

Earnings Downgrade

Sector: Pharmaceuticals

Target Price	Rs199
Market cap (bn)	Rs148.7/US\$3.3
52-week range	Rs275/191
Shares in issue (mn)	777.3
6-mon avg daily vol (no of shares)	1,967,645
6-mon avg daily vol (mn)	Rs376.5/US\$8.4
Bloomberg	CIPLA IN
Reuters	CIPL.BO
BSE Sensex	15,732
Website	www.cipla.com

Shareholding Pattern (%)

Promoter	39.4
FIs	15.7
MFs / FIs/ Banks	12.6
Others / Public	32.4

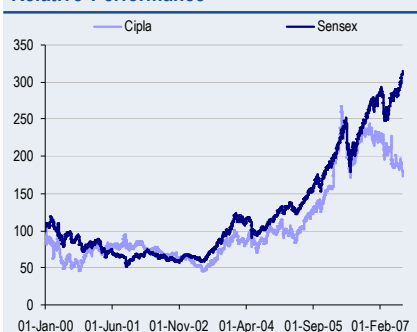
(As of 30 June 2007)

Price Performance (%)

	1M	3M	12M
Absolute	(8.8)	(18.2)	(13.1)
Relative*	(17.5)	(31.2)	(69.1)

* To the BSE Sensex

Relative Performance



(As of 23 July 2007)

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Much below our expectations

Cipla posted a 30% YoY drop in PAT (adjusted) at Rs1.20 bn (against our expectation of Rs1.97 bn) in 1Q FY08, impacted by weak sales, rupee appreciation and change in the products mix. EBITDA margin plunged 869 bps at 17.7% driven by higher raw material cost to sales, significant increase in staff cost and other expenses. Sales at Rs9.02 bn (4% growth) was much lower than our expectation of Rs10.33 bn in 1Q FY08. This has been due to slower growth of 7% in domestic formulations and muted formulations exports during the quarter.

We are revising our FY08E earnings estimate downward by 28.7% at Rs8.7 per share and introducing FY09E estimate with EPS of Rs9.9. We are maintaining our Sell rating on the stock with a revised target price of Rs199 (20x FY09E earnings) from earlier Rs244, as we believe that risks return metrics are not favourable and we do not see any significant upside from the current levels. The stock is trades at 22x FY08E earnings and 19.3x FY09E earnings.

Highlights

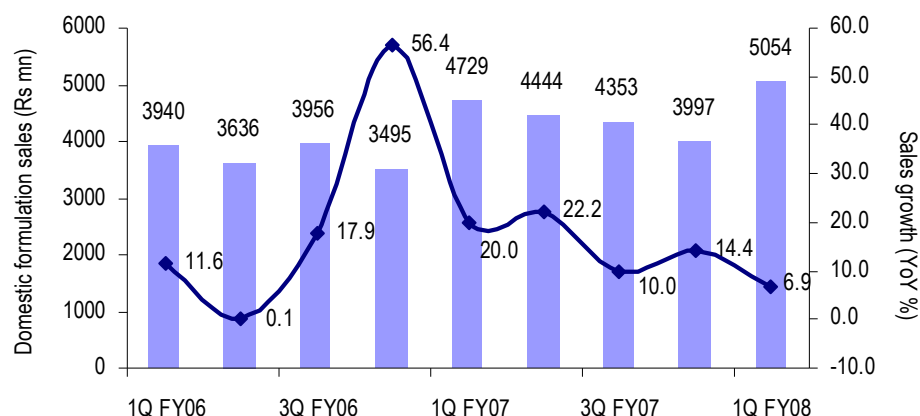
- Old products slow down growth in domestic formulations:** Domestic formulations sales posted a lackluster 7% YoY growth at Rs5.05 bn in 1Q FY08. Slow growth in old products at primary levels led this overall weak growth in the domestic markets. Cipla has been facing some pressure in the domestic markets with the growth slowing down vis-à-vis its traditional 15-17% growth momentum for the last few years (see Exhibit 1). We expect growth to come back on track in the coming quarters, to post a growth of 11-12% p.a., but it would still be lower than its past momentum.

Exhibit 1: Financial summary

(Rs mn)

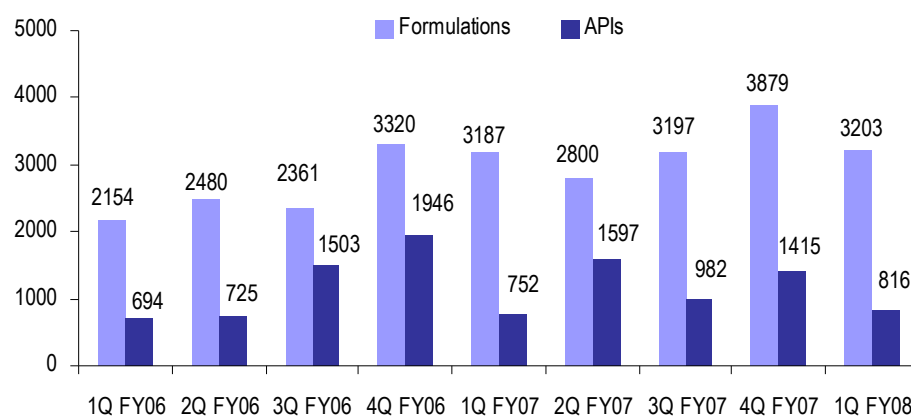
Y/E March	FY05	FY06	FY07	FY08E	FY09E
Net Sales	22,545	29,815	35,787	41,068	48,038
EBITDA	4,949	6,652	8,192	8,610	9,886
EBITDA (%)	22.0	22.3	22.9	21.0	20.6
Net Profit (Adjusted)	4,092	6,076	6,608	6,754	7,719
Net Profit (Reported)	4,092	6,076	6,608	6,754	7,719
EPS (Rs)	5.3	7.8	8.5	8.7	9.9
EPS Growth (%)	26.9	48.5	8.8	2.2	14.3
RoCE (%)	30.6	32.7	27.3	23.3	24.1
RoE (%)	27.2	32.6	25.1	19.9	20.3
PE (x)	36.3	24.5	22.5	22.0	19.3
Price/Book Value (x)	9.0	7.2	4.7	4.1	3.7
EV/EBITDA (x)	30.4	23.0	17.7	16.9	14.7

Source: Company data, ASK Securities. Note: Valuations as of 23 July 2007.

Exhibit 2: Slow down in domestic formulation sales

Source: Company data, ASK Securities.

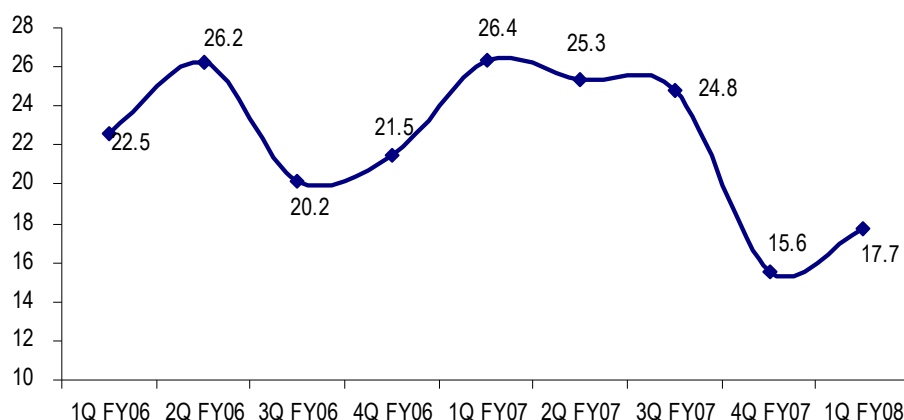
- Exports sales impacted by rupee appreciation and flat formulations sales:** Cipla registered a dismal 2% YoY growth in exports at Rs4.02 bn, impacted by flat formulations exports at Rs3.2 bn. Formulations exports is driven by registrations across all regions, ARVs in Africa and US generics. However, pricing pressure in the US generics markets and strong rupee vis-à-vis dollar has taken its toll on the growth of exports formulations. The current quarter could also witness similar trend. However, APIs sales grew 9% at Rs816 mn in 1Q FY08. We believe the overall exports growth would slow down to less than 20% in FY08E.

Exhibit 3: API and formulation exports**(Rs mn)**

Source: Company data, ASK Securities.

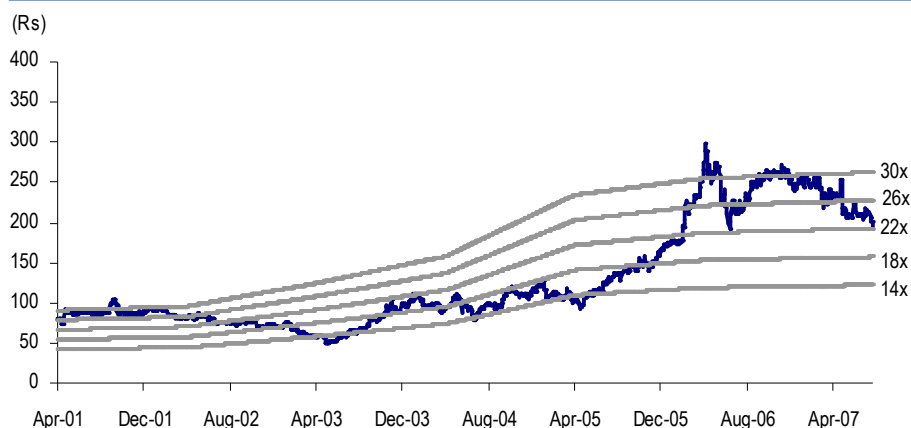
- Robust pipeline for the US generics, but pricing pressure taking its toll:** Cipla is currently working on more than 125 products at various stages of development/pending approvals and already has around 10 products in the market. This would primarily drive the exports in the regulated markets, as a large number of products are going off patent over the next 2-3 years. However, severe pricing pressure in the US generics space is capping the scale up in sales from these markets.

- Margins to remain under pressure:** EBITDA margin dropped 867 bps at 17.7% in 1Q FY08 against our expectation of 23.9%. Margins have got impacted owing to rupee appreciation as well as unfavourable change in the products mix. Cipla has been witnessing volatile margins for the last few quarters. We believe margins would continue to remain under pressure, going forward, with strong rupee and pricing pressure in the US generics and increased competition in the domestic markets.

Exhibit 4: Trend in EBITDA margin (%)


Source: Company data, ASK Securities.

- No significant upside:** We are revising our FY08E earnings estimate downward by 28.7% at Rs8.7 per share and introducing FY09E estimate with EPS of Rs9.9. We are maintaining our Sell rating on the stock with a revised target price of Rs199 (20x FY09E earnings) from earlier Rs244, as we believe that risks return metrics are not favourable, and we do not see any significant upside from current levels. The stock is currently trading at 22x FY08E earnings and 19.3x FY09E earnings.

Exhibit 5: PE band (1-year forward)


Source: Bloomberg, ASK Securities.

Exhibit 6: Quarter result**(Rs mn)**

	1Q FY08	1Q FY07	% chg	FY07	FY06	% chg
Net Revenues	9,018	8,636	4.4	35,787	29,958	19.5
EBITDA	1,597	2,278	(29.9)	8,192	6,722	21.9
EBITDA (%)	17.7	26.4		22.4	22.4	
Other Income	185	220	(15.5)	891	1,210	(26.4)
Interest	8	28	(70.6)	70	114	(39.1)
Depreciation	303	260	16.3	1,041	830	25.4
PBT	1,472	2,209	(33.4)	7,973	6,989	14.1
Tax	274	505	(45.7)	1,365	988	38.2
PAT (Adj)	1,198	1,704	(29.7)	6,608	6,001	10.1
Extraordinary Items	-	-		-	-	
PAT (Reported)	1,198	1,704	(29.7)	6,608	6,001	10.1
EPS (Rs)	1.54	2.19		8.50	7.72	

Source: Company data, ASK Securities.

Exhibit 7: Sales mix**(Rs mn)**

	1Q FY08	1Q FY07	% chg	FY07	FY06	% chg
Domestic	5,054	4,729	6.9	17,523	15,027	16.6
Exports	4,019	3,938	2.1	17,807	15,182	17.3
Formulations	3,203	3,187	0.5	13,062	10,315	26.6
APIs	816	752	8.5	4,745	4,867	(2.5)
Gross Sales	9,073	8,667	4.7	35,330	30,209	17.0
Technology income	113	90	25.7	766	416	84.2
Other operating income	102	112	(8.8)	575	528	8.8
Operating revenues (Gross)	9,288	8,869	4.7	36,671	31,153	17.7

Source: Company data, ASK Securities.

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