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## Pharmaceuticals

Target price Rs479

### Earnings revision

(%)	FY18E	FY19E
Sales	(1.4)	(1.8)
EPS	4.6	2.4

### Target price revision

Rs479 from Rs468

### I-Sec vs Bbg\* consensus

(%)	FY18E	FY19E	FY20E
Sales	(1.2)	(1.3)	(2.8)
Adj. PAT	1.5	0.1	1.3

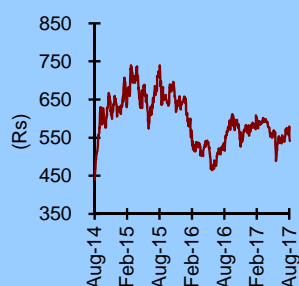
Source: \*Bloomberg, I-Sec research

### Shareholding pattern

	Dec '16	Mar '17	Jun '17
Promoters	37.5	37.5	37.3
Institutional investors	35.6	36.1	37.1
MFs and UTI	9.6	9.5	9.1
Insurance Cos.	6.6	5.1	5.8
FII	13.0	18.0	22.2
Others	26.9	27.4	25.6

Source: BSE India

### Price chart



### Research Analysts:

**Sriraam Rathi**

Sriraam.rathi@icicisecurities.com  
+91 22 6637 7574

**Vinay Bafna**

vinay.bafna@icicisecurities.com  
+91 22 6637 7339

INDIA

Cipla

**ICICI Securities**

**REDUCE**

**Maintained**

Margin beat, valuations remain expensive

**Rs543**

Reason for report: Q1FY18 result review and earnings revision

We maintain **REDUCE** on Cipla with revised target price of Rs479/share due to lower margin profile, subdued low return ratios and expensive valuations. We do not expect valuations to re-rate in near to mid-term considering (i) gradual recovery in margins but still far below peers' margins, (ii) muted return ratios of below 15% and (iii) industry wide challenging pricing environment in US market. Cipla reported better performance in Q1FY18 on margins front led by mix of cost control as well as certain non-recurring benefits. Revenue declined 3.4% YoY to Rs35.3bn (I-sec est. Rs37.1bn) due to lower than estimated sales in India and US markets. EBITDA margins were 280bps above our estimate due to higher gross margin because of favorable geographical mix, cost control measures and one-time benefits. Adj. PAT declined 6% YoY to Rs3.2bn vs estimated Rs2.5bn. We raise our earnings estimate by 2-5% to factor in better margins and lower depreciation charge.

- **Lower India sales affected revenue growth:** India business declined 12.3% YoY against our estimate of 10% decline, due to de-stocking at the channel prior to GST implementation. We expect domestic growth to recover going forward as inventory level normalizes. US revenue was flattish at US\$96mn (I-sec est. US\$105mn) led by new product launches. South Africa business reported strong growth of 21.1% YoY (10% in ZAR terms) led by robust growth in private market. However, Emerging Markets and the API business declined 3.6% and 0.8% YoY due to country specific issues and currency volatility.
- **Margin improvement partly led by non-recurring benefits:** EBITDA margin improved 160bps YoY to 18.3% led by higher gross margins. Cost control measures, favorable geographical mix and certain non-recurring items led to 410bps improvement in gross margins. R&D cost remained flat YoY and decreased 22.1% QoQ. We expect gradual improvement in EBITDA margin to 19.9% and 20.5% in FY19 and FY20 respectively.
- **Outlook:** We lower our revenue estimates by 1-2% for FY18-19 to factor in weak Q1FY18 revenue. However, we raise earnings estimate by 2-5% considering better margins and lower depreciation charge. Overall, we expect 13.2% revenue and 27.6% adjusted net profit CAGR over FY17-20 on low base with EBITDA margin expansion of 360bps. However, RoE and RoCE would remain muted at 15.5% and 13% in FY20.
- **Valuations and risks:** We maintain **REDUCE** rating with a revised target price of Rs479/share based on 18x FY19E earnings (earlier Rs468 based on 18x FY19E). Key upside risks are: launch of high value products in the US and appreciation of the ZAR currency.

Market Cap	Rs437bn/US\$6.8bn
Reuters/Bloomberg	CIPL.BO/CIPLA IN
Shares Outstanding (mn)	804.5
52-week Range (Rs)	696/465
Free Float (%)	62.7
FII (%)	22.2
Daily Volume (USD/'000)	11,700
Absolute Return 3m (%)	(3.3)
Absolute Return 12m (%)	4.1
Sensex Return 3m (%)	4.0
Sensex Return 12m (%)	13.6

Year to Mar	FY17	FY18E	FY19E	FY20E
Revenue (Rs mn)	146,302	163,885	187,144	211,962
Net Income (Rs mn)	8,963	16,525	21,412	26,110
EPS (Rs)	15.6	20.5	26.6	32.5
% Chg YoY	(18.6)	31.6	29.6	21.9
P/E (x)	34.8	26.4	20.4	16.7
CEPS (Rs)	14.5	22.1	27.7	33.2
EV/E (x)	16.6	13.7	11.6	10.3
Dividend Yield (%)	0.3	0.4	0.6	0.7
RoCE (%)	7.6	9.5	11.6	13.0
RoE (%)	10.4	12.5	14.4	15.5

Please refer to important disclosures at the end of this report

## Q1FY18 result and concall highlights

**Net revenues** declined 3.4% YoY to Rs35.3bn led by weak domestic performance.

- **Domestic sales** declined 12.3% YoY to Rs12.7bn in Q1FY18. It accounted for ~36% of the sales for the quarter. This decline was largely due to channel de-stocking prior to GST implementation. Management expects gradual recovery in domestic growth as primary sales have picked up.
- **US sales** remained flattish with 1.7% YoY decline to Rs6.5bn in Q1FY18. US accounted for ~18%. Invagen and Exelan generated US\$54-55mn in the quarter. The company is ramping up its ANDA filings with 3 filed (2 are limited competition) in Q1FY18. Overall the company has 98 pending ANDAs including 26 tentative approval.

The company expects to file ~20-25 ANDAs in FY18 with 10-11 launches throughout the year (including few meaningful). The company indicated that it has received TAD for Albuterol MDI and Nano-Paclitaxel and expect launch in FY18.

- **Emerging markets** contributed ~ 21% of the total revenue and declined 3.6% YoY mainly due to forex volatility and tender normalization and phasing out in its Global Access program. However, the company has partnered with American Cancer Society (ACS) and Clinton Health Access Initiative (CHAI) to expand access to essential cancer treatment medications across various African nations. The company has also launched FPSM (respiratory) in Australia with more products to follow.
- **Europe** registered revenue growth of 12.9% YoY. This growth was largely driven by FPSM sales and their strategic shift towards B2B platform. However, sale of *Seretide* in UK has been below their estimates.
- **South Africa** registered 21.1% YoY revenue growth. The company witnessed 10.3% growth in private market and strong tender business (30-35% of sales). The company has become the 3<sup>rd</sup> largest pharma company in South Africa.
- **Global API business** witnessed muted performance with 0.8% YoY decline to Rs1.3bn.
- **Gross margin** expanded 410bps YoY to 66.6% led by better revenue mix, cost control measures and few one-offs. The company expects to sustain 65% of gross margins going forward.
- **EBITDA margin** improved 160bps YoY to 18.3% on improvement in the gross margin. The company indicated that absolute EBITDA growth would exceed that of revenue in the coming years.
- **R&D costs** for Q1FY18 stood at 6.8% of sales vs 6.5% in Q1FY17. Going forward, Cipla expects R&D to increase to 8-9% of sales. There are 96 ANDAs pending for approval. The FTF launches from Invagen portfolio are expected FY19 onwards.
- **Capex guidance** for the company would be around Rs9-10bn in next 2-3 years.
- **Adjusted PAT** declined 6% YoY to Rs3.2bn.

**Table 1: Q1FY18 performance***(Rs mn, year ending March 31)*

	Q1FY18	Q1FY17	YoY % Chg	Q4FY17	QoQ % Chg
<b>Net Sales</b>	<b>35,251</b>	<b>36,500</b>	<b>(3.4)</b>	<b>35,820</b>	<b>(1.6)</b>
EBITDA	6,465	6,112	5.8	5,062	27.7
Other income	336	252	33.2	228	47.3
<b>PBIDT</b>	<b>6,800</b>	<b>6,364</b>	<b>6.9</b>	<b>5,290</b>	<b>28.5</b>
Depreciation	2,134	2,038	4.7	2,262	(5.6)
Interest	279	315	(11.5)	334	(16.6)
<b>PBT (before extraordinary)</b>	<b>5,566</b>	<b>4,011</b>	<b>38.8</b>	<b>(1,366)</b>	<b>(507.5)</b>
Tax	1,308	553	136.6	(757)	(272.7)
Minority Interest	170	68	150.9	9	1,723.7
<b>Adjusted PAT</b>	<b>3,187</b>	<b>3,391</b>	<b>(6.0)</b>	<b>1,191</b>	<b>167.5</b>
Extra ordinary income/ (exp.)	1,178	-		(4,060)	
<b>Reported PAT</b>	<b>4,088</b>	<b>3,391</b>	<b>20.6</b>	<b>(618)</b>	<b>(761.6)</b>
EBITDA margins (%)	18.3	16.7	160bps	14.1	420bps

Source: Company data, I-Sec research

**Table 2: Sales breakup***(Rs mn, year ending March 31)*

	Q1FY18	Q1FY17	YoY % Chg	Q4FY17	QoQ % Chg
India	12,710	14,490	(12.3)	11,970	6.2
South Africa	4,880	4,030	21.1	4,680	4.3
North America	6,460	6,570	(1.7)	6,460	-
Europe	1,580	1,400	12.9	1,800	(12.2)
Emerging Markets	7,310	7,580	(3.6)	8,130	(10.1)
Global APIs	1,300	1,310	(0.8)	1,620	(19.8)
Others	1,020	1,120	(8.9)	1,160	(12.1)
<b>Total</b>	<b>35,260</b>	<b>36,500</b>	<b>(3.4)</b>	<b>35,820</b>	<b>(1.6)</b>

Source: Company data, I-Sec research

## Revising sales and earnings estimates

For FY17-20, we forecast net sales and earnings to increase at CAGR of 13.2% and 27.6% respectively. We have reduced our sales estimates by 1.4% and 1.8% for FY18 and FY19 respectively to factor in lower revenue in Q1FY18 and increased competitive and pricing pressure in US. However, we raise our FY18 and FY19 earnings estimates by 4.6% and 2.4% respectively, due to better margins and lower depreciation charge. We introduce FY20 estimates with revenue and PAT growth of 13.3% and 21.9% respectively.

**Table 3: Earnings revision**

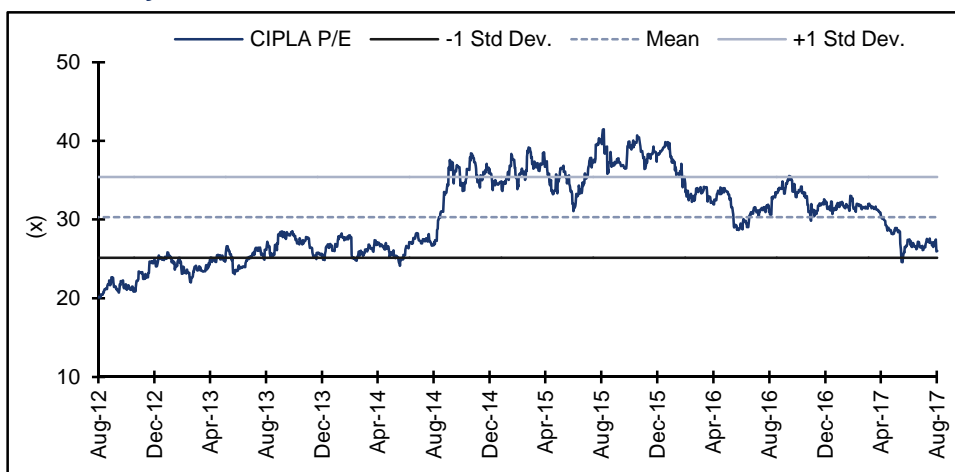
	FY18E	FY19E
<b>Total sales (Rs mn)</b>		
Sales – new	163,885	187,144
Sales – old	166,266	190,649
Change (%)	(1.4)	(1.8)
<b>EPS (Rs)</b>		
EPS – new	20.5	26.6
EPS – old	19.6	26.0
Change (%)	4.6	2.4

Source: I-Sec research

## Valuations

The stock currently trades at expensive valuations of 20.4x FY18E and 16.7x FY19E earnings and EV/EBITDA multiples of 11.6x FY18E and 10.3x FY19E. We maintain **REDUCE** rating on the stock due to lower margin profile, subdued return ratios and expensive valuations. We do not expect valuations to re-rate in near to mid-term considering (i) gradual recovery in margins but still far below peers' margins, (ii) muted return ratios of below 15% and (iii) industry wide challenging pricing environment in US market. We value it at 18x FY19E EPS and arrive at a revised target price of Rs479/share (earlier Rs468 based on 18x FY19E earnings).

**Chart 1: 1-year forward P/E**



Source: Company data, I-Sec research

## Summary financials (Consolidated)

Table 4: Profit &amp; Loss statement

(Rs mn, year ending March 31)

	FY17	FY18E	FY19E	FY20E
Domestic formulations	55,300	60,830	69,346	79,055
Export formulations	82,239	93,678	107,760	122,157
APIs	5,270	5,534	5,810	6,101
Other op. Income	3,494	3,843	4,227	4,650
<b>Total Gross Sales</b>	<b>146,302</b>	<b>163,885</b>	<b>187,144</b>	<b>211,962</b>
Excise duty				
<b>Total Net Revenue</b>	<b>146,302</b>	<b>163,885</b>	<b>187,144</b>	<b>211,962</b>
yoy Growth%	6.1%	12.0%	14.2%	13.3%
<b>Total Op. Exp.</b>	<b>121,545</b>	<b>133,235</b>	<b>149,992</b>	<b>168,441</b>
<b>EBITDA</b>	<b>24,758</b>	<b>30,650</b>	<b>37,153</b>	<b>43,521</b>
Margins %	16.9%	18.7%	19.9%	20.5%
yoy Growth%	-8.5%	23.8%	21.2%	17.1%
Depreciation	8,899	9,077	9,977	10,877
<b>EBIT</b>	<b>15,859</b>	<b>21,573</b>	<b>27,176</b>	<b>32,644</b>
Other Income	1,077	1,029	1,297	1,501
Interest	1,594	1,229	912	638
<b>PBT</b>	<b>12,222</b>	<b>21,373</b>	<b>27,560</b>	<b>33,507</b>
Tax	4,795	4,488	5,788	7,036
Tax Rate (%)	39.2%	21.0%	21.0%	21.0%
Minority Interest	360	360	360	360
<b>Adj PAT</b>	<b>8,963</b>	<b>16,525</b>	<b>21,412</b>	<b>26,110</b>
Net Margins (%)	6.1%	10.1%	11.4%	12.3%
EO Items	(3,120)	0	0	0
<b>Reported PAT</b>	<b>7,067</b>	<b>16,525</b>	<b>21,412</b>	<b>26,110</b>

Source: Company data, I-Sec research

Table 5: Balance sheet

(Rs mn, year ending March 31)

	FY17	FY18E	FY19E	FY20E
Paid-up Capital	1,609	1,609	1,609	1,609
Reserves & Surplus	123,645	137,783	156,102	178,441
<b>Total Equity</b>	<b>125,254</b>	<b>139,392</b>	<b>157,711</b>	<b>180,050</b>
Minority Interest	4,382	4,743	5,103	5,463
<b>Total Debt</b>	<b>41,126</b>	<b>30,626</b>	<b>22,626</b>	<b>14,626</b>
Deferred Liabilities	5,888	5,888	5,888	5,888
<b>Capital Employed</b>	<b>176,650</b>	<b>180,648</b>	<b>191,327</b>	<b>206,026</b>
Current Liabilities	31,201	34,465	39,204	44,386
<b>Total Liabilities</b>	<b>207,851</b>	<b>215,112</b>	<b>230,531</b>	<b>250,412</b>
<b>Net Fixed Assets</b>	<b>111,691</b>	<b>111,614</b>	<b>110,637</b>	<b>108,761</b>
Investments	1,232	1,380	1,576	1,785
Inventory	34,853	38,205	43,010	48,300
Debtors	24,974	27,976	31,946	36,182
Other Current Assets	20,623	22,700	25,449	28,381
Cash and Equivalents	14,477	13,237	17,913	27,003
<b>Total Cur. Assets</b>	<b>94,927</b>	<b>102,118</b>	<b>118,318</b>	<b>139,866</b>
<b>Total Assets</b>	<b>207,851</b>	<b>215,112</b>	<b>230,531</b>	<b>250,412</b>

Source: Company data, I-Sec research

Table 6: Cashflow statement

(Rs mn, year ending March 31)

	FY17	FY18E	FY19E	FY20E
PBT (Adj. for Extraordinary)	12,222	21,373	27,560	33,507
Depreciation	8,899	9,077	9,977	10,877
Net Chg in WC	530	(5,167)	(6,784)	(7,277)
Others	(4,795)	(4,488)	(5,788)	(7,036)
<b>CFO</b>	<b>16,856</b>	<b>20,795</b>	<b>24,965</b>	<b>30,070</b>
Capex	(6,120)	(9,000)	(9,000)	(9,000)
Net Investments made	(2,198)	(148)	(196)	(209)
<b>CFI</b>	<b>(8,318)</b>	<b>(9,148)</b>	<b>(9,196)</b>	<b>(9,209)</b>
Change in Share capital	-	-	-	-
Change in Debts	(10,790)	(10,500)	(8,000)	(8,000)
Div. & Div Tax	(1,937)	(2,387)	(3,093)	(3,772)
Others	1,710	-	-	-
<b>CFF</b>	<b>(11,017)</b>	<b>(12,887)</b>	<b>(11,093)</b>	<b>(11,772)</b>
<b>Total Cash Generated</b>	<b>(2,478)</b>	<b>(1,240)</b>	<b>4,676</b>	<b>9,089</b>
<b>Cash Opening Balance</b>	<b>8,582</b>	<b>6,104</b>	<b>4,863</b>	<b>9,539</b>
<b>Cash Closing Balance</b>	<b>6,104</b>	<b>4,863</b>	<b>9,539</b>	<b>18,629</b>

Source: Company data, I-Sec research

Table 7: Key ratios

(Year ending March 31)

	FY17	FY18E	FY19E	FY20E
Adj EPS	15.6	20.5	26.6	32.5
YoY Growth%	(18.6)	31.6	29.6	21.9
Cash EPS	14.5	22.1	27.7	33.2
EBITDA (%)	16.9	18.7	19.9	20.5
NPM (%)	6.1	10.1	11.4	12.3
Net Debt to Equity (x)	0.2	0.1	0.0	(0.1)
P/E (x)	34.8	26.4	20.4	16.7
EV/EBITDA (x)	16.6	13.7	11.6	10.3
P/BV (x)	3.5	3.1	2.8	2.4
EV/Sales (x)	2.8	2.6	2.3	2.1
RoCE (%)	7.6	9.5	11.6	13.0
RoE (%)	10.4	12.5	14.4	15.5
RoIC (%)	8.2	9.9	12.1	14.1
Book Value (Rs)	156	173	196	224
DPS (Rs)	2.0	2.5	3.2	3.9
Dividend Payout (%)	12.0	12.0	12.0	12.0
Div Yield (%)	0.3	0.4	0.6	0.7
Asset Turnover Ratio	0.7	0.8	0.8	0.9
Avg Collection days	61	59	58	59
Avg Inventory days	110	100	99	99

Source: Company data, I-Sec research

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