(20.6)%	8.1%
Margins(%)					
EBITDA	20.4%	22.4%	23.3%		
NPM	17.4%	11.6%	11.2%		
Per Share Data (Rs.)					
Adjusted EPS	2.5	1.8	2.0	(20.4)%	8.3%

Result Highlights

Cipla registered a strong top-line growth of 24.7% yoy in Q2'09, with its gross revenues topping Rs. 13 bn. Domestic sales reached Rs. 5.9 bn, surging 16.1% yoy, significantly ahead of the industry's average growth during the comparable period. Export sales witnessed a robust rise of 32.6% yoy to Rs. 7.3 bn, primarily boosted by a 48.4% yoy jump in the export of formulations to Rs. 6 bn. Export of APIs, at Rs. 1.2 bn, recorded a decline of 12.5% yoy. Technology know-how/fees was flat compared with last year but spiked up 176.1% qoq to Rs. 429.3 mn, albeit of a low base in Q1'09. Other revenues, at Rs. 93 million, dropped by half compared with similar periods qoq and yoy.

Material costs increased by 14.5% yoy to Rs. 6.3 bn; however, their proportion to the operating income dropped, mainly due to improved export realization on account of rupee depreciation and changes in the product mix. Moreover, employee costs soared by 48.7% yoy as annual increments were paid, manpower was added at various units (mainly Sikkim), and field staff increased. Other expenditures rose 21.7% yoy to Rs. 3.3 bn due to overall increases in manufacturing expenses, power and fuel costs, freight, and travel and conference expenditures.

Operating profit trended upwards by a healthy 43.7% yoy to Rs. 2.7 bn and the margin at 20.3% compared favourably against 17.4% posted in Q2'08. Net loss on revaluation of forward contracts and forward currency loans amounted to Rs. 1,040 mn. The effective tax rate fell as the Company availed tax incentives for the Baddi and Sikkim EOUs. For the quarter, Cipla reported a net income of Rs. 1.5 bn, a diminution of 20.6% yoy.

Segmental data

Quarterly Data (in mn)	Q2'09	Q2'08	YoY%	Q1'09	QoQ%
Domestic Sales	**5,913**	**5,094**	**16.1%**	**5,855**	**1.0%**
% of Domestic to total sales	44.9%	48.2%		49.3%	
Export Sales					
Formulations	6,024	4,059	48.4%	4,242	42.0%
APIs	1,240	1,417	(12.5)%	1,773	(30.1)%
Total Export Sales	**7,264**	**5,476**	**32.6%**	**6,015**	**20.8%**
% of Exports to total sales	55.1%	51.8%		50.7%	
Total Sales	**13,176**	**10,570**	**24.7%**	**11,870**	**11.0%**

Key Events

Cipla barred from using the Valcept trademark

The Bombay High Court ruled against Cipla, restraining the Company from using the trademark *Valcept*, the copycat version of Roche's patented brand *Valcyte*. Cipla was directed to implement the decision within three weeks of the ruling on December 11, 2008. Roche had filed two petitions on September 27, 2008, alleging Cipla's violation of Roche's patent by launching a generic version of *Valcyte* and violating the trademark by launching the product in a phonetically similar name, *Valcept*.

Pamidronate disodium injection gets FDA's nod

Cipla received an approval from US FDA to market vials of Pamidronate disodium injection in varying strengths. The drug is used to regulate blood calcium levels.

Key Risks

The following factors can pose a threat to our rating:

- Loss of marketing alliance(s) could impair profitability.
- Currency fluctuations could lead to muted margins.
- Tightening of the price controls or expanding the gambit of drugs under the price regulations of the Indian government could make production of certain products unviable.
- An unfavourable court ruling in an ongoing litigation between the Government of India and Cipla regarding alleged overcharging of certain drugs could potentially pressurise the Company's bottom line.

Outlook

We have adjusted our net sales estimate upwards by 3.2% for FY09E and by 1.2% for FY10E to 19.4% and 16.6%, respectively. We believe the Company's guidance of top-line growth of 12-15% for FY09 will be comprehensively surpassed, with steadily expanding domestic sales and robust export sales lending strength to our aggressive estimates. Cipla is scaling up inhaler production at its plants to fully capitalise on its position as the second largest inhaler manufacturer in the world as the Montreal protocol deadline for ban on CFC inhalers approaches in 2010. The anti-asthma segment is expanding at

20% annually and generates 25% of the Company's revenues. Cipla is also scaling up its R&D program, targeting high-value specialised formulation products. The ongoing launches of high-value non-CFC HFA inhalers and the probable launch of biosimilar products starting in FY11E are likely to lend considerable upside to our estimates. Consequently, Cipla is aggressively hiking its planned capacity in anticipation of a boost in the sales volume.

We are revising the operating margin upwards to 21.9% for FY09E and to 20.9% in FY2010E. We do not expect the anticipated pricing pressure in Q3'09 and Q4'09 to materialise as the Company is gradually transitioning its product mix from the price erosion prone API and chemicals segments to the relatively insulated aerosol and injections segments. The scheduled commissioning of the Indore plant in April 2010 is likely to squeeze the margin in FY10E as the materials and employee overheads climb upwards. Thereafter, in FY11E, we foresee the margin to sustain at an average level of 21% as operational leverage is expected to kick in.

Though Cipla's de-risked business model limits aggressive profit expansion, its comprehensive new product development program lends a considerable upside to the margins.

At the current market price (CMP) of Rs. 179.85, the stock is trading at a forward P/E of 26.0x and 17.2x for FY09E and FY10E earnings, respectively. Based on DCF valuation, we have arrived at a target price of Rs. 207, assuming an 8% Rf, a 5% terminal growth rate, and a 12.3% WACC. Our target price provides an upside of 15.2% from the current levels; thus, we upgrade the stock from Hold and recommend a Buy rating.

Key Figures

Year to March	FY06	FY07	FY08	FY09E	FY10E	CAGR
(Figures in Rs. mn, except per share data)						(FY08-10E)
Sales	29,858	35,620	42,033	50,119	58,495	18.0%
EBITDA	7,076	8,115	8,458	10,963	12,210	20.1%
Adjusted Net Profit	6,198	6,681	7,018	5,394	8,119	7.6%
Margins(%)						
EBITDA	23.7%	22.8%	20.1%	21.9%	20.9%	
NPM	20.8%	18.8%	16.7%	10.8%	13.9%	
Per Share Data (Rs.)						
Adjusted EPS	8.1	8.5	9.0	6.9	10.4	7.6%
PER (x)	32.7x	27.7x	19.9x	26.0x	17.2x	

Disclaimer

This report is not for public distribution and is only for private circulation and use. The Report should not be reproduced or redistributed to any other person or person(s) in any form. No action is solicited on the basis of the contents of this report.

This material is for the general information of the authorized recipient, and we are not soliciting any action based upon it. This report is not to be considered as an offer to sell or the solicitation of an offer to buy any stock or derivative in any jurisdiction where such an offer or solicitation would be illegal. It is for the general information of clients of Indiabulls Securities Limited. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. You are advised to independently evaluate the investments and strategies discussed herein and also seek the advice of your financial adviser.

Past performance is not a guide for future performance. The value of, and income from investments may vary because of changes in the macro and micro economic conditions. Past performance is not necessarily a guide to future performance.

This report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon as such. Any opinions expressed here in reflect judgments at this date and are subject to change without notice. Indiabulls Securities Limited (ISL) and any/all of its group companies or directors or employees reserves its right to suspend the publication of this Report and are not under any obligation to tell you when opinions or information in this report change. In addition, ISL has no obligation to continue to publish reports on all the stocks currently under its coverage or to notify you in the event it terminates its coverage. Neither Indiabulls Securities Limited nor any of its affiliates, associates, directors or employees shall in any way be responsible for any loss or damage that may arise to any person from any error in the information contained in this report.

The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject stock and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report. No part of this material may be duplicated in any form and/or redistributed without Indiabulls Securities Limited prior written consent.

The information given herein should be treated as only factor, while making investment decision. The report does not provide individually tailor-made investment advice. Indiabulls Securities Limited recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial adviser. Indiabulls Securities Limited shall not be responsible for any transaction conducted based on the information given in this report, which is in violation of rules and regulations of National Stock Exchange or Bombay Stock Exchange.