

Cadila Healthcare

BSE SENSEX 17,707	S&P CNX 5,368	CMP: INR664				TP: INR684				Neutral		
Bloomberg	CDH IN	Year	Net Sales	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
Equity Shares (m)	204.7	End	(INR m)	(INR m)	(INR)	Gr. (%)	(X)	(X)	(%)	(%)	Sales	EBITDA
52-Week Range (INR)	984/629	03/10A	36,868	5,011	24.5	55.2	-	-	35.4	26.4	-	-
1,6,12 Rel. Perf. (%)	-16/-28/-11	03/11A	46,302	6,334	30.9	26.4	21.5	6.3	37.5	30.5	3.1	14.0
M.Cap. (INR b)	135.9	03/12E	52,216	5,266	25.7	-16.9	25.8	5.1	25.3	21.3	2.9	14.0
M.Cap. (USD b)	2.8	03/13E	61,356	7,778	38.0	47.7	17.5	4.1	26.1	22.9	2.4	11.9

Cadila Healthcare's (CDH) 3QFY12 operational performance was in line with our estimates.

- Revenue increased 18.6% YoY to INR13.83b compared to our estimate of INR13.2b and EBITDA grew 3% YoY to INR2.64b, in line with our estimate of INR2.69b. But adjusted PAT declined 8% YoY to INR1.49b compared to our estimate of INR945m. PAT was impacted by INR342m in forex losses on hedges and forex loans.
- Revenue growth was led by export formulations which grew 42.8% YoY to INR7.1b. The growth was partially led by acquisition of Neshor Pharma in the US and Bremer Pharma in India. However, growth was pulled down by muted 8.4% YoY growth in domestic business to INR6.1b.
- EBITDA growth was muted on account of very low margins at Neshor and higher R&D expenses. Adjusted PAT declined 8% YoY to INR1.49b despite some growth in EBITDA, on account of INR342m of realized and unrealized forex losses on foreign currency hedges and loans.
- CDH's future growth will be led by increased traction in its international businesses, ramp-up in supplies to Hospira and sustained double-digit growth in domestic formulations and consumer businesses. We estimate 10.8% revenue and EPS CAGR for FY11-13 for the core operations and RoE of 25-26%.
- Revenue target of USD3b implies a topline CAGR of 25% for FY11-16, which we believe is very aggressive. CDH will have to invest significant resources to achieve this target which can potentially raise the risk profile of the company. Given the increasing risk profile of the company, various head-winds in domestic and US business, and decline in return ratios, we are reducing the P/E multiple assigned to the stock. Based on our revised estimates, CDH is valued at 25.8x FY12E consolidated EPS and 17.5x FY13E consolidated EPS. Maintain Neutral with a target price of INR684 (18x FY13E consolidated EPS).

Quarterly Performance (Consolidated)									(INR Million)	
Y/E March	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Revenues	11,338	11,166	11,668	12,130	12,457	12,450	13,832	13,473	46,302	52,216
YoY Change (%)	25.5	18.1	17.7	43.3	9.9	11.5	18.6	11.1	25.6	12.8
Total Expenditure	8,364	8,718	9,106	9,851	9,433	9,693	11,193	11,186	36,040	41,504
EBITDA	2,974	2,448	2,561	2,279	3,024	2,757	2,640	2,287	10,262	10,712
Margins (%)	26.2	21.9	22.0	18.8	24.3	22.1	19.1	17.0	22.2	20.5
Depreciation	314	304	334	317	347	375	465	531	1,269	1,719
Interest	224	179	187	108	189	255	276	279	699	997
Other Income	-63	57	23	113	140	-790	-160	249	131	-560
PBT after EO Income	2,373	2,022	2,064	1,967	2,628	1,337	1,739	1,727	8,425	7,436
Tax	338	254	368	104	285	235	174	347	1,064	1,041
Rate (%)	14.2	12.6	17.8	5.3	10.9	17.6	10.0	20.1	12.6	14.0
Minority Int/Adj on Consol	43	60	76	72	45	75	74	70	251	264
Reported PAT	1,992	1,708	1,620	1,791	2,298	1,027	1,492	1,310	7,110	6,131
Adj PAT	1,627	1,708	1,620	1,380	1,433	1,027	1,492	1,310	6,334	5,266
YoY Change (%)	29.6	27.3	24.0	24.7	-11.9	-39.9	-7.9	-5.1	26.4	-16.9
Margins (%)	14.3	15.3	13.9	11.4	11.5	8.2	10.8	9.7	13.7	10.1
Adj PAT incl one-offs	1,627	1,708	1,620	1,791	2,298	1,027	1,492	1,310	6,745	6,131

E: MOSL Estimates

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Growth led by US business and acquisitions; Domestic business continues to disappoint

Revenues grew 18.6% YoY to INR13.83b (v/s est INR13.2b), EBITDA grew 3% YoY to INR2.64b (v/s est INR2.69b) but Adj PAT declined 8% YoY to INR1.49b (v/s est INR945m). PAT was impacted by INR342m in forex losses on hedges and foreign currency loans.

Revenue growth was led by export formulation segment which grew by 43% YoY to INR7.1b. The growth was partially led by acquisition of Neshier Pharma in US and Bremer Pharma in India. The two acquisitions are likely to have contributed INR536m to revenue during the quarter. The growth was also led by favorable currency. US revenue grew 45% YoY to INR3.4b, while ex-Neshier the organic growth was 27% YoY. Europe grew by muted 1% YoY to INR889m while Brazil and emerging markets grew 5% and 3% YoY respectively due to inventory destocking and pricing erosion. Japan sales grew by healthy 44% YoY to INR154 albeit on a low base. Revenue from JVs grew by robust 58% YoY. However, the growth was pulled down by muted 8.4% YoY growth in domestic business to INR6.1b. Domestic formulations grew 10.6% YoY to INR4.7b impacted by increased competition in acute therapeutic segments and some inventory de-stocking. Consumer business declined 12% YoY to INR796m due to slowdown in artificial sweetener, and increased competitive activity in skin care segment. Animal healthcare business grew 13.7% YoY to INR412m.

Revenue Break-up (INR M)

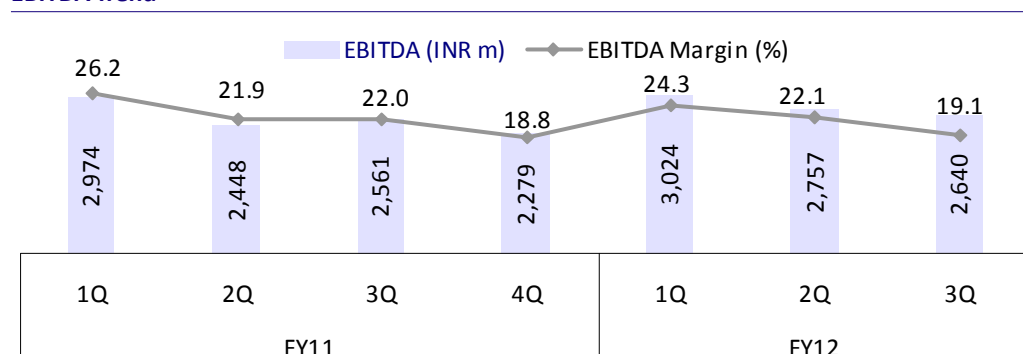
	3QFY12	3QFY11	% Chg	2QFY12	% Chg
Gross Domestic sales	6,058	5,588	8.4	6,100	-0.7
Formulations	4,693	4,243	10.6	4,700	-0.1
APIs	157	75	109.3	68	130.9
Consumer & Others	1,208	1,270	-4.9	1,332	-9.3
Export sales	7,679	5,883	30.5	6,290	22.1
Formulations	7,102	4,974	42.8	5,727	24.0
APIs	577	909	-36.5	563	2.5
Other operating income	308	323	-4.6	254	21.3
Gross Sales	14,045	11,794	19.1	12,644	11.1

Source: Company/MOSL

EBITDA grows by 3% YoY impacted by adverse product mix

EBITDA growth was muted at 3% YoY to INR2.64b despite healthy topline growth, due to (1) adverse product mix, (2) much lower profitability of Neshier, and (3) doubling of R&D expenditure on account of new filings in Japan and Mexico. EBITDA margins contracted 290bp YoY to 19.1%.

EBITDA Trend



Source: Company/MOSL

Adjusted PAT declines by 8% but above our estimates

Adjusted PAT declined 8% YoY to INR1.49b despite some growth in EBITDA, on account of INR342m of realized and unrealized forex losses on foreign currency hedges and loans. Still, PAT was above our estimates on account of lower than estimated forex losses, and change in accounting policies with respect to treatment of forex losses which boosted PAT by INR308m.

Domestic formulations business: Biochem acquisition to boost growth in FY13, Mgmt. guides for sustainable 15-19% growth

CDH's domestic formulations portfolio recorded a muted 10.6% growth for 3QFY12 though the growth has ramped up compared to 5.7% YoY growth for 6MFY12. The growth is impacted by (1) higher inventories, (2) increased competitive intensity in acute therapy segments, and (3) slower growth in some larger brands of the company. During the quarter, the company acquired 100% stake in Mumbai based Biochem Pharmaceuticals in order to strengthen its presence in acute therapeutic segments, increase distribution and strengthen its foothold in non metro and Tier II markets. Biochem has annual revenues of INR2.6b and employs 1,200 people including 950 MRs. The management mentioned that Biochem is growing at higher than market growth rate. Though the company has not disclosed the sum it has paid to acquire Biochem, the profitability of the company is lower than that of CDH. However, the company expects to expand Biochem margin over next 2 years. FY13 will see the full impact of Biochem acquisition in revenue and EBITDA. We expect FY13 domestic formulation revenue to grow 28% on the back of this acquisition (14% YoY ex-acquisition). We believe that a ramp-up in this business is imperative to support the company's initiatives in other markets as it is a high cash generating business. Management has guided for 15-19% sustainable growth rate for this business on the back of new launches, field force expansion, restructuring, etc.

US growth likely to be impacted in FY13 if 'Warning Letter' is not resolved at the earliest

CDH management has guided for 20% YoY growth in FY12 US revenues excluding the consolidation of the Neshier acquisition. Including Neshier, and considering 8% YoY INR depreciation v/s USD in FY12, US business is expected to report strong growth of 27% YoY in INR terms. We estimate Neshier to contribute USD35m in revenues for FY13 as against USD20m in FY12 on account of full year consolidation and launch of two new products in the market in FY13. However, ex Neshier, we estimate flat USD revenues for FY13 in the absence of new product approvals from USFDA post issuance of warning letter to its injectable facility. The management mentioned that the response to the USFDA 'Warning Letter' to company's injectable facility is already submitted and expect the re-inspection by USFDA in February 2012. The management is hopeful of early resolution of the issues, in the absence of which, the company may see further slowdown in US growth rate. Meanwhile, CDH has commenced development and filing of potential low-competition products with delivery advantages (e.g. transdermal patches, nasal, injectable and respiratory products) and is focusing on developing a pipeline of such niche products. These filings are likely to contribute to CDH's US growth from FY13/14.

Downgrading FY13 EPS estimates by 14%

Based on 3QFY12 results and considering the full year impact of three new acquisitions during FY12, we are revising our FY13 revenue upwards by 3%. We have estimated USD35m in revenue from Neshor, INR3.4b revenue from Biochem and INR420m revenue from Bremer in FY13. However, we are downgrading our EBITDA estimates by 5% for FY13 on account of lower profitability of acquired companies and margin pressure in base business due to slowdown in US business. Excluding the impact of acquisitions, we have increased FY13 core EBITDA margin (ex revenues from one-off opportunities) by 50bp YoY. Modeling in 3Q results and the acquisitions, we have downgraded FY14 EPS estimates by 14% on the back of (1) lower EBITDA, (2) higher depreciation on account of the acquisitions, and (3) higher tax rate guidance (20% v/s 15% earlier). Our revised FY13 EPS estimate stands at INR38 (ex one-off upsides).

Outlook and valuation

CDH's future growth will be led by increased traction in its international businesses, ramp-up in supplies to Hospira and sustained double-digit growth in domestic formulations and consumer businesses. We estimate 10.8% revenue and EPS CAGR for FY11-13 for the core operations and RoE of 25-26%. Sustained double-digit growth without diluting return ratios has been CDH's key USP over the past few years, leading to a significant re-rating for the stock.

We believe this track record is subject to many challenges as the company aggressively scales up to achieve its revenue target of USD3b by FY16. This target implies a topline CAGR of 25% for FY11-16, which we believe is very aggressive. The company will have to invest significant resources to achieve this target which can potentially raise the risk profile of the company. This is highlighted by INR12b addition to debt in last 9 months for strategic/inorganic investments. Given the increasing risk profile of the company, various headwinds in domestic and US business, and decline in return ratios, we are reducing the P/E multiple assigned to the stock.

Based on our revised estimates, CDH is valued at 25.8x FY12E and 17.5x FY13E consolidated EPS. Maintain **Neutral** with a target price of INR684 (18x FY13E).

Cadila Healthcare: an investment profile

Company description

Cadila is amongst one of the largest domestic pharma companies in India with a strong focus on the global generics opportunity. The company is gradually building its presence in the regulated generic markets beginning with the US and France. It also plans to tap some unique opportunities through its JVs with Altana, Hospira and Bharat Serums.

Key investment arguments

- Efforts to step up the number of filings in regulated markets and focus on partnerships in overseas markets would help build critical scale over 2-3 years
- De-risked strategy with less focus on patent challenges and expensive acquisitions.

Key investment risks

- Cadila is a late entrant in the international generics space and hence lags behind its peers in terms of global footprint and underlying product basket.

Recent development

- Received warning letter for one of its injectables manufacturing facilities. Acquires Bremmer Pharma to expand footprint in global Animal Healthcare industry. Acquires Biochem Pharma to expand presence in domestic acute therapeutic segments.

Valuation and view

- We forecast core EPS of INR25.7 for FY12 (down 17%) and INR38 (up 48%) implying 11% EPS CAGR over FY11-13. Cadila is currently valued at 25.8x FY12 and 17.5x FY13E consolidated earnings.
- Maintain **Neutral** with a target price of INR684 (18x FY13E).

Sector view

- Regulated markets would remain the key sales and profit drivers in the medium term. Europe is expected to emerge as the next growth driver.
- We are Overweight on companies that are towards the end of the investment phase.

Comparative valuations

		Cadila	Lupin	Sun
P/E (x)	FY12E	25.8	24.7	28.4
	FY13E	17.5	18.5	23.2
P/BV (x)	FY12E	5.1	5.4	4.7
	FY13E	4.1	4.5	4.1
EV/Sales (x)	FY12E	2.9	3.3	7.0
	FY13E	2.4	2.8	5.8
EV/EBITDA (x)	FY12E	14.0	18.7	22.1
	FY13E	11.9	14.9	17.6

EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	25.7	35.5	-27.6
FY13	38.0	44.3	-14.3

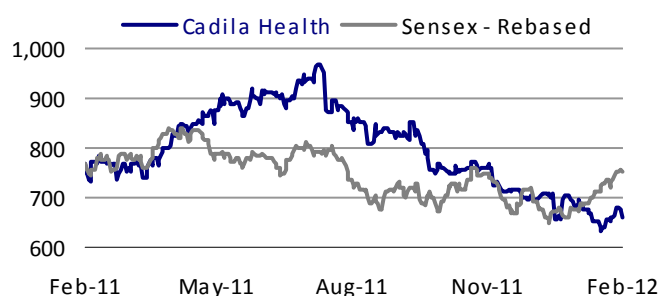
Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
664	684	3.0	Neutral

Shareholding pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	74.8	74.8	74.8
Domestic Inst	12.3	11.6	13.8
Foreign	5.4	6.2	5.1
Others	7.5	7.4	6.4

Stock performance (1 year)



Financials and Valuation

Income Statement		(INR Million)		
Y/E March	2010	2011	2012E	2013E
Net Sales	36,868	46,302	52,216	61,356
Change (%)	25.9	25.6	12.8	17.5
Total Expenditure	28,863	36,040	41,504	48,914
EBITDA	8,006	10,262	10,712	12,442
Margin (%)	21.7	22.2	20.5	20.3
Depreciation	1,339	1,269	1,719	1,929
EBIT	6,667	8,993	8,993	10,512
Int. and Finance Chrg	821	699	997	929
Other Income - Rec	159	131	-560	531
PBT before EO Expense	6,004	8,425	7,436	10,115
Extra Ordinary Expense	46	0	0	0
PBT after EO Expense	5,958	8,425	7,436	10,115
Current Tax	741	1,064	1,041	2,023
Tax	741	1,064	1,041	2,023
Tax Rate (%)	12.4	12.6	14.0	20.0
Reported PAT	5,217	7,361	6,395	8,092
Less: Mionrity Interest	247	251	264	314
Net Profit	4,970	7,110	6,131	7,778
PAT Adj for EO Items	5,011	6,334	5,266	7,778

Balance Sheet		(INR Million)		
Y/E March	2010	2011	2012E	2013E
Equity Share Capital	682	1,024	1,024	1,024
Total Reserves	15,501	20,691	25,705	31,870
Net Worth	16,183	21,715	26,728	32,894
Minority Interest	392	669	796	796
Deferred liabilities	1141	1127	1127	1127
Total Loans	10,905	10,973	19,942	16,886
Capital Employed	28,621	34,484	48,593	51,702
Gross Block	25,578	28,320	38,320	41,320
Less: Accum. Deprn.	8,734	9,994	11,713	13,642
Net Fixed Assets	16,844	18,326	26,607	27,678
Capital WIP	2,482	4,310	4,310	4,310
Investments	207	207	1,707	1,707
Curr. Assets	17,749	22,829	27,870	35,188
Inventory	7,504	8,119	10,376	13,229
Account Receivables	4,668	7,652	7,592	12,628
Cash and Bank Balanc	2,507	2,952	4,334	3,619
Loans & Advances	3,070	4,106	5,568	5,713
Curr. Liability & Prov.	8,661	11,188	11,901	17,181
Account Payables	6,710	8,955	9,111	13,530
Provisions	1,951	2,233	2,790	3,651
Net Current Assets	9,088	11,641	15,969	18,007
Appl. of Funds	28,621	34,484	48,593	51,702

E: MOSL Estimates

Ratios				
Y/E March	2010	2011	2012E	2013E
Basic (INR)				
EPS	24.5	30.9	25.7	38.0
Cash EPS	30.8	40.9	38.3	47.4
BV/Share	79.0	106.1	130.5	160.7
DPS	5.0	6.3	5.8	8.0
Payout (%)	23.7	20.8	21.6	23.8
Valuation (x)				
P/E		21.5	25.8	17.5
Cash P/E		16.2	17.3	14.0
P/BV		6.3	5.1	4.1
EV/Sales		3.1	2.9	2.4
EV/EBITDA		14.0	14.0	11.9
Dividend Yield (%)		0.9	0.9	1.2
Return Ratios (%)				
RoE	35.4	37.5	25.3	26.1
RoCE	26.4	30.5	21.3	22.9
Working Capital Ratios				
Fixed Asset Turnover (x)	2.3	2.6	2.3	2.3
Debtor (Days)	46	60	52	74
Inventory (Days)	74	64	73	79
Working Capital Turno	65	68	81	86
Leverage Ratio (x)				
Current Ratio	2.0	2.0	2.3	2.0
Debt/Equity	0.5	0.4	0.6	0.4

* Ratios adjusted for bonus issue

Cash Flow Statement		(INR Million)		
Y/E March	2010	2011	2012E	2013E
Oper. Profit/(Loss) bef	8,006	10,262	10,712	12,442
Interest/Dividends Re	159	131	-560	531
Direct Taxes Paid	-741	-1,064	-1,041	-2,023
(Inc)/Dec in WC	-402	-2,108	-2,947	-2,753
CF from Operations	7,022	7,222	6,165	8,197
EO Expense / (Income)	46	0	0	0
CF from Operating incl E	6,976	7,222	6,165	8,197
(inc)/dec in FA	-3,478	-4,579	-10,000	-3,000
(Pur)/Sale of Investme	42	0	-1,500	0
CF from Investments	-3,436	-4,579	-11,500	-3,000
Change in Networth	289	-301	0	0
Inc/(Dec) in Debt	-1,605	345	9,096	-3,056
Interest Paid	-821	-699	-997	-929
Dividend Paid	-1,237	-1,529	-1,381	-1,927
Others	-175	-14		
CF from Fin. Activity	-3,550	-2,198	6,717	-5,911
Inc/Dec of Cash	-10	445	1,382	-715
Add: Beginning Balanc	2,517	2,507	2,952	4,334
Closing Balance	2,507	2,952	4,334	3,619

N O T E S

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Cadila Healthcare

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