

Sector: Pharmaceuticals

Target Price	Rs450
Market cap (bn)	Rs45.1/US\$1.1
52-week range	Rs400/231
Shares in issue (mn)	125.6
6-mon avg daily vol (no of shares)	72,996
6-mon avg daily vol (mn)	Rs26.2/US\$0.6
Bloomberg	CDH IN
Reuters	CADI.BO
BSE Sensex	14209
Website	www.zyduscadila.com

Shareholding Pattern (%)

Promoters	72.0
FII	4.4
MFs/FIs/Banks	14.8
Others	8.9

(As of 30 September 2006)

Price Performance (%)

	1M	3M	12M
Absolute	7.2	9.5	42.7
Relative*	1.7	(2.0)	(6.5)

*To the BSE Sensex

Relative Performance



(As of 22 January 2007)

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High R&D, low Altana sales hit profits

Cadila Healthcare posted 15% YoY growth in consolidated profits (adjusted) at Rs426 mn in 3Q FY07, lower than our expectation of Rs519 mn. Profits have been primarily impacted by 85% YoY increase in R&D cost at Rs294 mn, higher A&P spent on consumer healthcare business and lower sales in Altana JV. A 25% YoY growth in consolidated sales is primarily driven by US and French generics markets, which grew 147% at Rs928 mn (20% of sales). However, domestic formulations business witnessed slower growth at 6% impacted by VAT implementation in Tamil Nadu and drop in generics business.

The management indicated 20% growth over the next few years driven by generics markets and pick up in APIs. The stock trades at 20.0x FY07E earnings and 15.2x FY08E earnings and trades at 14.4x FY07E EV/EBITDA and 11.3x FY08E EV/EBITDA. We maintain our Buy rating on the stock with a target price of Rs450 (14x FY08E EV/EBITDA).

Highlights

- US generics business picking up momentum:** Cadila Healthcare posted US generics sales of Rs386 mn (US\$8.7 mn) in 3Q FY07 and Rs937 mn (US\$20 mn) in 9M FY07. Currently, the company has eight products in the market. Cadila filed three ANDA in 3Q FY07 and has cumulative 18 ANDA approvals in the US market. Recently launched Simvastatin has already garnered 10% market share though price discounting is as severe as 99%. The company expects to receive the final approval for Pravastatin soon, which got delayed due to additional data requirement by the US FDA. US generics business would be a key driver going forward with 20 plus ANDAs filings annually and accelerated launches in future. The company had guided for US\$30 mn sales from the US in FY07E.
- Decline in Altana's revenues impact profitability:** Due to low supplies to Altana, the revenues in Altana JV declined 38% YoY at Rs96 mn in 3Q FY07 impacting the overall profitability of the company. However, the management indicated that the third quarter generally witnesses a slowdown in supplies to Altana. We believe that Atlanta's contribution would pick up going forward in 4Q FY07.

Exhibit 1: Key financials (Consolidated)

(Rs mn)

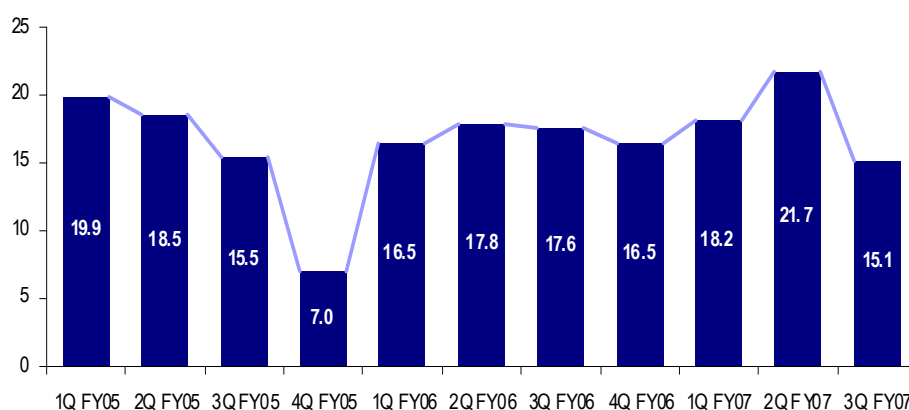
Y/E March	2004	2005	2006	2007E	2008E
Net Sales	11,962	12,430	14,545	17,755	21,410
EBITDA	2,229	2,079	2,562	3,402	4,231
EBITDA (%)	18.6	16.7	17.6	19.2	19.8
Net Profit (adj)	1,393	1,285	1,631	2,259	2,965
EPS (Rs)	11.1	10.2	13.0	18.0	23.6
EPS Growth (%)	50.4	(7.7)	26.9	38.5	31.2
ROCE (%)	19.2	17.6	19.8	23.0	25.5
ROE (%)	26.4	21.5	24.1	28.4	30.4
PE (x)	32.4	35.1	27.7	20.0	15.2
Price/Book Value (x)	1.0	1.0	1.0	1.2	1.4
EV/EBITDA (x)	21.8	23.0	19.0	14.4	11.3

Source: Company, ASK Raymond James. Note: Valuations as of 22 January 2007.

Please see important disclaimer at the end of the report.

- French subsidiary to break-even by FY08E:** Alpharma reported 188% YoY growth in sales at Rs542 mn in 3Q FY07 driven by higher off take from pharmacies owing to reduction in rebate by 5% from January 2007. In addition, launch of Pravastatin (as AZ-EUR 2 mn sales) and other new launches also helped post strong growth during the quarter. The company improved its market share to 1.6% (from 0.3% earlier) and expects to garner 2.6% market share going forward. The company reported marginal loss of Rs16 mn in 3Q FY07 lower than Rs45 mn in 3Q FY06. The management indicated that the French subsidiary would break-even by FY08E.
- Shifting base to India to reduce cost:** The company has received four site variation approvals, of which two have been shifted to India. The company plans to shift around 60% of its products to India for manufacturing in order to reduce costs. These initiatives would help Cadila Healthcare to turnaround its French subsidiary by FY08 from losses of Rs238 mn incurred in FY06.
- Slower growth in domestic formulations:** The company recorded 6% YoY growth at Rs2.58 bn in total domestic formulations business in 3Q FY07. The slower growth was led by decline in domestic generics formulations portfolio and Rs70 mn loss in Tamil Nadu due to VAT related issues. We believe domestic formulations would track the industry growth going forward.
- EBITDA margin hit by R&D expenses and lower Altana revenues:** Cadila witnessed 251 bps decline in EBITDA margin at 15.1% during 3Q FY07 (see Exhibit 2) led by 85% YoY increase in R&D expenses at Rs294 mn and lower contribution from Altana. R&D expenses (6.4% of net sales) grew 18% YoY at Rs874 mn in 9M FY07. We expect margins trend to remain volatile on QoQ basis depending upon the business mix and cost structure but we expect the trend of 100-200 bps improvement in margin on YoY basis to continue.

Exhibit 2: Trend in EBITDA margin (%)



Source: Company data, ASK Raymond James.

- Maintain Buy with target price of Rs450:** The stock trades at 20.0x FY07E earnings and 15.2x FY08E earnings and trades at 14.4x FY07E EV/EBITDA and 11.3x FY08E EV/EBITDA. We maintain our Buy rating on the stock with a target price of Rs450 (14x FY08E EV/EBITDA).

Exhibit 3: Quarterly financials (Consolidated)**(Rs mn)**

Y/E March	3Q FY07	3Q FY06	% chg	9M FY07	9M FY06	% chg
Gross sales	4,815	3,869	24.5	14,272	11,576	23.3
Excise	206	174	18.4	629	488	28.9
Net sales	4,609	3,695	24.7	13,643	11,088	23.0
EBITDA	695	650	6.9	2,501	1,917	30.5
EBITDA (%)	15.1	17.6		18.3	17.3	
Other Income	115	127	(9.4)	290	341	(15.0)
Interest	49	103	(52.4)	172	215	(20.0)
Depreciation	212	214	(0.9)	622	585	6.3
PBT	549	460	19.3	1,997	1,458	37.0
Tax	85	49	73.5	251	167	50.3
PAT (Adj)	464	405	14.5	1,843	1,276	44.4
Extraordinary	196	(14)	(1500.0)	245	(89)	(375.3)
PAT (reported)	660	396	66.7	2,006	1,217	64.8
EPS (Rs)	3.7	3.2	14.5	14.7	10.2	44.4

Source: Company data, ASK Raymond James.

Exhibit 4: Sales break-up (Consolidated)**(Rs mn)**

Y/E March	3Q FY07	3Q FY06	% chg	9M FY07	9M FY06	% chg
Domes tic	3,138	2,868	9.4	9,912	9,062	9.4
Formulations	2,580	2,430	6.2	8,301	7,815	6.2
APIs	82	139	(41.0)	294	374	(21.4)
OTC/Others	476	299	59.2	1,317	873	50.9
Exports	1,677	1,001	67.5	4,361	2,513	73.5
Formulations	1,212	591	105.1	2,762	1,322	108.9
APIs	465	410	13.4	1,599	1,191	34.3
Total	4,815	3,869	24.5	14,273	11,575	23.3

Source: Company data, ASK Raymond James.

Exhibit 5: Subsidiaries performance**(Rs mn)**

Y/E March	Sales			Net Profit		
	3Q FY07	3Q FY06	% chg	3Q FY07	3Q FY06	% chg
Altana (50% share)	96	155	(38.1)	73	113	(35.4)
Alpharma	54.2	188	188.3	(16)	(45)	
Ambalal Sarabhai	111	105	5.7	17	11	54.5
US generics	38.6	188	105.3	(3)	1	(400.0)
Total sales	1135	636	78.5	71	80	(11.3)

Source: Company data, ASK Raymond James.

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