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Cadila Healthcare Ltd.

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US business to get booster dose after Moraiya facility received clearance

Cadila Healthcare (Cadila) is one of India's leading pharmaceutical company and is vertically integrated with presence across the value chain. It manufactures finished dosage forms, active pharmaceutical ingredients, animal healthcare products and wellness products.

Investment Rationale

Exports on a strong footing as Moraiya facility received clearance from USFDA: Cadila has a sharp focus on exports, wherein it is targeting developed as well as emerging markets, which contributed nearly 60% to its revenues in FY16. It has established a dominant presence in the developed markets of US & Europe (France and Spain). The growth in exports (especially) to the US along with other regions like Europe would be driven by new product launches. With its key plant 'Moraiya' receiving clearance from USFDA in its recent inspection, we expect quick approvals for the pending ANDAs pipeline. Notably, Moraiya has ~60 of the 198 ANDAs ((80 Para IV filings) pending approval including some critical ones, which were stalled due to the warning letter received in Dec-15. Toprol XL, Prevacid & Asacol HD are the key pending approvals from Moraiya with market size of USD 955mn. Hence, we expect Cadila's US business to post a ~16.2% CAGR over FY16-19E.

Robust domestic portfolio: Cadila is the fourth largest pharma player in the domestic market with a share of 4.2%. The company has a well-diversified product portfolio with strong presence in key therapy areas including cardiac, anti-infective, GI, gynaec & respiratory. We believe Cadila is well positioned to leverage the volume-driven growth in the domestic pharma market given its new product launches, penetration into tier II towns & increasing sales force productivity. Further, Cadila has a strong consumer division through its listed subsidiary Zydus Wellness which owns premium brands including Sugarfree & Nutralite. We expect India business to grow at CAGR of 13.7% over FY16-19E on account of new product launches (~40 products per year) and rising market share in existing therapies.

Acquisitions to aid growth: Cadila has acquired US-based specialty pharmaceutical company Sentynl Therapeutics, engaged in marketing of products in the pain management segment. This acquisition marks Cadila's foray into the USD8bn specialty pain management drug market in US, as it gains access to Sentynl's distribution network & large prescriber base. Likewise, acquisition of brands from MSD & Astra Zeneca in India helps expand offerings in the domestic market.

Valuations: With its key plant 'Moraiya' receiving no observations from the USFDA, we factor in faster product approvals as all the key oral solids, transdermal & nasal products are from this facility. Further, EBITDA margins are expected to expand by 70bps over FY16-19E on account of a) exclusivity (up to 180 days) on certain product launches and b) shifting of business mix towards high-margin specialty products. We expect revenue/PAT to grow at a CAGR of 11.5%/14.4% over FY16-19E. Hence, we initiate Cadila with a BUY rating with a TP of Rs.491 based on 22x FY19E EPS.

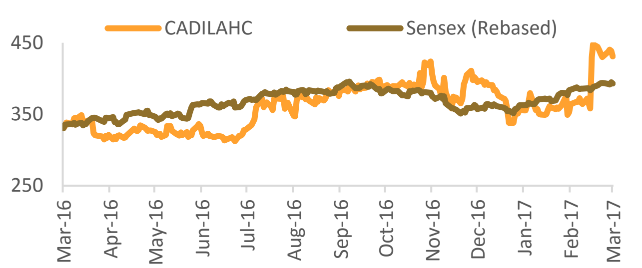
Market Data

Rating	**BUY**
CMP (Rs.)	431
Target (Rs.)	491
Potential Upside	14%
Duration	Long Term
Face Value (Rs.)	1.0
52 week H/L (Rs.)	460/305
Adj. all time High (Rs.)	460
Decline from 52WH (%)	6.3
Rise from 52WL (%)	41.3
Beta	1.2
Mkt. Cap (Rs.Cr)	44,119

Fiscal Year Ended

Y/E	FY16	FY17E	FY18E	FY19E
Net sales (Rs.Cr)	9,838	9,899	11,652	13,619
Adj. profit (Rs.Cr)	1,525	1,264	1,772	2,284
Adj. EPS (Rs.)	14.9	12.3	17.3	22.3
P/E (x)	29.1	35.1	25.0	19.4
P/BV (x)	8.3	7.1	5.8	4.6
ROE (%)	31.8	21.8	25.5	26.5

One year Price Chart

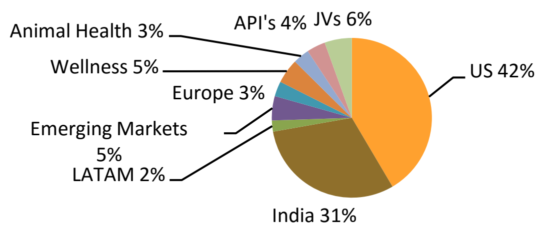


Shareholding Pattern	Dec-16	Sep-16	Chg.
Promoters (%)	74.8	74.8	-
Public (%)	25.2	25.2	-

Cadila Healthcare Ltd: Business Overview

Cadila Healthcare (Cadila) is one of India's leading pharmaceutical company and is vertically integrated with presence across the value chain. It maufactures finished dosage forms, active pharmaceutical ingredients, animal healthcare products and wellness products. Cadila has a worldwide presence with particular focus on the US (~42% of FY16 revenues), India (~31% of revenues), Europe & RoW.

Revenue break-up (FY16)



Source: Company, In-house research

US business to be the key growth driver

US business contribution to total sales has significantly risen from 18.5% in FY10 to 42% in FY16. The company is present in the generic pharmaceuticals market through its wholly owned subsidiary, Zydus Pharmaceuticals (USA) Inc. Interestingly, Zydus Pharma is ranked amongst the top 10 generics companies in US based on prescriptions. US formulations business grew at a stellar CAGR of ~34% over FY12-16 led by HCQs & price hikes in some of its products. In terms of ANDA filings, 42 ANDAs were filed with the USFDA during 9MFY17 (30 in FY16), taking the cumulative number of pending ANDAs with USFDA to 198 (80 Para IV filings). Further, Cadila received 5 more approvals in 9MFY17 (10 in FY16), taking the cumulative number of approved ANDAs to 105.

Resolution of the Moraiya plant – A booster dose

Approvals have been delayed primarily due to the warning letter issued by USFDA for its Moraiya facility in Dec-2015. However, the company has cleared re-inspection without any Form-483 observations in Feb-2017. This will help in aiding US business growth in FY18 through increasing approval rate as 198 ANDAs are pending for approval. In order to enhance its share in the US generics, the company continues to focus on launching complex, difficult-to-make oral solids and formulations of other dosage forms like injectables, nasals, creams and ointments.

Forays into the specialty pain market

Cadila has acquired Sentynl Therapeutics Inc., a US based specialty pharma company specialized in the pain management segment (market size of USD8bn). While the acquisition will enable it to leverage its existing assets in US, further, it gains access to the specialty distribution network and a large prescriber base.

ANDAs pipeline

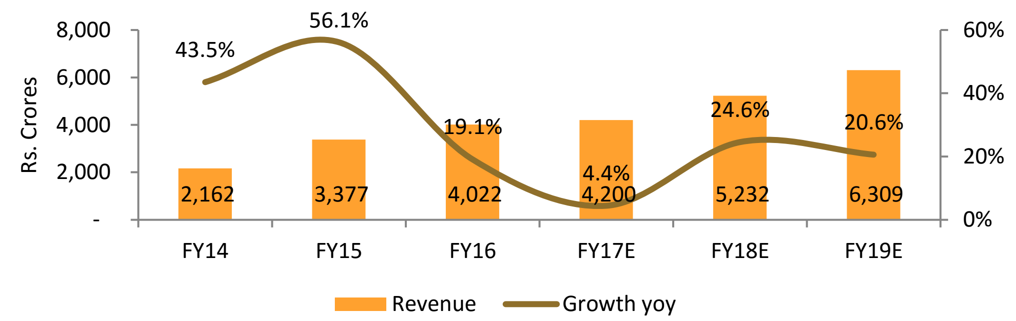
Particulars	Pending	Approved
Injectables	17	4
Orals modified release	42	23
Transdermal patches	7	3
Nasals	3	0
Topicals	18	0
Orals- Immediate release	111	77
Total	**198**	**107**

Source: Company, In-house research

US business to grow at a robust CAGR of ~16.2%

We expect US business to grow at a CAGR of 16.2% over FY16-19E on account of several new launches expected over the next few quarters (generic Asacol, Toprol XL, Prevacid with a market size of worth USD950mn) coupled with recent approvals for Methotrexate & Oseltamavir (Market size of USD582mn).

US revenue to grow at 16.2% CAGR over FY16-19E



Source: Company, In-house research

Investing in innovative drugs and Biosimilars

Cadila continues to invest in building R&D capabilities to create a quality pipeline. Currently, it has 5 NCEs in pipeline along with 18 biosimilars at various stages of development. Further, it has 10 vaccines under development & Cadila was the first company to launch indigenously developed H1N1 vaccine VaxiFlu in 2010. Moreover, it has received approval from USFDA to initiate PhaseII clinical studies of Saroglitazar Magnesium (used for curing lever disease).

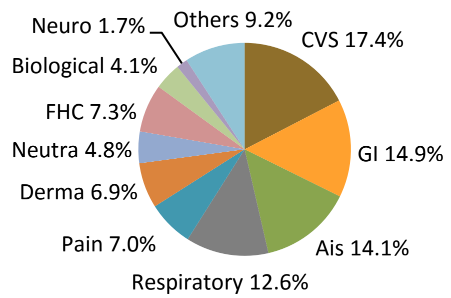
India business- 31% of total sales

India business, the second largest contributor to the consolidated revenues (31% of total sales), grew at a CAGR of 11.6% over FY12-16. Notably in FY16, India business grew by 10.8% YoY despite the challenges in the form of lower growth of mature brands, fixed dose combination (FDC) ban and the extended NLEM list. The company is among the top 3 players in the key therapy areas including Cardiology, Gynecology & Pain Management. Similarly, it is ranked among the top 5 players in therapy areas namely Gastro Intestinal, Respiratory and Dermatological space. Interestingly, 15 brands of the company are listed among the top 300 pharmaceutical brands in India.

India business to outperform the IPM growth

The company continues to add new products to its portfolio and launched more than 15 new products (5 products for the first time in India) during 9MFY17 (40 in FY16). Recently, the company acquired trademarks and rights for 6 products in India from MSD to strengthen its product presence in men's & women's health, wound management and cardiovascular therapy areas. Importantly, the acquired portfolio had clocked sales of Rs84cr in 2015. Besides, it also acquired trademarks & rights for select products in India from AstraZeneca to strengthen its presence in the anesthesia, gynecology and anti-infective therapies.

Therapeutic contribution (FY16)

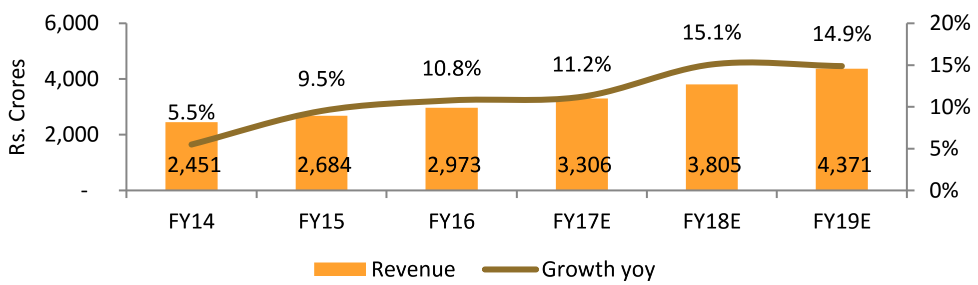


Source: Company, In-house research

Recent acquisitions to drive India business

We expect India business to grow at CAGR of 13.7% over FY16-19E on account of a) new product launches (~40 products per year), b) incremental sales from acquired brands & c) rising market share in existing therapies.

Revenue to grow at CAGR of 13.7% during FY16-19E

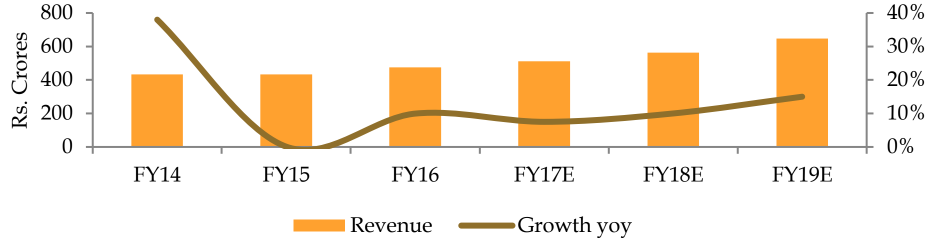


Source: Company, In-house research

Emerging markets to register steady growth

Cadila operates in different markets of Asia Pacific, Africa and Middle East with leadership position in several of these markets. Emerging markets (EMs) contribute 5% to total revenues. The company is continuously focusing on brand building and strengthening the branded generics portfolio in these key markets to ensure sustainable growth. During FY16, it has launched 8 new products in different markets of Asia Pacific, Africa and Middle East. This included the launch of "Pegihep" (Pegylated Interferon alpha 2b) in Myanmar, the first biosimilar launch by the company in the emerging markets. We expect EMs business to grow at a CAGR of 10.8% over FY16-19E led by ramp-up in existing product portfolio coupled with new launches.

EMs grow at 10.8% CAGR over FY16-19E



Source: Company, In-house research

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Europe business to report flat growth

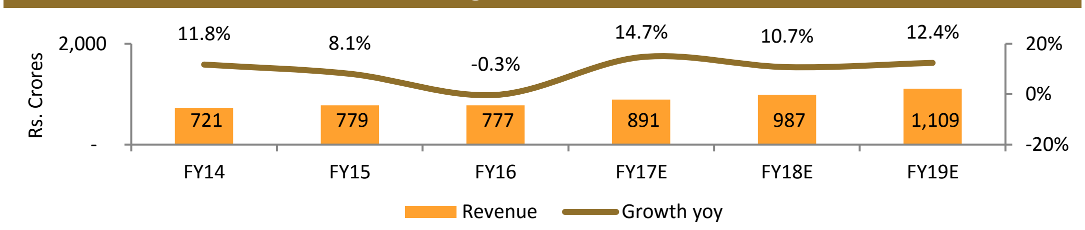
Europe business contributed 3% to the total revenues in FY16.There is intense competition in the European market as government keeps on reducing prices in order to keep healthcare costs down. During FY16, Cadila rationalized its product portfolio both in France and Spain by expanding the business of in-house products' portfolio. This strategy impacted the growth in revenues but resulted in improved profitability. The company launched 3 new products in France (2 from India) and 4 new products in Spain (all from India). Going forward, in both the markets, the focus will continue to be on increasing the proportion of products supplied from India, so as to remain competitive in these markets.

Other businesses to provide tailwinds

The company's other businesses include consumer wellness & animal health. Zydus Wellness Limited, a subsidiary of the company, operates in the consumer wellness space having three established brands namely Sugar Free (a low calorie sugar substitute), EverYuth (a range of skincare products) and Nutralite (a cholesterol free table spread).

Likewise, in the veterinary business, Cadila ranks amongst the leading animal health companies. Notably, Bremer Pharma (German subsidiary) runs the global animal health business & has presence in more than 50 markets across the world. The company strengthened its position in the Indian market by launching 8 new products in FY16. Further, it is in the process of penetrating into newer markets, while strengthening its current product portfolio in the existing markets. We expect other businesses to grow at a CAGR of 12.6% over FY16-19E.

Other businesses to grow at 12.6% CAGR over FY16-19E

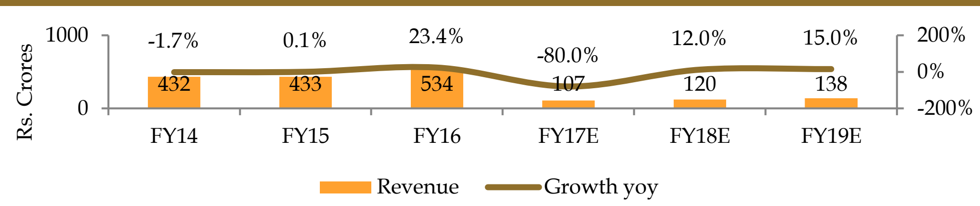


Source: Company, In-house research

JVs (Joint Ventures) & alliances growth to recover

Cadila's JVs & alliances contribute 6% to total revenues & grew by 6.6% CAGR over FY12-16. The company has tied up with various global pharma players (Takeda, Hospira and Bayer Schering Pharma) to manufacture a range of generic APIs covering various therapeutic categories and oncology injectable products exclusively for the JV partners. In FY16, the company received approval from USFDA for 2 ANDAs and 1 NDA which were filed on behalf of partners. However, during 9MFY17 revenue was adversely impacted due to warning letter issued by FDA.

JVs (Joint Ventures) and alliances



Source: Company, In-house research

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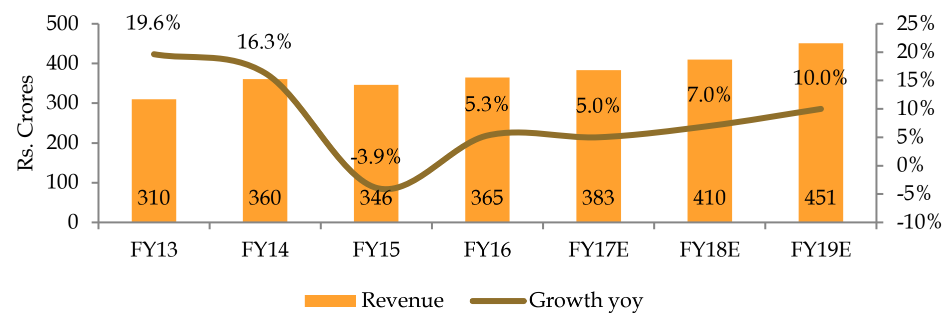
APIs

The company's APIs and intermediates' business (4% of total sales) is the foundation for the formulations business as it ensures the uninterrupted supply of key input materials in a timely and cost efficient manner. In FY16, the company filed 6 more DMFs with the USFDA, taking the cumulative number of filings to 122. We expect APIs business to report a CAGR of 7.3% over FY16-19E.

APIs to grow at a CAGR of 7.3% over FY16-19E



Source: Company, In-house research

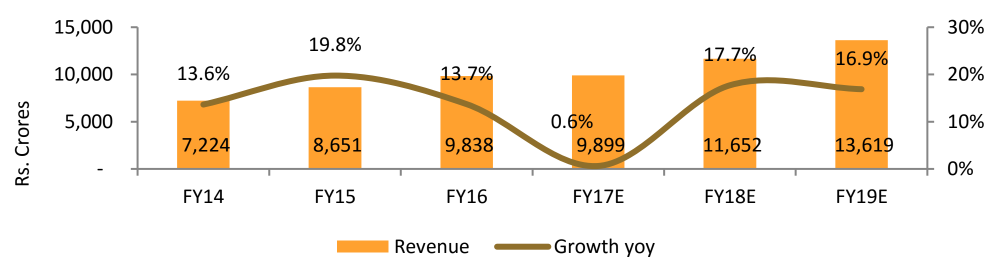
Financials

Revenue to grow at 11.5% CAGR over FY16-19E

Cadila's revenue grew at a robust CAGR of 16.2% over FY11-16 driven largely by strong performance of US & India businesses. Cadila's strategic shift to focus on US generics market over the last few years led to strong CAGR of 33% during FY11-16. Notably, the revenue contribution of US business increased from 18.6% in FY11 to 41.6% in FY16. However, FY17 was a tough year for the company as it witnessed tepid approvals from FDA due to warning letter issued against its critical facility at Moraiya along with price erosion and channel consolidation in US.

We expect company's revenue to grow at a CAGR of 11.5% driven by key launches in the US coupled with a strong domestic franchise in India.

Revenue to grow at 11.5% CAGR during FY16-19E

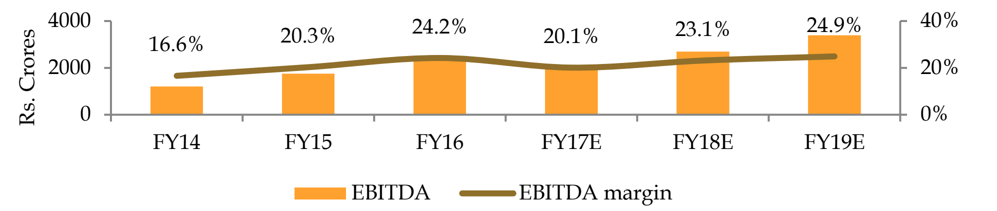


Source: Company, In-house research

EBITDA Margins to improve by 70bps….

In FY16, EBITDA margin stood at 24.2%, an improvement of 250bps over FY11-16. However, margin declined to 20.7% for 9MFY17 mainly due to delayed approvals from Morayia facility, price erosion and consolidation in the industry. Going ahead, we expect EBITDA margin to expand by 70bps over FY16-19E on account of a) exclusivity (up to 180 days) on certain product launches and b) shifting of business mix towards high-margin specialty products.

EBITDA to grow at 12.5% CAGR over FY16-19E

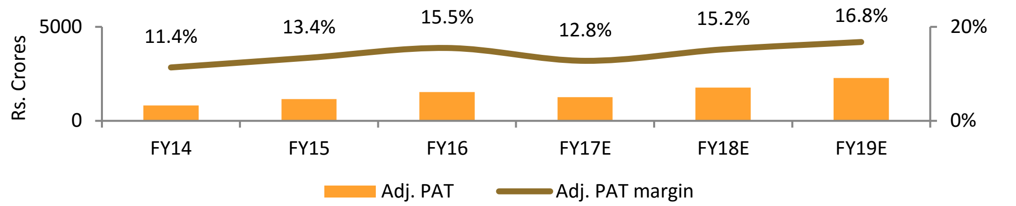


Source: Company, In-house research

PAT margin to improve by 130bps

Adj. PAT grew at 16.5% CAGR over FY11-16. However, PAT margin improved marginally by 10bps to 15.5% during the same period due to higher depreciation & tax expense. We expect Adj. PAT to grow at a CAGR of 14.4% with 130bps improvement in PAT margin over FY16-19E.

PAT to grow at 14.4% CAGR over FY16-19E

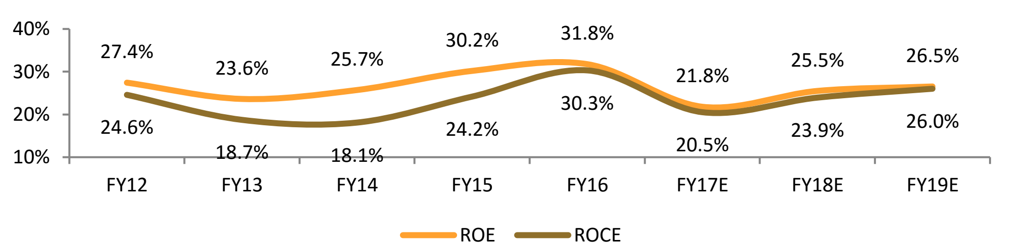


Source: Company, In-house research

Healthy balance sheet

Cadila's D/E ratio sharply increased to 0.9 in FY13 from 0.5 in FY11 on account of higher capex which was funded by debt. However, it stood at 0.4x in FY16 and we expect it to reduce to 0.3x by FY19E owing to strong free cash flow generation to the tune of Rs3,110cr over FY17-19E. Receivables stood at 64days (67 in FY15), inventory at 100 days (112 in FY15) and payables at 66 days (58 days in FY15). While ROCE & ROE is expected to decline in FY17E on account of lower margins, we expect improvement in ROCE/ROE from FY18E onwards as margins improve. However, ROE/ROCE is expected to stabilize at 26.5%/26% on account of huge free cash flow generation & low leverage.

Return ratios trend



Source: Company, In-house research

Key risks

- USFDA scrutiny against company's manufacturing plants regarding CGMP (Current Good Manufacturing Practices) and delay in product approvals.
- Price erosion in the US business due to channel consolidation and new entrants.
- Adverse currency movements in related markets.

Profit & Loss Account (Consolidated)

Y/E (Rs. Cr)	FY16	FY17E	FY18E	FY19E
Total operating Income	**9,838**	**9,899**	**11,652**	**13,619**
Raw Material cost	3,277	3,594	4,123	4,692
Employee cost	1,332	1,389	1,604	1,877
Other operating expenses	2,846	2,926	3,231	3,660
EBITDA	**2,383**	**1,990**	**2,695**	**3,390**
Depreciation	302	344	404	449
EBIT	**2,081**	**1,646**	**2,291**	**2,940**
Interest cost	49	60	60	60
Other Income	94	75	83	91
Profit before tax	**2,126**	**1,662**	**2,314**	**2,972**
Tax	571	357	497	639
Profit after tax	**1,555**	**1,304**	**1,816**	**2,333**
Minority Interests	30	70	77	85
P/L from Associates	-	30	33	36
Adjusted PAT	**1,525**	**1,264**	**1,772**	**2,284**
E/o income / (Expense)	(25)	-	-	-
Reported PAT	**1,500**	**1,264**	**1,772**	**2,284**

Balance Sheet (Consolidated)

Y/E (Rs. Cr)	FY16	FY17E	FY18E	FY19E
Paid up capital	102	102	102	102
Reserves and Surplus	5,250	6,144	7,546	9,461
Net worth	**5,352**	**6,246**	**7,649**	**9,563**
Minority interest	135	205	282	367
Total Debt	2,107	2,720	2,720	2,720
Other non-current liabilities	226	226	226	226
Total Liabilities	**7,820**	**9,397**	**10,877**	**12,876**
Total fixed assets	3,819	5,145	5,741	6,092
Capital WIP	971	500	300	300
Goodwill	0	0	0	0
Investments	266	266	266	266
Net Current assets	2,008	2,730	3,813	5,462
Deferred tax assets (net)	-	(61.1)	(61.1)	(61.1)
Other non-current assets	756	756	756	756
Total Assets	**7,820**	**9,397**	**10,877**	**12,876**

Cash Flow Statement (Consolidated)

Y/E (Rs. Cr)	FY16	FY17E	FY18E	FY19E
Pretax profit	**2,124**	**1,692**	**2,347**	**3,008**
Depreciation	302	344	404	449
Chg. in Working Capital	266	(69)	(345)	(357)
Others	27	(15)	(23)	(31)
Tax paid	(651)	(357)	(497)	(639)
Cash flow from operating activities	**2,068**	**1,594**	**1,885**	**2,430**
Capital expenditure	(972)	(1,200)	(800)	(800)
Chg. in investments	(0)	-	-	-
Other investing cashflow	(6)	75	83	91
Cash flow from investing activities	**(978)**	**(1,125)**	**(718)**	**(709)**
Equity raised/(repaid)	-	-	-	-
Debt raised/(repaid)	(209)	613	-	-
Dividend paid	(579)	(370)	(370)	(370)
Other financing activities	(165)	(60)	(60)	(60)
Cash flow from financing activities	**(953)**	**183**	**(429)**	**(429)**
Net chg in cash	137	653	738	1,292

Key Ratios (Consolidated)

Y/E	FY16	FY17E	FY18E	FY19E
Growth (%)				
Net Sales	11.4	2.6	17.9	17.0
EBITDA	35.7	(16.5)	35.4	25.8
Net profit	31.4	(17.1)	40.2	28.9
Margin (%)				
EBITDA	24.2	20.1	23.1	24.9
EBIT	21.2	16.6	19.7	21.6
NPM	15.5	12.8	15.2	16.8
Return Ratios (%)				
RoE	31.8	21.8	25.5	26.5
RoCE	30.3	20.5	23.9	26.0
Per share data (Rs.)				
EPS	14.9	12.3	17.3	22.3
DPS	3.2	3.0	3.0	3.0
Valuation(x)				
P/E	29.1	35.1	25.0	19.4
EV/EBITDA	19.3	23.1	16.8	13.0
EV/Net Sales	4.9	4.7	4.0	3.3
P/B	8.3	7.1	5.8	4.6
Turnover Ratios (x)				
Net Sales/GFA	1.7	1.4	1.4	1.5
Sales/Total Assets	1.0	0.9	0.9	0.9

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Upside or downside is less than 10%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than equal to -10%	**Hold**	Between 0% & 10%
		Reduce/sell	Less than 0%

* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

* CADILAHC is a large-cap company.

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