Pharmaceuticals | India

Cadila Healthcare CDH IN

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RESULTS FIRST LOOK

Cadila's 2QFY12 sales growth of 10.2% y-y was lower than our estimate (2% miss). India, Emerging markets, Consumer business and API disappointed, whereas US and Latin America exceeded expectations. Unlike at peers, the EBITDA margin was better than expected, recording a 50bps increase y-y adjusted for forex gain/loss. We expect a slowdown in the domestic business, and the FDA warning letter could remain an overhang for the stock near term. We are reviewing our estimates. Cadila has increased its debt for a near-term strategic investment, as per management.

Price target: 937.0 INR

Price (09 Nov 2011): 760.8 INR

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Publish Date: 10 Nov 2011

Net profit, adjusted for forex, better than expected

- **Earnings vs. our Forecast:** **IN LINE**

Likely Impact:

- **Earnings Estimates:** **NO CHANGE**
- **Dividend Estimates:** **NO CHANGE**
- **Price Target:** **NO CHANGE**
- **Long-term View:** **CONFIRMED**

Revenue disappoints

Overall sales growth of 10.2% y-y was lower than our estimate (2% miss). Sales growth in India, Emerging markets, Consumer business and API was disappointing. US and Latin America exceeded expectations.

Fig 1: Revenue mix review

Sales Mix (INR mn)	Q2FY12	Q1FY12	Q-Q %	Q2FY11	Y-Y%
Domestic	**6100**	**5946**	**2.6%**	**5675**	**7.5%**
Formulations	**4700**	**4574**	**2.7%**	**4409**	**6.6%**
Branded Formulations	4404	4328	1.8%	4140	6.4%
Generic Formulations	296	246	20.2%	269	10.0%
API	**68**	**66**	**3.0%**	**64**	**6.3%**
Consumer & Others	**1332**	**1306**	**2.0%**	**1202**	**10.8%**
Consumer Products	879	914	-3.8%	799	10.0%
Animal Health & Others	453	392	15.6%	403	12.5%
Exports	**5540**	**4816**	**15.0%**	**4803**	**15.3%**
Formulations	**4977**	**4136**	**20.3%**	**4002**	**24.4%**
North America (US)	3070	2393	28.3%	2258	36.0%
Europe	619	769	-19.5%	588	5.4%
Latin America	655	470	39.4%	584	12.2%
Japan	120	112	7.1%	98	21.9%
Emerging Markets	429	392	9.4%	474	-9.5%
Animal Health	84	0	n/a	0	n/a
API	**563**	**680**	**-17.3%**	**801**	**-29.8%**
Others	563	680	-17.3%	801	-29.8%

All JVs	**750**	**1127**	**-33.5%**	**735**	**2.0%**
Gross Sales	**12389**	**11889**	**4.2%**	**11213**	**10.5%**

Source: Company data, Nomura estimates

Domestic business revenue growth remained muted at 6.6% y-y. The branded generic business revenue growth – at 6.4% for Q2FY12 and 7.5% for H1FY12 – was below the average market growth rate. Besides the higher sales booked in Q4FY11, the slower sales growth is due to: a) overall market slowdown, particularly in the anti-infective segment, and b) slower growth in some of the larger molecules. The company expects to deliver double-digit growth for FY12 and expects a revival in 2HFY12. The company has launched 20 new products, taking the number of H1 launches to 40. In H2FY12, the company expects to step up new launches, with more than 40 launches scheduled in 3QFY12.

US growth remained strong despite no material launches in the recent past. Ex the Nesher acquisition, revenue growth was at 26% y-y in Q2FY12. Nesher was consolidated for two months during the quarter and contributed US$5m in revs, by our estimate. As per management, growth in the US was largely on account of volume increases and there were no material price rises. The company expects two additional launches in the US in 2HFY12. The Baddi formulation facility has now been approved by the US FDA, and additional product approvals are expected from the facility in the near term. Four ANDAs have been filed from the Baddi facility. We think some of the filings were transferred to Baddi from the Moraiya facility in view of the FDA warning letter.

Nesher currently has one product on the market and has annual sales of US$30m. The company expects two new approvals in FY13.

API export sales declined on price erosion and market share loss in clopidogrel, one of the key products.

Sales in LatAm were ahead of expectation but were lower in other Emerging markets. Given uncertain political and financial conditions in certain geographies, the company is going slow on sales to manage receivable risks.

The consumer business of Zydus Wellness is under pressure owing to: a) slower growth in the Sugar free category, which is currently growing at 6-7%; b) increased competition from MNCs in the face wash segment; and c) an increase in Neutralite prices has impacted volume growth.

In our assessment, Hospira JV sales have come down substantially q-q. Given that Hospira is holding on to a 50% market share and tht price erosion has been limited with additional players, we think sales are likely to pick up in subsequent quarters.

EBITDA margins better than expected

Fig 2: Income statement review

Income Statement (INR mn)	Q2FY12	Q1FY12	Q-Q %	Q2FY11	Y-Y%
Gross Sales	12389	11889	4.2%	11214	10.5%
Excise Duty	192	154	25.0%	150	27.9%
Net Sales	**12196**	**11735**	**3.9%**	**11063**	**10.2%**
Other Income From Operations	168	722	-76.8%	104	61.6%
Operational Income	12364	12457	-0.7%	11167	10.7%
Total Expenditure	9993	9433	5.9%	8718	14.6%
Core EBITDA	**2371**	**3024**	**-21.6%**	**2449**	**-3.2%**
Other Income	110	63	75.0%	39	186.8%
Interest	769	112	589.3%	179	328.9%
Depreciation	375	347	8.1%	304	23.3%
Exchange Rate Fluctuations	0	0	n/a	-19	-100.0%
Exceptional expenses/(income)	0	0	n/a	0	n/a
PBT	1337	2628	-49.1%	2022	-33.9%
Tax	235	285	-17.6%	254	-7.4%
PAT (Before EO)	**1102**	**2343**	**-53.0%**	**1768**	**-37.7%**
PAT	1102	2343	-53.0%	1768	-37.7%
Adjustments on consolidation	-75	-45	68.2%	-60	25.5%
PAT after Adjustments	**1027**	**2298**	**-55.3%**	**1708**	**-39.9%**

Margins (%)	Q2FY12	Q1FY12	Q-Q %	Q2FY11	Y-Y%
Core EBITDA	19.4%	25.8%	-633 bps	22.1%	-269 bps
Consumption of material	36.7%	36.2%	44 bps	33.8%	288 bps
Tax Rate	17.6%	10.9%	672 bps	12.6%	503 bps

Net Margin	8.4%	19.6%	-1117 bps	15.4%	-702 bps

Source: Company data, Nomura estimates

Core EBITDA at INR 2.37bn was 8% lower than our estimate. Other expenditure included a forex loss of INR 386m, which we had not projected. Adjusted for the forex loss, EBITDA at INR 2.76bn was 7% higher than our estimates. Adjusted for forex loss/gain and licensing income, EBITDA margins have been stable at 22-24%. In Q2FY12, the adjusted EBITDA margin expanded by 50bps y-y.

Increased debt as company looks at a strategic investment in the near term

Net debt to equity has increased to 0.56 from 0.36 at the start of the year. Receivable days have declined (to 54 days from 62 days), but inventory days have increased (from 65.5 days to 75.7 days) over the same period. The rise in debt is also on account of the Nesher acquisition. Cash and liquid investments have increased by INR 4.6bn over the last six months, and are currently at INR 7.76bn. The increase is on account of a strategic investment in the near term as per management.

Fig 3: Balance Sheet

Balance Sheet (INR mn)	Sep-11	Mar-11
Capital	1,024	1,024
Reserves and Surplus	23,835	20,691
Loan Funds	19,852	10,973
Minority Interest	796	669
Deferred Tax Liability / (Asset)	1,168	1,127
Liabilities	8,953	8,955
Provisions	725	2,233
Forex Monetary Items Translation Difference Account	(155)	0
Total Sources of Funds	**56,198**	**45,673**
Fixed Assets	26,186	22,636
Investments	1,702	207
Inventories	9,890	8,119
Sundry Debtors	7,075	7,652
Cash and Bank Balances	6,057	2,952
Loans and Advances	5,288	4,106
Total Application of Funds	**56,198**	**45,673**

Source: Company data, Nomura estimates

Valuation Methodology and Investment Risks: See below.

Note: Ratings and Price Targets are as of the date of the most recently published report (http://go.nomuranow.com/research/globalresearchportal) rather than the date of this email.

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Mentioned companies

Issuer name	Ticker	Price	Price date	Stock rating	Disclosures

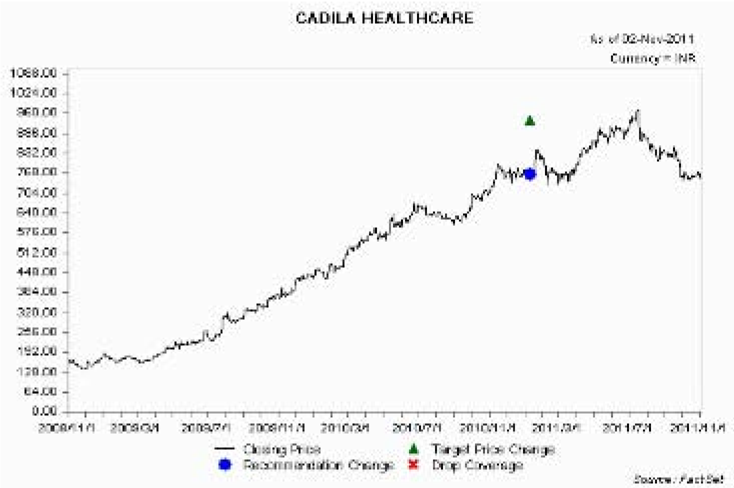
Cadila Healthcare	CDH IN	760.8 INR	09 Nov 2011	Buy

Previous Rating

Issuer name	Previous Rating	Date of change
Cadila Healthcare	Not Rated	11 Jan 2011

Cadila Healthcare (CDH IN) **760.8 INR (09 Nov 2011)** Buy

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
11-Jan-2011		937.00	766.00
11-Jan-2011	Buy		766.00

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our 12-month target price of INR937 is based on 20x FY12-13F blended EPS. Our valuation multiple is in line with the current trading multiple, but at a 15% discount to front-line generic peers. We believe with improvement in growth visibility, the discount to front-line peers could narrow, presenting further upside to our current target price. We are quite comfortable with the valuation multiple given forecast compound growth of >20% in profits and RoE at 28-30% over the next three years.

Risks that may impede the achievement of the target price Risks that could impede the achievement of our target price include but are not restricted to the following: Lower-than-expected growth in emerging market revenues; Significant delay in approval of new products from the US FDA and other regulatory issues; Material delays in execution in the US market leading to delayed launches; Greater-than-expected price decline in any of the markets due to competition or regulatory changes; Lower-than-estimated growth in the Hospira JV and Significant appreciation in the INR against export currencies.

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