REDUCE

Price	**Rs261**
Target Price	**Rs238**
Investment Period	**12 Months**

Stock Info

Sector	Pharmaceutical
Market Cap (Rs cr)	20,247
Beta	0.5
52 Week High / Low	295 / 146
Avg. Daily Volume	296350
Face Value (Rs)	2
BSE Sensex	15,688
Nifty	4,659
BSE Code	500087
NSE Code	CIPLA
Reuters Code	CIPL.BO
Bloomberg Code	CIPLA@IN

Shareholding Pattern (%)	
Promoters	39.4
MF / Banks / Indian FIs	19.7
FII / NRIs / OCBs	19.2
Indian Public / Others	21.7

Abs.	3m	1yr	3yr
Sensex (%)	12.8	8.6	35.6
Cipla (%)	16.4	10.0	5.5

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Key Takeaways from the AGM

- **Exports to outperform Domestic sales:** Cipla recorded a 30% growth in its Exports in FY2009, which now form 55% of the top-line, while its Domestic sales grew by 15% yoy. In the US, which now accounts for 29% of its exports, Cipla has partnered with 21 companies for 118 products. Through its partners, Cipla has received approvals for 36 products, of which 23 have been commercialised. In Europe, the company has tied up with 60 partners and has 410 dossiers under registration, with 292 approved and 51 commercialised.

- **Still in Expansion mode:** Cipla has invested about Rs2,000cr in capex over the past three years. In FY2008, Cipla had invested Rs310cr in the Sikkim project, catering to the Domestic formulation segment, which commenced operations in FY2009 and contributed nearly 5% of company's FY2009 sales. Cipla is also setting up an SEZ in Indore, at an estimated cost of Rs 750cr, and expects it to commence operations in FY2010E. However, Cipla's SEZ project at Kerim, Goa remains suspended due to the stop-work order issued by the state government; the company has incurred an expenditure of Rs130cr on this project. Going ahead, the company is contemplating an incremental capex of Rs500-600cr (in addition to Rs 300cr maintenance capex), and would also require an additional Rs300cr on the Working Capital front.

- **To tap the market for Raising funds:** Cipla is planning to tap the capital market in the near future to raise around Rs1,500cr, primarily to fund its incremental capex, working capital needs and to repay its short-term debts. We believe that this will lead to equity dilution to the tune of 7-8%, at the current market price. Though Cipla's overall leverage ratio is on the lower side as compared to the industry average, we believe that the incremental capex has failed to generate higher returns (RoCE of 25-30%), as witnessed in the past, and the RoCE likely to remain in the 18-20% range, going forward. Given the supply-based model, we believe that in order to clock a healthy growth in the top-line, the company will continue requiring additional capex, which will suppress its return ratios.

Key Financials (Consolidated)

Y/E March (Rs cr)	FY2008	FY2009	FY2010E	FY2011E
Net Sales	**4,010**	**4,961**	**5,586**	**6,220**
% chg	*16.6*	*23.7*	*12.6*	*11.3*
Net Profit	**701**	**771**	**1,055**	**1,158**
% chg	*5.1*	*9.9*	*36.8*	*9.8*
EPS (Rs)	**9.0**	**9.9**	**13.6**	**14.9**
EBITDA Margin (%)	15.6	19.1	18.8	17.5
P/E (x)	28.9	26.3	19.2	17.5
RoE (%)	20.1	19.0	22.1	20.3
RoCE (%)	18.7	22.4	20.9	19.4
P/BV (x)	5.4	4.7	3.9	3.3
EV/Sales (x)	5.2	4.3	3.8	3.4
EV/EBITDA (x)	33.1	22.3	20.2	19.4

*Source: Company, Angel Research. * Note: EBITDA Margins exclude technology and licensing income*

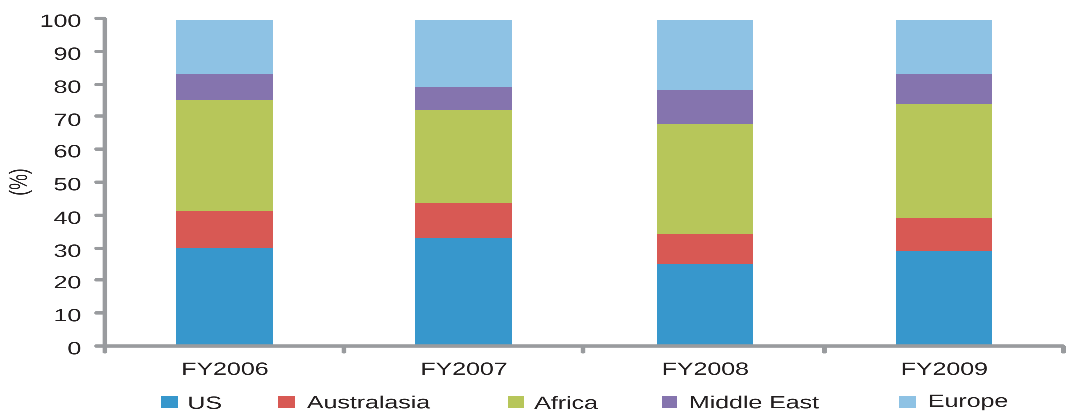
Key Highlights

Exports to outperform Domestic sales

Cipla recorded a 30% growth in its Exports in FY2009, which now form 55% of the top-line, while its Domestic sales grew by 15% yoy. In the US, which now accounts for 29% of its exports, Cipla has partnered with 21 companies for 118 products. Through its partners, Cipla has received approvals for 36 products, of which 23 have been commercialised. In Europe, the company has tied up with 60 partners and has 410 dossiers under registration, with 292 approved and 51 commercialised.

Moreover, Cipla is working on 9 Non-CFC inhalers in Europe, and expects their approvals to kick-in from the current year. The company is scouting for a JV/alliance in the biotech space, with a Chinese player.

Exhibit 1: Break-up of Exports



Source: Company, Angel Research

Still in Expansion mode

Cipla has invested about Rs2,000cr in capex over the past three years. In FY2008, Cipla had invested Rs310cr in the Sikkim project, catering to the Domestic formulation segment, which commenced operations in FY2009 and contributed nearly 5% of company's FY2009 sales. Cipla is also setting up an SEZ in Indore, at an estimated cost of Rs 750cr, and expects it to commence operations in FY2010E. However, Cipla's SEZ project at Kerim, Goa remains suspended due to the stop-work order issued by the state government; the company has incurred an expenditure of Rs130cr on this project. Going ahead, the company is contemplating an incremental capex of Rs500-600cr to set up an API facility in Bangalore, and for expansions at its existing facilities in Patalganga and Kurkumbh. Cipla would also require an additional Rs300cr on the Working Capital front.

Exhibit 2: Operating Cash flows have failed to meet capex requirements

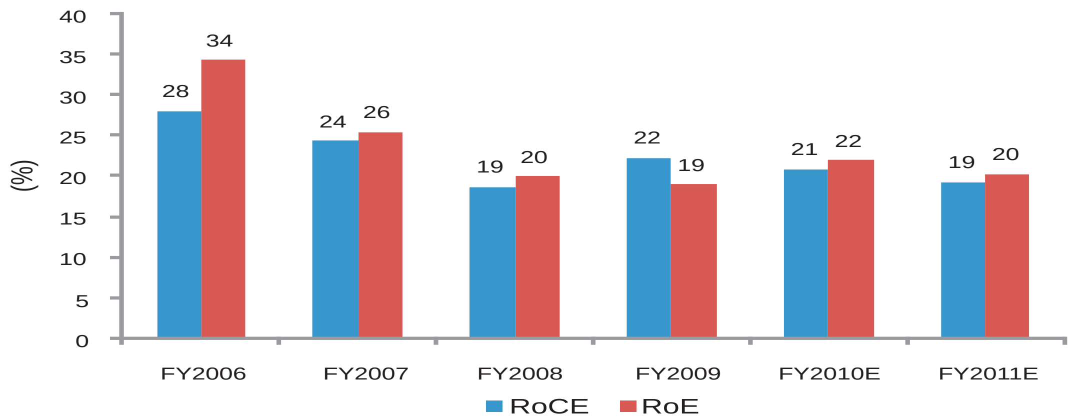
(Rs cr)	FY2006	FY2007	FY2008	FY2009
Capex	389	421	563	700
Free Cash Flow	(133)	(32)	(170)	(408)

Source: Company, Angel Research

Return Ratios

Though Cipla's overall leverage ratio is on the lower side as compared to the industry average, we believe that the incremental capex has failed to generate higher returns (RoCE of 25-30%), as witnessed in the past, and the RoCE likely to remain in the 18-20% range, going forward. We believe that in order to clock a healthy growth in the top-line, the company will continue requiring additional capex, which will suppress its return ratios.

Exhibit 3: Declining Trend in Return Ratios



Source: Company, Angel Research

To tap the market for raising the funds

Cipla is planning to tap the capital market in the near future to raise around Rs1,500cr, primarily to fund its incremental capex, working capital needs and to repay its short-term debts. We believe that this will lead to equity dilution to the tune of 7-8%, at the current market price.

Overpricing issue

Cipla has received notices to the tune of Rs1,177.3cr from the government, for overcharging with respect to drugs under the Drugs (Price Control) Order, and the matter is currently sub judice. The company believes that none of the demand notices from the government are tenable and, as a result, it has not provided for the aforesaid amount in its books. We believe that any adverse decision could have a material impact on the company's financials, as this works out to 24% of its Top-line and 117% of its Operating Cash flow of FY2009.

On the US FDA

Cipla has received nine audit observations from the US FDA, on its Bangalore unit, in April 2009. The company has responded to the queries and is awaiting response from the regulator.

Other Highlights

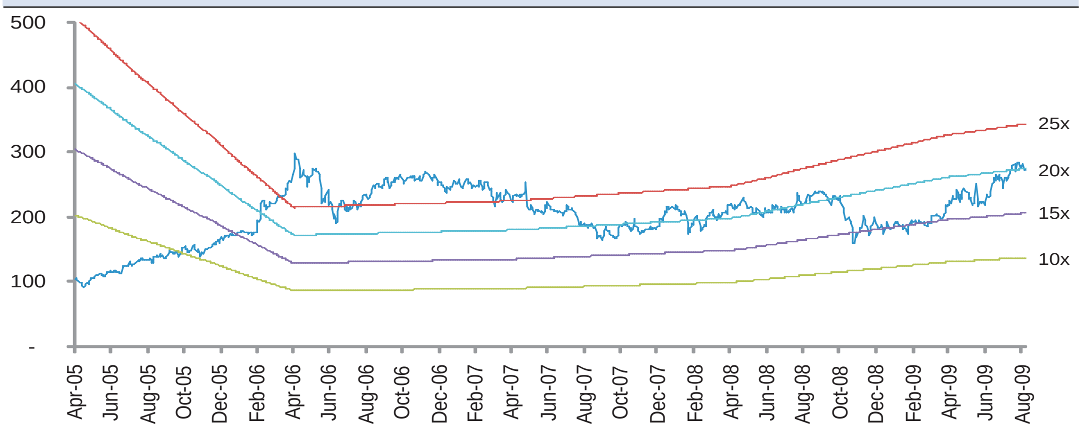
- Cipla is the only generic producer of both the Swine flu medicines, Oseltamivir and Zanamivir. The company has started exporting Oseltamivir.
- The company expects its tax rate to be around 17%.
- Cipla has an employee base of 11,000 personnel, of which 4,300 people are in the sales team.
- Cipla would be looking out for JV/Opportunities in the Domestic and Emerging markets, in niche segments.
- After forex losses of Rs228cr in FY2009, the company is hedging all its foreign denominated loans, and covering 100% of its net exports on a month-on-month basis.
- Cipla expects the growth in Technology and licensing income to continue.

Outlook and Valuation

We have marginally tweaked our estimates, after factoring in a higher sales growth of 12% CAGR over FY2009-11E, primarily driven by exports; we have also increased the estimated tax rate to 17% for FY2010-11E. Given the supply-based model, we believe that in order to clock a healthy growth in the top-line, the company will continue requiring additional capex, which will suppress its return ratios.

During the past month, the stock has underperformed the market and is down 8%. At Rs261, the stock is trading at 19.2x its FY2010E and 17.5x its FY2011E earnings. **We recommend a Reduce rating on the stock, with a Target Price of Rs238.**

Exhibit 4: One-year forward P/E chart



Source: Company, Angel Research

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Ratings (Returns) :	Buy (Upside > 15%)	Accumulate (Upside upto 15%)	Neutral (5 to -5%)
	Reduce (Downside upto 15%)	Sell (Downside > 15%)	

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