

Stock borrowing: n/a

Volatility (30-day): 29.89%

Volatility (6-month trend): ↑

52-week range: 280.35-178.00

Sensex: 14228.88

BBG AP Pharm & Biotech: 170.62

Source: ABN AMRO, Bloomberg

Results and guidance disappoint

We cut our 2008F earnings by 20% for Cipla on significantly lower-than-expected 4Q07 profit. Management guidance also looks very conservative at 10-12% top-line and bottom-line growth. We downgrade to Hold and reduce our target price to Rs213.

Key forecasts

	FY05A	FY06A	FY07F	FY08F	FY09F
Revenue (Rsm)	22226.8	29443.1	35146.5	42245.3	48867.7
EBITDA (Rsm)	4634.8	6321.9	7652.4▼	7797.8▼	9308.4▼
Reported net profit (Rsm)	4096.1	6076.6	6609.2▼	7080.2▼	8315.0▼
Normalised net profit (Rsm) ¹	4096.1	6076.6	6609.2	7080.2	8315.0
Normalised EPS (Rs)	5.46	8.11	8.51▼	9.12▼	10.7▼
Dividend per share (Rs)	1.40	2.07	2.26▼	2.42▼	2.84▼
Dividend yield (%)	0.64	0.96	1.04	1.11	1.31
Normalised PE (x)	39.7	26.8	25.5▼	23.8▲	20.3▲
EV/EBITDA (x)	36.8	27.3	21.8	21.6	17.7
Price/book value (x)	10.5	8.21	5.24	4.54	3.92
ROIC (%)	16.8	19.2	16.7	13.5	13.3

1. Post-goodwill amortisation and pre-exceptional items

Accounting Standard: Local GAAP

Source: Company data, ABN AMRO forecasts

year to Mar, fully diluted

4Q07 performance disappoints

Cipla's 4Q07 (March year-end) net profit fell a sharp 26% yoy, vs our 5% decline forecast. The disappointing performance was due mainly to sales being skewed towards more low-margin anti-retrovirals (ARVs) and due to increasing competitive pressure in the US market. Sales grew only 6% yoy to Rs9.2bn. The company's 4Q07 EBITDA margin declined 460bp to 15%, the lowest in the past 16 quarters. The company ended the year with a net profit of Rs6.6bn and reported EPS of Rs8.8.

Guidance looks very conservative

Management says Cipla should be able to deliver 10-12% yoy top-line and bottom-line growth. It also expects EBITDA margin to be sustained at 15% levels. The company appears to be facing pressure in the US market. However, the contribution of the US to its overall profit is low at 10-15%, so it should have little impact on Cipla's profitability. We think the already-high share of ARVs will increase further, which may keep margins under pressure as evidenced by the 2Q07 results. Despite all this, we think the key profitability element for Cipla is its Indian business, which accounts for nearly 50% of its total sales, and should contribute positively in the upcoming quarters after a weak seasonality in 4Q. Overall, we think the 15% operating guidance is on the conservative side, but we accept the fact that the days of 20% operating margins are now over, at least in the near term.

Downward revisions to earnings and target price

We reduce our FY08 estimates considering the lower FY07 base and lower growth prospects. We expect Cipla to report net profit of Rs7,080m (7% yoy growth) and EPS of Rs9.1. The stock trades at 23.8x our FY08 estimates. We use a SOTP-based methodology to value the Indian generic companies, assigning higher value to the emerging geographies in Eastern Europe and India. In light of the above, we cut our target price for Cipla is Rs213 (from Rs284) and downgrade our rating to Hold (from Buy).

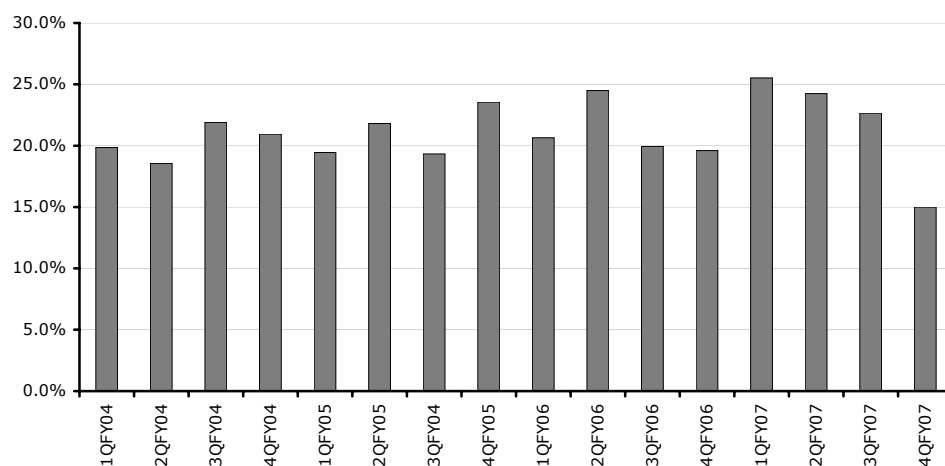
Priced at close of business 27 April 2007. Use of ▲▼ indicates that the line item has changed by at least 5%.

Table 1 : Cipla 4QFY07 results

Rs m	4QFY06	4QFY07	% yoy	Comment
Sales	8762	9291	6.0%	Growth marginally above expectations on higher ARV sales
Technical know-how	75	242	221.0%	
Excise	(250)	(220)		
Total revenues	8587	9313	8.5%	
COGS	(4738)	(5408)	14.1%	Higher COGS with product mix skewed towards low-margin ARVs
Gross profit	3848	3904	1.5%	
Other expenditure	(2165)	(2507)	15.8%	Higher-than-expected other expenditure, as overheads increase
EBITDA	1684	1398	-17.0%	EBITDA margin fell 460bp yoy
Depreciation	(250)	(261)	4.3%	
Other income	390	292	-25.2%	
Interest	(33)	(13)	-60.8%	
PBT	1791	1416	-20.9%	
Tax	(80)	(160)	99.4%	
Net income	1711	1256	-26.6%	
Extraordinary	197			
Margins				
Gross margin	44.8%	41.9%		
EBITDA margin	19.6%	15.0%	4.6%	Management guides EBITDA margin will be sustained at around 15%
NPM	19.9%	13.5%		
Sales				
Domestic	3495	3997	14.4%	
Exports	5266	5293	0.5%	
Formulations	3320	3879	16.8%	
API	1946	1415	-27.3%	
COGS				
Inc/dec in materials	142	(285)	-301.0%	
Raw material	(4454)	(4690)	5.3%	
as % of sales	-52.3%	-54.8%		
Staff cost	(426)	(433)	1.8%	
as % of sales	-5.0%	-4.8%		
COGS as % of sales	-55.7%	-59.6%		
Excise as % of sales	-2.9%	-2.4%		
Other expense growth			15.8%	
Tax rate	-4.5%	-11.3%		
EPS (Rs)	2.3	1.7		

Source: Company data, ABN AMRO

Chart 1 : Cipla EBITDA margin trend



Source: Company data, ABN AMRO

Table 2 : Management guidance

Rsm	FY07A	Implied	Guidance comments	ABN	Our assumptions
		FY08F		FY08F	
Sales	3,5147	3,9365	Guides 12% growth	42,245	20% revenue growth
EBITDA	7,652	5,905	15% operating margin guidance implies a 22% decline	7798	18.5% EBITDA margin, or 1.9% growth
Net profit	6,609	5,078	Implied net profit decline of 20% seems at odds with bottom-growth guidance of 10-12%	7080	7% net profit growth

Source: Company guidance, ABN AMRO forecasts

Company guidance implies a net profit decline for FY08, rather than 10-12% growth; we believe revenue growth will be marginally lower than FY07, while operating margin may be around 18%

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CIPLA: KEY FINANCIAL DATA

Income statement

Rsm	FY05A	FY06A	FY07F	FY08F	FY09F
Revenue	22226.8	29443.1	35146.5	42245.3	48867.7
Cost of sales	-17592	-23121	-27494	-34447	-39559
Operating costs	n/a	n/a	n/a	n/a	n/a
EBITDA	4634.8	6321.9	7652.4	7797.8	9308.4
DDA & Impairment (ex gw)	-550.5	-801.8	-1040.8	-1104.2	-1300.0
EBITA	4084.3	5520.1	6611.6	6693.7	8008.4
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
EBIT	4084.3	5520.1	6611.6	6693.7	8008.4
Net interest	-76.3	-114.2	-69.6	-67.2	-29.7
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	1138.2	1692.7	1467.2	1703.2	1803.7
Reported PTP	5146.1	7098.6	8009.2	8329.7	9782.4
Taxation	-1050.0	-1022.0	-1400.0	-1249.4	-1467.4
Minority interests	n/a	n/a	n/a	n/a	n/a
Exceptionals (post-tax)	0.00	0.00	0.00	0.00	0.00
Other post-tax items	0.00	0.00	0.00	0.00	0.00
Reported net profit	4096.1	6076.6	6609.2	7080.2	8315.0
Normalised Items Excl. GW	0.00	0.00	0.00	0.00	0.00
Normalised net profit	4096.1	6076.6	6609.2	7080.2	8315.0

Source: Company data, ABN AMRO forecasts

year to Mar

Balance sheet

Rsm	FY05A	FY06A	FY07F	FY08F	FY09F
Cash & market secs (1)	112.0	444.8	6347.3	3187.8	4993.0
Other current assets	17378.5	22478.0	26696.7	32677.2	37698.8
Tangible fixed assets	8448.7	11436.2	14411.2	17307.0	17007.0
Intang assets (incl gw)	n/a	n/a	n/a	n/a	n/a
Oth non-curr assets	183.0	224.3	250.0	300.0	325.0
Total assets	26122.3	34583.3	47705.2	53472.1	60023.9
Short term debt (2)	n/a	n/a	n/a	n/a	n/a
Trade & oth current liab	7784.4	9082.0	9976.4	12149.3	14115.8
Long term debt (3)	1912.0	4689.1	4189.1	2689.1	1189.1
Oth non-current liab	889.5	979.5	1381.5	1460.6	1656.5
Total liabilities	10585.8	14750.6	15547.0	16299.0	16961.4
Total equity (incl min)	15536.3	19832.9	32158.2	37173.0	43062.5
Total liab & sh equity	26122.1	34583.5	47705.2	53472.1	60023.9
Net debt (2+3-1)	1800.0	4244.3	-2158.2	-498.7	-3803.9

Source: Company data, ABN AMRO forecasts

year ended Mar

Cash flow statement

Rsm	FY05A	FY06A	FY07F	FY08F	FY09F
EBITDA	4634.8	6321.9	7652.4	7797.8	9308.4
Change in working capital	-2272.0	-4377.8	-3479.6	-3945.1	-3415.3
Net interest (pd) / rec	1061.8	1578.5	1397.6	1636.0	1774.0
Taxes paid	-1050.0	-1022.0	-1400.0	-1249.4	-1467.4
Other oper cash items	-8.40	-183.8	-15.8	0.00	0.00
Cash flow from ops (1)	2366.2	2316.9	4154.6	4239.3	6199.8
Capex (2)	-2458.8	-3800.0	-4000.0	-4000.0	-1000.0
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	1121.1	148.3	-25.7	-50.0	-25.0
Cash flow from invest (3)	-1337.6	-3651.8	-4025.7	-4050.0	-1025.0
Incr / (decr) in equity	0.02	0.02	7644.0	0.00	0.00
Incr / (decr) in debt	-193.8	2777.1	-500.0	-1500.0	-1500.0
Ordinary dividend paid	-1014.8	-1199.1	-1772.6	-1928.0	-2065.4
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	230.0	90.0	402.0	79.2	195.8
Cash flow from fin (5)	-978.7	1668.1	5773.4	-3348.8	-3369.5
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Inc/(decr) cash (1+3+5+6)	49.9	333.2	5902.3	-3159.5	1805.2
Equity FCF (1+2+4)	-92.6	-1483.2	154.6	239.3	5199.8

Lines in bold can be derived from the immediately preceding lines.

Source: Company data, ABN AMRO forecasts

year to Mar

CIPLA: PERFORMANCE AND VALUATION

Standard ratios	Cipla					Lupin Ltd			Wockhardt		
Performance	FY05A	FY06A	FY07F	FY08F	FY09F	FY07F	FY08F	FY09F	FY06F	FY07F	FY08F
Sales growth (%)	18.4	32.8	18.7	20.3	15.8	17.0	28.2	-1.22	21.8	31.9	15.0
EBITDA growth (%)	18.0	36.4	21.0	1.90	19.4	22.8	67.7	-16.6	11.3	28.8	17.9
EBIT growth (%)	15.8	35.2	19.8	1.24	19.6	25.0	77.0	-22.0	8.44	31.3	19.7
Normalised EPS growth (%)	29.5	48.3	4.99	7.13	17.4	27.5	63.4	-4.38	-2.96	21.7	23.8
EBITDA margin (%)	21.2	21.8	22.3	18.9	19.4	13.8	18.1	15.3	21.3	20.8	21.3
EBIT margin (%)	18.7	19.1	19.2	16.2	16.7	11.5	15.9	12.6	18.0	18.0	18.7
Net profit margin (%)	18.8	21.0	19.2	17.1	17.4	11.1	14.2	13.7	14.5	13.4	14.4
Return on avg assets (%)	17.2	20.3	16.2	14.1	14.7	9.04	13.5	11.0	10.6	11.5	12.1
Return on avg equity (%)	29.1	34.4	25.4	20.4	20.7	31.0	37.7	27.4	25.6	23.0	21.7
ROIC (%)	16.8	19.2	16.7	13.5	13.3	12.7	20.4	14.3	20.0	21.9	22.7
ROIC - WACC (%)	6.43	8.75	4.51	1.31	1.10	0.56	8.26	2.16	8.49	10.4	11.2
				<i>year to Mar</i>			<i>year to Mar</i>			<i>year to Dec</i>	
Valuation											
EV/sales (x)	7.81	5.97	4.84	4.07	3.44	3.35	2.55	2.44	3.01	2.20	1.79
EV/EBITDA (x)	36.8	27.3	21.8	21.6	17.7	24.2	14.1	16.0	14.2	10.6	8.38
EV/EBITDA @ tgt price (x)	36.1	26.8	21.3	21.2	17.4	23.7	13.8	15.7	14.1	10.6	8.35
EV/EBIT (x)	41.7	31.3	25.2	25.1	20.6	29.1	16.0	19.5	16.7	12.3	9.56
EV/invested capital (x)	9.35	6.90	5.30	4.41	4.03	5.17	4.53	4.45	4.28	3.58	3.08
Price/book value (x)	10.5	8.21	5.24	4.54	3.92	7.80	5.61	4.46	4.50	3.39	2.60
Equity FCF yield (%)	-0.06	-0.91	0.09	0.14	3.08	1.53	3.47	6.28	0.90	2.32	4.95
Normalised PE (x)	39.7	26.8	25.5	23.8	20.3	28.3	17.3	18.1	20.5	16.8	13.6
Norm PE @tgt price (x)	39.0	26.3	25.0	23.4	19.9	27.8	17.0	17.8	20.4	16.8	13.5
Dividend yield (%)	0.64	0.96	1.04	1.11	1.31	0.66	0.75	0.88	1.17	1.17	1.40
				<i>year to Mar</i>			<i>year to Mar</i>			<i>year to Dec</i>	
Per share data	FY05A	FY06A	FY07F	FY08F	FY09F	Solvency	FY05A	FY06A	FY07F	FY08F	FY09F
Tot adj dil sh, ave (m)	749.7	749.7	776.7	776.7	776.7	Net debt to equity (%)	11.6	21.4	-6.71	-1.34	-8.83
Reported EPS (INR)	5.46	8.11	8.51	9.12	10.7	Net debt to tot ass (%)	6.89	12.3	-4.52	-0.93	-6.34
Normalised EPS (INR)	5.46	8.11	8.51	9.12	10.7	Net debt to EBITDA	0.39	0.67	-0.28	-0.06	-0.41
Dividend per share (INR)	1.40	2.07	2.26	2.42	2.84	Current ratio (x)	2.25	2.52	3.31	2.95	3.02
Equity FCF per share (INR)	-0.12	-1.98	0.20	0.31	6.70	Operating CF int cov (x)	-2.22	-1.12	-2.97	-2.35	-3.32
Book value per sh (INR)	20.7	26.5	41.4	47.9	55.4	Dividend cover (x)	3.90	3.91	3.91	3.91	3.91
				<i>year to Mar</i>						<i>year to Mar</i>	

Priced as follows: CIPL.BO - Rs217.10; LUPN.BO - Rs709.10; WCKH.BO - Rs429.15
Source: Company data, ABN AMRO forecasts

CIPLA: VALUATION METHODOLOGY

We assign a higher valuation to the 'branded formulations' business of Indian generic companies than to the 'commoditised generics' business in the US, the UK and some parts of EU. We assign only 16x PE to Cipla's ARV business, given strong competition and a declining price trend for first-line ARV therapies (see our report, *Distancing from the US*, dated 12 January 2007, for further details on valuation).

Table 3 : SOTP valuation, based on 2008F numbers

Business (Rs m)	Export - formulations	ARVs	Export - Bulk	Domestic
Sales	142	215	161	492
Net profit	11	13	6	138
Net revenue from segments	1,010			
Net profit from segments	169			
	Value (Rsm)	PER	Implied P/sales	
Export formulations at blended PER of 18x	204	18	1.4	
ARVs at PE of 16x	207	16	1.0	
Export bulk at PE of 13x	84	13	0.5	
Total ex-India formulations value	494			
Current market cap	4,623			
Implied india formulations value	4,129			
Implied India formulations PE	30			
TARGET PRICE (Rs)	213			

Source: ABN AMRO estimates

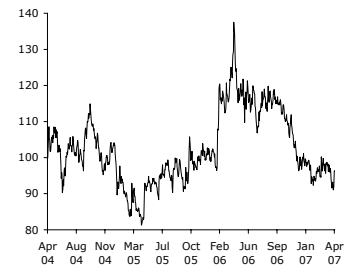
Cipla

Company description

Cipla is one of the premier Indian pharmaceutical companies. It is headed by Dr Hamied, who owns 41% of the company and is the driving force behind its success. Cipla has strong R&D capabilities and supplies bulk drugs and formulations to a number of generic companies in Europe and the US. It is well known for its different drug-delivery capabilities in anti-asthma research.

Hold

Price relative to country



Strategic analysis

Average SWOT company score: 3

Revenue breakdown, FY08F

Strengths

Wide range of products with strength in anti-infective and anti-asthma franchise. Strong research and development. **4**

Weaknesses

Management depth. No initiative as yet to increase its presence in the advanced markets. Succession an issue. **2**

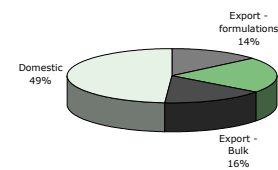
Opportunities

The huge US market for generics, the South African AIDS market and the anti-asthma market in Europe. **4**

Threats

Increasing competition from other players. A lot of smaller companies are emerging with business models similar to Cipla's. Pressure on margins is likely. **3**

Scoring range is 1-5 (high score is good)



Source: ABN AMRO forecasts

Market data

Headquarters
Mumbai Central, Mumbai-400 008. India.
Website
www.cipla.com
Shares in issue
776.7m
Freefloat
59%
Majority shareholders
Dr. Hamied & associates (40%)

India

Country view

Neutral

Country rel to Asia Pacific

The market looks expensive, but we believe it will remain supportive when regional funds seek a domestically-driven home with continuing robust earnings growth. The ABN AMRO Indian PMI suggests the economy is still powering ahead despite the global headwinds, thanks to its domestically-oriented economic structure. At the sector level, we still like autos, software and construction-related stocks.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.



Competitive position

Average competitive score: 2+

Broker recommendations

Supplier power

Fully backward integrated. Strength in R&D helps produce complex products in the anti-asthma range. **3+**

Barriers to entry

Historically, Cipla's research in asthma and anti-infective products has been strong. Its drug-delivery technology in anti-asthma products is difficult to replicate, in our view. **3+**

Customer power

Customers have a wide range of products to choose from, given the stiff competition in the anti-infective segment in the domestic market. **2-**

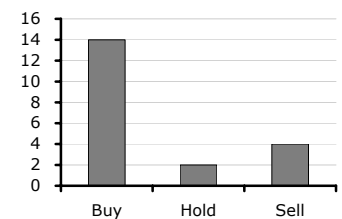
Substitute products

Some therapeutic groups like anti-histamines, antibiotics and pain-management products are substitutable. However, Cipla's different technology in asthma means it has pricing power. **2+**

Rivalry

Intense competition from various players, mainly in the domestic market. Some of these companies compete with Cipla overseas as well. **2-**

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse



Source: Bloomberg