

BSE SENSEX	S&P CNX	CMP: INR307	TP: INR378	Buy
16,883	5,069			
Bloomberg	CIPLA IN			
Equity Shares (m)	802.9			
52-Week Range (INR)	381/274			
1,6,12 Rel. Perf. (%)	8/9/6			
M.Cap. (INR b)	246.5			
M.Cap. (USD b)	4.9			

Cipla's 2QFY12 performance was above our estimates. Key highlights

- Net revenues grew 10% YoY to INR17.78b (v/s est of INR17.6b), EBITDA grew by 25% YoY to INR4.37b (v/s est of INR4.1b) and Adj. PAT grew by 17% to INR3.09b (v/s est. of INR2.87b).
- Revenue growth was led by a 10% growth in domestic formulations (net) sales and a 13.2% growth in formulation exports but was partly tempered down by a 5.2% de-growth in API exports.
- EBITDA Margins were above estimates due to better product mix and ramp up in revenues from Indore SEZ leading to better absorption of on-going fixed costs at the facility. EBITDA grew by 24.5% YoY to INR4.37b (v/s est of INR4.1b) while EBITDA margins expanded by 284bps to 24.6% (v/s est of 23.3%). EBITDA was partly boosted by INR140m of realized forex gains.
- Adjusted PAT grew by 17.5% YoY to INR3.09b (v/s est of INR2.87b). PAT growth was lower than EBITDA growth due to lower other income and higher taxes.
- Management has maintained its guidance of 10% topline growth for FY12.

We believe that Cipla is one of the best plays on emerging markets amongst Indian companies. Improving capacity utilization at Indore SEZ (capex of INR8-9b) will help boost margins and return ratios over the next 2 years. After a long delay, we believe Cipla's CFC-free inhaler pipeline is likely to gradually get commercialized in Europe and upsides from high-margin opportunities like Seretide can potentially come through over the next two years (our estimates do not include these upsides). Based on our revised estimates, stock currently trades at 22.3x FY12E and 17.9x FY13E earnings. Maintain **Buy** with TP of INR378 (22x FY13E EPS).

Quarterly Performance

(INR Million)

Y/E March	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Revenues	14,798	16,154	15,537	16,657	15,914	17,780	17,712	17,784	63,145	69,190
YoY Change (%)	7.5	12.1	8.0	23.4	7.5	10.1	14.0	6.8	12.6	9.6
Total Expenditure	11,152	12,638	12,355	13,783	12,219	13,404	13,582	14,261	49,927	53,466
EBITDA	3,646	3,516	3,182	2,875	3,695	4,376	4,130	3,523	13,218	15,725
Margins (%)	24.6	21.8	20.5	17.3	23.2	24.6	23.3	19.8	20.9	22.7
Depreciation	548	639	653	702	703	656	702	747	2,542	2,807
Interest	1	3	29	140	43	24	41	51	173	159
Other Income	28	316	257	521	249	243	308	434	1,122	1,234
Profit before Tax	3,124	3,190	2,757	2,554	3,199	3,939	3,695	3,159	11,625	13,992
Tax	550	560	430	412	666	850	739	684	1,952	2,938
Rate (%)	17.6	17.6	15.6	16.1	20.8	21.6	20.0	21.7	16.8	21.0
Reported PAT	2,574	2,630	2,327	2,142	2,533	3,090	2,956	2,475	9,673	11,054
Adj PAT	2,574	2,630	2,327	2,142	2,533	3,090	2,956	2,475	9,673	11,054
YoY Change (%)	6.5	-3.9	-19.5	-0.6	-1.6	17.5	27.0	15.6	-5.2	14.3
Margins (%)	17.4	16.3	15.0	12.9	15.9	17.4	16.7	13.9	15.3	16.0
Domestic formulation sales	6,615	7,477	7,196	6,395	7,202	8,208	8,150	7,165	27,682	30,724
YoY Change (%)	3.7	20.8	11.5	14.8	8.9	9.8	13.3	12.0	12.6	11.0
Other operating income	524	355	523	440	411	462	440	395	1,842	1,708
YoY Change (%)	3.2	-49.0	-44.6	40.0	-21.6	30.2	-15.9	-10.4	-25.2	-7.3

E: MOSL Estimates

Formulations led the revenue growth

Net revenues grew 10% YoY to INR17.78b (v/s est of INR17.6b), EBITDA grew by 25% YoY to INR4.37b (v/s est of INR4.1b) and Adj. PAT grew by 17% to INR3.09b (v/s est. of INR2.87b).

Cipla's revenue growth was led by both domestic and export formulations segments. Domestic formulations grew by 10% YoY to INR8.2b (v/s est of INR7.9b). The company has indicated that it is doing well in newly launched therapeutic segments like CNS and Oncology. Export formulations grew by 13.2% YoY to INR7.5b (v/s est of INR7.2b) with lower share of low-margin ARV business. The management indicated that, formulation exports from new Indore SEZ is ramping up well and reported INR1.5b in revenues for 2QFY12. API exports declined by 5% YoY to INR1.6b (v/s est of INR2.1b).

Sales mix (INR m)

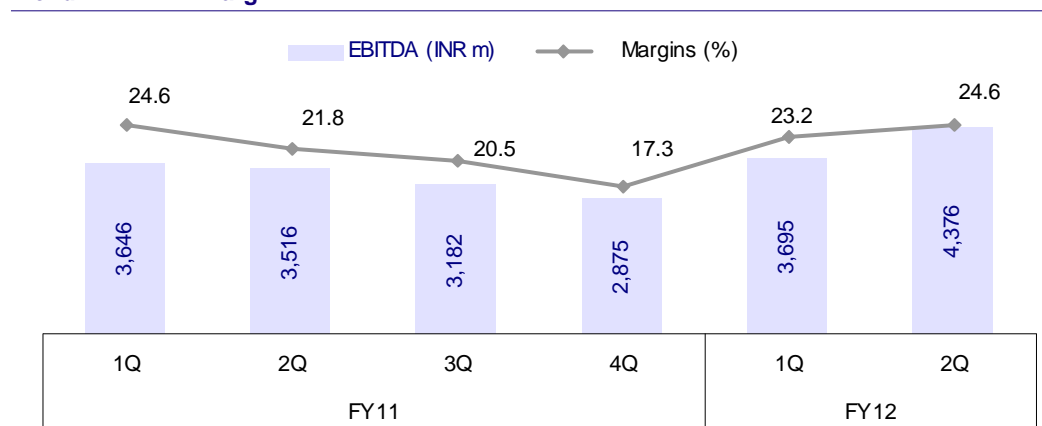
	2QFY12	2QFY11	YoY (%)	1QFY12	QoQ (%)
Domestic	8,470	7,564	12.0	7,436	13.9
% of revenues	47	47		46	
Exports	9,111	8,322	9.5	8,302	9.7
% of revenues	50	51		51	
Formulations	7,516	6,639	13.2	6,589	14.1
APIs	1,595	1,683	(5.2)	1,713	(6.9)
Other Operating Income	462	355	30.2	411	12.4
% of revenues	3	2		3	
Total Gross Revenues	18,043	16,241	11.1	16,149	11.7

Source: Company

EBITDA grew by 24.5% YoY to INR4.4b in line with estimates

EBITDA Margins were above estimates due to better product mix and ramp up in revenues from Indore SEZ (INR1.5b in sales for 2Q) leading to better absorption of on-going fixed costs at the facility. EBITDA grew by 24.5% YoY to INR4.37b (v/s est of INR4.1b) while EBITDA margins expanded by 284bps to 24.6% (v/s est of 23.3%). EBITDA was partly boosted by INR140m of realized forex gains. We have forecast lower margins for 2HFY12 assuming that the 2QFY12 gross margins of 60% may not be sustainable in the coming quarters.

Trend in EBITDA margin



Source: Company

Adjusted PAT grew by 17.5% YoY to INR3.09b (v/s est of INR2.87b). PAT growth was lower than EBITDA growth due to lower other income and higher taxes.

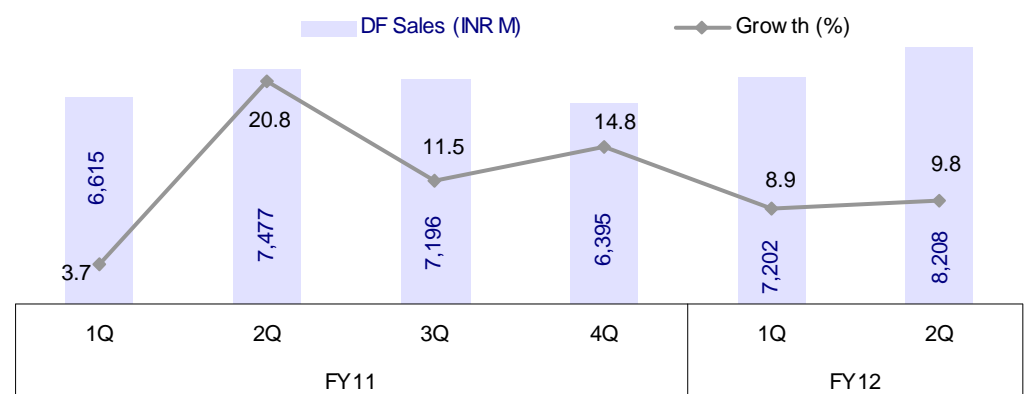
Ramp up in revenue from Indore SEZ - to improve margins

Cipla has invested significantly in setting up new facilities in the past 3 years. Its investment of INR9b on Indore SEZ (commissioned in 1QFY11), is amongst the largest in an SEZ in Indian Pharma. Cipla was incurring losses on the SEZ as revenues were yet to ramp up to absorb the fixed costs. However, revenues from this facility are gradually ramping up (INR3b sales for 1HFY12 v/s INR1b for full year FY11). We believe that, with the ramp-up in revenues from the facility, the profitability will improve going forward. Management has mentioned that the plant is now approved by all major global regulatory authorities except US FDA (Cipla has not yet applied for a US FDA inspection of this facility). It has also indicated that it expects this SEZ to contribute about 10-12% of overall sales by end of FY12, i.e., about INR7b contribution to topline.

Needs to improve growth traction in the domestic formulations business

Cipla is a dominant player in domestic formulations market and enjoys No 2 ranking in the industry. This business contributes ~46% of Cipla's overall revenues and is a key earnings driver. However, for the past few quarters, Cipla has not been able to record strong growth in this business due to high base and increasing competition in acute therapy segments. To counter this management has been expanding the sales force and has increased the marketing and promotional spend. The company has recently increased its sale-force by 500 MRs to ~6500MRs. This is one of the largest field force in the industry. The company now will focus on optimizing the productivity of such a large field force.

Cipla - Domestic Formulation (DF) Performance



Source: Company

CFC-free Inhalers remain key long-term trigger

Launch of CFC-free inhalers in EU & US remains as a key long-term trigger for the company. Its overall inhaler capacity is amongst the top 5 globally. It has already commercialized some of its inhalers in UK, Germany, Spain and Portugal. While ramp-up in sales of these inhalers remains a key trigger in the long-term, as of now the visibility on the launch time-lines is poor. Management expects its full range of inhalers to be commercialized in Europe over the next 2-3 years and expects a total of 3-6 players for

each product in this category implying that this will be a low-competition, high-margin opportunity. We note that while Cipla has one of the largest capacities of inhalers globally, its capacity utilization for inhalers is very low mainly due to delay in commercialization, pending regulatory approvals.

NPPP 2011 - To impact EPS by 4-6%

The government has recently released the draft of the National Pharmaceuticals Pricing Policy, 2011 (NPPP). It has invited comments from the industry and other sources by 30-Nov-2011 on the draft. The policy proposes a significant increase in span of price control from current 20% to ~60%, restricting pricing to the weighted average of the top 3 brands and allowing inflation-linked price increases. While the policy is yet to be implemented, we believe that the impact of the policy (in its current form) will be adverse for large players like Cipla in the short-term. We expect Cipla's domestic formulation revenues to be impacted by ~2-3% (INR0.7-1b) which will flow through directly up to the PBT level thus impacting FY13 EPS adversely by 4-6%. Our estimates currently do not factor-in this impact pending the implementation of the policy.

Raising earnings estimates by 3-4%

On account of better than expected 2QFY12 performance, we have raised our earnings estimates by 2.8% and 3.8% for FY12 and FY13 respectively. Based on our revised estimate, we expect EPS of INR13.8 (up 14.2%) and INR17.2 (up 24%) for FY12 and FY13.

Valuation and view

We believe that Cipla is one of the best plays on emerging markets amongst Indian companies. Improving capacity utilization at Indore SEZ (capex of INR8-9b) will help boost margins and return ratios over the next 2 years. After a long delay, we believe Cipla's CFC-free inhaler pipeline is likely to gradually get commercialized in Europe and upsides from high-margin opportunities like Seretide can potentially come through over the next two years (our estimates do not include these upsides). Based on our revised estimates, the stock currently trades at 22.3x FY12E and 17.9x FY13E earnings. Maintain **Buy** with TP of INR378 (22x FY13E EPS).

Cipla: an investment profile

Company description

Cipla is the largest player in the domestic formulations market and has a presence across most therapeutic areas. The company also has robust exports to several markets including US, Europe, South Africa, Australia and the Middle East. Cipla's strategy for regulated markets (Europe and US) exports is built around supply tie-ups with global players.

Key investment arguments

- Supply agreements with 22 US players for 118 products to drive growth in the medium term, as partners scale up filings and patents expire - adding to the exports momentum.
- Commencement of exports of CFC free inhalers to Europe will be a key positive; Cipla has the third largest capacity of inhalers in the world and could be a key beneficiary of the unfolding opportunity in the long-term.
- Potential MNC contracts are likely to raise earnings for FY12/13

Key investment risks

- NPPA liability of INR 12b (if it materializes) could result in a significant one-time cash outflow.
- The new pharmaceutical policy (proposed) has raised

uncertainties regarding pricing of drugs in India. Further clarity on this is awaited.

- Consolidation in the global generic space can have an adverse impact on the upside from the partnership model adopted by the company.

Recent developments

- Commissioning of Indore SEZ

Valuation and view

- Revenue and EPS CAGR of 12.5% and 19.4% respectively expected over FY11-13.
- One of the strongest generic pipelines coupled with de-risked strategy and large under-utilized capacities should bring in long-term benefits.
- The stock currently trades at 22.3x FY12E and 17.9x FY13E earnings. Maintain **Buy**.

Sector view

- Emerging markets would remain the key sales and profit drivers in the medium term. Japan is expected to emerge as the next growth driver, particularly for companies with a direct marketing presence.
- We are overweight on companies that are towards the end of the investment phase, with benefits expected to start coming in from the next fiscal.

Comparative valuations

		Cipla	DRL	Ranbaxy
P/E (x)	FY12E	22.3	21.3	26.2
	FY13E	17.9	19.2	20.5
P/BV (x)	FY12E	3.3	5.2	2.8
	FY13E	2.9	4.6	2.5
EV/Sales (x)	FY12E	3.6	3.4	2.4
	FY13E	3.1	3.1	2.2
EV/EBITDA (x)	FY12E	15.8	17.3	20.9
	FY13E	13.0	15.5	17.1

EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	13.8	13.6	1.8
FY13	17.2	16.1	6.6

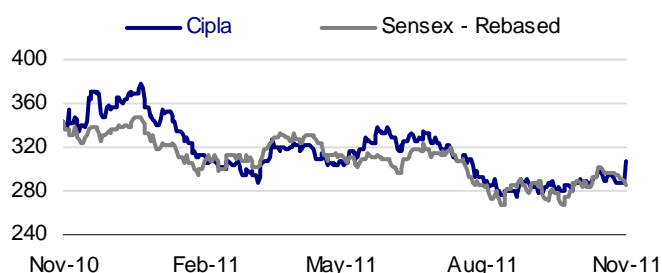
Target Price and Recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
307	378	23.1	Buy

Shareholding Pattern (%)

	Sep-11	Jun-11	Sep-10
Promoter	36.8	36.8	36.8
Domestic Inst	19.9	19.1	18.3
Foreign	17.1	18.4	19.3
Others	26.3	25.8	25.7

Stock performance (1 year)



Financials and Valuation

Income Statement		(INR Million)			
Y/E March	2010	2011	2012E	2013E	
Gross Sales	54,117	61,798	68,036	78,195	
Change (%)	7.8	14.2	10.1	14.9	
Exports	29,004	33,548	36,759	42,696	
Net Domestic Sales	24,592	27,755	30,724	34,872	
Other Operating Income	2,462	1,842	1,708	1,782	
Net Income	56,057	63,145	69,190	79,349	
Change (%)	7.1	12.6	9.6	14.7	
Total Expenditure	42,315	49,927	53,466	60,614	
EBITDA	13,742	13,218	15,725	18,735	
Margin (%)	24.5	20.9	22.7	23.6	
Depreciation	1,671	2,542	2,807	3,144	
EBIT	12,071	10,677	12,918	15,591	
Int. and Finance Charges	230	173	159	133	
Other Income - Rec.	469	1,122	1,234	1,357	
PBT before EO Items	12,311	11,625	13,992	16,815	
Extra Ordinary Expense	-950	0	0	0	
PBT but after EO Exp.	13,261	11,625	13,992	16,815	
Tax	2,435	1,954	2,938	3,027	
Tax Rate (%)	18.4	16.8	21.0	18.0	
Reported PAT	10,826	9,671	11,054	13,788	
Adj PAT	10,050	9,671	11,054	13,788	
Change (%)	29.4	-3.8	14.3	24.7	
Margin (%)	17.9	15.3	16.0	17.4	

Balance Sheet		(INR Million)			
Y/E March	2010	2011	2012E	2013E	
Equity Share Capital	1,606	1,606	1,606	1,606	
Reserves	57,410	64,966	73,256	83,597	
Revaluation Reserves	90	90	90	90	
Net Worth	59,106	66,661	74,952	85,293	
Loans	51	5,719	2,219	2,219	
Deferred Liabilities	1,792	2,131	1,180	675	
Capital Employed	60,948	74,511	78,350	88,187	
Gross Block	28,973	42,411	47,411	52,411	
Less: Accum. Deprn.	8,861	11,465	14,272	17,417	
Net Fixed Assets	20,112	30,946	33,139	34,994	
Capital WIP	6,842	2,853	2,853	2,853	
Investments	2,464	5,904	5,904	5,904	
Curr. Assets	43,673	46,599	50,579	60,920	
Inventory	15,126	19,062	20,337	22,314	
Account Receivables	15,666	14,908	17,708	19,281	
Cash and Bank Balance	621	1,010	173	4,666	
Others	12,260	11,619	12,361	14,659	
Curr. Liability & Prov.	12,144	11,791	14,125	16,485	
Account Payables	12,144	11,791	14,125	16,485	
Net Current Assets	31,530	34,808	36,454	44,435	
Appl. of Funds	60,948	74,511	78,350	88,187	

E: MOSL Estimates

Ratios		(INR Million)			
Y/E March	2010	2011	2012E	2013E	
Basic (INR)					
EPS	12.5	12.0	13.8	17.2	
Cash EPS	14.6	15.2	17.3	21.1	
BV/Share	73.5	82.9	93.2	106.1	
DPS	4.7	6.5	5.9	7.3	
Payout (%)	19.8	30.8	25.0	25.0	
Valuation (x)					
P/E		25.5	22.3	17.9	
PEG (x)		-6.8	1.6	0.7	
Cash P/E		20.2	17.8	14.6	
P/BV		3.7	3.3	2.9	
EV/Sales		4.0	3.6	3.1	
EV/EBITDA		19.0	15.8	13.0	
Dividend Yield (%)		2.1	1.9	2.4	
Return Ratios (%)					
RoE	17.0	14.5	14.8	16.2	
RoCE	20.6	15.8	18.1	19.2	
Working Capital Ratios					
Fixed Asset Turnover (x)	2.8	2.5	2.2	2.3	
Debtor (Days)	102	86	93	89	
Inventory (Days)	98	110	107	103	
Working Capital (Days)	201	195	191	183	
Leverage Ratio (x)					
Current Ratio	3.6	4.0	3.6	3.7	
Debt/Equity	0.0	0.1	0.0	0.0	

Cash Flow Statement		(INR Million)			
Y/E March	2010	2011	2012E	2013E	
Op. Profit/(Loss) before Tax	13,742	13,218	15,725	18,735	
Interest/Dividends Recd.	469	1,122	1,234	1,357	
Direct Taxes Paid	-2,285	-1,614	-3,890	-3,531	
(Inc)/Dec in WVC	-1,289	-2,889	-2,483	-3,488	
CF from Operations	10,637	9,837	10,585	13,073	
EO expense	-950	0	0	0	
CF from Oper. incl EO Ex	11,587	9,837	10,585	13,073	
(inc)/dec in FA	-5,037	-9,386	-5,000	-5,000	
(Pur)/Sale of Investments	-1,651	-3,440	0	0	
CF from Investments	-6,688	-12,826	-5,000	-5,000	
Issue of Shares	6,912	867	0	0	
Inc/(Dec) in Debt	-9,352	5,668	-3,500	0	
Interest Paid	-230	-173	-159	-133	
Dividend Paid	-2,139	-2,983	-2,764	-3,447	
CF from Fin. Activity	-4,809	3,379	-6,422	-3,580	
Inc/Dec of Cash	91	390	-837	4,493	
Add: Beginning Balance	530	621	1,010	173	
Closing Balance	621	1,010	173	4,666	

N O T E S

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	Cipla
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