



## Cadila Healthcare

STOCK INFO.	BLOOMBERG
BSE Sensex: 17,287	CDH IN
	REUTERS CODE
S&P CNX: 5,166	CADI.BO

30 April 2008

Buy

Previous Recommendation: Buy

Rs288

Equity Shares (m)	125.6
52-Week Range	412/201
1,6,12 Rel. Perf. (%)	7/10/-35
M.Cap. (Rs b)	36.2
M.Cap. (US\$ b)	0.9

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END*	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/07A	18,288	2,343	18.7	43.5	15.4	4.2	29.9	24.1	2.2	11.2
03/08A	23,245	2,632	20.5	9.9	14.0	3.4	26.7	23.6	1.7	8.7
03/09E	27,042	3,114	24.8	20.9	11.6	2.8	26.4	20.9	1.5	7.6
03/10E	31,706	4,063	32.3	30.5	8.9	2.3	28.1	23.0	1.2	6.1

Cadila's 4QFY08 performance was above estimates. Key highlights:

- Net sales grew by 29.3% to Rs5.6b (v/s estimate of Rs5.5b), driven by 61% YoY growth in formulation exports to Rs1.6b. API exports de-grew by 10% to Rs615m while domestic sales grew by 23.2% to Rs3.4b. EBITDA margins improved by 380bp YoY to 20.1% (v/s estimate of 14.5%) led by lower RM costs and lower than expected margin erosion for Pantoprazole intermediates. PAT recorded 34% growth to Rs520m (v/s estimate of Rs388m).
- New launches to drive growth in the US market:** Cadila has a pipeline of 44 ANDAs pending approval and has received 34 ANDA approvals (including tentative approvals). During FY09E, the company expects about 10 product launches in the US with revenues expected at Rs3.2b (27% growth).
- Hospira supplies to commence in FY09E:** Management has indicated that supplies to Hospira are expected to commence from 2HFY09 and ramp-up will be visible in FY10E. We believe that this will partly compensate for the loss of profits from Pantoprazole for FY09E and will contribute more than total peak Pantoprazole profits of Rs600m by FY10E.

We expect Cadila to record 20% earnings CAGR for FY07-10 period despite loss of Pantoprazole profits. We expect the company to record EPS of Rs24.8 and Rs32.3 for FY09E and FY10E respectively. Traction in international business, commencement of Hospira supplies coupled with a de-risked business model should ensure good long-term potential for the company. Cadila is currently valued at 11.6x FY09E, and 8.9x FY10E consolidated earnings. We believe that valuations are attractive given the expected traction in the business. Reiterate **Buy** with target price of Rs365 (15x FY09E earnings).

### QUARTERLY PERFORMANCE (CONSOLIDATED)

(Rs Million)

Y/E MARCH	FY07				FY08				FY07	FY08
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
<b>Net Revenues</b>	<b>4,458</b>	<b>4,748</b>	<b>4,724</b>	<b>4,357</b>	<b>5,722</b>	<b>6,097</b>	<b>5,794</b>	<b>5,632</b>	<b>18,288</b>	<b>23,245</b>
YoY Change (%)	19.5	27.3	27.8	25.9	28.4	28.4	22.7	29.3	23.2	27.1
Total Expenditure	3,560	3,658	3,901	3,646	4,610	4,780	4,759	4,498	14,767	18,647
<b>EBITDA</b>	<b>898</b>	<b>1,090</b>	<b>823</b>	<b>711</b>	<b>1,112</b>	<b>1,317</b>	<b>1,035</b>	<b>1,134</b>	<b>3,521</b>	<b>4,598</b>
Margins (%)	20.1	23.0	17.4	16.3	19.4	21.6	17.9	20.1	19.3	19.8
Depreciation	197	213	212	200	239	235	270	225	823	969
Interest	69	54	49	52	73	127	66	178	223	444
Other Income	49	3	0	15	94	0	2	22	264	118
<b>PBT before EO Income</b>	<b>681</b>	<b>826</b>	<b>562</b>	<b>474</b>	<b>894</b>	<b>955</b>	<b>701</b>	<b>753</b>	<b>2,739</b>	<b>3,303</b>
EO Exp/(Inc)	0	0	-196	0	0	24	45	0	0	69
<b>PBT after EO Income</b>	<b>681</b>	<b>826</b>	<b>758</b>	<b>474</b>	<b>894</b>	<b>931</b>	<b>656</b>	<b>753</b>	<b>2,739</b>	<b>3,234</b>
Tax	76	100	98	50	121	114	177	201	324	613
Rate (%)	11.2	12.1	12.9	10.5	13.5	12.2	27.0	26.7	11.8	19.0
Minority Int/Adj on Consol	21	21	1	35	34	16	-37	32	77	45
<b>Reported PAT</b>	<b>584</b>	<b>705</b>	<b>659</b>	<b>389</b>	<b>739</b>	<b>801</b>	<b>516</b>	<b>520</b>	<b>2,338</b>	<b>2,576</b>
<b>Adj PAT</b>	<b>584</b>	<b>705</b>	<b>488</b>	<b>389</b>	<b>739</b>	<b>822</b>	<b>549</b>	<b>520</b>	<b>2,338</b>	<b>2,632</b>
YoY Change (%)	47.2	38.8	18.4	13.0	26.5	16.6	12.4	33.7	40.7	12.6
Margins (%)	13.1	14.8	10.3	8.9	12.9	13.5	9.5	9.2	12.8	11.3

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

### Formulation exports and consolidation of acquired companies drive revenue growth

Net sales grew by 29.3% to Rs5.6b (v/s estimate of Rs5.5b), driven by 61% YoY growth in formulation exports to Rs1.6b. API exports de-grew by 10% to Rs615m while domestic sales grew by 23.2% to Rs3.4b. Domestic sales growth was led by higher growth in the consumer business and consolidation of acquired companies.

#### REVENUES BREAK-UP (RS M)

	4QFY08	4QFY07	% CHG	3QFY08	% CHG
<b>Gross Dom. sales</b>	<b>3,430</b>	<b>2,785</b>	<b>23.2</b>	<b>3,604</b>	<b>-4.8</b>
Formulations	2,688	2,302	16.8	2,778	-3.2
APIs	151	85	77.6	110	37.3
Consumer & Others	591	398	48.5	716	-17.5
<b>Export sales</b>	<b>2,242</b>	<b>1,690</b>	<b>32.7</b>	<b>2,293</b>	<b>-2.2</b>
Formulations	1,627	1,008	61.4	1,784	-8.8
APIs	615	682	-9.8	509	20.8
<b>Gross Sales</b>	<b>5,672</b>	<b>4,475</b>	<b>26.7</b>	<b>5,897</b>	<b>-3.8</b>

Source: Company

### New launches would drive growth in the US market

Cadila initiated filings for the US generic markets in the year 2003. It has received 34 ANDA approvals (including tentative approvals) and has 44 ANDAs awaiting US FDA approval. During FY09E, the company expects about 10 product launches leading to a 30-35% revenue growth in US\$ terms. 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 (excluding profit on sale of brands) for FY07, more viable. Also, revenue growth is expected to be driven by strong growth in existing portfolio and new product launches would result in higher revenues.

### 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 31 site transfers of which 25 have been approved till date. While we believe that such site transfers will have a positive impact on the profitability of Cadila's French business, government mandated price declines may temper down the benefits of margin expansion.

### Pantoprazole Update - Guides for maintaining PAT contribution at Rs480m

Management has clarified that of the global Pantoprazole API market of 120t, USA accounts for about 20-25t and that the launch of generic versions by Teva and Sun Pharma will reduce Cadila's bottom-line by Rs180m only, contrary to the expectation of a much higher impact. It recorded revenues of about Rs668m and PAT of Rs480m by way of supplies of Pantoprazole intermediates to Nycomed. Management has guided that it will be able to retain the revenue and profit contribution at these levels even for FY09E. We, however, continue to believe that there could be a further decline in these supplies (already factored in our estimates).

#### PANTOPRAZOLE: CADILA'S SHARE (RS M)

	FY07	FY08E	FY09E	FY10E
Sales	837	668	601	902
PAT	550	480	350	400
% of Total PAT	22.8	18.3	11.2	9.8

Source: Company/Motilal Oswal Securities

### **Hospira JV to start contributing from FY09E onwards**

Cadila has indicated that it will be commissioning the new facility for catering to supplies to Hospira in 2H FY09 and that it expects revenues of Rs750m (Cadila's share from the JV) for FY09E subject to regulatory approvals. We believe that this will partly compensate for the loss of profits from Pantoprazole for FY09E and will contribute more than total Pantoprazole profits by FY10E. Management has indicated peak revenues of about US\$200m for the JV when all the products covered under the agreement are commercialized (likely to take a few years).

### **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 had, in the past, indicated that it 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.

### **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 20% CAGR over FY07-10, led mainly by a 43% CAGR in the international formulations business. The US and French operations are likely to be the major contributors to this growth. Overall exports are likely to account for about 42% of sales by FY10 compared to the current 37%.

While the domestic formulations business is likely to be steady performer with 11% CAGR for FY07-10, Cadila's consumer business is likely to record 27% CAGR aided by higher growth in existing portfolio and consolidation of acquired companies, viz., Carnation and Liva Healthcare.

We expect a 20% bottom-line CAGR for FY07-10. 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 RoCE (20-22%) for the next two years.

Cadila is currently valued at 11.6x FY09E and 8.9x FY10E consolidated earnings. We believe that valuations are attractive given the expected traction in international operations (mainly the US and France) and commencement of supplies to Hospira. We expect 20% earnings CAGR for FY07-10 period despite loss of Pantoprazole profits. This coupled with a de-risked business model should ensure good long-term potential for the company. Reiterate **Buy** with a price target of Rs365.

## 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
- ✎ Loss of patent protection for Pantoprazole will impact short-term earnings.

### Recent Developments

- ✎ Expanded API sourcing agreement with Nycomed.

### Valuation and view

- ✎ Valuations at 11.6x FY09E and 8.9x FY10E 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 Rs365.

### 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)	FY09E	11.6	16.3	30.3
	FY10E	8.9	13.4	25.7
P/BV (x)	FY09E	2.8	4.3	5.3
	FY10E	2.3	3.5	4.6
EV/Sales (x)	FY09E	1.5	2.3	8.0
	FY10E	1.2	1.9	6.5
EV/EBITDA (x)	FY09E	7.6	11.2	22.9
	FY10E	6.1	9.1	18.6

#### SHAREHOLDING PATTERN (%)

	MAR-08	DEC-07	MAR-07
Promoter	72.0	72.0	72.0
Domestic Inst	15.5	15.5	14.5
Foreign	4.8	4.7	5.2
Others	7.7	7.7	8.2

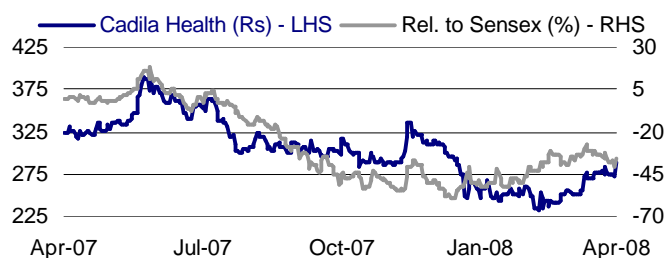
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY09	24.8	23.9	3.7
FY10	32.3	28.8	12.5

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
288	365	26.7	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2006	2007	2008E	2009E	2010E
<b>Net Sales</b>	<b>14,845</b>	<b>18,288</b>	<b>23,245</b>	<b>27,042</b>	<b>31,706</b>
Change (%)	16.2	23.2	27.1	16.3	17.2
Total Expenditure	11,969	14,767	18,647	21,871	25,285
<b>EBITDA</b>	<b>2,876</b>	<b>3,521</b>	<b>4,598</b>	<b>5,170</b>	<b>6,421</b>
Margin (%)	19.4	19.3	19.8	19.1	20.3
Depreciation	779	823	969	1,119	1,275
<b>EBIT</b>	<b>2,097</b>	<b>2,698</b>	<b>3,629</b>	<b>4,051</b>	<b>5,146</b>
Int. and Finance Charges	251	223	444	507	518
Other Income - Rec.	36	264	118	120	151
<b>PBT before EO Expense</b>	<b>1,882</b>	<b>2,739</b>	<b>3,303</b>	<b>3,664</b>	<b>4,780</b>
Extra Ordinary Expense/(Inc)	115	0	69	0	0
<b>PBT after EO Expense</b>	<b>1,767</b>	<b>2,739</b>	<b>3,234</b>	<b>3,664</b>	<b>4,780</b>
Current Tax	146	287	613	440	574
Deferred Tax	87	37	0	110	143
Tax	233	324	613	550	717
Tax Rate (%)	13.2	11.8	19.0	15.0	15.0
<b>Reported PAT</b>	<b>1,534</b>	<b>2,415</b>	<b>2,621</b>	<b>3,114</b>	<b>4,063</b>
Less: Minority Interest	1	72	45	0	0
<b>Net Profit</b>	<b>1,523</b>	<b>2,338</b>	<b>2,576</b>	<b>3,114</b>	<b>4,063</b>
<b>PAT Adj for EO Items</b>	<b>1,633</b>	<b>2,343</b>	<b>2,632</b>	<b>3,114</b>	<b>4,063</b>

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2006	2007	2008E	2009E	2010E
Equity Share Capital	314	628	628	628	628
Total Reserves	6,675	8,027	9,986	12,322	15,369
<b>Net Worth</b>	<b>6,989</b>	<b>8,655</b>	<b>10,614</b>	<b>12,950</b>	<b>15,997</b>
Minority Interest	7	142	0	0	0
Deferred liabilities	1097	1137	1137	1247	1390
Total Loans	4,432	4,535	7,927	8,450	8,627
<b>Capital Employed</b>	<b>12,525</b>	<b>14,469</b>	<b>19,678</b>	<b>22,647</b>	<b>26,014</b>
Gross Block	12,086	13,527	15,527	17,527	19,527
Less: Accum. Deprn.	4,393	4,968	5,991	7,110	8,385
<b>Net Fixed Assets</b>	<b>7,693</b>	<b>8,559</b>	<b>9,536</b>	<b>10,417</b>	<b>11,142</b>
Capital WIP	636	1,224	0	0	500
Investments	714	261	3,396	4,352	4,591
<b>Curr. Assets</b>	<b>6,491</b>	<b>9,871</b>	<b>11,330</b>	<b>13,252</b>	<b>16,170</b>
Inventory	2,475	3,896	4,532	5,301	6,530
Account Receivables	1,990	2,784	3,512	4,108	5,131
Cash and Bank Balance	438	990	793	928	1,088
Loans & Advances	1,588	2,201	2,493	2,915	3,421
<b>Curr. Liability &amp; Prov.</b>	<b>3,009</b>	<b>5,446</b>	<b>4,584</b>	<b>5,374</b>	<b>6,389</b>
Account Payables	2,404	4,588	3,626	4,240	4,976
Provisions	605	858	958	1,133	1,413
<b>Net Current Assets</b>	<b>3,482</b>	<b>4,425</b>	<b>6,746</b>	<b>7,878</b>	<b>9,782</b>
Misc Expenditure	0	0	0	0	0
<b>Appl. of Funds</b>	<b>12,525</b>	<b>14,469</b>	<b>19,678</b>	<b>22,647</b>	<b>26,014</b>

E: Most Estimates

RATIOS					
Y/E MARCH	2006	2007	2008E	2009E	2010E
<b>Basic (Rs)</b>					
<b>EPS</b>	<b>13.0</b>	<b>18.7</b>	<b>20.5</b>	<b>24.8</b>	<b>32.3</b>
Cash EPS	18.3	25.2	28.2	33.7	42.5
BV/Share	55.6	68.9	84.5	103.1	127.4
DPS	1.5	4.0	4.5	5.3	6.9
Payout (%)	31.5	27.5	25.3	25.0	25.0
<b>Valuation (x)</b>					
P/E	22.2	15.4	14.0	11.6	8.9
Cash P/E	15.7	11.4	10.2	8.5	6.8
P/BV	5.2	4.2	3.4	2.8	2.3
EV/Sales	2.7	2.2	1.7	1.5	1.2
EV/EBITDA	13.7	11.2	8.7	7.6	6.1
Dividend Yield (%)	0.5	1.4	1.6	1.8	2.4
<b>Return Ratios (%)</b>					
RoE	23.7	29.9	26.7	26.4	28.1
RoCE	20.2	24.1	23.6	20.9	23.0
<b>Working Capital Ratios</b>					
Debtor (Days)	47	53	53	53	57
Creditor (Days)	154	263	167	162	162
Inventory (Days)	61	78	71	72	75
Working Capital Turnover (I)	75	69	93	94	100
<b>Leverage Ratio (x)</b>					
Current Ratio	2.2	1.8	2.5	2.5	2.5
Debt/Equity	0.6	0.5	0.7	0.7	0.5

\* Ratios adjusted for bonus issue

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2006	2007	2008E	2009E	2010E
Oper. Profit/(Loss) before T	2,876	3,521	4,598	5,170	6,421
Interest/Dividends Recd.	36	264	118	120	151
Direct Taxes Paid	-146	-287	-613	-440	-574
(Inc)/Dec in WC	-1,330	-391	-2,518	-997	-1,743
<b>CF from Operations</b>	<b>1,436</b>	<b>3,107</b>	<b>1,585</b>	<b>3,853</b>	<b>4,256</b>
EO Expense / (Income)	115	0	69	0	0
<b>CF from Operating incl</b>	<b>1,321</b>	<b>3,107</b>	<b>1,516</b>	<b>3,853</b>	<b>4,256</b>
(inc)/dec in FA	-1,202	-2,277	-722	-2,000	-2,500
(Pur)/Sale of Investments	-247	453	-3,135	-957	-238
<b>CF from Investments</b>	<b>-1,449</b>	<b>-1,824</b>	<b>-3,857</b>	<b>-2,957</b>	<b>-2,738</b>
Issue of Shares	0	0	0	0	1
(Inc)/Dec in Debt	605	238	3,250	523	176
Interest Paid	-251	-223	-444	-507	-518
Dividend Paid	-483	-664	-662	-779	-1,016
Others	83	-82	0	0	-1
<b>CF from Fin. Activity</b>	<b>-46</b>	<b>-731</b>	<b>2,144</b>	<b>-762</b>	<b>-1,357</b>
<b>Inc/Dec of Cash</b>	<b>-174</b>	<b>552</b>	<b>-197</b>	<b>135</b>	<b>161</b>
Add: Beginning Balance	612	438	990	793	928
<b>Closing Balance</b>	<b>438</b>	<b>990</b>	<b>793</b>	<b>928</b>	<b>1,088</b>



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#### 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 |

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