

April 28, 2008

Rating	Market Performer
Price	Rs215
Target Price	Rs247
Implied Upside	14.9%
Sensex	17,016

(Prices as on April 28, 2008)

#### Trading Data

Market Cap. (Rs bn)	167.2
Shares o/s (m)	777.5
Free Float	60.6%
Avg. Daily Vol ('000)	1,448.1
Avg. Daily Value (Rs m)	298.1

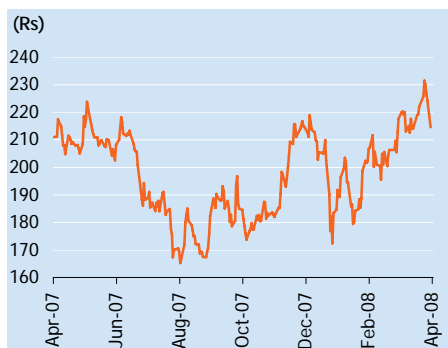
#### Major Shareholders

Promoters	39.4%
Foreign	16.7%
Domestic Inst.	14.1%
Public & Others	29.8%

#### Stock Performance

(%)	1M	6M	12M
Absolute	(1.4)	16.0	(1.2)
Relative	(5.4)	27.5	(23.5)

#### Price Performance (RIC: CIPL.BO, BB:CIPLA IN)



Source: Bloomberg

## Cipla

### Export gains

- Results:** Cipla's Q4FY08 results were below our expectations. Net sales grew by 19.6%YoY from Rs9.39bn to Rs11.22bn (we expected Rs11.76bn), mainly due to good growth on the export front. The company reported 23% growth on the export front. Its EBIDTA margin improved by 240bps from 15.7% to 18.1% YoY (we expected 24.3%), due to decline in material cost and other expenses. Material cost declined by 220bps from 53.0% to 50.8% of net sales due to higher exports. Other expenses dropped by 210bps from 26.7% to 24.6% of net sales due to cost control. Cipla's personnel cost went up by 190bps from 4.6% to 6.5% of net sales due to annual increments and increase in manpower. The company's net profit grew by 43% YoY from Rs1.26bn to Rs1.79bn (we expected Rs2.36bn).
- Capex update:** Cipla and its group companies have spent over Rs2.0bn on the development of an SEZ in Goa. However, the same has been mired in controversies as the Goa government has denotified the SEZ, which was already notified and sanctioned earlier. The matter has been referred to the Centre and the company has filed a court case against the Goa government.
- Valuation:** We expect the company to report 15% CAGR in net sales and 23% CAGR in net profit over FY08-10. We also expect its EBIDTA margin to improve from 20.1% in FY08 to 22.9% in FY10 due to the introduction of new products, higher exports and entry into new geographies. We have downgraded our EPS estimates for FY09 and FY10 by 9% and 7% respectively.

At the CMP of Rs215, the stock trades at 23.9x FY08E EPS of Rs9.0, 18.9x FY09E EPS of Rs11.4 and 15.6x FY10E EPS of Rs13.7. We reiterate Market Performer rating on the stock with a price target of Rs247 (18x FY10 earnings) over the next 12 months, an upside of 14.9% over the CMP.

Key financials (Y/e March)	FY07	FY08A/E	FY09E	FY10E
Revenue (Rs m)	35,619	42,268	48,651	56,297
Growth (%)	19.5	18.7	15.1	15.7
EBITDA (Rs m)	8,114	8,496	10,581	12,889
PAT (Rs m)	6,678	7,005	8,838	10,684
EPS (Rs)	8.6	9.0	11.4	13.7
Growth (%)	9.9	4.9	26.2	20.9
Net DPS (Rs)	2.0	3.5	4.0	4.0

Source: Company Data; PL Research

Profitability & valuation	FY07	FY08A/E	FY09E	FY10E
EBITDA margin (%)	22.8	20.1	21.7	22.9
RoE (%)	25.6	20.5	22.8	23.9
RoCE (%)	22.4	18.8	20.5	21.2
EV / sales (x)	4.7	4.0	3.5	3.1
EV / EBITDA (x)	20.8	20.1	16.1	13.4
PE (x)	25.0	23.9	18.9	15.6
P / BV (x)	5.2	4.6	4.0	3.5
Net dividend yield (%)	0.9	1.6	1.9	1.9

Source: Company Data; PL Research

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## Highlights

### Excellent export growth

Cipla posted 19.6% YoY growth of in net revenue from Rs9.39bn to Rs11.22bn due to good growth on the export front. The company reported 13% YoY growth on the domestic front in line with the industry growth of 13-14% during the quarter. On the export front, formulations grew 22%, whereas API registered a higher sales growth of 25%. Exports contributed 57% to total sales. Cipla's other operating income grew by 29% from Rs313m to Rs405m. This included Rs259m from technical know-how fees received from its partners on various projects. Sales composition is shown in the following table:

#### Sales composition

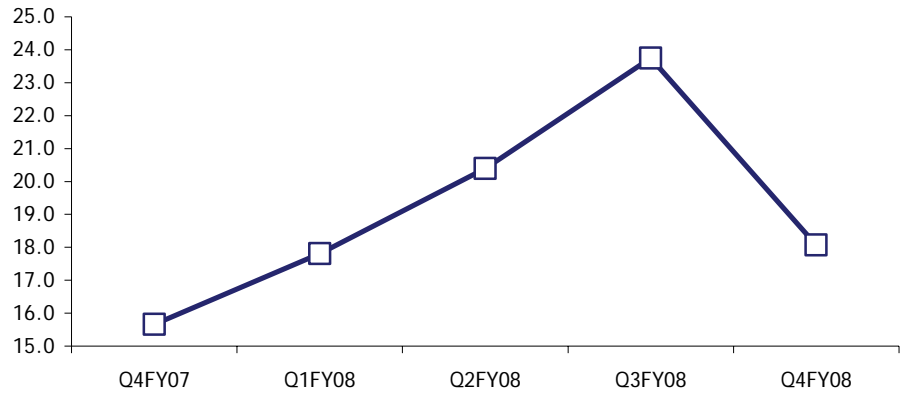
Y/e March	Q4FY08	Q4FY07	YoY gr. (%)	Q3FY08	FY07	FY08	YoY gr. (%)
Domestic	4,525	3,997	13.2	5,195	17,527	19,868	13.4
Export-formulations	4,729	3,879	21.9	3,711	12,968	15,702	21.1
Exports-API	1,769	1,415	25.0	1,398	4,836	5,400	11.7
Exports-total	6,498	5,294	22.7	5,109	17,804	21,102	18.5
Other op. income	405	313	29.4	980	1,325	2,204	66.3
Total income	11,428	9,604	19.0	11,284	36,656	43,174	17.8
Excise duty	207	219	(5.5)	239	949	907	(4.4)
Net sales	11,221	9,385	19.6	11,045	35,707	42,267	18.4
<i>Exports - as % of total income</i>	<i>56.9</i>	<i>55.1</i>		<i>45.3</i>	<i>48.6</i>	<i>48.9</i>	

Source: Company Data, PL Research

### Margin improve 240bps

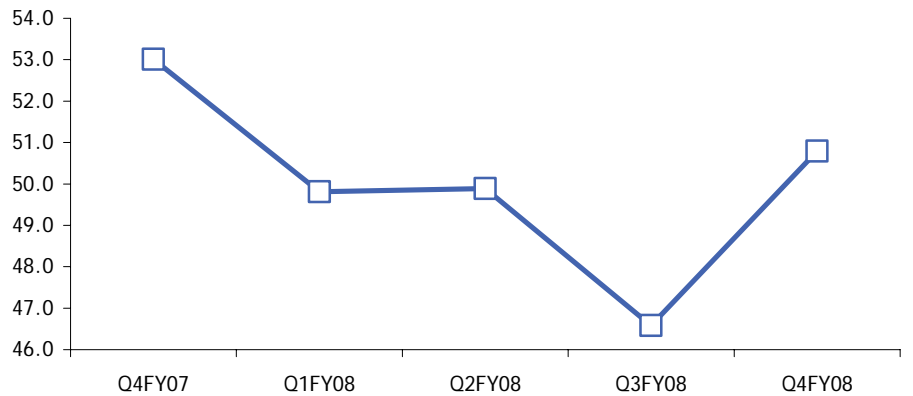
Due to decline in the material cost and other expenses, Cipla's EBIDTA margin improved by 240bps from 15.7% to 18.1% YoY. Material cost declined by 220bps from 53.0% to 50.8% of net sales due to the change in product mix with higher export sales. Other expenses also declined by 210bps from 26.7% to 24.6% of net sales due to cost savings. Personnel cost increased by 190bps from 4.6% to 6.5% of net sales due to the annual salary rise, increase in manpower and impact of change in accounting guidelines relating to earned leave, gratuity and LTA. The company's material cost and EBIDTA margin over the last five quarters are shown in the following graphs:

**EBITDA margin**



Source: Company Data, PL Research

**Material cost as % of sales**



Source: Company Data, PL Research

As seen from the above graphs, the company's EBITDA margin improved from 15.7% in Q4FY07 to 23.7% in Q3FY08 and then declined by 560bps QoQ to 18.1%. Similarly, material cost had declined from 53.0% in Q4FY07 to 46.6% in Q3FY08, but increased by 420bps QoQ to 50.8% in Q4FY08. This indicates that the performance of Q4FY08 suffered due to QoQ increase in material cost.



## PAT grew by 43%YoY

Cipla's other income was up by 84% Rs221m to Rs407m due to forex gains of Rs250m during the quarter. Cipla's depreciation increased by 41% from Rs261m to Rs367m due to expansion at the Goa facility. Interest cost increased by 254% from Rs13m to Rs46m during the quarter due to increase in working capital. The company's PBT for the quarter grew by 43% from Rs1.42bn to Rs2.02bn. Effective tax rate was maintained at 11.3% during the quarter. This has resulted in a PAT growth of 43% from Rs1.26bn to Rs1.79bn.

## Outlook

We expect the company to report better growth on the export front, due to the increase in regulatory approvals, entry into new geographies and higher off-take of API by its generic partners in the US. Cipla has presence in 172 countries and has no major dependence on the US market, unlike its competitors.

Cipla is likely to get a sizeable order from South African tender of over US\$200m for the supply of anti-HIV drugs. The company is the leading player in the anti-HIV segment and is likely to benefit from this tender, which is likely to be finalised in May 2008.

The company has introduced CFC-free inhalers in Germany and Spain and is in the process of introducing it in other European countries. Cipla has plans to introduce solvent-free dry powder inhalers in Europe.

The company has launched generic Tarceva (Eterotinib), an anti-cancer product, in the domestic market at 1/3 the innovator's price. The company has generated sales of Rs0.4-0.5m per month.

Cipla has reported a forex gain of Rs250m during Q4FY08 and Rs650m during FY08. The company has no exposure to forex derivatives. Rising rupee against the dollar has led to offset rise in raw material cost to an extent. This has given a natural hedge to the company to an extent.

Cipla is likely to shift its SEZ to Madhya Pradesh and has plans to invest Rs9.0bn in SEZ and EOU units. Benefits from the same are likely to accrue from FY10 onwards.



## Concerns

Cipla's group company, Meditab Specialties, is developing 123.2 hectare of SEZ at Goa and has already invested over Rs2.0bn on this project. The Goa government has denotified the approved SEZ project due to public opposition. Cipla has filed a case against the Goa government in the Mumbai High Court.

## Valuation

We expect the company to report 15% CAGR in net sales and 23% CAGR in net profit over the next two years. We also expect the company's EBIDTA margin to improve from 20.1% in FY08 to 22.9% in FY10 due to the decline in raw material cost and other expenses. The company's RoE is likely to improve from 20.5% in FY08 to 23.9% in FY10. Cipla's RoCE is likely to improve from 18.8% in FY08 to 21.2% in FY10. We have downgraded our EPS estimates for FY09 and FY10 by 9% (from Rs12.5 to Rs11.4) and 7% (from Rs14.8 to Rs13.7) respectively, in view of results lower than our expectations.

At the CMP of Rs215, the stock trades at 23.9x FY08E EPS of Rs9.0, 18.9x FY09E EPS of Rs11.4 and 15.6x FY10E EPS of Rs13.7. We reiterate Market Performer rating on the stock with a price target of Rs247 (18x FY10 earnings) over the next 12 months, an upside of 14.9% over CMP.



## Q4FY08 result overview

(Rs m)

Y/e March	Q4FY08	Q4FY07	YoY gr. (%)	Q3FY08	FY07	FY08	YoY gr. (%)
Net sales	11,221	9,385	19.6	11,045	35,707	42,267	18.4
<b>Expenditure</b>							
Raw materials	5,699	4,975	14.6	5,144	17,255	20,814	20.6
<i>as % of net sales</i>	50.8	53.0		46.6	48.3	49.2	
Personnel expenses	730	433	68.6	638	1,846	2,543	37.8
<i>as % of net sales</i>	6.5	4.6		5.8	5.2	6.0	
Other expenses	2,764	2,507	10.3	2,640	8,403	10,413	23.9
<i>as % of net sales</i>	24.6	26.7		23.9	23.5	24.6	
Total expenditure	9,193	7,915	16.1	8,422	27,504	33,770	22.8
OPBDIT	2,028	1,470	38.0	2,623	8,203	8,497	3.6
<i>Op. margin (%)</i>	18.1	15.7		23.7	23.0	20.1	
Other income	407	221	84.2	242	981	1,252	27.6
PBDIT	2,435	1,691	44.0	2,865	9,184	9,749	6.1
Depreciation	367	261	40.6	330	1,034	1,327	28.3
Interest	46	13	253.8	38	70	116	66.3
PBT	2,022	1,417	42.7	2,497	8,080	8,306	2.8
Prov. for tax	228	160	42.5	390	1,400	1,302	(7.0)
<i>% of PBT</i>	11.3	11.3		15.6	17.3	15.7	
PAT	1,794	1,257	42.7	2,107	6,680	7,004	4.8



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#### PL's Recommendation Nomenclature

<b>BUY</b>	: > 15% Outperformance to BSE Sensex	<b>Outperformer (OP)</b>	: 5 to 15% Outperformance to Sensex
<b>Market Performer (MP)</b>	: -5 to 5% of Sensex Movement	<b>Underperformer (UP)</b>	: -5 to -15% of Underperformance to Sensex
<b>Sell</b>	: <-15% Relative to Sensex		
<b>Not Rated (NR)</b>	: No specific call on the stock	<b>Under Review (UR)</b>	: Rating likely to change shortly

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