4QFY06 Results Update
SECTOR: PHARMACEUTICALS

Cipla

STOCK INFO.	BLOOMBERG
BSE Sensex: 11,939	CIPLA IN
	REUTERS CODE
S&P CNX: 3,556	CIPLA.BO

Equity Shares (m)	777.3
52-Week Range (Rs)	305/96
1,6,12 Rel. Perf. (%)	5/26/81
M.Cap. (Rs b)	204.1
M.Cap. (US$ b)	4.5

26 April 2006

Neutral

Previous Recommendation: Neutral Rs263

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
03/06A	29,857	6,001	8.0	46.1	32.8	9.8	29.9	30.8	6.9	30.7
03/07E	36,696	7,272	9.4	16.7	28.1	6.1	21.8	24.1	5.3	21.2
03/08E	43,540	8,705	11.2	19.5	23.4	5.1	21.6	24.0	4.4	17.4

Cipla 4QFY06 results are ahead of our estimates with revenue growth of 63% (to Rs8.7b) and PAT growth of 81% (to Rs1.91b). Key takeaways from the results include:

- Net revenue growth of 63% (to Rs8.7b) was driven primarily by strong growth in both domestic sales (up by 72% YoY due low base in 4QFY05 due to VAT) and exports (up by 64% YoY). Growth in international markets was driven by APIs (up 190% YoY) and formulation (up by 30% YoY) sales.
- Higher share of domestic business (37% of sales v/s 35% in 4QFY05) resulted in margin declining by 490bp to 20.7%, translating into only 32% growth in EBITDA.
- However, higher other income (at to Rs468m v/s Rs155m in 4QFY05) due to insurance claim (of Rs197m) and lower tax provisioning (at 4% of PBT v/s 22.7% in 4QFY05) boosted PAT growth to 81% at Rs1.91b. Tax provisioning was lower due to higher contributions from tax exempt plants of Goa and Baddi for formulations and from EOU plants at Kurkumbh and Bangalore.
- We have revised our EPS estimate upwards by 10.9% to Rs9.4 for FY07E and 6.7% to Rs11.2 for FY08E, to factor in for strong momentum in its international business.

While Cipla would continue to report steady growth going forward (led mainly by increased exports to regulated markets), at 28.1x FY07E and 23.4x FY08E EPS, valuations are a fair reflection of the company's growth prospects. Maintain **Neutral.**

QUARTERLY PERFORMANCE (Rs Million)

Y/E MARCH	FY05				FY06				FY05	FY06
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Net Sales	**5,335**	**5,814**	**5,961**	**5,350**	**6,628**	**6,717**	**7,806**	**8,706**	**22,545**	**29,857**
YoY Change (%)	*17.4*	*20.2*	*24.0*	*-6.1*	*24.2*	*15.5*	*30.9*	*62.7*	*9.7*	*32.4*
Total Expenditure	4,267	4,495	4,757	3,981	5,129	4,944	6,217	6,903	17,592	23,193
EBITDA	**1,067**	**1,319**	**1,205**	**1,369**	**1,499**	**1,773**	**1,589**	**1,803**	**4,953**	**6,664**
Margins (%)	*20.0*	*22.7*	*20.2*	*25.6*	*22.6*	*26.4*	*20.4*	*20.7*	*22.0*	*22.3*
Depreciation	130	125	128	148	135	215	230	250	551	830
Interest	14	40	12	10	14	17	51	33	76	114
Other Income	119	74	412	155	84	15	744	468	820	1,311
Profit before Tax	**1,043**	**1,229**	**1,477**	**1,366**	**1,434**	**1,556**	**2,053**	**1,988**	**5,146**	**7,031**
Tax	250	270	220	310	320	330	300	80	1,050	1,030
Rate (%)	*24.0*	*22.0*	*14.9*	*22.7*	*22.3*	*21.2*	*14.6*	*4.0*	*20.4*	*14.6*
Reported PAT	**793**	**959**	**1,257**	**1,056**	**1,114**	**1,226**	**1,753**	**1,908**	**4,096**	**6,001**
YoY Change (%)	17.9	37.9	66.8	3.8	40.6	27.9	39.5	80.7	25.1	46.5
Margins (%)	*14.9*	*16.5*	*21.1*	*19.7*	*16.8*	*18.3*	*22.5*	*21.9*	*18.2*	*20.1*

E: MOSt Estimates; FY05 quarterly numbers don't add up to full year numbers due to restatement

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Strong growth in both domestic and international business

Cipla's net revenue in 4QFY06 grew by 63% YoY to Rs8.7b, driven primarily by strong growth in both domestic (up by 72% YoY) and international (up by 64% YoY) business. While domestic business growth of 72% was largely on account on low base of 4QFY05 due to VAT, international business witnessed strong growth in API business which grew by 190% YoY. The company has indicated that it has commenced export of one of the APIs (name not disclosed) to its customer in regulated markets.

BUSINESS BREAK UP (RS M)

	4QFY06	4QFY05	CHG. (%)	3QFY06	CHG. (%)
Domestic	3,245	1,890	71.7	3,643	-10.9
% of Revenues	*37.3*	*35.3*		*46.7*	
Exports	5,266	3,217	63.7	3,864	36.3
% of Revenues	*60.5*	*60.1*		*49.5*	
Formulations	3,320	2,546	30.4	2,361	40.6
APIs	1,946	670	190.3	1,503	29.5
Other Oper. Income	195	243	-20.0	300	-35.1
% of Revenues	*2.2*	*4.5*		*3.8*	
Total Gross Rev.	**8,706**	**5,350**	**62.7**	**7,806**	**11.5**

Source: Company

Anti-asthmatic, CVS and anti-biotic products were the main drivers in domestic growth. In the exports business, Cipla has witnessed better performance in the anti-retroviral, anti-malarials, anti-asthmatic, anti-depressant and CVS segments.

Adverse product mix and higher expenses lead to lower margins

EBITDA for the quarter grew by just 32% YoY to Rs1.8b. Higher contribution from the low-margin domestic business (37.3% v/s 35.3% in 4QFY05), higher staff costs (up 33% YoY) and other expenditure (up 50% YoY) led to a 490bp decline in EBITDA margins to 20.7%.

Phased commissioning of Cipla's facilities at Baddi and Goa resulted in higher depreciation (up 70% YoY) for the quarter. However, higher other income (at Rs468m v/s Rs155m in 4QFY05) due to insurance claim (of Rs197m) and lower tax provisioning (at 4% of PBT v/s 22.7% in 4QFY05) due to higher contribution from EOUs and tax exempt plants, boosted into PAT growth of 81% to Rs1.91b.

Strong generic pipeline

Cipla has one of the strongest generic pipelines in India with about 160 products at various stages of development. We believe that Cipla's partners have a pipeline of about 90 ANDAs filed with the US FDA. We expect this pipeline to start generating revenues from FY07E onwards. While more clarity on these products will emerge over a period of time, we believe that this is one of the strongest generic pipelines amongst Indian companies. Approvals for these products are expected to take between 12-15 months. We expect ANDA approvals for Cipla's partners to start coming through from FY07E onwards resulting in a revenue upside of US$25m. Our estimates for FY07E include the revenue upside from these approvals. Supplies linked to Para-IV filings will remain uncertain till resolution of patent litigations and hence are excluded from our estimates. We have, however, included upsides from supply of generic Sertraline API to Ivax (Teva) and supply of Finasteride and Fluticasone formulations to the US market in our estimates for FY07E. These products together are likely to contribute about Rs1/ share to our FY07E EPS.

Cipla is targeting overall sales growth of 15-20% for FY07E (we are estimating 23% growth). While the management has always denied any plans of stake sale, we continue to believe that Cipla is a long-term sell-out candidate due to absence of a clear strategy on succession planning.

Partnerships with generic companies help in spreading risks

Cipla has tied up with various generic companies (in USA & EU) for supplying about 160 products over the next few years. This has helped the company spread its risks associated with the generic markets. We believe that the company has also attempted to spread risks across product categories like plain vanilla generics, patent challenges and first to files. It should be noted that Cipla, as a policy, does not get directly involved in patent challenges and remains only a supplier to the generic company filing the patent challenge. Hence, the company does not carry any litigation risks linked to patent challenges. To sum up, we believe that Cipla follows a de-risked strategy for the generic markets.

Significant capex for future growth

Cipla has undertaken a significant capex for setting up facilities to drive future growth. The company has already incurred a capex of about Rs4b in the last two years. It has recently raised about US$170m through a GDR issue (@Rs274 per share) to part-fund its future capex. This is an indication of the management's confidence regarding the long-term future of the company.

Multiple opportunities for generic Seretide

Cipla has entered into a tie-up with Neolab (UK) for supplying a combination of Salmeterol & Fluticasone Propionate (useful for asthma treatment). GSK is the innovator of the drug and sells it under the "Seretide/Advair" brand. Neolab has challenged GSK's patent expiring in 2013. This patent relates to the combination of Salmeterol & Fluticasone Propionate. The patent expiry date of 2013 includes supplementary protection certificate (SPC). Individual patents on Salmeterol and Fluticasone Propionate expire in 2005. Other patents on Seretide include the Diskus device patent expiring in 2011 and the CFC-free MDI patent expiring in 2012, which have not been challenged.

The London Court has given its ruling in favour of generic companies (this ruling applies only to UK). GSK has appealed against this ruling. We believe that GSK's data exclusivity (valid till 2008) will prevent any generic entry unless generic companies conduct their own limited clinical trials for the product. We believe that Cipla/Neolab have already commenced clinical trials for this product and hence a commercial launch may be possible in UK before 2008 (provided the London Court ruling is upheld in the higher court). The UK market for Seretide is estimated at US$240m while the global sales are estimated at about US$4b with USA accounting for 55% of the sales. We believe that Cipla will try to address the US opportunity also (through its partners). **It should be noted that we have not included any upsides from Seretide in our estimates since it is linked to the successful outcome of a patent challenge.**

Anti-AIDS products represent a high-volume opportunity

Cipla is one of the leading players in the anti-AIDS market and is likely to participate in the US government's PEPFAR program for supplying low-priced ARVs to under-developed nations facing a healthcare emergency (like the African subcontinent). Miniscule healthcare budgets of African governments and intensifying competition will limit the upside for generic players. Inadequate global funding for anti-AIDS programs for African nations is also a hindrance to supply of anti-AIDS drugs to these countries. We believe that the anti-AIDS opportunity is a high volume-low margin opportunity.

Key risks

- The company has not yet made provisions for the NPPA demand of Rs1.8b. The matter is in litigation with the Supreme Court. If Cipla loses the case, it will have to immediately pay-up the amount to NPPA. It should be noted that the total liability (raised by the NPPA's demand) is about Rs3.6b, of which NPPA is demanding 50% as of now. **It should also be noted that the liability roughly equals 50% of our full-year FY07E profit estimate of Rs7.27b.**

- The proposed new drug policy (based on the recommendations of the PMO's task force) plans to have a ceiling price for a host of drugs based on the pricing of the top three brands in respective product categories. We believe that, if the recommendations are implemented in the current form, it will amount to bringing more drugs under indirect price control. This may adversely impact all the players having large domestic operations including Cipla. The pharmaceutical industry has represented to the government to take a more pragmatic view on the new policy. We are awaiting further details on this from the government.

Revising estimates

We have raised our EPS estimates for FY07E by 11% to Rs9.4 and FY08E by 7% to Rs11.2 to factor in for:

- strong momentum in international operations
- Higher other income due to idle GDR proceeds
- Lower tax outgo due to higher contribution from tax-exempt plants at Baddi, Goa and EOUs at Kurkumbh and Bangalore

REVISED ESTIMATES (RS M)

	FY07E			FY08E		
	REV	OLD	CHG (%)	REV	OLD	CHG (%)
Net Sales	36,696	34,900	5.1	43,540	41,434	5.1
Net Profit	7,272	6,556	10.9	8,705	8,158	6.7
EPS (Rs)	9.4	8.4	10.9	11.2	10.5	6.7

Source: Motilal Oswal Securities

Valuations

Generic supplies to partners in regulated markets remain long-term triggers. Cipla has tied up with various generic companies for supplying more than 160 products over the next few years. While more clarity on these products will emerge over a period of time, we believe that this is one of the strongest generic pipelines amongst Indian companies. While Cipla would continue to report steady growth going forward (led mainly by increased exports to regulated markets), at 28.1x FY07E and 23.4x FY08E EPS, valuations are a fair reflection of the company's growth prospects. Maintain **Neutral.**

Cipla : an investment profile

Company description

Cipla is the second largest player in the domestic formulations market and has a presence across most therapeutic areas. The company also has robust exports to several markets including US, Europe, South Africa, Australia and the Middle East.

Key investment arguments

- Supply agreements with five US players (around 160 products) to drive growth in the medium term.
- Commencement of exports of CFC-free inhalers to Europe is a key positive.
- Strong core business with healthy growth rates gives it a firm base to scale up overseas markets initiatives.

Key investment risks

- NPPA liability of Rs.1.80b (if it materializes) could result in a significant one-time cash outflow
- Growing competition in the domestic market, sales of "generic generics" and rapid growth in anti-AIDS sales could put pressure on margins if regulated market initiatives are delayed.
- Inadequate disclosure about key business metrics leads to low visibility on operations.

Recent developments

- Raised US$170m recently through a GDR issue @Rs274/share to fund future capex and acquisitions.

Valuation and view

- Revenue and EPS CAGR of 25% and 27% expected over FY05-08.
- One of the strongest generic pipelines coupled with de-risked strategy should bring in long-term benefits.
- Re-iterate **Neutral** with price target of Rs280 (~25x FY08E).

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, particularly for companies with a direct marketing presence.
- FY06 to be year of consolidation in terms of profitability, as companies divert efficiency gains towards seeding their regulated markets and R&D initiatives.
- We are overweight on companies that are towards the end of the investment phase, with benefits expected to start coming in from the next fiscal.

COMPARATIVE VALUATIONS

		CIPLA	DRL	RANBAXY
P/E (x)	FY07E	28.1	37.0	38.1
	FY08E	23.4	25.1	28.2
P/BV (x)	FY07E	6.1	4.3	6.2
	FY08E	5.1	3.7	74.7
EV/Sales (x)	FY07E	5.3	3.8	3.3
	FY08E	4.4	3.2	2.4
EV/EBITDA (x)	FY07E	21.2	38.4	24.1
	FY08E	17.4	23.7	17.1

SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	40.9	40.9	41.0
Domestic Institutions	9.7	10.6	9.2
FIIs/FDIs	21.4	22.2	20.7
Others	28.0	26.3	29.1

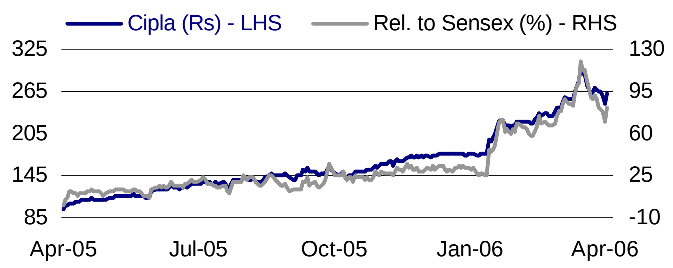
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	9.4	8.6	9.7
FY08	11.2	11.3	-1.1

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
263	280	6.5	Neutral

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					(Rs Million)
Y/E MARCH	2004	2005	2006	2007E	2008E
Net Income	**19,230**	**22,545**	**29,857**	**36,696**	**43,540**
Change (%)	*31.7*	*17.2*	*32.4*	*22.9*	*18.6*
Total Expenditure	15,038	17,592	23,193	27,553	32,498
EBITDA	**4,192**	**4,953**	**6,664**	**9,143**	**11,042**
Margin (%)	*21.8*	*22.0*	*22.3*	*24.9*	*25.4*
Depreciation	403	551	830	951	1,105
Int. and Finance Charges	104	76	114	96	84
Other Income - Rec.	356	817	1,311	360	270
PBT before EO Items	**4,041**	**5,143**	**7,031**	**8,455**	**10,122**
Extra Ordinary Expense	207	0	0	0	0
Profit before Taxes but	**3,833**	**5,143**	**7,031**	**8,455**	**10,122**
Tax	878	1,050	1,030	1,184	1,417
Tax Rate (%)	*19.0*	*20.4*	*14.6*	*14.0*	*14.0*
Reported PAT	**2,956**	**4,093**	**6,001**	**7,272**	**8,705**
Adj PAT	**3,274**	**4,093**	**6,001**	**7,272**	**8,705**
Change (%)	*32.2*	*25.0*	*46.6*	*21.2*	*19.7*
Margin (%)	*17.0*	*18.2*	*20.1*	*19.8*	*20.0*

BALANCE SHEET					(Rs Million)
Y/E MARCH	2004	2005	2006	2007E	2008E
Equity Share Capital	600	600	600	1,555	1,555
Reserves	11,939	14,835	19,468	31,831	38,764
Revaluation Reserves	102	102	102	102	102
Net Worth	**12,641**	**15,536**	**20,169**	**33,487**	**40,420**
Loans	2,106	1,950	2,200	1,302	1,502
Deferred liabilities	659	889	792	707	606
Capital Employed	**15,406**	**18,376**	**23,161**	**35,497**	**42,528**
Gross Block	7,408	9,867	11,967	13,067	16,367
Less: Accum. Deprn.	1,932	2,478	3,308	4,259	5,364
Net Fixed Assets	**5,476**	**7,389**	**8,660**	**8,808**	**11,003**
Capital WIP	560	1,060	960	450	500
Investments	1,804	183	1,266	1,266	1,266
Curr. Assets	**14,362**	**17,529**	**21,677**	**36,041**	**42,452**
Inventory	5,689	7,457	9,141	11,270	13,397
Account Receivables	4,982	5,873	6,207	7,658	9,121
Cash and Bank Balance	62	154	1,667	11,562	13,285
Others	3,628	4,045	4,661	5,551	6,649
Curr. Liability & Prov.	**6,796**	**7,785**	**9,401**	**11,068**	**12,692**
Account Payables	6,796	7,785	9,401	11,068	12,692
Net Current Assets	**7,566**	**9,744**	**12,276**	**24,973**	**29,759**
Appl. of Funds	**15,406**	**18,376**	**23,161**	**35,497**	**42,528**

E: MOSt Estimates

RATIOS					
Y/E MARCH	2004	2005	2006	2007E	2008E
Basic (Rs)					
EPS	**4.4**	**5.5**	**8.0**	**9.4**	**11.2**
Cash EPS	4.9	6.2	9.1	10.6	12.6
BV/Share	16.7	20.6	26.8	43.0	51.9
DPS	1.2	1.4	1.6	1.8	2.0
Payout (%)	34.3	29.2	22.8	21.9	20.4
Valuation (x)					
P/E		48.1	32.8	28.1	23.4
Cash P/E		42.4	28.8	24.8	20.8
P/BV		12.8	9.8	6.1	5.1
EV/Sales		9.1	6.9	5.3	4.4
EV/EBITDA		41.6	30.7	21.2	17.4
Dividend Yield (%)		0.5	0.6	0.7	0.8
Return Ratios (%)					
RoE	26.1	26.5	29.9	21.8	21.6
RoCE	26.9	28.4	30.8	24.1	24.0
Working Capital Ratios					
Asset Turnover (x)	1.2	1.2	1.3	1.0	1.0
Debtor (Days)	95	95	76	76	76
Inventory (Days)	108	121	112	112	112
Working Capital (Days)	144	158	150	248	249
Leverage Ratio (x)					
Current Ratio	2.1	2.3	2.3	3.3	3.3
Debt/Equity	0.2	0.1	0.1	0.0	0.0

CASH FLOW STATEMENT					(Rs Million)
Y/E MARCH	2004	2005	2006	2007E	2008E
Oper. Profit/(Loss) before Ta	4,192	4,953	6,664	9,143	11,042
Interest/Dividends Recd.	356	817	1,311	360	270
Direct Taxes Paid	-780	-820	-1,128	-1,268	-1,518
(Inc)/Dec in WC	-690	-2,086	-1,019	-2,802	-3,064
CF from Operations	**3,077**	**2,863**	**5,829**	**5,433**	**6,730**
(inc)/dec in FA	-2,440	-2,964	-2,000	-590	-3,350
(Pur)/Sale of Investments	-538	1,621	-1,083	0	0
CF from Investments	**-2,977**	**-1,343**	**-3,083**	**-590**	**-3,350**
(Inc)/Dec in Debt	1,158	-155	250	-898	200
Interest Paid	-104	-76	-114	-96	-84
Dividend Paid	-1,015	-1,197	-1,368	-1,595	-1,773
CF from Fin. Activity	**39**	**-1,429**	**-1,232**	**5,052**	**-1,657**
Inc/Dec of Cash	**-69**	**92**	**1,513**	**9,895**	**1,723**
Add: Beginning Balance	131	62	154	1,667	11,562
Closing Balance	**62**	**154**	**1,667**	**11,562**	**13,285**

N O T E S

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Disclosure of Interest Statement	Cipla
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No

MOSt is not engaged in providing investment-banking services.