

Cipla Ltd

Subdued numbers; maintain HOLD

Cipla's Q3FY11 results were below our estimates due to lower other operating income and higher expenses, particularly related to the Indore SEZ. Overall, the company reported a subdued 8% revenue growth for the quarter. Growth in the domestic market was also disappointing at 11%. The revenue impact of investments made for the Indore SEZ is unlikely to reflect in the coming quarters. Maintain HOLD.

Subdued topline performance: Cipla reported an 8% YoY growth for Q3FY11. The company's performance was impacted by lower other operating income (down 45% YoY), which the management attributed to the high base of last year due to a partially non-recurring technology income.

Disappointing domestic performance: For the last several quarters, Cipla is facing competitive pressures in the domestic market. While the company had reported encouraging recovery in Q2FY11, with a ~20% growth in this market, the same was not sustainable with growth slipping to 11% in Q3FY11. The export formulations business also posted a modest 12% for the quarter (4% impact of unfavourable cross-currency movements). The API business reported an 11% growth for the quarter.

Margins contract on account of Indore SEZ expenses: Cipla reported a 593bps YoY contraction in its EBITDA margins due to lower other operating and higher expenses. After adjusting for other operating income, its core EBITDA margin plunged 365bps to 17.7%. Staff costs increased 238bps due to expenses incurred for the Indore SEZ, annual increments and regrouping of contractual staff at the Goa facility. Other expenses increased 129bps on account of higher expenses at the Indore SEZ (Rs 250mn–300mn) and increased selling expenses.

Adj. PAT declines by 19%, core PAT by 10%: Lower other operating income led to a 19% decline in adj. PAT to Rs 2.3bn. Moreover, depreciation charges for Q3FY11 increased by 43%. Cipla's core business PAT also declined by 10% to Rs 1.9bn primarily on account of lower operating profits.

Awaiting triggers; Maintain HOLD: The stock is trading at 21.2x FY12E earnings. These valuations, we believe, capture Cipla's low-risk business model. The two catalysts, (a) sustainable recovery in the domestic business and (b) revenue impact of investments in the Indore SEZ, are not visible in the near term. Hence, we maintain our HOLD rating on the stock. Our December '11 target price of Rs 370 is based on 21x Dec '12 earnings.

Financial highlights

(Rs mn)	FY10	FY11E	FY12E	FY13E
Revenue	56,300	62,539	70,953	85,162
Growth (%)	6.8	11.1	13.5	20.0
Adj net income	10,505	10,508	12,287	15,449
Growth (%)	2.6	0.0	16.9	25.7
FDEPS (Rs)	13.1	13.1	15.3	19.2
Growth (%)	(0.7)	0.0	16.9	25.7

Profitability and return ratios

(%)	FY10	FY11E	FY12E	FY13E
EBITDA margin	25.3	23.8	24.1	24.7
EBIT margin	21.9	19.8	20.4	21.6
Adj PAT margin	18.7	16.8	17.3	18.1
ROE	20.5	16.6	16.8	18.2
ROIC	17.6	15.2	15.6	17.2
ROCE	19.1	16.6	16.8	18.2

What's New?

Target

Rating

Estimates

CMP	TARGET	RATING	RISK
Rs 324	Rs 370	HOLD	LOW

BSE	NSE	BLOOMBERG
500087	CIPLA	CIPLA IN

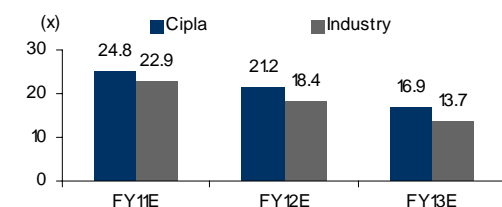
Company data

Market cap (Rs mn / US\$ mn)	260,387/5,708
Outstanding equity shares (mn)	803
Free float (%)	63.2
Dividend yield (%)	0.6
52-week high/low (Rs)	381/299
2-month average daily volume	1,491,078

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Cipla	324	(13.8)	(8.1)	1.4
BSE HC	6,071	(8.9)	(9.4)	8.6
Sensex	18,008	(8.6)	(14.3)	(0.7)

P/E comparison



Valuation matrix

(x)	FY10	FY11E	FY12E	FY13E
P/E @ CMP	24.8	24.8	21.2	16.9
P/E @ Target	28.3	28.3	24.2	19.2
EV/EBITDA @ CMP	18.9	18.1	15.8	12.8





Result highlights

Fig 1 - Actual vs estimated performance

(Rs mn)	Actual	Estimate	% Variance
Revenue	15,537	15,817	(1.8)
EBITDA	3,182	3,689	(13.7)
Adj net income	2,327	2,571	(9.5)
FDEPS (Rs)	2.9	3.2	(9.5)

Source: RCML Research

Fig 2 - Quarterly performance

(Rs mn)	Q3FY11	Q3FY10	% Chg YoY	Q2FY10	% Chg QoQ
Revenue	15,537	14,385	8	16,154	(4)
Expenditure	12,355	10,586	17	12,313	0
Operating profit	3,182	3,799	(16)	3,841	(17)
Other income	257	178	44	166	54
Interest	29	44	(33)	3	946
Depreciation	653	457	43	639	2
PBT	2,757	3,477	(21)	3,190	(14)
Tax	430	587	(27)	560	(23)
PAT	2,327	2,890	(19)	2,805	(17)
EBITDA margin (%)	20.5	26	(593bps)	23.8	(330bps)
FDEPS (Rs)	2.9	3.6	(19)	3.5	(17)

Source: Company, RCML Research

Fig 3 - Core business performance (excl. other op income)

Rs mn	Q3FY11	Q3FY10	Ch, YoY
Sales	15,014	13,442	12
EBITDA	2,659	2,855	(7)
Adj. PAT	1,885	2,106	(10)
EPS	2.3	2.6	(10)
EBITDA margin	17.7	21.2	(353bps)

Source: Company, RCML Research

Results below estimates due to higher expenses at the Indore SEZ

Lower other operating income impacted reported sales

Higher expenses (Indore SEZ) exerted pressure on profitability



Consolidated financials

Profit and Loss statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Revenues	56,300	62,539	70,953	85,162
Growth (%)	6.8	11.1	13.5	20.0
EBITDA	14,237	14,856	17,070	21,055
Growth (%)	11.0	4.3	14.9	23.3
Depreciation & amortisation	1,888	2,476	2,611	2,662
EBIT	12,350	12,380	14,458	18,393
Growth (%)	11.0	0.2	16.8	27.2
Interest	237	-	-	-
Other income	877	755	710	680
EBT	12,990	13,136	15,169	19,072
Income taxes	2,485	2,627	2,882	3,624
Effective tax rate (%)	19.1	20.0	19.0	19.0
Extraordinary items	315	-	-	-
Min into / inc from associates	-	-	-	-
Reported net income	10,820	10,508	12,287	15,449
Adjustments	315	-	-	-
Adjusted net income	10,505	10,508	12,287	15,449
Growth (%)	2.6	0.0	16.9	25.7
Shares outstanding (mn)	802.9	802.9	802.9	802.9
FDEPS (Rs) (adj)	13.1	13.1	15.3	19.2
Growth (%)	(0.7)	0.0	16.9	25.7
DPS (Rs)	2.0	2.0	2.0	2.0

Cash flow statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Net income + Depreciation	12,708	12,985	14,898	18,111
Non-cash adjustments	(1,171)	817	882	1,139
Changes in working capital	(311)	(6,581)	(6,379)	(9,374)
Cash flow from operations	11,226	7,222	9,401	9,876
Capital expenditure	(6,401)	(6,000)	(5,000)	(5,110)
Change in investments	-	-	(2,400)	(2,800)
Other investing cash flow	-	-	-	-
Cash flow from investing	(6,401)	(6,000)	(7,400)	(7,910)
Issue of equity	6,760	-	-	-
Issue/repay debt	(9,402)	-	-	-
Dividends paid	(1,819)	(1,879)	(1,879)	(1,879)
Other financing cash flow	(16)	-	-	-
Change in cash & cash eq	348	(657)	122	87
Closing cash & cash eq	900	243	366	453

Economic Value Added (EVA) analysis

Y/E March	FY10	FY11E	FY12E	FY13E
WACC (%)	11.3	11.3	11.3	11.3
ROIC (%)	17.6	15.2	15.6	17.2
Invested capital (Rs mn)	60,425	69,741	80,044	93,578
EVA (Rs mn)	3,787	2,731	3,471	5,484
EVA spread (%)	6.3	3.9	4.3	5.9

Balance sheet

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and cash eq	900	243	366	453
Accounts receivable	16,609	21,263	21,641	28,529
Inventories	14,643	17,588	18,908	22,274
Other current assets	13,372	14,099	14,877	15,713
Investments	801	801	3,201	6,001
Gross fixed assets	33,849	39,849	44,849	49,958
Net fixed assets	24,953	28,477	30,866	33,313
CWIP	3,148	3,148	3,148	3,148
Intangible assets	-	-	-	-
Deferred tax assets, net	(2,304)	(3,092)	(3,957)	(5,044)
Other assets	-	-	-	-
Total assets	72,121	82,526	89,049	104,387
Accounts payable	4,964	5,766	6,520	7,815
Other current liabilities	5,832	6,776	2,119	2,540
Provisions	2,182	2,211	2,229	2,281
Debt funds	-	-	-	-
Other liabilities	-	-	-	-
Equity capital	1,606	1,606	1,606	1,606
Reserves & surplus	57,538	66,167	76,575	90,145
Shareholder's funds	59,143	67,773	78,181	91,751
Total liabilities	72,121	82,526	89,049	104,387
BVPS (Rs)	73.7	84.4	97.4	114.3

Financial ratios

Y/E March	FY10	FY11E	FY12E	FY13E
Profitability & Return ratios (%)				
EBITDA margin	25.3	23.8	24.1	24.7
EBIT margin	21.9	19.8	20.4	21.6
Net profit margin	18.7	16.8	17.3	18.1
ROE	20.5	16.6	16.8	18.2
ROCE	19.1	16.6	16.8	18.2
Working Capital & Liquidity ratios				
Receivables (days)	114	111	110	108
Inventory (days)	211	204	204	192
Payables (days)	70	68	69	67
Current ratio (x)	4.2	4.2	6.5	6.5
Quick ratio (x)	1.5	1.7	2.5	2.8
Turnover & Leverage ratios (x)				
Gross asset turnover	1.9	1.7	1.7	1.8
Total asset turnover	0.8	0.8	0.8	0.9
Interest coverage ratio	52.2	-	-	-
Adjusted debt/equity	-	-	-	-
Valuation ratios (x)				
EV/Sales	4.8	4.3	3.8	3.2
EV/EBITDA	18.9	18.1	15.8	12.8
P/E	24.8	24.8	21.2	16.9
P/BV	4.4	3.8	3.3	2.8



Quarterly trend

Particulars	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenue (Rs mn)	14,385	13,747	14,798	16,154	15,537
YoY growth (%)	7	1	8	12	8
QoQ growth (%)	(0)	(4)	8	9	(4)
EBITDA (Rs mn)	4,039	2,780	3,646	3,841	3,182
EBITDA margin (%)	28	20	25	24	20
Adj net income (Rs mn)	3,130	2,320	2,714	2,805	2,327
YoY growth (%)	18	(12)	1	5	(19)
QoQ growth (%)	17	(26)	17	3	(17)

DuPont analysis

(%)	FY09	FY10	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	89.2	80.9	80.0	81.0	81.0
Interest burden (PBT/EBIT)	103.2	105.2	106.1	104.9	103.7
EBIT margin (EBIT/Revenues)	21.1	21.9	19.8	20.4	21.6
Asset turnover (Revenues/Avg TA)	85.9	81.0	80.9	82.7	88.1
Leverage (Avg TA/Avg equity)	151.5	135.5	121.8	117.6	113.8
Return on equity	25.3	20.5	16.6	16.8	18.2

Company profile

Cipla is the second largest Indian pharmaceuticals company in terms of market capitalization and one of the largest players in terms of domestic market share. It is amongst the first few generics to adopt a partnership model for the regulated markets. The company has a wide geographical presence in over 170 countries globally, and derived 56% of its FY10 revenues from exports to regions including US, Europe, Middle East, Africa and Australia.

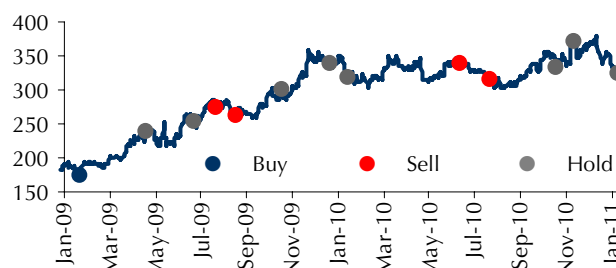
Shareholding pattern

(%)	Jun-10	Sep-10	Dec-10
Promoters	36.8	36.8	36.8
FIs	16.2	15.2	15.4
Banks & FIs	17.5	18.3	18.7
Public	29.6	29.8	29.1

Recommendation history

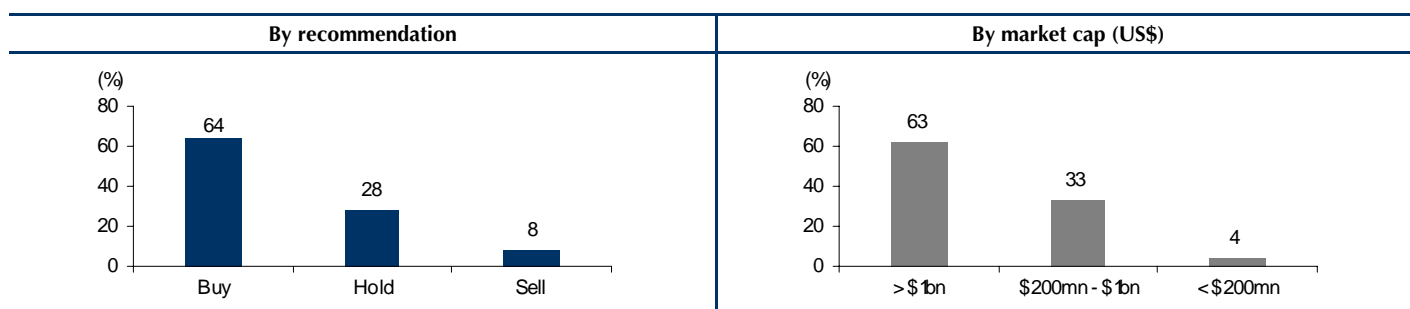
Date	Event	Reco price	Tgt price	Reco
23-Jan-09	Results Review	173	212	Buy
25-Apr-09	Results Review	240	229	Hold
2-Jul-09	Quarterly Preview	253	250	Hold
29-Jul-09	Results Review	274	269	Sell
26-Aug-09	Company Update	262	269	Sell
28-Oct-09	Results Review	301	302	Hold
6-Jan-10	Quarterly Preview	339	347	Hold
29-Jan-10	Results Review	318	352	Hold
5-Jul-10	Company Update	339	330	Sell
13-Aug-10	Results Review	315	330	Sell
11-Nov-10	Results Review	333	370	Hold
6-Dec-10	Company Update	371	370	Hold
6-Feb-11	Results Review	324	370	Hold

Stock performance





Coverage Profile



Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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