Cadila Healthcare

STOCK INFO.	BLOOMBERG
BSE Sensex: 19,243	CDH IN
	REUTERS CODE
S&P CNX: 5,702	CADI.BO

Equity Shares (m)	125.6
52-Week Range	412/285
1,6,12 Rel. Perf. (%)	-14/-43/-62
M.Cap. (Rs b)	37.7
M.Cap. (US$ b)	0.9

26 October 2007

Buy

Previous Recommendation: Buy

Rs300

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
03/07A	18,288	2,343	18.7	43.5	16.1	4.4	29.9	24.1	2.2	11.6
03/08E	23,128	2,652	21.1	13.2	14.2	3.5	27.4	23.4	1.8	9.4
03/09E	27,088	3,246	25.8	22.4	11.6	2.8	27.1	23.7	1.5	7.9

- Net sales grew by 28.4% to Rs6.1b driven by 122% YoY growth in formulation exports to Rs1.8b. Domestic formulation sales grew by only 6.6% reflecting the recent slow-down in the acute therapy segments. Overall revenue growth was partly boosted by consolidation of acquired companies which together contributed Rs1b in sales for the quarter compared to Rs210m for 2QFY07. Organically, Cadila has recorded about 11.6% top-line growth. EBITDA margins declined 140bp YoY to 21.6% (vs est. of 20.6%) while PAT recorded 16.6% growth to Rs822m.
- **New launches to drive growth in the US market -** Cadila has filed 66 ANDAs with the US FDA till date and has received 30 ANDA approvals with 36 ANDAs awaiting US FDA approval. During FY08E, the company expects about 8 product launches in the US with revenues expected at US$50m (80% growth).
- **Pantoprazole Update -** Management has clarified that of the global Pantoprazole API market of 120t, USA accounts for about 20t. Hence, even if Teva and Sun Pharma were to launch their generic versions, it will only partly impact Cadila's supplies of Pantoprazole.

Cadila is currently valued at 14.2x FY08E and 11.6x FY09E consolidated earnings. Traction in international operations (mainly the US and France) and steady contribution from Altana JV are likely to be key growth drivers over the next two years. This coupled with a de-risked business model should ensure good long-term potential for the company. Early loss of patent protection for Pantoprazole remains a key risk (it contributes about 17-20% of PAT). Teva & Sun Pharma can potentially undertake a launch-at-risk for Pantoprazole. Maintain **Buy**.

QUARTERLY PERFORMANCE (CONSOLIDATED) (Rs Million)

Y/E MARCH	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Revenues	**4,458**	**4,748**	**4,724**	**4,357**	**5,722**	**6,097**	**5,889**	**5,421**	**18,288**	**23,128**
YoY Change (%)	*19.5*	*27.3*	*27.8*	*25.9*	*28.4*	*28.4*	*24.7*	*24.4*	*23.2*	*26.5*
Total Expenditure	3,560	3,658	3,901	3,646	4,610	4,780	4,801	4,565	14,767	18,756
EBITDA	**898**	**1,090**	**823**	**711**	**1,112**	**1,317**	**1,088**	**856**	**3,521**	**4,373**
Margins (%)	*20.1*	*23.0*	*17.4*	*16.3*	*19.4*	*21.6*	*18.5*	*15.8*	*19.3*	*18.9*
Depreciation	197	213	212	200	239	235	250	299	823	1,023
Interest	69	54	49	52	73	127	95	81	223	376
Other Income	49	3	0	15	94	0	30	0	264	40
PBT before EO Income	**681**	**826**	**562**	**474**	**894**	**955**	**773**	**476**	**2,739**	**3,014**
EO Exp/(Inc)	0	0	-196	0	0	24	0	0	0	24
PBT after EO Income	**681**	**826**	**758**	**474**	**894**	**931**	**773**	**476**	**2,739**	**2,990**
Tax	76	100	98	50	121	114	94	33	324	362
Rate (%)	*11.2*	*12.1*	*12.9*	*10.5*	*13.5*	*12.2*	*12.1*	*7.0*	*11.8*	*12.1*
Minority Int/Adj on Consol	21	21	1	35	34	16	0	0	77	0
Reported PAT	**584**	**705**	**659**	**389**	**739**	**801**	**680**	**443**	**2,338**	**2,628**
Adj PAT	**584**	**705**	**488**	**389**	**739**	**822**	**680**	**443**	**2,338**	**2,650**
YoY Change (%)	*47.2*	*38.8*	*18.4*	*13.0*	*26.5*	*16.6*	*39.2*	*13.8*	*40.7*	*13.3*
Margins (%)	*13.1*	*14.8*	*10.3*	*8.9*	*12.9*	*13.5*	*11.5*	*8.2*	*12.8*	*11.5*

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

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Exports and consolidation of acquired companies drive revenue growth

Net sales grew by 28.4% to Rs6.1b (vs est. of Rs6.1b), driven by 122% YoY growth in formulation exports to Rs1.8b. API exports declined by 16.7% to Rs488m while domestic sales grew by 12.4% to Rs3.9b. Domestic sales growth was led by higher growth in the consumer business and consolidation of acquired companies. In fact, domestic formulation sales grew by only 6.6% reflecting the recent slow-down in the acute therapy segments. Overall revenue growth was partly boosted by consolidation of acquired companies, viz., Nikkho, Carnation, Sarabhai & Liva Healthcare which together contributed Rs1b in sales for the quarter compared to Rs210m for 2QFY07. Organically, Cadila has recorded about 11.6% top-line growth.

REVENUES BREAK-UP (RS M)

	2QFY08	2QFY07	% CHG	1QFY08	% CHG
Gross Domestic Sales	**3,928**	**3,496**	**12.4**	**3,925**	**0.1**
Formulations	3,163	2,968	6.6	3,134	0.9
APIs	111	119	-6.3	134	-17.2
Consumer & Others	654	410	59.5	657	-0.5
Export Sales	**2,286**	**1,396**	**63.8**	**1,930**	**18.4**
Formulations	1,798	810	122.0	1,256	43.2
APIs	488	586	-16.7	674	-27.6
Gross Sales	**6,214**	**4,892**	**27.0**	**5,855**	**6.1**

Source: Company

Higher staff costs, other expenses and currency appreciation impact margins

EBITDA margins declined 140bp YoY to 21.6%, impacted by higher staff costs (due to consolidation of acquired companies) and a 34% increase in other expenses. Performance was also impacted by 11% currency appreciation. Management has indicated that it lost about Rs34m in top-line due to currency appreciation and booked a net forex loss of Rs22m operationally while the translation of forex debt resulted in a gain of Rs10m. Since Cadila has about 63% of revenues from domestic market, it is relatively less impacted by currency appreciation vs other pharma companies. We believe that the sensitivity to currency movement will become more pronounced going forward as exports are expected to record strong growth in the coming years.

New launches would drive growth in the US market

Cadila initiated filings for the US generic markets in the year 2003 and has filed 66 ANDAs with the US FDA till date. It has received 30 ANDA approvals (including tentative approvals) and has about 36 ANDAs awaiting US FDA approval. During FY08E, the company expects about 8 product launches. Most of the company's products are backward integrated into APIs; this is likely to enhance its sustainability in the intensely competitive generics markets. The company plans to file about 15 ANDAs on annualized basis for the next few years. We believe that Cadila's nascent US business is likely to grow significantly (albeit on a lower base) over the next few years, as its generics pipeline gets commercialized.

French operations turn around

Cadila had acquired Alpharma's loss-making French business, consisting of a combination of generics and branded OTC and mature products in 2003 for EUR5.5m. It later sold the branded business to Aerocid for EUR7m and has entered into a distribution agreement with Evolupharm.

Cadila will transfer products to Evolupharm at a certain price (including profit margin) and the latter will sell the products in France. The resultant fixed cost reduction had made Cadila's French operations, which reported a loss of Rs160m (excl profit on sale of brands) for FY07, more viable. As the new distribution arrangement has come into force from 1 January 2007, the full impact of this arrangement will be visible from FY08. Also, revenue growth is expected to be driven by strong growth in existing portfolio and new product launches would result in higher revenues.

The French business recorded revenues of Rs364m (up 38% YoY) led by new launches and growth in existing business. It has also reported a marginal profit for the quarter.

Gradual site transfer to India will improve profitability of French business

Cadila is in the process of transferring manufacturing of products for the French market to India through the site transfer mechanism. It has applied for 25 site transfers of which 11 have been approved till date. It plans to file a total of 28 site transfers. While we believe that such site transfers will have a positive impact on the profitability of Cadila's French business, longer approval times could delay the benefits of margin expansion. Site transfer approvals from the French regulatory authorities are taking longer than expected. The first site transfer took almost 15 months to come through. Hence, the margin expansion due to site transfer is likely to be very gradual.

Domestic branded business – growth slows down

Cadila's domestic sales grew by 12.4% to Rs3.9b. Growth was led by higher growth in the consumer business and consolidation of acquired companies. In fact, domestic formulation sales grew by only 6.6% reflecting the recent slow-down in the acute therapy segments.

Pantoprazole Update

Cadila has clarified that of the global Pantoprazole API market of 120t, USA accounts for about 20t. Hence, even if Teva and Sun Pharma were to launch their generic versions, it will only partly impact Cadila's supplies of Pantoprazole. This product contributed about 23% of Cadila's PAT for FY07 and 14% for 2QFY08. We expect it to contribute about 17% and 14% respectively to Cadila's consolidated PAT for FY08E and FY09E.

PANTOPRAZOLE: CADILA'S SHARE (RS M)

	FY05	FY06	FY07	FY08E	FY09E
Sales	648	653	837	700	700
PAT	571	460	550	455	455
% of Total PAT	*48.5*	*30.0*	*22.8*	*17.2*	*14.0*

Source: Company/Motilal Oswal Securities

Contract manufacturing contribution unlikely to be significant

Cadila has entered into various contracts with innovator pharmaceutical companies for CCS and commercial supplies. It has also entered into contract manufacturing arrangements with some of the generics companies for supply of commercial quantities. The management has indicated that it currently has a pipeline of 25 contracts with peak revenues of about US$38m.

We believe that this is likely to be achieved by FY10, implying that the contribution from this initiative is unlikely to be significant in the short-to-medium term. We also believe that the peak revenue of US$38m is contingent on successful commercialization of some of the products which currently are undergoing clinical development.

Targets small-sized acquisitions for market entry and filling in portfolio gaps

1. Nikkho (Brazil) acquisition – In June-2007, Cadila signed an agreement to acquire Nikkho (in Brazil) for a consideration of US$26m at 1x sales. While management has not disclosed the profitability of Nikkho, we believe that the acquisition has been made at 8-9x EBITDA. Cadila management has indicated that Nikkho is a profit-making company.

The acquisition gives Cadila access to the branded generic market in Brazil. Cadila currently has presence in the pure generic segment in Brazil through its portfolio of about 13 products. Nikkho currently has a portfolio of about 22 products across 13 brands and has a strong pipeline of products pending launch.

Nikkho currently has a sales force of 125 people covering about 60,000 medical practitioners. Its product basket comprises therapies across a wide range of therapeutic segments such as general medicine, pediatrics, gynecology, neurology, gastroenterology, otolaryngology, respiratory, dermatology, and others. It has manufacturing facilities for solids, injectables and liquids in Brazil.

Nikkho's lower profitability implies scope for margin expansion

While it seems that, Nikkho's EBITDA margins at 11-12% are significantly lower that of Cadila's (~20%), we believe that this is mainly due to the large sales force selling relatively lesser number of products. As Nikkho's future product pipeline gets commercialized, margins are expected to improve. In fact, EBITDA margins for the branded generic businesses in India (supposed to be one of the cheapest markets globally) are in the range of 20-25%. However, we also believe that the possibility of shifting manufacturing back to India is remote if the regulatory changes make it mandatory to have a local manufacturing base in Brazil. Nikkho contributed about Rs479m to Cadila's 2QFY08 revenues.

2. Liva Healthcare acquisition – Cadila acquired Liva Healthcare in March-2007 gaining entry in to the Rs15b domestic dermatology market. Liva recorded revenues of about Rs370m for FY07 and is a profit making company. It contributed about Rs108m to Cadila's 2QFY08 revenues.

Dermatology products constitute 56% of Liva's therapeutic coverage. It also has a presence in the respiratory segment which accounts for 24% of its revenues. Its top five brands of the company ~ Fusys, Nasoclear, Oflatoon, Clobetasole combinations and BTN contribute over 63% of sales. With 325 medical representatives and a nationwide reach, Liva has a strong equity with dermatologists, cosmetologists and physicians. The acquisition also includes Liva's GMP compliant manufacturing facility at Sinnar, near Nasik.

Valuation and outlook

We believe that Cadila has reached the inflexion point from where all of its major business initiatives will record significant growth:

1. International business is likely to grow significantly, as Cadila's generic pipeline gets commercialized. The restructuring of French operations is also likely to aid overall export growth.
2. With the distribution and portfolio restructuring for the domestic operations completed, Cadila is likely to revert back to its normal double-digit growth in the domestic branded market.

We expect Cadila's topline to record 22% CAGR over FY07-09, led mainly by a 44% CAGR in the international formulations business. This division is likely to contribute about 28% of sales by FY09 as compared to 20% for FY07. The US and French operations are likely to be the major contributors to this growth. Overall exports are likely to account for about 38% of sales by FY09, as compared to 32% for FY07.

While the domestic formulations business is likely to be steady performer with 14% CAGR for FY07-09, Cadila's consumer business is likely to record 30% CAGR aided by higher growth in existing portfolio and consolidation of acquired companies, viz., Carnation and Liva Healthcare.

We expect a 18% bottom-line CAGR for FY07-09. Fiscal benefits arising out of operations in tax-exempt zones (enjoying excise duty and income tax exemption) are also likely to aid bottom-line growth. We expect Cadila to maintain a consistent higher RoE (>25%) for the next two years since we do not expect any significant capex post FY07.

Cadila is currently valued at 14.2x FY08E and 11.6x FY09E consolidated earnings. Traction in international operations (mainly the US and France) and steady contribution from Altana JV are likely to be key growth drivers over the next two years. This coupled with a de-risked business model should ensure good long-term potential for the company. Early loss of patent protection for Pantoprazole and possibility of further currency appreciation remain as key risks. Maintain **Buy** with target price of Rs400.

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.
- Large domestic presence and expected to out-perform the average industry growth.
- 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.
- Early loss of patent protection for Pantoprazole may impact earnings.

Recent Developments

- Acquired Nikkho in Brazil as an entry vehicle to the branded generic market.

Valuation and view

- Valuations at 14.2x FY08E and 11.6x FY09E are not demanding.
- Increased traction based on improvement in both the domestic and international businesses coupled with de-risked strategy; Maintain **Buy** with target price of Rs400.

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	NPIL	SUN
P/E (x)	FY08E	14.2	23.3	24.5
	FY09E	11.6	18.8	20.5
P/BV (x)	FY08E	3.5	4.9	4.5
	FY09E	2.8	4.2	3.8
EV/Sales (x)	FY08E	1.8	2.5	7.5
	FY09E	1.5	2.2	6.1
EV/EBITDA (x)	FY08E	9.4	15.8	21.1
	FY09E	7.9	13.0	17.5

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	72.0	72.0	72.0
Domestic Inst	15.6	15.1	14.7
Foreign	4.4	5.0	4.7
Others	7.9	7.9	8.6

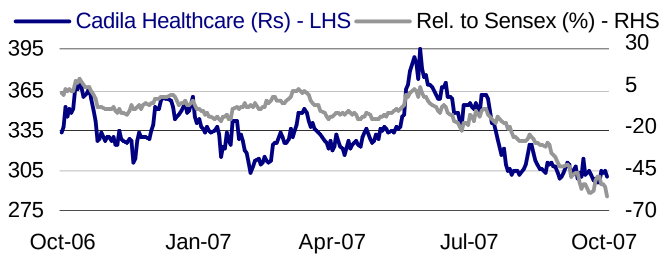
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	21.1	22.3	-5.4
FY09	25.8	26.5	-2.5

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
300	400	33.3	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (Rs Million)

Y/E MARCH	2005	2006	2007	2008E	2009E
Net Sales	**12,779**	**14,845**	**18,288**	**23,128**	**27,088**
Change (%)	*4.3*	*16.2*	*23.2*	*26.5*	*17.1*
Total Expenditure	10,350	11,969	14,767	18,756	21,929
EBITDA	**2,429**	**2,876**	**3,521**	**4,373**	**5,158**
Margin (%)	*19.0*	*19.4*	*19.3*	*18.9*	*19.0*
Depreciation	718	779	823	1,023	1,163
EBIT	**1,711**	**2,097**	**2,698**	**3,350**	**3,995**
Int. and Finance Charges	245	251	223	376	427
Other Income - Rec.	29	36	264	40	120
PBT before EO Expens	**1,495**	**1,882**	**2,739**	**3,014**	**3,689**
Extra Ordinary Expense/(Inc	125	115	0	0	0
PBT after EO Expense	**1,370**	**1,767**	**2,739**	**3,014**	**3,689**
Current Tax	86	146	287	292	350
Deferred Tax	106	87	37	69	92
Tax	192	233	324	362	443
Tax Rate (%)	*14.0*	*13.2*	*11.8*	*12.0*	*12.0*
Reported PAT	**1,178**	**1,534**	**2,415**	**2,652**	**3,246**
Less: Mionrity Interest	-20	1	72	0	0
Net Profit	**1,198**	**1,523**	**2,338**	**2,652**	**3,246**
PAT Adj for EO Items	**1,306**	**1,633**	**2,343**	**2,652**	**3,246**

BALANCE SHEET (Rs Million)

Y/E MARCH	2005	2006	2007	2008E	2009E
Equity Share Capital	314	314	628	628	628
Total Reserves	5,619	6,675	8,027	10,096	12,623
Net Worth	**5,933**	**6,989**	**8,655**	**10,724**	**13,251**
Minority Interest	0	7	142	0	0
Deferred liabilities	1010	1097	1137	1206	1299
Total Loans	3,834	4,432	4,535	5,013	5,691
Capital Employed	**10,777**	**12,525**	**14,469**	**16,943**	**20,240**
Gross Block	11,158	12,086	13,527	15,527	17,527
Less: Accum. Deprn.	3,677	4,393	4,968	5,991	7,154
Net Fixed Assets	**7,481**	**7,693**	**8,559**	**9,536**	**10,373**
Capital WIP	425	636	1,224	0	0
Investments	467	714	261	609	1,936
Curr. Assets	**4,992**	**6,491**	**9,871**	**11,324**	**13,275**
Inventory	2,221	2,475	3,896	4,530	5,310
Account Receivables	1,235	1,990	2,784	3,511	4,115
Cash and Bank Balance	612	438	990	793	929
Loans & Advances	924	1,588	2,201	2,491	2,920
Curr. Liability & Prov.	**2,666**	**3,009**	**5,446**	**4,526**	**5,344**
Account Payables	2,060	2,404	4,588	3,624	4,248
Provisions	606	605	858	902	1,096
Net Current Assets	**2,326**	**3,482**	**4,425**	**6,798**	**7,931**
Misc Expenditure	78	0	0	0	0
Appl. of Funds	**10,777**	**12,525**	**14,469**	**16,943**	**20,240**

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007	2008E	2009E
Basic (Rs)					
EPS	**9.5**	**13.0**	**18.7**	**21.1**	**25.8**
Cash EPS	15.3	18.3	25.2	29.3	35.1
BV/Share	46.6	55.6	68.9	85.4	105.5
DPS	1.5	1.5	4.0	4.1	5.0
Payout (%)	41.5	31.5	27.5	22.0	22.2
Valuation (x)					
P/E		23.1	16.1	14.2	11.6
Cash P/E		16.4	11.9	10.3	8.5
P/BV		5.4	4.4	3.5	2.8
EV/Sales		2.8	2.2	1.8	1.5
EV/EBITDA		14.2	11.6	9.4	7.9
Dividend Yield (%)		0.5	1.3	1.4	1.7
Return Ratios (%)					
RoE	21.7	23.7	29.9	27.4	27.1
RoCE	18.1	20.2	24.1	23.4	23.7
Working Capital Ratios					
Debtor (Days)	34	47	53	53	53
Creditor (Days)	155	154	263	158	158
Inventory (Days)	63	61	78	71	72
Working Capital Turnover (I	49	75	69	95	94
Leverage Ratio (x)					
Current Ratio	1.9	2.2	1.8	2.5	2.5
Debt/Equity	0.7	0.6	0.5	0.5	0.4

** Ratios adjusted for bonus issue*

CASH FLOW STATEMENT (Rs Million)

Y/E MARCH	2005	2006	2007	2008E	2009E
Oper. Profit/(Loss) before T	2,429	2,876	3,521	4,373	5,158
Interest/Dividends Recd.	29	36	264	40	120
Direct Taxes Paid	-86	-146	-287	-292	-350
(Inc)/Dec in WC	181	-1,330	-391	-2,571	-996
CF from Operations	**2,553**	**1,436**	**3,107**	**1,550**	**3,932**
EO Expense / (Income)	125	115	0	0	0
CF from Operating incl	**2,428**	**1,321**	**3,107**	**1,550**	**3,932**
(inc)/dec in FA	-881	-1,202	-2,277	-776	-2,000
(Pur)/Sale of Investments	12	-247	453	-348	-1,327
CF from Investments	**-869**	**-1,449**	**-1,824**	**-1,124**	**-3,327**
Issue of Shares	0	0	0	0	0
(Inc)/Dec in Debt	-542	605	238	336	678
Interest Paid	-245	-251	-223	-376	-427
Dividend Paid	-489	-483	-664	-584	-719
Others	-113	83	-82	0	0
CF from Fin. Activity	**-1,390**	**-46**	**-731**	**-623**	**-468**
Inc/Dec of Cash	**170**	**-174**	**552**	**-197**	**137**
Add: Beginning Balance	442	612	438	990	793
Closing Balance	**612**	**438**	**990**	**793**	**929**

NOTES

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Disclosure of Interest Statement	Cadila Healthcare
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No