

February 7, 2011

<b>Reco</b>	<b>Previous Reco</b>
Reduce	Accumulate
<b>CMP</b>	<b>Target Price</b>
Rs324	Rs310
EPS change FY11E/12E (%)	-12 / -11
Target Price change (%)	-11
Nifty	5,396
Sensex	18,008

### Price Performance

(%)	1M	3M	6M	12M
Absolute	(14)	(7)	1	4
Rel. to Nifty	(3)	8	2	(7)

Source: Bloomberg

### Relative Price Chart



Source: Bloomberg

### Stock Details

Sector	Pharmaceuticals
Bloomberg	CIPLA@IN
Equity Capital (Rs mn)	1606
Face Value(Rs)	2
No of shares o/s (mn)	803
52 Week H/L	381/299
Market Cap (Rs bn/USD mn)	260/5,694
Daily Avg Volume (No of sh)	1827497
Daily Avg Turnover (US\$mn)	14.1

### Shareholding Pattern (%)

	D'10	S'10	J'10
Promoters	36.8	36.8	36.8
FII/NRI	19.3	20.3	19.3
Institutions	18.3	17.5	18.7
Private Corp	3.9	3.9	4.1
Public	21.8	21.5	21.1

Source: Capitaline

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- **Cipla's Q3FY11 result were disappointing with a) Revenues at Rs15.5bn (est. Rs16.1bn) b) EBITDA at Rs3.2bn (est. Rs3.9bn) and c) APAT at Rs2.3bn (est. Rs2.8bn)**
- **OPM contracted 593bps YoY to 20.5%, led by 24% increase in overheads, largely due to the commissioning of the Indore SEZ plant**
- **On account of earnings disappointment and optimal utilization at Indore SEZ still 2 years away, we cut our EPS estimates for FY11/12E by 12%/11% respectively**
- **With EPS acceleration potentially an FY13 story; we downgrade the stock to Reduce with a target price of Rs310**

### Subdued performance in the domestic business and lower tech income dragged revenue growth

Lower than expected growth in the domestic formulation (11% vs. est. of 15%) and lower technology income (Rs151mn versus expectations of Rs400mn) resulted in 8% growth vs est. of 12% in the top line. In the domestic market, branded as well as the generic business registered lower than expected growth of 16% and 12% respectively on account of higher competitive intensity. Going ahead, we expect the domestic business to grow at below than industry growth rates at 10-12% rate. Total export business for the quarter grew by 12% YoY driven by 12% growth in formulation business (est. 14%) and 13% growth in APIs. Decline in technology licensing income from Rs703mn to Rs151mn this quarter (as most of the projects are in completion stages and partly due to presence of one-time higher income in Q3FY10) also dragged the overall growth.

In the exports business, Cipla launched Seroflo inhaler in the South African market (US\$15-20mn opportunity) and is looking to supply in Russian markets (market size US\$150mn) over the next 2 quarters. Management expects increased traction from Seroflo opportunity given the limited competition in the market and has indicated that they will start getting approval for combination inhalers in some of the EU markets from FY12E onwards.

### Revenue Break-up

	Rs mn				
Rs mn	Q3FY10	Q2FY11	Q3FY11	YoY Gr.	QoQ Gr.
<b>Domestic</b>	<b>6592</b>	<b>7564</b>	<b>7340</b>	<b>11.3%</b>	<b>-3.0%</b>
<b>Total Exports</b>	<b>6987</b>	<b>8322</b>	<b>7818</b>	<b>11.9%</b>	<b>-6.1%</b>
Export Formulation	5758	6639	6432	11.7%	-3.1%
API	1229	1683	1386	12.7%	-17.6%
<b>Total</b>	<b>13579</b>	<b>15886</b>	<b>15158</b>	<b>11.6%</b>	<b>-4.6%</b>
Technology Fees	703	120	151	-78.5%	26.5%
Other operating income	241	235	372	54.4%	58.2%
<b>Total Income</b>	<b>14522</b>	<b>16241</b>	<b>15681</b>	<b>8.0%</b>	<b>-3.4%</b>

### Financials

	Rs mn									
YE-	Net	EBITDA			EPS	EPS	RoE	EV/		
Mar	Sales	(Core)	(%)	APAT	(Rs)	% chg	(%)	P/E	EBITDA	P/BV
FY09	52,343	12,218	23.3	9,719	12.1	53.2	19.1	26.8	21.3	6.0
FY10	56,057	13,742	24.5	10,686	13.3	9.9	21.1	24.3	18.9	4.4
FY11E	62,695	13,735	21.9	10,081	12.6	(5.7)	16.0	25.8	18.6	3.9
FY12E	70,885	16,121	22.7	12,460	15.5	23.6	17.3	20.9	15.6	3.4

## Key Financials – Quarterly

Rs mn

Rs mn	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	YoY (%)	QoQ (%)	YTD'11	YTD'10	YoY (%)
<b>Revenue</b>	<b>14,385</b>	<b>13,747</b>	<b>15,361</b>	<b>16,154</b>	<b>15,537</b>	<b>8.0</b>	<b>(3.8)</b>	<b>47,051</b>	<b>42,574</b>	<b>10.5</b>
<b>Expenditure</b>	<b>10,586</b>	<b>11,167</b>	<b>11,837</b>	<b>12,488</b>	<b>12,355</b>	<b>16.7</b>	<b>(1.1)</b>	<b>36,680</b>	<b>31,552</b>	<b>16.3</b>
as % of sales	73.6	81.2	77.1	77.3	79.5			78.0	74.1	
Consumption of RM	6,248	6,108	6,862	7,487	6,958	11.4	(7.1)	21,307	18,710	13.9
as % of sales	43.4	44.4	44.7	46.3	44.8			45.3	43.9	
Employee Cost	890	999	1,055	1,376	1,351	51.9	(1.8)	3,781	2,704	39.9
as % of sales	6.2	7.3	6.9	8.5	8.7			8.0	6.4	
Other expenditure	3,449	4,060	3,920	3,625	4,046	17.3	11.6	11,591	10,138	14.3
as % of sales	24.0	29.5	25.5	22.4	26.0			24.6	23.8	
<b>EBITDA</b>	<b>3,799</b>	<b>2,580</b>	<b>3,524</b>	<b>3,666</b>	<b>3,182</b>	<b>(16.2)</b>	<b>(13.2)</b>	<b>10,371</b>	<b>11,022</b>	<b>(5.9)</b>
Depreciation	457	495	500	639	653	42.9	2.1	1,792	1,393	28.6
<b>EBIT</b>	<b>3,342</b>	<b>2,085</b>	<b>3,024</b>	<b>3,027</b>	<b>2,529</b>	<b>(24.3)</b>	<b>(16.4)</b>	<b>8,580</b>	<b>9,630</b>	<b>(10.9)</b>
Other Income	178	451	160	166	257	44.0	54.4	583	426	36.8
Interest	44	5	0	3	29	(33.0)	946.4	32	232	(86.2)
<b>PBT</b>	<b>3,477</b>	<b>2,531</b>	<b>3,184</b>	<b>3,190</b>	<b>2,757</b>	<b>(20.7)</b>	<b>(13.6)</b>	<b>9,131</b>	<b>9,824</b>	<b>(7.1)</b>
Total Tax	587	726	550	560	430	(26.7)	(23.2)	1,540	1,759	(12.5)
<b>Adjusted PAT</b>	<b>3,087</b>	<b>2,285</b>	<b>2,794</b>	<b>2,486</b>	<b>2,327</b>	<b>(24.6)</b>	<b>(6.4)</b>	<b>7,607</b>	<b>8,419</b>	<b>(9.6)</b>
(Profit)/loss from JV's/Ass/MI	0	0	0	0	0	-	-	0	0	-
<b>APAT after MI</b>	<b>3,087</b>	<b>2,285</b>	<b>2,794</b>	<b>2,486</b>	<b>2,327</b>	<b>(24.6)</b>	<b>(6.4)</b>	<b>7,607</b>	<b>8,419</b>	<b>(9.6)</b>
<b>Extra ordinary items</b>	<b>-197</b>	<b>471</b>	<b>0</b>	<b>0</b>				<b>0</b>	<b>-354</b>	
<b>Reported PAT</b>	<b>2,890</b>	<b>2,755</b>	<b>2,634</b>	<b>2,630</b>	<b>2,327</b>	<b>(19.5)</b>	<b>(11.5)</b>	<b>7,591</b>	<b>8,065</b>	<b>(5.9)</b>
<b>AEPS</b>	<b>3.8</b>	<b>2.8</b>	<b>3.5</b>	<b>3.1</b>	<b>2.9</b>	<b>(24.6)</b>	<b>(6.4)</b>	<b>9.5</b>	<b>10.5</b>	<b>(9.6)</b>

Margins (%)						(bps)	(bps)			(bps)
EBIDTA	26.4	18.8	22.9	22.7	20.5	(593)	(221)	22.0	25.9	(385)
EBIT	23.2	15.2	19.7	18.7	16.3	(435)	(246)	18.2	22.6	(438)
EBT	24.2	18.4	20.7	19.7	17.7	(364)	(200)	19.4	23.1	(367)
PAT	21.5	16.6	18.2	15.4	15.0	(329)	(41)	16.2	19.8	(361)
Effective Tax rate	16.9	28.7	17.3	17.6	15.6	(74)	(196)	16.9	17.9	(104)

### Increased overheads at Indore SEZ and lower Tech income impacted margins

Operating income for the quarter was lower at Rs3.2bn (est. of R3.96bn). OPM for the quarter contracted by 593bps to 20.5% because of a) Lower tech income b) Lower realization on exports (4% negative impact due to currency fluctuation), c) 250bps increase in employee cost due to increase in manpower at Indore facility, reclassification of contracted staff at its Goa facility and annual increments, and d) Higher other expenditure mainly due to increase in selling expenses and factory overheads at Indore SEZ. Total operating cost at Indore facility is ~ Rs250-300mn per quarter, which is fixed in nature. Excluding this cost, EBITDA margins stood at 22.1% in Q3FY11. We believe higher overheads will continue to pressurize margins as it will take atleast 2 years for the Indore SEZ to reach optimal levels of utilisation. However, recent approvals from other regulators such as UK MHRA, WHO and ANVISA will help to over-ride some of the cost overheads at the plant. The company expects Indore SEZ to contribute ~10-12% of the total revenues by Q4FY12, which in our view, is on the higher side.

### Lower EBITDA and higher capital cost impacted APAT

Despite a) higher other income (up by 44%), b) lower interest cost (down by 33%), due to repayment of short term working capital loans and c) lower tax provision (15.6% of PBT vs. 17.6% of PBT in Q3FY10), APAT de-grew by 24.6% to Rs2.3bn. The growth in the APAT was further impacted due to 43% increase in depreciation cost due to addition to fixed assets mainly on account of commissioning of Indore SEZ factory. The EPS for the quarter and 9MFY11 stood at Rs2.9 and Rs9.5 respectively.

### Owing to earnings disappointment and EPS acceleration potentially an FY13 story, we cut earning estimates and downgrade the stock to Reduce

Owing to earnings disappointment (sub-optimal performance in the domestic market, lower tech income, higher overheads) and delay in ramp-up at the Indore SEZ facility, we cut our EPS estimates for FY11/12E by 12%/10% to Rs12.6 (earlier Rs14.2) and Rs15.5 (Rs17.4 earlier). Further, with EPS acceleration potentially an FY13 story, we downgrade the stock to Reduce (earlier Accumulate) with a revised target price of Rs Rs310 (earlier Rs350). We believe Cipla to trade at discount to its peers, as huge capex incurred in the past is yet to materialize in the near future. While management remains upbeat about the growth prospects for the company, its time-frame for delivery of returns to shareholders may be longer than current market expectations.

#### Revised Financials

Rs mn.	Old Estimates		New Estimates		% Change	
	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Sales	62695	70885	62,695	70,885	-	-
EBITDA	15330	17803	13,735	16,121	-10.4	-9.4
EBITDA %	24.5	25.1	21.9	22.7	(254)bps	(237)bps
PAT	11427	13987	10,081	12,460	-11.8	-10.9
EPS	14.2	17.4	12.6	15.5	-11.6	-10.8

#### Key risk to our call:

- Commencement of API supplies to Teva
- Higher traction of products tied-up with Dr. Reddy
- Earlier than expected launch of combination inhalers
- Faster ramp-up in the domestic business
- Higher traction from inhaler launch in CIS and South African markets
- Supply agreements with MNC's

## Financials

## Income Statement

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
<b>Net Sales</b>	<b>52,343</b>	<b>56,057</b>	<b>62,695</b>	<b>70,885</b>
Growth (%)	24.2	7.1	11.8	13.1
<b>Expenditure</b>	<b>40,125</b>	<b>42,315</b>	<b>48,960</b>	<b>54,764</b>
Raw Materials	23,474	24,530	28,425	32,227
SGA	10,166	10,975	11,431	13,191
Employee Cost	2,714	3,191	5,111	4,673
Other Exp	3,771	3,620	3,992	4,673
<b>EBITDA</b>	<b>12,218</b>	<b>13,742</b>	<b>13,735</b>	<b>16,121</b>
Growth (%)	46.9	12.5	-0.1	17.4
<b>EBITDA margin (%)</b>	<b>23.3</b>	<b>24.5</b>	<b>21.9</b>	<b>22.7</b>
Depreciation	1,518	1,671	2,454	2,691
<b>EBIT</b>	<b>10,700</b>	<b>12,071</b>	<b>11,280</b>	<b>13,430</b>
<b>EBIT margin (%)</b>	<b>20.4</b>	<b>21.5</b>	<b>18.0</b>	<b>18.9</b>
Other Income	918	1,075	863	1,595
Interest expenses	329	230	63	94
<b>PBT</b>	<b>8,955</b>	<b>13,263</b>	<b>12,080</b>	<b>14,931</b>
Tax	1,245	2,435	1,999	2,471
Effective tax rate (%)	13.9	18.4	16.6	16.6
<b>Adjusted PAT</b>	<b>9,719</b>	<b>10,686</b>	<b>10,081</b>	<b>12,460</b>
(Profit)/loss from JV's/MI	0	0	0	0
<b>Adjusted PAT after MI</b>	<b>9,719</b>	<b>10,686</b>	<b>10,081</b>	<b>12,460</b>
Growth (%)	53.2	9.9	-5.7	23.6
<b>Net Margin (%)</b>	<b>18.6</b>	<b>19.1</b>	<b>16.1</b>	<b>17.6</b>
E/O items	-2,333	346	0	0
<b>Reported PAT</b>	<b>7,710</b>	<b>10,828</b>	<b>10,081</b>	<b>12,460</b>
Growth (%)	21.6	40.4	-6.9	23.6

## Cash Flow

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
<b>PBT (Ex-Other income)</b>	<b>8,038</b>	<b>12,188</b>	<b>11,217</b>	<b>13,336</b>
Depreciation	1,518	1,671	2,454	2,691
Interest Provided	329	230	63	94
Other Non-Cash items	0	0	0	0
Chg in working cap	-5,828	-1,310	-3,463	-3,869
Tax paid	-1,095	-2,285	-1,999	-2,471
<b>Operating Cashflow</b>	<b>2,962</b>	<b>10,493</b>	<b>8,272</b>	<b>9,781</b>
Capital expenditure	-6,161	-5,037	-3,855	-3,610
<b>Free Cash Flow</b>	<b>-3,199</b>	<b>5,456</b>	<b>4,417</b>	<b>6,171</b>
Other income	918	1,075	863	1,595
Investments	134	-1,664	0	0
<b>Investing Cashflow</b>	<b>-5,109</b>	<b>-5,625</b>	<b>-2,992</b>	<b>-2,015</b>
Equity Capital Raised	35	6,656	0	0
Loans Taken / (Repaid)	3,998	-9,352	2,012	-1,000
Interest Paid	-329	-230	-63	-94
Dividend paid (incl tax)	-1,820	-1,855	-1,769	-2,916
Income from investments	0	0	0	0
Others	0	0	0	0
<b>Financing Cashflow</b>	<b>1,884</b>	<b>-4,781</b>	<b>179</b>	<b>-4,009</b>
<b>Net chg in cash</b>	<b>-264</b>	<b>88</b>	<b>5,460</b>	<b>3,757</b>
Opening cash position	797	533	621	6,080
<b>Closing cash position</b>	<b>533</b>	<b>621</b>	<b>6,080</b>	<b>9,837</b>

## Balance Sheet

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
Equity share capital	1,555	1,606	1,606	1,606
Reserves & surplus	41,923	57,500	65,795	75,340
<b>Net worth</b>	<b>43,478</b>	<b>59,105</b>	<b>67,401</b>	<b>76,946</b>
<b>Minority Interest</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Secured Loans	28	4	4	4
Unsecured Loans	9,375	47	2,059	1,059
<b>Loan Funds</b>	<b>9,402</b>	<b>51</b>	<b>2,063</b>	<b>1,063</b>
Net deferred tax liability	1,642	1,792	1,792	1,792
<b>Total Liabilities</b>	<b>54,522</b>	<b>60,948</b>	<b>71,255</b>	<b>79,800</b>
Gross Block	26,933	28,973	32,775	37,063
Less: Depreciation	7,008	8,861	10,975	13,348
<b>Net block</b>	<b>19,925</b>	<b>20,112</b>	<b>21,800</b>	<b>23,715</b>
Capital work in progress	3,663	6,842	6,555	5,559
<b>Investment</b>	<b>801</b>	<b>2,464</b>	<b>2,464</b>	<b>2,464</b>
<b>Current Assets</b>	<b>42,228</b>	<b>43,673</b>	<b>55,018</b>	<b>65,427</b>
Inventories	13,983	15,126	16,877	19,171
Sundry debtors	18,529	15,666	18,147	20,614
Cash & bank balance	533	621	6,080	9,837
Loans & advances	9,183	12,260	13,913	15,804
Other current assets	0	0	0	0
<b>Current liab &amp; Prov</b>	<b>12,095</b>	<b>12,143</b>	<b>14,581</b>	<b>17,365</b>
Current liabilities	10,129	9,980	10,516	11,706
Provisions	1,966	2,164	4,066	5,660
<b>Net current assets</b>	<b>30,133</b>	<b>31,530</b>	<b>40,436</b>	<b>48,062</b>
<b>Total Assets</b>	<b>54,522</b>	<b>60,948</b>	<b>71,255</b>	<b>79,800</b>

## Key Ratios

Y/E, Mar	FY09	FY10	FY11E	FY12E
<b>Profitability (%)</b>				
EBITDA Margin	23.3	24.5	21.9	22.7
Net Margin	18.6	19.1	16.1	17.6
ROCE	23.5	22.8	18.4	19.9
ROE	19.1	21.1	16.0	17.3
RoIC	23.8	24.1	21.1	22.8
<b>Per Share Data (Rs)</b>				
EPS	12.1	13.3	12.6	15.5
CEPS	16.9	15.0	15.6	18.9
BVPS	54.0	73.5	83.8	95.7
DPS	2.3	2.3	2.2	3.6
<b>Valuations (x)</b>				
PER	26.8	24.3	25.8	20.9
P/CEPS	19.2	21.7	20.8	17.2
P/BV	6.0	4.4	3.9	3.4
EV / Sales	5.0	4.6	4.1	3.5
EV / EBITDA	21.3	18.9	18.6	15.6
Dividend payout(%)	23.6	17.3	15.0	20.0
<b>Gearing Ratio (x)</b>				
Net Debt/ Equity	0.2	0.0	-0.1	-0.1
Net Debt/EBITDA	0.7	0.0	-0.3	-0.5
Working Cap Cycle (days)	220	215	224	226

**Recommendation History: Cipla – CIPLA IN**

Date	Reports	Reco	CMP	Target
30/12/2010	<a href="#"><u>Cipla Company Update</u></a>	Accumulate	367	350
12/11/2010	<a href="#"><u>Cipla Q2FY11 Result Update</u></a>	Accumulate	332	350
16/08/2010	<a href="#"><u>Cipla Q1FY11 Result Update</u></a>	Reduce	315	313
10/05/2010	<a href="#"><u>Cipla Q4FY10 Result Update</u></a>	Hold	342	328

**Recent Research Reports**

Date	Reports	Reco	CMP	Target
02/02/2011	<a href="#"><u>Glenmark Pharma Q3FY11 Result Update</u></a>	Accumulate	301	371
01/02/2011	<a href="#"><u>Sun Pharma Q3FY11 Result Update</u></a>	Hold	441	460
28/01/2011	<a href="#"><u>Lupin Q3FY11 Result Update</u></a>	Accumulate	420	496
27/01/2011	<a href="#"><u>Ipca Laboratories Q3FY11 Result Update</u></a>	Accumulate	312	336

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