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India

Healthcare

Reuters CIPL.BO
Bloomberg CIPLA IB

Priced on 2 May 2012

India Sensex @ 17,301.9

12M hi/lo Rs359.00/273.60

12M price target Rs360.00
±% potential +13%

Shares in issue 802.9m
Free float (est.) 63.2%

Market cap US\$4,854m

3M average daily volume
Rs521.1m (US\$10.3m)

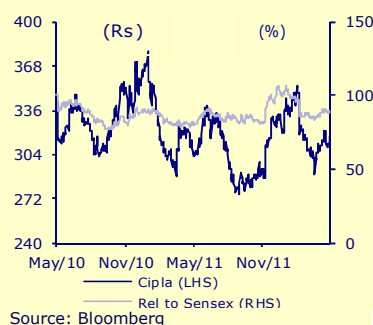
Foreign s'holding 16.1%

Major shareholders

Promoters 36.8%

Stock performance (%)

	1M	3M	12M
Absolute	2.9	(6.5)	0.8
Relative	4.7	(4.9)	8.0
Abs (US\$)	(0.4)	(12.7)	(15.0)



Source: Bloomberg

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Near term triggers

We expect Cipla to deliver stronger operating performance over the coming quarters on back of multiple near term triggers, namely Lexapro supplies to Teva and weakening currency. Further milestone and royalty income on recently approved Meda's (partner) product Dymista will provide longer term accretion to earnings as the product sales ramp up in the US. After recent correction in the stock, we find valuations reasonable and upgrade the stock to O-PF while maintain target of Rs360/ share.

Dymista approval a tad positive for Cipla

US FDA approved Meda's drug Dymista for Allergic Rhinitis. Being a partner, Cipla will benefit through product supplies over the longer term. The product is widely estimated to reach US\$300-500m in annual sales over the coming years. Apart from approval (outside North America) related milestone payment (US\$5m), we expect gradual increase in Cipla's sales from product related supplies to Meda. Assuming Cipla supplies product at 10-15% of sales, it could earn US\$50-75m at peak sales.

Rupee weakening likely to aid margins

Cipla is one of strongest beneficiaries of a weakening rupee. We expect improving margins over the coming quarters on back of a weak rupee and a low base. We expect strong operating profit growth over coming quarters led by margin expansion and high margin product supplies.

Lexapro supplies to Teva, a short term boost

Teva launched Lexapro in March 2012 under six months exclusivity. Cipla benefits from formulation supplies (likely at high margin) during this period. This will help Cipla reported numbers though should be excluded while assigning a price to core earnings multiple. Additionally, a low base in domestic formulations could result in reasonable India growth. AIOCD data on domestic market suggests improving growth for Cipla.

Reasonable valuations, Upgrade to O-PF

Post 3QFY12 results, Cipla's share has corrected more than 10%. We believe margin blip shown in 3Q could correct with multitude of positive triggers like Lexapro supplies and continued weakness in rupee. While we expect modest 12% growth in sales to Rs18.2bn, we see margins expanding by nearly 500bps YoY (low base) and flat QoQ resulting in 47% Ebitda growth and 36% PAT growth to Rs2.9bn (assuming higher tax rate). We upgrade the stock to O-PF on back of multiple triggers and reasonable valuations while maintaining our target of Rs360/ share based on 19x one year forward earnings.

Financials

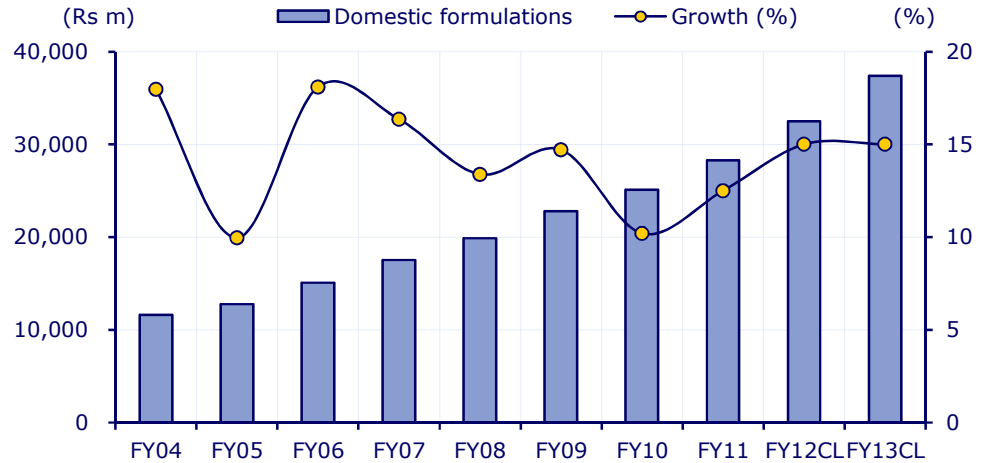
Year to 31 Mar	10A	11A	12CL	13CL	14CL
Revenue (Rsm)	53,581	61,302	67,141	78,136	89,241
Net profit (Rsm)	10,826	9,895	11,380	13,514	15,285
EPS (Rs)	13.7	12.3	14.2	16.8	19.0
CL/consensus (33) (EPS%)	-	-	101	101	99
EPS growth (% YoY)	37.1	(10.1)	15.0	18.7	13.1
PE (x)	23.2	25.8	22.4	18.9	16.7
Dividend yield (%)	0.6	0.9	0.8	0.8	0.9
PB (x)	4.3	3.8	3.4	2.9	2.6
ROE (%)	21.1	15.7	16.0	16.6	16.4
Net debt/equity (%)	(5.1)	(1.8)	(7.8)	(9.8)	(12.1)

Source: CLSA Asia-Pacific Markets

We expect steady domestic growth in FY13

Figure 1

Cipla's domestic formulations growth trend

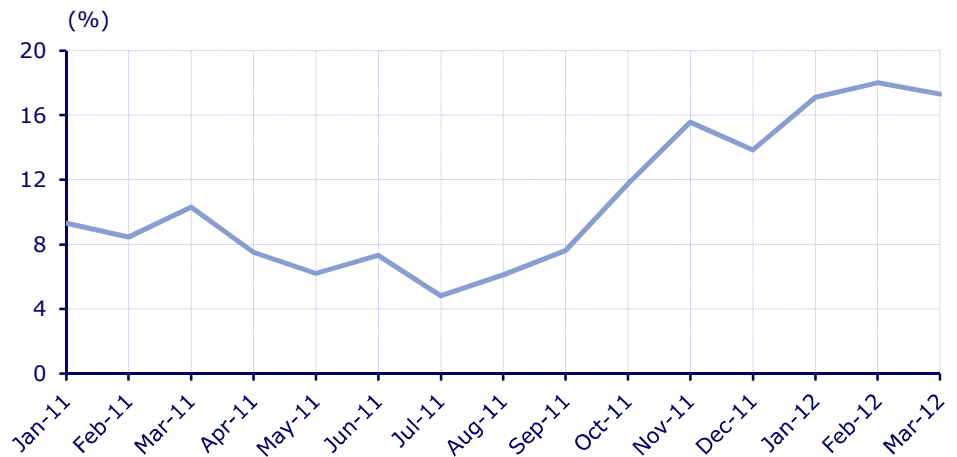


Source: Company, CLSA Asia-Pacific Markets

AIOCD data suggests improving growth trend for Cipla

Figure 2

Cipla's estimated monthly growth in secondary sales in domestic market

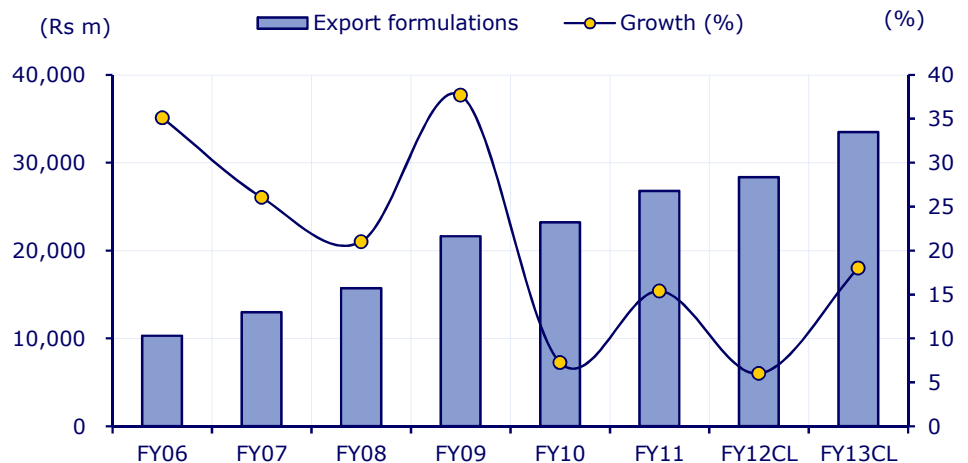


Source: AIOCD AWACs, CLSA Asia-Pacific Markets

We expect pick up in export formulations in FY13

Figure 3

Cipla's export formulations growth trend

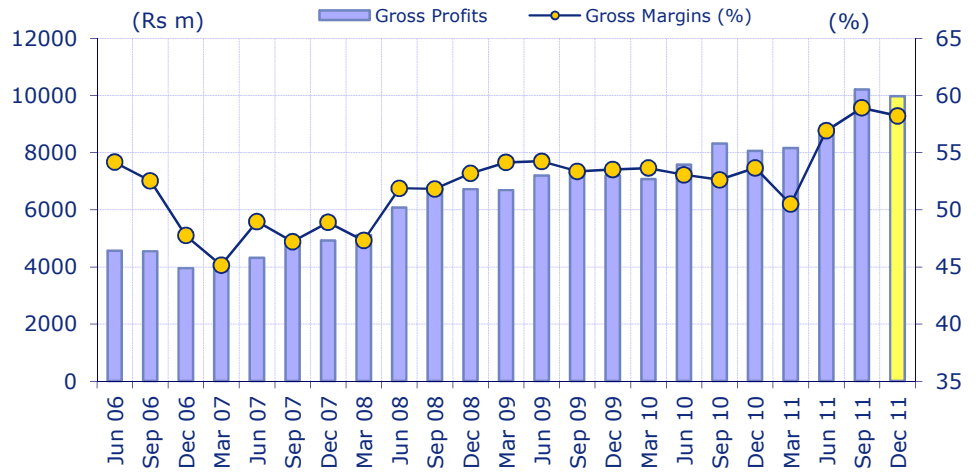


Source: CLSA Asia-Pacific Markets

Gross margins rise on YoY basis though lower QoQ despite even weaker rupee in 3QFY12

Figure 4

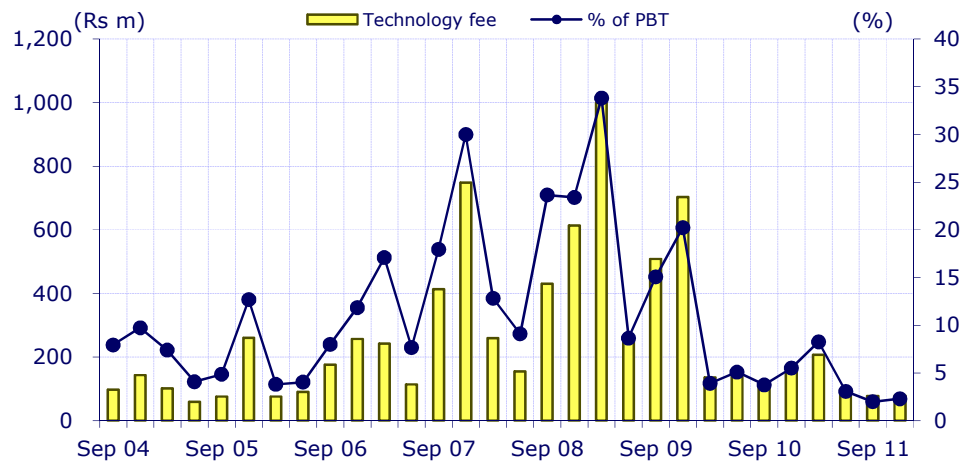
Gross margins trend



Source: Company filings, CLSA Asia-Pacific Markets

Figure 5

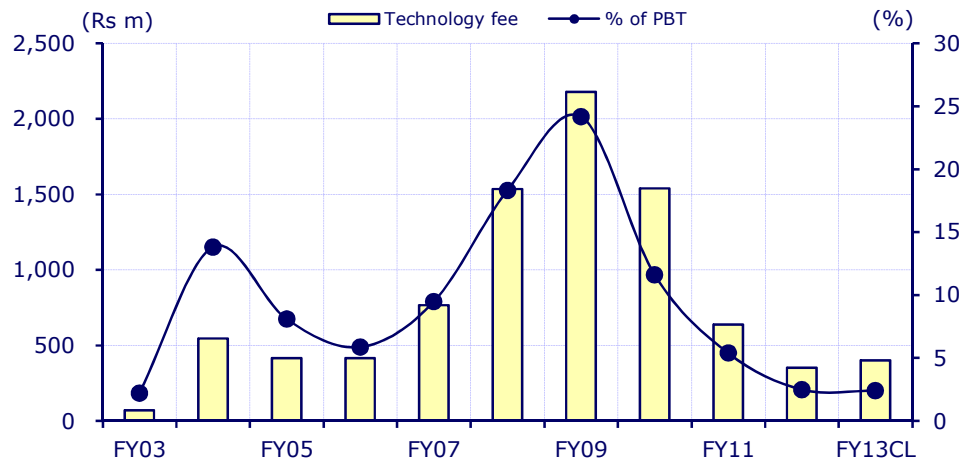
Technology license income



Source: Company filings, CLSA Asia-Pacific Markets

Figure 6

Technology license income assumption



Source: CLSA Asia-Pacific Markets

The management guides for pick up in exports on back of previous licensing deals

We assume mild growth in technology income in FY13

Valuations are reasonable in comparison other leading pharma names

Figure 7

Pharma valuations

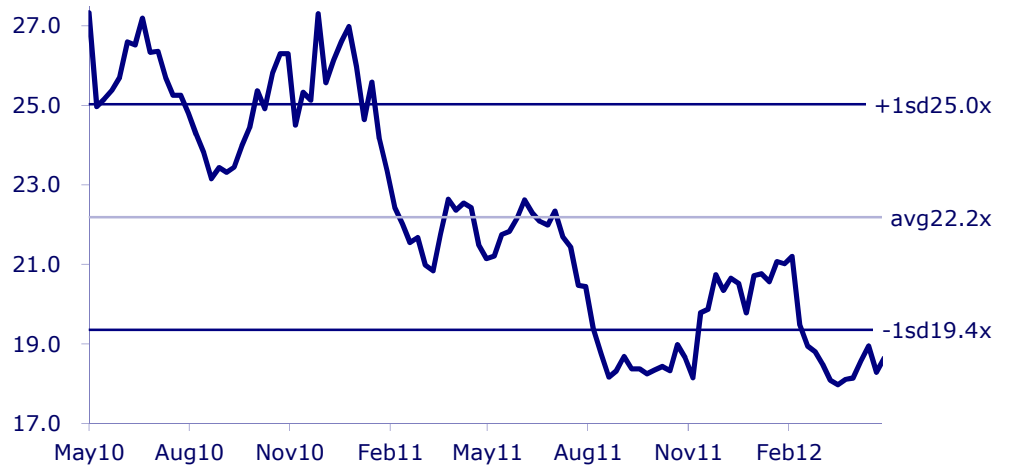
Pharma Valuations	Price (Rs)	Mkt Cap US\$m	EPS Mar12/ Dec11	EPS Mar13/ Dec12	EPS Mar14/ Dec13	P/E Mar12/ Dec11	P/E Mar13/ Dec12	P/E Mar14/ Dec13	EV/ Sales (FY12)
Ranbaxy	500	3,947	8.3	11.0	12.9	60.2	45.4	38.7	2.2
Dr Reddy's	1,748	5,545	82.8	99.7	107.9	21.1	17.5	16.2	3.2
Cipla	318	4,775	14.2	16.8	19.0	22.4	18.9	16.7	3.8
Sun	600	11,560	23.3	25.0	28.2	25.7	24.0	21.2	7.6
Biocon	237	889	16.9	19.1	21.0	14.0	12.4	11.3	2.3
Lupin	539	4,511	21.2	26.5	32.4	25.5	20.4	16.6	3.7
Cadila	735	2,817	32.0	37.3	47.5	22.9	19.7	15.5	3.1
Divis Labs	867	2,153	37.8	47.8	56.2	22.9	18.1	15.4	6.8
Ipca	361	851	22.2	29.0	33.5	16.3	12.5	10.8	2.1
Torrent	656	1,039	40.6	47.0	53.7	16.1	13.9	12.2	2.3
Glaxo	2,171	3,442	50.6	83.8	94.0	42.9	25.9	23.1	6.9

Source: CLSA Asia-Pacific Markets

The stock has de-rated over last two years

Figure 8

Cipla's PE band chart

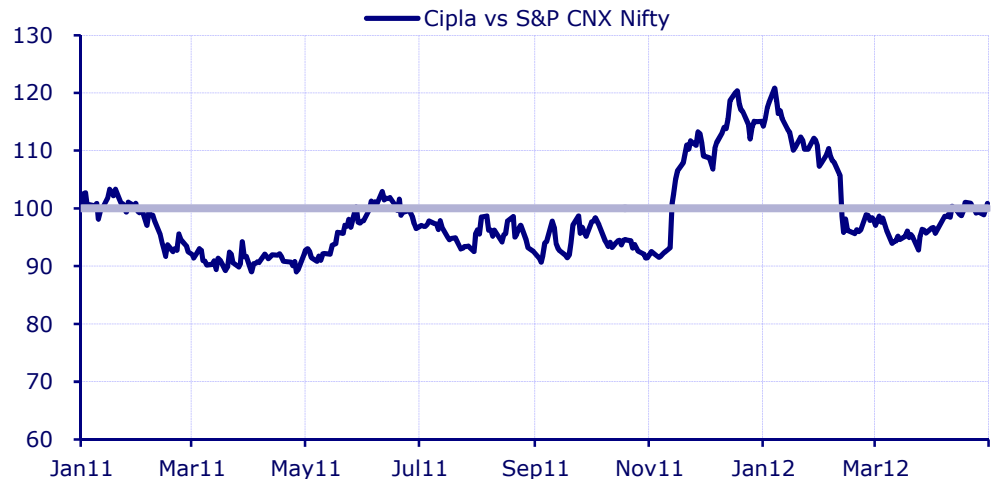


Source: CLSA Asia-Pacific Markets

The stock has been performed in-line with market though underperformed most of the leading pharma stocks

Figure 9

Relative performance chart



Source: CLSA Asia-Pacific Markets

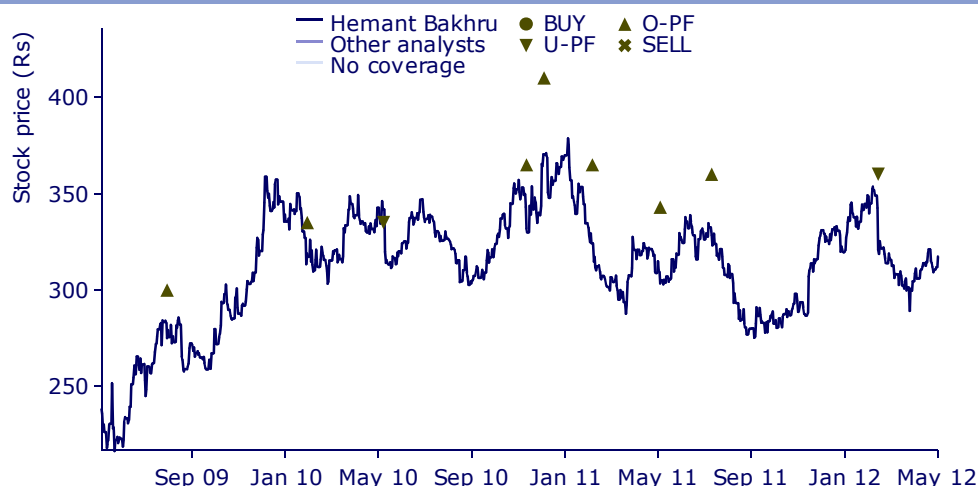
Summary financials

Year to 31 March	2010A	2011A	2012CL	2013CL	2014CL
Summary P&L forecast (Rsm)					
Revenue	53,581	61,302	67,141	78,136	89,241
Op Ebitda	11,474	11,567	14,095	16,880	19,072
Op Ebit	9,586	8,834	11,169	13,534	15,306
Interest income	0	0	0	0	0
Interest expense	(237)	(173)	(138)	(75)	(30)
Other items	3,911	3,188	3,107	3,286	3,594
Profit before tax	13,261	11,849	14,137	16,745	18,870
Taxation	(2,435)	(1,954)	(2,757)	(3,232)	(3,585)
Minorities/Pref divs	0	0	0	0	0
Net profit	10,826	9,895	11,380	13,514	15,285
Summary cashflow forecast (Rsm)					
Operating profit	9,586	8,834	11,169	13,534	15,306
Operating adjustments	-	-	-	-	-
Depreciation/amortisation	1,888	2,733	2,926	3,346	3,766
Working capital changes	(1,310)	(2,889)	(677)	(4,931)	(5,527)
Net interest/taxes/other	(1,335)	(1,614)	(2,888)	(3,132)	(3,485)
Net operating cashflow	8,829	7,064	10,530	8,817	10,060
Capital expenditure	(5,254)	(9,578)	(6,500)	(7,000)	(4,394)
Free cashflow	3,576	(2,514)	4,030	1,817	5,666
Acq/inv/disposals	-	-	-	-	-
Int, invt & associate div	2,725	2,790	2,713	2,920	3,237
Net investing cashflow	(2,529)	(6,788)	(3,787)	(4,080)	(1,157)
Increase in loans	-	-	(2,219)	(2,000)	(1,000)
Dividends	(1,606)	(2,248)	(1,927)	(2,088)	(2,248)
Net equity raised/other	(2,944)	5,801	(64)	(55)	(3,153)
Net financing cashflow	(4,550)	3,553	(4,210)	(4,143)	(6,401)
Incr/(decr) in net cash	1,750	3,830	2,532	594	2,502
Exch rate movements	0	0	0	0	0
Opening cash	1,334	3,085	6,914	9,446	10,040
Closing cash	3,085	6,914	9,446	10,040	12,542
Summary balance sheet forecast (Rsm)					
Cash & equivalents	3,085	6,914	9,446	10,040	12,542
Debtors	15,666	14,908	17,475	20,337	23,227
Inventories	15,126	19,062	19,124	21,534	24,645
Other current assets	12,260	11,619	13,429	15,628	17,849
Fixed assets	26,954	33,799	37,373	41,027	44,761
Intangible assets	-	-	-	-	-
Other term assets	-	0	-	-	-
Total assets	73,091	86,302	96,847	108,565	123,024
Short-term debt	47	5,719	3,500	1,500	500
Creditors	9,980	9,581	13,035	15,044	17,218
Other current liabs	2,164	2,210	2,518	3,047	3,570
Long-term debt/CBs	4	0	0	0	0
Provisions/other LT liabs	1,792	2,131	2,000	2,100	2,200
Minorities/other equity	0	0	0	0	0
Shareholder funds	59,106	66,661	75,795	86,874	99,537
Total liabs & equity	73,091	86,302	96,847	108,565	123,024
Ratio analysis					
Revenue growth (% YoY)	8.0	14.4	9.5	16.4	14.2
Ebitda growth (% YoY)	18.1	0.8	21.9	19.8	13.0
Ebitda margin (%)	21.4	18.9	21.0	21.6	21.4
Net profit margin (%)	20.2	16.1	16.9	17.3	17.1
Dividend payout (%)	14.6	22.7	16.9	15.4	14.7
Effective tax rate (%)	18.4	16.5	19.5	19.3	19.0
Ebitda/net int exp (x)	48.5	66.8	101.9	225.1	635.7
Net debt/equity (%)	(5.1)	(1.8)	(7.8)	(9.8)	(12.1)
ROE (%)	21.1	15.7	16.0	16.6	16.4
ROIC (%)	14.1	11.8	12.9	14.3	14.6
EVA@/IC (%)	0.5	(1.8)	(0.7)	0.7	1.0

Source: CLSA Asia-Pacific Markets

Companies mentioned

Recommendation history of Cipla CIPLA IB



Date	Rec*	Target	Date	Rec*	Target
14 February 2012	U-PF	360.00	11 November 2010	O-PF	365.00
11 July 2011	O-PF	360.00	08 May 2010	U-PF	335.00
05 May 2011	O-PF	343.00	28 January 2010	O-PF	335.00
05 February 2011	O-PF	365.00	29 July 2009	O-PF	300.00
04 December 2010	O-PF	410.00			

Source: CLSA Asia-Pacific Markets

Key to CLSA investment rankings: **BUY:** Total return expected to exceed market return AND provide 20% or greater absolute return; **O-PF:** Total return expected to be greater than market return but less than 20% absolute return; **U-PF:** Total return expected to be less than market return but expected to provide a positive absolute return; **SELL:** Total return expected to be less than market return AND to provide a negative absolute return. For relative performance, we benchmark the 12-month total return (including dividends) for the stock against the 12-month forecast return (including dividends) for the local market where the stock is traded.

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Note: In the interests of timeliness, this document has not been edited.

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