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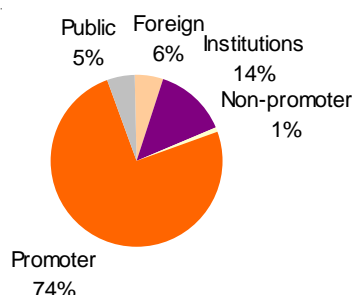
Cadila Healthcare

Emerging Star
Stock Update
Price target revised to Rs780
Buy; CMP: Rs663

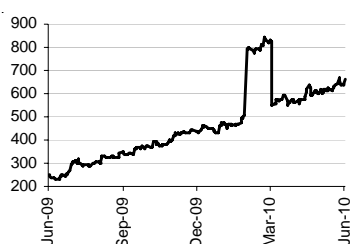
Company details

Price target:	Rs780
Market cap:	Rs13,580 cr
52 week high/low:	Rs679/223
NSE volume: (No of shares)	34,358
BSE code:	532321
NSE code:	CADILAH
Sharekhan code:	CADILAHEAL
Free float: (No of shares)	3.4 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.8	18.1	48.4	147.6
Relative to Sensex	4.1	18.5	46.1	105.6

Key points

- Increasing Para IV filings:** Cadila Healthcare (Cadila)'s recent Para IV filing of Lialda could lead to an incremental earnings per share (EPS) of Rs6-7 upon the launch (patent expiry in 2020) whereas the recently-approved Anastrozole (a breast cancer drug with shared exclusivity) would fetch in a decent Rs2-3 for the same. We think the market is yet to factor in the company's potential abbreviated new drug application (ANDA) pipeline (95 filed ANDAs, 50 approved and 27 launched). The company has already filed for four aerosols and 11 parenterals till date and plans to file 12-15 ANDAs every year. Besides this, the company has also received a nod from the Drug Controller General of India (DCGI) for conducting phase I clinical trials for its oral anti-diabetic molecule, Glucagon.
- H1N1 to add spruce to vaccines portfolio:** Cadila has recently received the approval from DCGI to market its H1N1 vaccine in India. The company has priced VaxiFlu-S at Rs350/dose, translating into a potential market opportunity of around Rs1,700-1,800 crore. The addition of flu vaccine would spruce up the company's current vaccine portfolio of anti-rabies and anti-typhoid vaccines.
- Strategic deal with Abbott to boost branded generic segment:** The licensing deal with Abbott for a portfolio of 24 products in 15 emerging markets such as Russia, Turkey and Brazil paves way for Cadila to achieve its sales target of \$3 billion by 2015. Cadila received US\$10 million from Abbott as upfront milestone payment and the deal is expected to contribute from FY2012 onwards. We remain positive on the management's ability to strike lucrative deals to boost its branded generic business.
- Visible growth acceleration over the next 2-3 years:** Cadila is in accelerated growth phase over the next two-three years, driven by incremental contribution from Hospira joint venture (compounded annual growth of [CAGR] of 32% over FY2010-12E) besides the robust US business (CAGR of 18%), strong Brazil (CAGR of 16%) and RoW markets (CAGR of 22%), and consumer division business (CAGR of 24%) in addition to reinvigorated domestic formulation sales (CAGR of 15%), which would result in a top line CAGR of 16% over FY2010-12E.

Valuation table

Particulars	FY2008	FY2009	FY2010	FY2011E	FY2012E
Net sales (Rs cr)	2324.5	2927.5	3686.9	4253.9	4922.8
Adj. net profit (Rs cr)	261.4	327.1	534.5	590.9	707.2
Shares in issue (cr)	20.5	20.5	20.5	20.5	20.5
EPS (Rs)	12.8	16.0	26.1	28.9	34.5
PER (x)	52.0	41.5	25.4	23.0	19.2
EV/EBITDA (x)	31.2	24.1	18.0	15.2	12.8
Book value (Rs/share)	51.9	60.3	81.1	105.8	134.5
P/BV (x)	12.8	11.0	8.2	6.3	4.9
Mcap/sales	5.8	4.6	3.7	3.2	2.8
RoCE (%)	17.8	19.7	23.8	23.7	24.1
RoNW(%)	24.6	26.5	32.2	27.3	25.7

- ♦ **Maintain Buy with a revised price target of Rs780:** Backed by the licensing deal, the monetisation of its strong research and development (R&D) pipeline and the early success in trans-dermal and oncology segments would act as a trigger going forward. Given the company's strong potential ANDA pipeline we have worked out the value of the stock on a sum of the parts (SOTP) valuation. We value Cadila's base business at 18x FY2012 EPS (Rs622 per share) while adding 50% probability (arrived through NPV method; Rs158) to the successful monetisation of its R&D and ANDA pipeline. Hence we arrive at our revised price target of Rs780 and maintain our Buy recommendation on the stock.

USFDA approval for breast cancer drug

Cadila has received the US Food and Drug Administration (USFDA)'s approval for marketing Anastrozole tablets in the USA. The sale of the tablets as per NDC Health was estimated at \$1.1 billion. Anastrozole is used for the treatment of breast cancer. The patent for the product expired on June 27, 2010. However on the positive side, the exclusivity for the product stays from December 2011 to June 2012. Given the lower competition(with only three other players: Dr Reddy's Laboratories, Teva, Natco) we value the drug on 80% price erosion and 15% market share, resulting in an incremental EPS of Rs2.8 upon the launch of the same.

Expect more Para IV and niche ANDA filings

With critical mass having been achieved, Cadila has now begun focusing on filing Para IV and niche ANDAs to move up the value chain and maintain the strong growth momentum. It has recently filed Para IV for generic Lialda (Mesalamine) used to treat ulcerative colitis. The patent for the drug expires in June 2020. The drug has ~US\$235 million in annual revenues in the USA, growing at the rate of 20% per annum. This would make it a sizeable

product over the next three to four years when Cadila may be able to launch the product in the USA. The potential upside to Cadila could be US\$50 million in revenues and ~US\$20 million in profits during the 180-day exclusivity.

We have attempted to value Cadila's potential ANDA pipeline using the NPV methodology, which leads us to a value of Rs314 per share. Given the uncertainty over the launch of the products as well the risk associated with the R&D pipeline we add a 50% success probability to the same.

Potential R&D pipeline

Cadila has a large pipeline of seven vaccines under development, which could be introduced over the next two to three years, in addition to the collaborative research partnerships with Eli Lilly, Karo Bio and Prolong. We expect the pipeline monetisation to happen over the next 18-24 months. We think the market is yet to factor in the potential ANDA pipeline (Cadila has 95 filed ANDAs, 50 approved and 27 launched). The company has already filed for four aerosols and 11 parenterals till date and plans to file 12-15 ANDAs per annum.

Besides this, the company has also received a nod from DCGI to conduct phase I clinical trials for its oral anti-diabetic molecule, Glucagon.

H1N1 vaccine to add spruce to vaccine portfolio

Cadila has recently received an approval from DGCI to market its H1N1 vaccine in India. The company would market the vaccine under the brand name, VaxiFlu-S. As per industry sources, global sales of influenza vaccine in CY2009 were ~US\$1.8 billion. Reportedly, the demand for H1N1 vaccine in India is estimated to touch 50-60 million doses in the initial phase. It has the capacity to produce up to 80 million dosages per annum. Cadila has priced

Potential opportunities

Branded drug	Sales (\$ mn)	Innovator company	Indication	Patent expiry
Cozaar	3,558	Merck	Diabetic Nephropathies	2010
Caduet	589	Pfizer Inc	Variant Angina, Pectoris	2010
Adalat Cc	916	Bayer	Diabetic Nephropathies	2010
Aricept	2,545	Eisai	Alzheimer Disease	2010
Actos	3,465	Takeda	Gestational Diabetes	2011
Femara	1,129	Novartis AG	Breast Neoplasms	2011
Lipitor	8,500	Pfizer	Myocardial Infarction	2011
Zyprexa	4,696	Eli Lilly	Catalepsy, Dementia	2011
Plavix	5,603	Bristol-Myers Squibb	Transient Ischemic attack	2011
Lexapro	2,292	Forest Laboratories	Anxiety, Depression	2012
Celebrex	2,489	Pfizer	Adenoma, Nasopharyngeal	2014
Nexium	5,200	Astra Zeneca	Barrett Esophagus	2014

VaxiFlu-S at Rs350/dose, translating into a potential market opportunity of ~Rs1,700-1,800 crore. The other companies in the follow-up are Panacea Biotec and Bharat Biotec (filed for H1N1 vaccine in India), which are yet to launch the drug. Thus the addition of flu vaccine would spruce up Cadila's current vaccine portfolio of anti-rabies and anti-typhoid vaccines.

Strategic deal with Abbott resulting in a milestone payment of \$10 million

Recently, Cadila and Abbott announced a licensing and supply agreement for a portfolio of 24 products, including medicines to treat pain, cancer and heart disease, which Abbott will commercialise in 15 emerging markets such as Russia, Turkey and Brazil. The agreement also includes an option for further addition of more than 40 products. The sales are expected to start from early FY2012.

Cadila received US\$10 million from Abbott as upfront milestone payment. We remain positive on the management's ability to strike a lucrative deal for branded generic business. Cadila will be entitled for a share in the revenue/profit in addition to the milestone payment.

Valuation and view

Cadila has created multiple growth platforms to ensure a steady growth over the medium to long term. We view the emerging markets like Brazil, France and South Africa to drive the uptrend in its growth.

With a steady working capital situation, comfortable debt/equity ratio (to go down from 0.7x in FY2010 to 0.3x by FY2012), steady return ratios (RoE --25%+ over the next two years) and expansion in facilities to cater to newer markets (focused approach), the management guides for continuation of this trend. Further, backed by the licensing deal, the monetisation of its strong R&D pipeline and the early success in trans-dermal and oncology segments would act as a trigger going forward.

At the current market price of Rs663, the stock is available at valuations of 23x FY2011E and 19.2x FY2012E estimated earnings. Given Cadila's strong potential Para IV pipeline we value the stock on a SOTP valuation. We thus value Cadila's base business at 18x while adding 50% probability to the successful monetisation of its R&D and ANDA pipeline. Hence we arrive at a revised price target of Rs780 and maintain our Buy recommendation on the stock.

The author doesn't hold any investment in any of the companies mentioned in the article.

Sharekhan Special

Q1FY2011 Auto earnings preview

Key points

- ♦ **Strong volume growth continues:** Automobile (auto) sales continued to post robust volumes in Q1FY2011, with the sector witnessing a strong 32.1% year-on-year (y-o-y) growth in the first two months of the quarter. The growth was achieved on account of a strong demand environment, a low base, incremental volumes of the new launches and the occurrence of the marriage season in May this year.
- ♦ **Healthy demand leads to better pricing power:** The strong demand environment in the sector has led to a better pricing power for the automobile companies, which have not shied away from hiking product prices. After the excise duty roll-back and sharp increase in the commodity prices, the automakers hiked the prices of their products by 4-5% during the quarter to protect their margins.

Thus, we expect the Q1FY2011 results to be good and be driven by volume growth. Consequently, we expect the Sharekhan automobile universe to report sales growth and net profit growth of 35.6% and 29.4% respectively for the quarter.

- ♦ **Outlook:** However, we believe the volume growth is likely to taper down going forward on account of the following: (a) The high base effect that will kick in by the end of H1FY2011; (b) the expectations of rising interest rates due to inflationary pressure; and (c) the impact of the price increases taken by the automakers and the fuel price hikes in the country. Furthermore, the margins are also likely to be lower year on year (yoy) on account of a sharp increase in the raw material prices on a y-o-y basis; all these remain the key challenges going ahead for the sector. However, the anticipation of a normal monsoon in the country is likely

to be a comforting factor in terms of volume growth for the major companies like Mahindra and Mahindra (M&M) and Maruti Suzuki.

Consequently, we believe that the bottom line growth of automobile companies is likely to slow down considerably in FY2011 on account of the factors mentioned above. Moreover, any negative surprise in the sector that could hinder the volume growth momentum remains a key risk, especially considering the current valuation of the automobile companies.

Key things to watch out for in Q1FY2011

Volume growth momentum continues

The sector has seen an impressive volume growth so far, with a strong demand across segments and the success of the new launches in the market. For the first two months of Q1FY2011 the sector posted a robust volume growth of 32.1% yoy.

Top line driven by healthy volumes

We expect the Sharekhan automobile universe to report a top line growth of 35.6% yoy on account of a handsome 44.5% y-o-y growth in the volumes.

Company	Net sales (Rs cr)			Volume estimates (in lakh)		
	Q1 FY11E	Q1 FY10	% yoy	Q1 FY11E	Q1 FY10	% yoy
Maruti Suzuki	8798.1	6364.7	38.2	2.94	2.26	29.8
Bajaj Auto	3920.9	2338.5	67.7	9.23	5.48	68.5
M&M	5346.1	4242.6	26.0	1.30	1.02	26.8
Apollo Tyres*	1126.3	1180.1	-4.6	0.67	0.79	-15.2
Subros	266.6	209.9	27.0	2.15	1.72	25.2
Greaves Cotton#	340.3	262.5	29.6	-	-	-
Sharekhan Auto Universe	19798.3	14598.3	35.6	16.28	11.27	44.5

*Stand-alone numbers

June ending company

Margins likely to contract

Although the prices of the key raw materials, such as steel, aluminium and natural rubber, are much higher as compared to that in Q1FY2010, we expect the margins to contract marginally by 23 basis points yoy, primarily due to the much higher scale of operations and the price increases undertaken by the companies. However, on a sequential basis, despite a 7% volume growth, the margins are expected to slide by 135 basis points on account of a higher raw material cost.

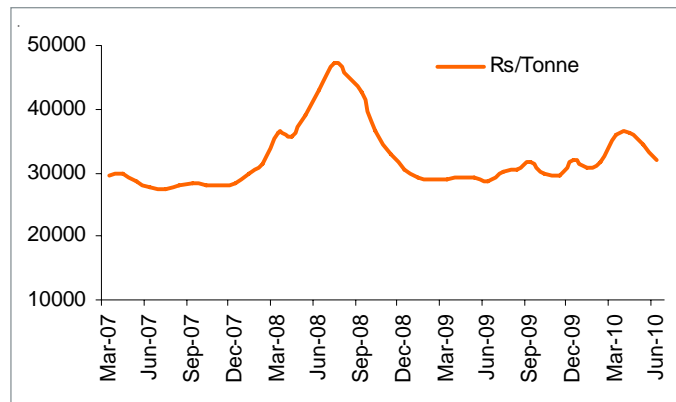
Thus, though the margins of the automobile companies under our coverage are expected to decline marginally on a y-o-y basis, we expect their bottom line to grow by 29.4% yoy, primarily driven by an expected volume growth of 44.5% yoy.

Company	OPM (%)			Adj. PAT (Rs cr)		
	Q1 FY11E	Q1 FY10	Chg in bps	Q1 FY11E	Q1 FY10	% yoy
Maruti Suzuki	10.7	10.4	20	715.5	583.5	22.6
Bajaj Auto	20.8	19.5	132	582.9	317.5	83.6
M&M	15.0	16.2	-123	536.3	459.0	16.9
Apollo Tyres*	8.5	16.5	-795	28.7	94.7	-69.7
Subros	9.9	8.7	113	9.2	3.3	180.3
Greaves Cotton#	15.3	9.4	587	30.2	12.6	140.5
Sharekhan Auto Universe	13.8	14.0	-23	1902.8	1470.5	29.4

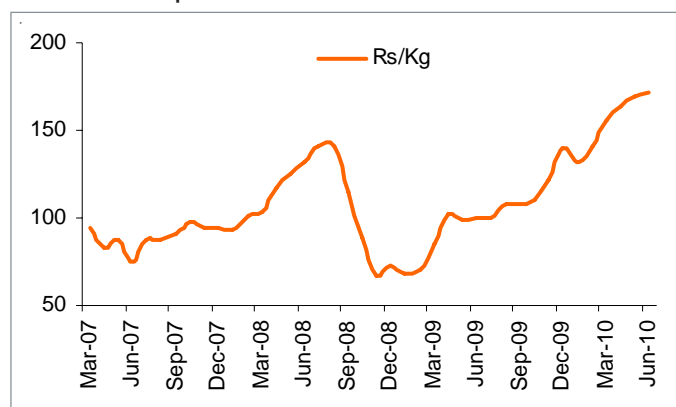
*Stand-alone numbers

June ending company

Steel prices



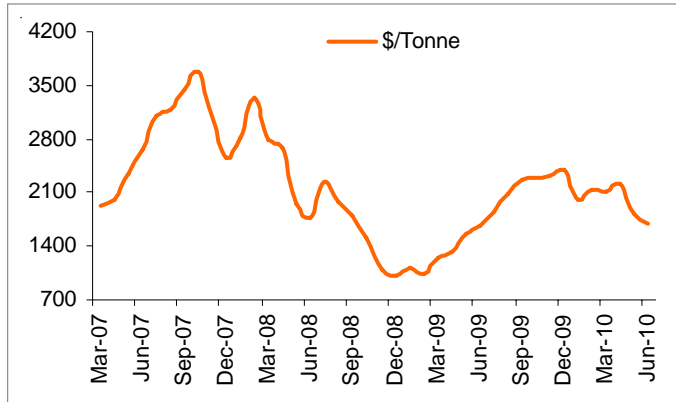
Natural rubber prices



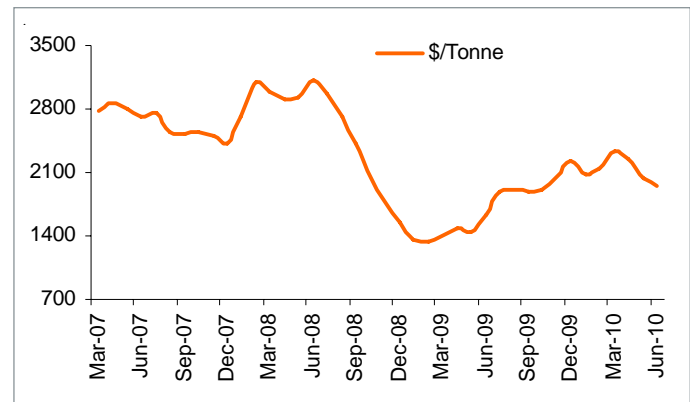
Raw material cost as percentage to sales (%)

Company	Q1FY11E	Q1FY10	Chg in bps (yoy)	Q4FY10	Chg in bps (qoq)	Comments
Maruti Suzuki	78.5	77.9	60.0	77.4	110.0	New steel contracts entered into in May 2010 likely to be at higher prices. The full impact of price hike given to tyre manufacturers in mid Q4FY2010 to be seen in Q1FY2011.
Bajaj Auto	70	66.2	384	69.3	74	Steel contracts entered into in April 2010 at higher prices on a sequential basis.
M&M	68.8	66.1	270	67.6	120	Prices of steel and tyre higher on a sequential basis.
Apollo Tyres	73.7	58.8	1490	67.8	590	Natural rubber prices have soared up to Rs179 a kg vs an average of Rs143 a kg in Q4FY2010. This is likely to affect the margins by 590 basis points on a sequential basis despite an increase in the tyre prices. Moreover, the loss of volumes on account of a lock-out at the Perambra plant likely to result in significant contraction in the margins.
Subros	74.5	76.9	-240	73.3	120	Higher volumes and better realisations yoy to mitigate the higher raw material prices.
Greaves Cotton	69.7	71.2	-150	69.2	50	Marginal increase in the raw material prices likely on a sequential basis.

Lead prices



Aluminium prices



Valuations

Company	CMP (Rs)	FY2011E	EPS (Rs)	FY2011E	PE (x)	FY2012E
	30-06-2010		FY2012E		FY2011E	
Maruti Suzuki	1424	94.1	105.2	15.1	13.5	
Bajaj Auto	2483	155.3	172.8	16.0	14.4	
M&M	625	40.5	45.0	15.4	13.9	
Apollo Tyres	65	9.4	10.2	6.9	6.4	
Subros	46	5.8	7.5	7.9	6.1	
Greaves Cotton	343	30.9	34.0	11.1	10.1	

Stand-alone numbers

*Consolidated numbers

The author doesn't hold any investment in any of the companies mentioned in the article.

Evergreen

Housing Development Finance Corporation
HDFC Bank
Infosys Technologies
Larsen & Toubro
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
Apollo Tyres
Bajaj Auto
Bajaj Finserv
Bajaj Holdings & Investment
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Emerging Star

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Cadila Healthcare
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Greaves Cotton
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