Cipla

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,086	CIPLA IN
	REUTERS CODE
S&P CNX: 2,945	CIPL.BO

Equity Shares (m)	777.3
52-Week Range (Rs)	305/128
1,6,12 Rel. Perf. (%)	0/19/27
M.Cap. (Rs b)	171.1
M.Cap. (US$ b)	3.6

21 July 2006

Buy

Previous Recommendation: Buy

Rs220

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	29,919	6,076	8.1	48.0	27.2	8.4	30.8	31.6	5.8	25.4
03/07E	36,696	7,246	9.3	14.9	23.6	5.1	21.8	24.1	4.4	17.6
03/08E	43,540	8,661	11.1	19.3	19.8	4.3	21.6	23.9	3.6	14.4

Cipla 1QFY07 results were below our estimates, with sales growth of just 30% to Rs8.6b. Key highlights:

- Net sales grew by 30% to Rs8.6b primarily driven by 38% YoY growth in export sales (to Rs3.9b) and 26% YoY growth in domestic formulations (to Rs4.5b).
- EBITDA margins improved by 390bp to 26.5% led mainly by higher formulations sales in international and domestic markets and excise duty savings due to commissioning of facilities at Baddi (HP).
- Impact of higher depreciation (up 93%) was diluted by higher other income (at Rs220m v/s Rs84m) translating into PAT growth of 53% to Rs1.7b.

Although, Cipla's 1QFY07 performance was below our estimates, we continue to believe that it has one of the strongest generic pipelines as its partners will have filed about 110-120 ANDAs cumulatively (35 in FY07E) with the US FDA by Mar-07. We are also enthused by the management's intention of spending significant amount (about Rs8b) in expanding manufacturing facilities in the FY05-08 period. Such a large capex coupled with strong product pipeline implies that the company is expecting strong product flow in the generic markets. Cipla is currently valued at 23.6x FY07E and 19.8x FY08E earnings. Maintain **Buy**.

QUARTERLY PERFORMANCE (Rs Million)

Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Net Sales	**6,628**	**6,717**	**7,806**	**8,706**	**8,636**	**8,265**	**9,545**	**10,250**	**29,919**	**36,696**
YoY Change (%)	*24.2*	*15.5*	*30.9*	*62.7*	*30.3*	*23.1*	*22.3*	*17.7*	*32.7*	*22.7*
Total Expenditure	5,129	4,944	6,217	6,903	6,347	6,039	7,392	7,804	23,121	27,583
EBITDA	**1,499**	**1,773**	**1,589**	**1,803**	**2,289**	**2,227**	**2,152**	**2,446**	**6,798**	**9,114**
Margins (%)	*22.6*	*26.4*	*20.4*	*20.7*	*26.5*	*26.9*	*22.6*	*23.9*	*22.7*	*24.8*
Depreciation	135	215	230	250	260	225	250	216	802	951
Interest	14	17	51	33	28	23	20	26	114	96
Other Income	84	15	744	468	220	108	45	-13	1,216	359
Profit before Tax	**1,434**	**1,556**	**2,053**	**1,988**	**2,220**	**2,087**	**1,927**	**2,191**	**7,098**	**8,426**
Tax	320	330	300	80	516	219	202	242	1,022	1,180
Rate (%)	*22.3*	*21.2*	*14.6*	*4.0*	*23.2*	*10.5*	*10.5*	*11.0*	*14.4*	*14.0*
Reported PAT	**1,114**	**1,226**	**1,753**	**1,908**	**1,704**	**1,868**	**1,725**	**1,949**	**6,076**	**7,246**
YoY Change (%)	40.6	27.9	39.5	80.7	53.0	52.4	-1.6	2.2	48.3	19.3
Margins (%)	*16.8*	*18.3*	*22.5*	*21.9*	*19.7*	*22.6*	*18.1*	*19.0*	*20.3*	*19.7*

E: MOSt Estimates;

Nimish Desai (Nimishdesai@MotilalOswal.com); Tel: +91 22 39825406 / Jinesh K Gandhi (Jinesh@MotilalOswal.com); Tel +91 22 39825416

Strong growth in both domestic and international business

Cipla's net revenue in 1QFY07 grew by 30% YoY to Rs8.6b, driven primarily by strong growth in both domestic (up by 26% YoY) and international (up by 38% YoY) business. Domestic business growth of 26% is on high base of 1QFY06 which witnessed recovery of sales on account of VAT issue in 4QFY05. International sales were driven by 48% YoY growth in formulation exports (to Rs3.2b). However, API exports growth at 8% (to Rs752m) was below our estimates.

BUSINESS BREAK UP (RS M)

	1QFY07	1QFY06	% CHG.	4QFY06	% CHG.
Domestic	4,495	3,559	26.3	3,245	38.5
% of Revenues	*52.1*	*53.7*		*37.3*	
Exports	3,938	2,847	38.3	5,266	-25.2
% of Revenues	*45.6*	*43.0*		*60.5*	
Formulations	3,187	2,154	48.0	3,320	-4.0
APIs	752	694	8.4	1,946	-61.4
Other Operating Income	202	222	-8.8	195	3.9
% of Revenues	*2.3*	*3.3*		*2.2*	
Total Gross Revenues	**8,636**	**6,628**	**30.3**	**8,706**	**-0.8**

Source: Company

Anti-asthmatic, anti-retrovirals 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-malarial and anti-asthmatic segments.

Improved business mix boosts EBITDA margins

EBITDA margins improved by 390bp to 26.5% led mainly by improved business mix in favor of international sales (47% of revenues v/s 44% in 1QFY06) and excise duty savings due to commissioning of facilities at Baddi (HP).

Phased commissioning of Cipla's facilities at Baddi and Goa resulted in higher depreciation (up 93% YoY) for the quarter. However, higher other income (at Rs220m v/s Rs84m in 1QFY06) due to forex gain and interest income diluted the impact of higher depreciation and translated into PAT growth of 53% to Rs1.7b.

Strong generic pipeline

Cipla has one of the strongest generic pipelines in India with about 160 products at various stages of development. We estimate that Cipla's partners will have filed about 110-120 ANDAs cumulatively (35 in FY07E) with the US FDA by March 2007.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. It is currently selling about 9 products in the US market and expects 5 new launches in FY07E.

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.

Maintaining guidance

Cipla is targeting overall sales growth of 18% for FY07E (we are estimating 23% growth) and PAT growth of 20% led mainly by exports to regulated markets.

Cipla has indicated acquiring small companies/technologies to gain access to biotech products and that currently it is in the process of conducting due diligence for the same.

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.

CFC-free inhalers – good long-term potential

Cipla is in the process of developing nine anti-asthma inhalers using non-CFC propellants. It has already developed few CFC-free inhalers including Budesonide, Formeterol, Salbutamol, and combination of Budesonide and Formeterol. It has initiated the process of registering these inhalers in major markets in Europe. However, the company may have to conduct clinical trials for obtaining registrations, implying that the launch of most of these inhalers is still some time away. Our estimates do not include the upsides from CFC-free inhalers expect for the Budesonide inhaler, which Cipla has already launched in Germany, Portugal and Spain.

EU regulations are aimed at encouraging CFC-free inhalers

Although the Montreal Protocol (on phasing out CFC based products) has set 2010 as the deadline for complete eradication of CFC inhalers, its current regulations are aimed at encouraging CFC-free inhalers. The regulations require a complete shift from CFC to non-CFC inhalers subject to the two conditions mentioned below:

1) At least two CFC-free alternatives are available on the market
2) The CFC-free inhalers have undergone a post-marketing surveillance of at least 12 months

The above conditions reflect a clear focus on a total phase-out of CFC inhalers much before the 2010 deadline.

Shift to CFC-free inhalers to open up a large market

The total market size for asthma inhalers in the EU is estimated at US$2.5b. This includes both CFC and CFC-free products, with the former accounting for a major chunk of the market. The gradual shift to CFC-free products is expected to open up a huge market for the manufacturers of these products over the next five years.

Multinationals have already introduced CFC-free inhalers…

As a consequence of the 2010 deadline and a favourable regulatory environment, multinational companies (the patent holders) have already started introducing CFC-free inhalers in various European markets. The shift of prescriptions in favour of CFC-free products has already commenced.

…but there is good long-term potential for players like Cipla

We believe that export of CFC-free inhalers to Europe can contribute significantly to Cipla's revenues in the long-term, as we expect limited competition. The company has done significant work on developing these inhalers over the past few years. It has launched its Budesonide asthma inhaler in Germany in FY05 through three generics companies, although it lost the first mover advantage to an Italian company. The company is planning to commence sales of Salbutamol inhaler in Denmark over the next 4 months. It is also targeting launch of this inhaler in other EU markets. We do not expect any significant upsides from the Denmark launch as the entire European market for Salbutamol inhaler is estimated at about US$200-300m. Cipla has a pipeline of about 9 CFC-free inhalers under various stages of development which, could result in long-term upsides as we expect relatively less competition in this space for Cipla. It is already supplying Budesonide inhalers to Germany, Portugal and Spain.

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 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.
- The global generics space is witnessing significant consolidation as larger generic companies try to gain scale through inorganic initiatives. The intense pricing pressure (due to entry of more players) in regulated markets has accentuated the need for consolidation. Cipla has clearly indicated that it intends to remain as a supplier of generic products (the partnership model) and is unlikely to have a front-end in the regulated markets. This implies that it will have to rely completely on its partners as far as its supplies to the regulated markets are concerned. This raises uncertainties on the sustainability of the partnership arrangement in the event of Cipla's partners been taken over by other large generic companies. Although, past consolidations do not seem to have altered Cipla's supply arrangements with its partners, we do not rule out changes in the coming years.

Valuations and outlook

Cipla is currently valued at 23.6x FY07E and 19.8x FY08E earnings. 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. This coupled with the company's low-risk strategy should ensure good long-term potential.

Our estimates include potential upsides from ANDA approvals for FY07 and FY08. We expect Cipla's bottom-line to record sustainable 20% growth for both FY07 and FY08 to Rs7.25b and Rs8.7b, respectively. Our estimates do not include upsides from patent challenges filed by Cipla's partners due to the uncertainties linked with patent litigations.

The recent global consolidation has resulted in Cipla's tie-ups with leading generic companies like Teva, Sandoz and Watson. Although, apprehensions have arisen about the sustainability of Cipla's product sourcing arrangement with Ivax (post the latter's acquisition by Teva), we do not expect any major alterations in the sourcing arrangement.

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 Rs1.8b (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 markets 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 21% and 17% expected over FY06-08.
- One of the strongest generic pipelines coupled with de-risked strategy should bring in long-term benefits. Maintain **Buy** with price target of Rs280

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	23.6	32.2	28.4
	FY08E	19.8	20.4	20.9
P/BV (x)	FY07E	5.1	3.9	4.9
	FY08E	4.3	3.4	44.4
EV/Sales (x)	FY07E	4.4	3.0	2.4
	FY08E	3.6	2.6	1.6
EV/EBITDA (x)	FY07E	17.6	27.3	15.1
	FY08E	14.4	18.7	10.1

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

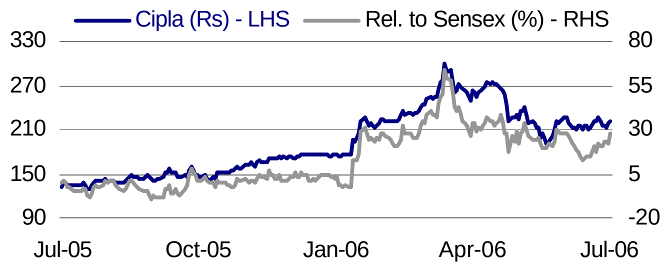
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	9.3	9.6	-3.1
FY08	11.1	11.5	-3.3

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
220	280	27.2	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					(Rs Million)
Y/E MARCH	**2004**	**2005**	**2006**	**2007E**	**2008E**
Net Income	**19,230**	**22,545**	**29,919**	**36,696**	**43,540**
Change (%)	*31.7*	*17.2*	*32.7*	*22.7*	*18.6*
Total Expenditure	15,038	17,592	23,121	27,583	32,550
EBITDA	**4,192**	**4,953**	**6,798**	**9,114**	**10,990**
Margin (%)	*21.8*	*22.0*	*22.7*	*24.8*	*25.2*
Depreciation	403	551	802	951	1,105
Int. and Finance Charges	104	76	114	96	84
Other Income - Rec.	356	817	1,216	359	270
PBT before EO Items	**4,041**	**5,143**	**7,098**	**8,426**	**10,071**
Extra Ordinary Expense	207	0	0	0	0
Profit before Taxes but	**3,833**	**5,143**	**7,098**	**8,426**	**10,071**
Tax	878	1,050	1,022	1,180	1,410
Tax Rate (%)	*19.0*	*20.4*	*14.4*	*14.0*	*14.0*
Reported PAT	**2,956**	**4,093**	**6,076**	**7,246**	**8,661**
Adj PAT	**3,274**	**4,093**	**6,076**	**7,246**	**8,661**
Change (%)	*32.2*	*25.0*	*48.5*	*19.2*	*19.5*
Margin (%)	*17.0*	*18.2*	*20.3*	*19.7*	*19.9*

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	19,139	31,743	38,632
Revaluation Reserves	102	102	102	102	102
Net Worth	**12,641**	**15,536**	**19,841**	**33,399**	**40,288**
Loans	2,106	1,950	2,200	1,302	1,502
Deferred liabilities	659	889	799	715	614
Capital Employed	**15,406**	**18,376**	**22,840**	**35,417**	**42,405**
Gross Block	7,408	9,867	11,967	13,067	16,367
Less: Accum. Deprn.	1,932	2,478	3,279	4,231	5,336
Net Fixed Assets	**5,476**	**7,389**	**8,688**	**8,836**	**11,031**
Capital WIP	560	1,060	960	450	500
Investments	1,804	183	1,266	1,266	1,266
Curr. Assets	**14,362**	**17,529**	**20,773**	**36,849**	**43,845**
Inventory	5,689	7,457	9,133	11,270	13,397
Account Receivables	4,982	5,873	6,399	7,658	9,121
Cash and Bank Balance	62	154	575	12,379	14,695
Others	3,628	4,045	4,666	5,542	6,633
Curr. Liability & Prov.	**6,796**	**7,785**	**8,846**	**11,985**	**14,238**
Account Payables	6,796	7,785	8,846	11,985	14,238
Net Current Assets	**7,566**	**9,744**	**11,927**	**24,864**	**29,608**
Appl. of Funds	**15,406**	**18,376**	**22,840**	**35,417**	**42,405**

E: MOSt Estimates

RATIOS					
Y/E MARCH	**2004**	**2005**	**2006**	**2007E**	**2008E**
Basic (Rs)					
EPS	**4.4**	**5.5**	**8.1**	**9.3**	**11.1**
Cash EPS	4.9	6.2	9.2	10.5	12.6
BV/Share	16.7	20.6	26.3	42.8	51.7
DPS	1.2	1.4	0.8	3.0	4.0
Payout (%)	34.3	29.3	29.2	18.3	20.5
Valuation (x)					
P/E		40.3	27.2	23.6	19.8
Cash P/E		35.5	24.0	20.9	17.5
P/BV		10.7	8.4	5.1	4.3
EV/Sales		7.7	5.8	4.4	3.6
EV/EBITDA		34.9	25.4	17.6	14.4
Dividend Yield (%)		0.6	0.4	1.4	1.8
Return Ratios (%)					
RoE	26.1	26.5	30.8	21.8	21.6
RoCE	26.9	28.4	31.6	24.1	23.9
Working Capital Ratios					
Asset Turnover (x)	1.2	1.2	1.3	1.0	1.0
Debtor (Days)	95	95	78	76	76
Inventory (Days)	108	121	111	112	112
Working Capital (Days)	144	158	146	247	248
Leverage Ratio (x)					
Current Ratio	2.1	2.3	2.3	3.1	3.1
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	6,798	9,114	10,990
Interest/Dividends Recd.	356	817	1,216	359	270
Direct Taxes Paid	-780	-820	-1,112	-1,264	-1,511
(Inc)/Dec in WC	-690	-2,086	-1,761	-1,134	-2,427
CF from Operations	**3,077**	**2,863**	**5,141**	**7,076**	**7,322**
(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	-1,199	-1,772	-1,329	-1,772
CF from Fin. Activity	**39**	**-1,429**	**-1,637**	**5,318**	**-1,656**
Inc/Dec of Cash	**-69**	**92**	**421**	**11,804**	**2,316**
Add: Beginning Balance	131	62	154	575	12,379
Closing Balance	**62**	**154**	**575**	**12,379**	**14,695**

NOTES

For more copies or other information, contact
Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari
Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

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
4. Investment Banking relationship with company covered	No