

# Cadila Healthcare

**BUY**  
Maintained  
**Rs608**

## Moving into big league

Reason for report: Company update

Cadila Healthcare is at the cusp of entering the elite club of top-tier Indian pharma companies such as Sun Pharma, Dr. Reddy's Labs and Lupin. Cadila's recent strategic licencing agreement with Abbott Laboratories for its 24 branded generics (for 15 key emerging markets) is unique and lucrative, with US\$10mn upfront milestone payment received, similar to a typical NCE licencing deal. With critical mass of US\$150mn revenues from the US generics market being achieved, the company has started filing Para IV and niche ANDAs – it recently filed for generic *Lialda* (mesalamine), which if successful could chip in US\$30-40mn profits. Backed by its licensing deal with Eli Lilly, the company is well poised to further monetise its pipeline of seven NCEs in the next three years, which could result in re-rating. We expect Cadila to post strong ~26% EPS CAGR during FY10-12E.

- ▶ **Abbott deal – Lucrative & unique, thereby boosting FY11E EPS 5%.** The US\$10mn upfront milestone payment is similar to a typical NCE licencing deal, e.g. Glenmark's first NCE licencing with Forest Labs involved US\$10mn upfront milestone. More importantly, in other similar deals (Dr. Reddy's-GSK plc, Aurobindo-Pfizer Inc, Torrent Pharma-AstraZeneca), the Indian partner has either not received upfront income or the income is relatively low. The milestone income boosts FY11E EPS 5% and we value the same at 10x, i.e. Rs15/share, resulting in revised target price of Rs728/share.
- ▶ **Filed Para IV for *Lialda*.** With critical mass attained, Cadila has now begun focussing on filing Para IV and niche ANDAs; Para IV filed for generic *Lialda* recently. The drug belongs to Shire with its patent expiring in June '20. The brand has annual revenues of ~US\$235mn in the US, which could potentially grow to ~US\$500mn over the next 3-4 years when Cadila may be able to launch the product in the US. The potential upside to Cadila could be US\$70-80mn in revenues and US\$30-40mn in profits during the 180-day exclusivity.
- ▶ **Top-tier player in the making; reiterate BUY.** Despite being one of the late entrants in strategic business segments such as US generics drug discovery, Cadila has shown remarkable discipline to move up the value chain. The company is now entering the top league and with ~26% EPS CAGR in FY10-12E. Maintain BUY.

## Pharmaceuticals

Target price Rs728

### Shareholding pattern

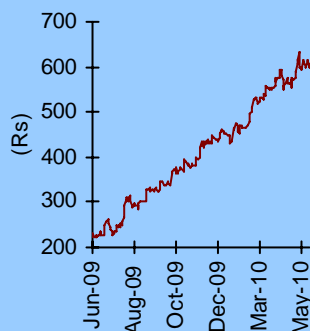
(%)	Sep '09	Dec '09	Mar '10
Promoters	74.8	74.8	74.8
Institutional investors	17.5	17.5	17.3
MFs and UTI	8.0	8.0	7.7
Insurance Cos.	6.4	5.9	5.8
FII	3.1	3.6	3.8
Others	7.7	7.7	7.9

Source: NSE

### Target price revision

Rs728 from Rs713

### Price chart



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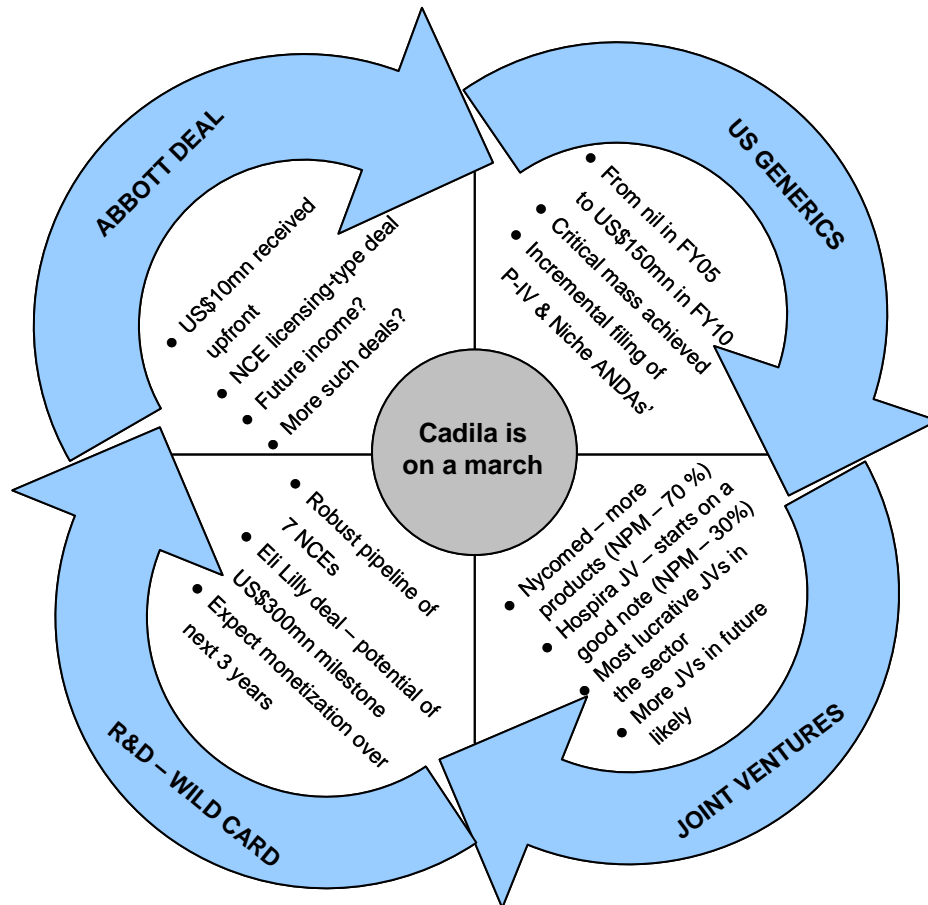
Market Cap	Rs124bn/US\$2.6bn
Reuters/Bloomberg	CADI.BO/CDH IN
Shares Outstanding (mn)	205
52-week Range (Rs.)	636/220
Free Float (%)	25.2
FII (%)	3.8
Daily Volume (US\$'000)	1,360
Absolute Return 3m (%)	14.0
Absolute Return 12m (%)	172.8
Sensex Return 3m (%)	0.2
Sensex Return 12m (%)	13.4

Year to Mar	2009	2010P	2011E	2012E
Revenue (Rs mn)	29,275	36,869	46,061	54,867
Net Income (Rs mn)	3,157	5,103	6,900	8,148
EPS (Rs)	15.4	24.9	33.7	39.8
% Chg YoY	26.3	61.7	35.2	18.1
P/E(x)	39.4	24.4	18.0	15.3
CEPS (Rs)	20.9	31.5	41.0	47.9
EV/E(x)	22.2	16.4	12.6	10.6
Dividend Yield	0.6	0.8	1.9	2.3
RoCE (%)	17.3	21.1	24.9	25.5
RoE (%)	27.5	35.7	37.3	34.8

## Growth drivers at a glance

During the financial tsunami, Cadila delivered impressive performance with EPS growing 26% YoY in FY09 and 62% YoY in FY10 which among the highest in the sector. This was owing to its endeavour to move up the value chain via investments in developed markets as well through acquisitions. The company has put in place strong building blocks for growth (Chart 1) to move into the top-tier category (Table 1).

Chart 1: Cadila – Growth drivers



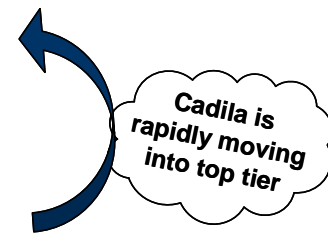
Source: I-Sec Research

### Cadila – Rapidly moving into top tier

Despite being one of the late entrants into the key strategic business segments such as the US generics drug discovery, Cadila has shown remarkable discipline and focus to invest appropriately in such segments and executed them well. During FY07-08, we maintained that Cadila has all the ingredients to become a top-tier pharma company from India and we see that materialising now (Table 1).

**Table 1: Rapid shift to top tier**

	Ranbaxy	Dr. Reddy's	Sun Pharma*	Glenmark	Lupin	Cadila
<b>Tier-I</b>						
Drug discovery						
US branded generics						
US generics, P-IVs & Niche ANDAs						
Generics - Japan and Western Europe						
<b>Tier-II</b>						
US generics (Non P-IVs), Eastern Europe and LatAm						
Strong DDF market						
RoW branded generics						
Backward integration/ World class infrastructure						
CRAMs						



\* Includes drugs discovery of SPARC  
Source: I-Sec Research

## Abbott deal – Big boost

### Deal at a glance

On May 11, '10 Cadila and Abbott announced a licencing and supply agreement for a portfolio of 24 products, including medicines to treat pain, cancer and heart disease, which Abbott will commercialise in 15 emerging markets such as Russia, Turkey and Brazil. The agreement also includes an option for further addition of more than 40 products. The sales are expected to start from early '12.

### Upfront milestone of US\$10mn received

Cadila received US\$10mn from Abbott as upfront milestone payment. The size of the payment is similar to a NCE licencing deal e.g. Glenmark's first NCE licencing with Forest Labs involved US\$10mn upfront milestone. More importantly, in other similar deals (Dr. Reddy's-GSK plc, Aurobindo-Pfizer Inc, Torrent Pharma-AstraZeneca), the Indian partner has either not received upfront income or the income is relatively low. We are quite impressed with the management's ability to strike a lucrative and unique deal for branded generics. In such deals, typically, the Indian company receives a share in revenues/profits in addition to milestone payments.

### Sensitivity analysis

Cadila has not disclosed the possibility of future milestone income from Abbott and hence, we are excluding it in our estimates. Also, we cannot value such an income at normal P/E multiple given the base business of the company. Hence, we have applied 8x-12x P/E multiple (historically ascribed to profits from FTF ANDAs) to arrive at the sensitivity of potential incremental upside to Cadila’s stock price if such an income materialises in future.

**Table 2: Sensitivity at a glance**

	Further milestone payments (US\$mn)	Potential upside (Rs/share)			Potential upside to CMP (%)		
		5	10	15	5	10	15
P/E	8x	6.2	12.3	18.5	1.0	2.0	3.0
	10x	7.7	15.4	23.1	1.3	2.5	3.8
	12X	9.2	18.5	27.7	1.5	3.0	4.6

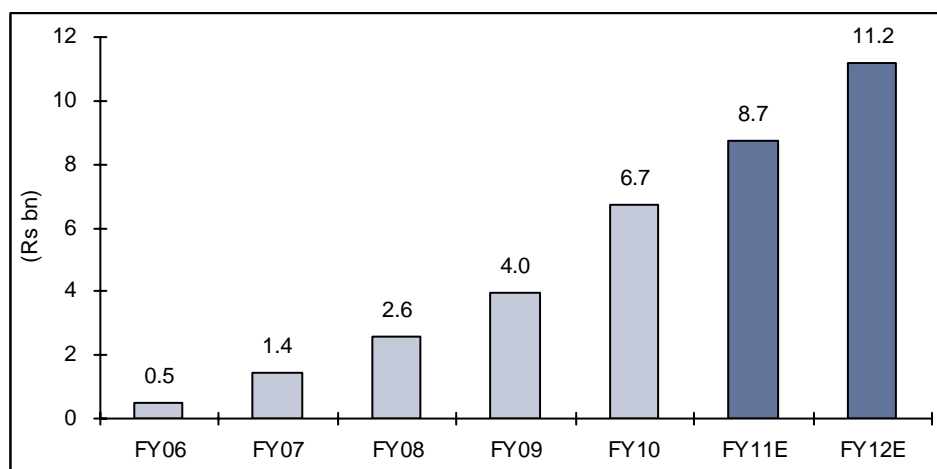
Source: I-Sec Research

### US business – Moving into next orbit

#### Critical mass achieved in US generics

Despite being a late entrant, Cadila has rapidly built a high-quality, sustainable and profitable international business in the past five years. Its performance is commendable with ~Rs6.7bn revenues (~US\$150mn dosage form revenues) in FY10, from a nil in FY05. We believe that US\$150mn is critical mass for an Indian company in the US generics market. Also, the company has built a strong pipeline of 106 ANDAs (filed), of which 52 are pending approval.

**Chart 2: Rapid scale-up of US generics business**



Source: Company data, I-Sec Research

### **Expect more Para IV & niche ANDA filings**

With critical mass being achieved, Cadila has now begun focussing on filing Para IV and niche ANDAs to move up the value chain and maintain the strong growth momentum. A case in point is the recent Para IV filing for generic *Lialda* (mesalamine), used to treat ulcerative colitis, proctitis and proctosigmoiditis, and to prevent the symptoms of ulcerative colitis from recurring. The drug belongs to Shire with its patent expiring in June '20. The brand has ~US\$235mn annual revenues in the US, which could potentially grow to ~US\$500mn over the next 3-4 years when Cadila may be able to launch the product in the US. The potential upside to Cadila could be US\$70-80mn in revenues and US\$30-40mn in profits during the 180-day exclusivity.

### **First to launch H1N1 vaccine in India**

Cadila has recently received approval from Drug Controller General of India (DGCI) to market the H1N1 vaccine in India. The company would market the vaccine under the brand name, *VaxiFlu-S*. Cadila has thus become the first Indian company to launch the vaccine. As per industry sources, global sales of influenza vaccine in CY09 were ~US\$1.8bn. Reportedly, demand for H1N1 vaccine in India is estimated to touch 50-60mn doses in the initial phase. Cadila has priced *VaxiFlu-S* at Rs350/dose, translating into a potential market opportunity of Rs15-18bn. Note that Panacea Biotec and Bharat Biotec have also filed H1N1 vaccine in India. With this Cadila's current vaccine portfolio of anti-rabies and typhoid vaccine will get expanded. The company is committed to developing a wide range of vaccines for viral and bacterial infections.

## Financial Summary (Consolidated as per Indian GAAP)

Table 3: Profit and Loss statement

(Rs mn., year ending Mar 31)

	FY09	FY10P	FY11E	FY12E
<b>Operating Income (Sales)</b>	<b>29,275</b>	<b>36,869</b>	<b>46,061</b>	<b>54,867</b>
of which Exports	12,736	17,418	23,089	28,896
of which Domestic	16,539	19,451	22,972	25,971
<b>Operating Expenses</b>	<b>23,217</b>	<b>28,782</b>	<b>35,663</b>	<b>42,696</b>
<b>EBITDA</b>	<b>6,058</b>	<b>8,087</b>	<b>10,399</b>	<b>12,170</b>
% margins	18.9	19.5	20.6	20.1
Depreciation & Amortisation	1,118	1,339	1,488	1,651
Gross Interest	1,106	809	763	632
Other Income	17	159	166	171
<b>Recurring PBT</b>	<b>3,851</b>	<b>6,098</b>	<b>8,313</b>	<b>10,059</b>
Extraordinaries (Net)	(153)	(59)	0	0
Less: Taxes	666	741	1,413	1,911
- Current tax	412	610	1,081	1,308
- Deferred tax	84	131	333	604
<b>Net Income (Reported)</b>	<b>3,031</b>	<b>5,051</b>	<b>6,900</b>	<b>8,148</b>
<b>Recurring Net Income</b>	<b>3,157</b>	<b>5,103</b>	<b>6,900</b>	<b>8,148</b>

Source: Company data, I-Sec Research

Table 4: Balance sheet

(Rs mn., year ending Mar 31)

	FY09	FY10P	FY11E	FY12E
<b>Assets</b>				
Total Current Assets	15,611	17,770	22,348	27,518
of which cash & cash eqv.	2,517	2,533	2,924	3,053
Total Current Liabilities & Provisions	6,915	8,437	10,650	12,984
<b>Net Current Assets</b>	<b>8,696</b>	<b>9,332</b>	<b>11,698</b>	<b>14,534</b>
<b>Investments</b>				
of which	<b>249</b>	<b>762</b>	<b>762</b>	<b>762</b>
Strategic/Group	0	513	513	513
Other Marketable	249	249	249	249
<b>Net Fixed Assets</b>	<b>12,885</b>	<b>13,746</b>	<b>14,758</b>	<b>15,807</b>
Capital Work-in-Progress	1,889	1,547	1,786	1,981
<b>Goodwill</b>	<b>4,740</b>	<b>4,740</b>	<b>4,740</b>	<b>4,740</b>
<b>Total Assets</b>	<b>26,570</b>	<b>28,580</b>	<b>31,959</b>	<b>35,843</b>
<b>Liabilities</b>				
Borrowings	12,674	10,924	9,424	7,424
Deferred Tax Liability	1,316	1,447	1,779	2,383
Minority Interest	228	0	0	0
Equity Share Capital	682	1,024	1,024	1,024
Face Value per share (Rs)	5	5	5	5
Reserves & Surplus*	11,670	15,186	19,731	25,013
<b>Net Worth</b>	<b>12,352</b>	<b>16,210</b>	<b>20,755</b>	<b>26,036</b>
<b>Total Liabilities</b>	<b>26,570</b>	<b>28,580</b>	<b>31,959</b>	<b>35,843</b>

Source: Company data, I-Sec Research

Table 7: Quarterly trend

(Rs mn., year ending Mar 31)

	Jun-09	Sep-09	Dec-09	Mar-10
Net sales	8,803	9,126	9,654	8,159
% growth (YoY)	28.4	23.7	31.1	16.1
EBITDA	2037	2057	2099	1894
Margin (%)	20.5	18.9	19.1	19.4
Other income	42	41	25	51
Extraordinaries (Net)	(23)	(51)	27	(11)
Net profit	1,268	1,364	1,274	1,198

Source: Company data, I-Sec Research

Table 5: Cashflow statement

(Rs mn., year ending Mar 31)

	FY09	FY10P	FY11E	FY12E
<b>Operating Cash flow</b>	<b>3,855</b>	<b>6,193</b>	<b>8,555</b>	<b>10,231</b>
Working Capital Changes	(933)	(620)	(1,975)	(2,707)
Capital Commitments	(4,240)	(2,200)	(2,500)	(2,700)
<b>Free Cash Flow</b>	<b>(1,318)</b>	<b>3,372</b>	<b>4,080</b>	<b>4,824</b>
Other Capital Commitments	5	(513)	0	0
FCF post Capital Commitments	(1,313)	2,859	4,080	4,824
<b>Cash flow from Investing</b>				
<b>Activities</b>	<b>17</b>	<b>159</b>	<b>166</b>	<b>171</b>
Issue of Share Capital	54	342	0	0
Inc (Dec) in Borrowings	4,297	(1,750)	(1,500)	(2,000)
Dividend paid	(796)	(1,024)	(2,355)	(2,866)
<b>Extraordinary Items</b>	<b>241</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Chg. in Cash &amp; Bank balance</b>	<b>1,591</b>	<b>16</b>	<b>391</b>	<b>129</b>

Source: Company data, I-Sec Research

Table 6: Key ratios

(Year ending Mar 31)

	FY09	FY10P	FY11E	FY12E
<b>Per Share Data (in Rs.)</b>				
EPS(Basic Recurring)	15.4	24.9	33.7	39.8
Diluted Recurring EPS	15.4	24.9	33.7	39.8
Recurring Cash EPS	20.9	31.5	41.0	47.9
Dividend per share (DPS)	3.9	5.0	11.5	14.0
Book Value per share (BV)	60.3	79.2	101.4	127.2
<b>Growth Ratios (%)</b>				
Operating Income	26.1	25.9	24.9	19.1
EBITDA	32.7	33.5	28.6	17.0
Recurring Net Income	26.3	61.7	35.2	18.1
Diluted Recurring EPS	26.3	61.7	35.2	18.1
Diluted Recurring CEPS	23.2	50.7	30.2	16.8
<b>Valuation Ratios (x)</b>				
P/E	39.4	24.4	18.0	15.3
P/CEPS	29.1	19.3	14.8	12.7
P/BV	10.1	7.7	6.0	4.8
EV / EBITDA	22.2	16.4	12.6	10.6
EV / Operating Income	4.6	3.7	2.9	2.4
EV / Operating FCF	46.1	23.8	19.9	17.1
<b>Operating Ratio</b>				
Raw Material/Sales (%)	33.4	33.0	33.0	32.5
SG&A/Sales (%)	40.5	39.8	39.3	38.9
Other Income / PBT (%)	0.4	2.6	2.0	1.7
Effective Tax Rate (%)	18.0	12.3	17.0	19.0
NWC / Total Assets (%)	23.3	23.8	27.5	32.0
Inventory Turnover (days)	194.8	176.8	160.5	170.4
Receivables (days)	52.6	56.0	57.3	59.1
Payables (days)	169.7	184.0	186.2	194.3
D/E Ratio	113.3	76.3	54.0	37.7
<b>Return/Profitability Ratio (%)</b>				
Recurring Net Income Margins	10.8	13.8	14.9	14.8
RoCE	17.3	21.1	24.9	25.5
RoNW	27.5	35.7	37.3	34.8
Dividend Payout Ratio	25.2	20.1	34.1	35.2
Dividend Yield	0.6	0.8	1.9	2.3
EBITDA Margins	18.9	19.5	20.6	20.1

Source: Company data, I-Sec Research

*I-Sec investment ratings (all ratings relative to Sensex over next 12 months)*

**BUY:** +10% outperformance; **HOLD:** -10% to +10% relative performance; **SELL:** +10% underperformance

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