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Cipla Ltd.

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Strong Inhalation portfolio to drive growth…

Cipla is one of the largest producers of pMDIs (Metered Dose Inhalers) in the world with more than 65 different inhaled devices. Cipla derives 54% of its revenue from exports and 39% from domestic business.

Investment Rationale

- **Respiratory business to sustain the growth momentum:** Cipla is among a handful of innovators in the inhalation space globally. The company's overall respiratory business is close to USD350mn p.a. and it aims to triple the revenues from this segment over the next couple of years. While 50% of this growth will come from increasing market share in existing markets (India, South Africa and emerging markets), the rest will be driven by new product launches in the developed markets (US, Europe).

- **Domestic market to outperform the industry growth:** Cipla has a strong foothold in respiratory & anti-infectives and the two are the key growth drivers in the domestic market. Notably, prescription business accounts for 81% of overall domestic business providing revenue stability. We expect the company's domestic formulation business to post a CAGR of 14.3% over FY2016-19E on account of new product launches in the branded segment and higher contribution from other chronic therapies.

- **South Africa to post strong growth:** Cipla has a strong leadership position in the Respiratory, CNS and Oncology segments in South Africa. To further strengthen its position, it entered into a sales and distribution agreement with Teva Pharmaceuticals Ltd to market its chronic products. We expect South Africa business to deliver strong CAGR of 20% over FY16-19E on account of increased sales from private & institutional business.

- **Invagen acquisition to drive the US revenue:** Cipla has a strong product pipeline of 214 ANDAs, out of which, 131 are approved and 83 ANDAs are pending for approval including complex generics from Invagen portfolio. Going forward, the company expects to file 20-25 ANDA's and launch 15 products every year with more focus on limited competition opportunities. We expect US business to grow at 20% CAGR driven by key launches (Fosrenol, Renvela) and monetization of oncology portfolio.

Valuations: We expect Cipla's revenue and PAT to grow at a moderate CAGR of 13% and 14.5%, respectively over FY16-19E on account of key inhalation launches and scale up of US revenue from InvaGen acquisition. Hence, we recommend BUY rating on the stock with a TP of Rs633 at 22.5x FY19E earnings in-line with the peers.

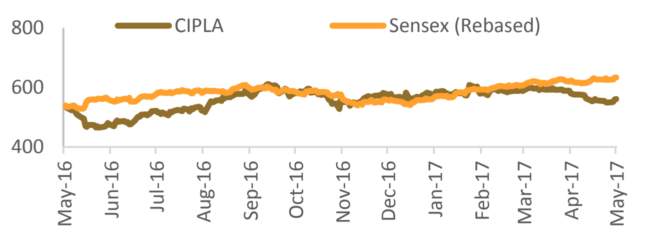
Market Data

Rating	**BUY**
CMP (Rs.)	567
Target (Rs.)	633
Potential Upside	12%
Duration	Long Term
Face Value (Rs.)	2
52 week H/L (Rs.)	622/458
Adj. all time High (Rs.)	622
Decline from 52WH (%)	8.9
Rise from 52WL (%)	23.6
Beta	0.4
Mkt. Cap (Rs.Cr)	45,586

Fiscal Year Ended

Y/E	FY16	FY17E	FY18E	FY19E
Revenue (Rs.Cr)	13,678	15,289	17,253	19,684
Adj. profit (Rs.Cr)	1,379	1,409	1,777	2,260
Adj. EPS (Rs.)	18.7	17.5	22.1	28.1
P/E (x)	33.0	32.3	25.6	20.1
P/BV (x)	3.8	3.4	3.0	2.7
ROE (%)	11.9	11.0	12.5	14.1

One year Price Chart



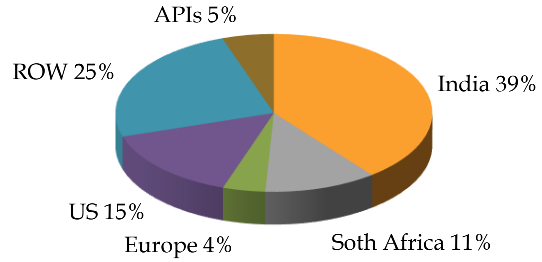
Source: Company, In-house research

Shareholding Pattern	Mar-17	Dec-16	Chg.
Promoters (%)	37.5	37.5	-
Public (%)	62.5	62.5	-

Cipla Ltd: Business overview

Cipla is one of the largest producers of pMDIs (Metered Dose Inhalers) in the world with more than 65 different inhaled products and devices. It manufactures metered dose inhalers, innovative dry powder inhalers, nasal sprays and nebulizers. Apart from strong presence in respiratory, it also manufactures drugs for anti-infectives, cardiac, gastroenterology, and urology. Cipla derives 54% of its revenue from exports and 39% from domestic business. In the domestic market, chronic and acute therapies contribute 53% and 47% respectively to the revenue.

Region wise revenue break-up (FY16)



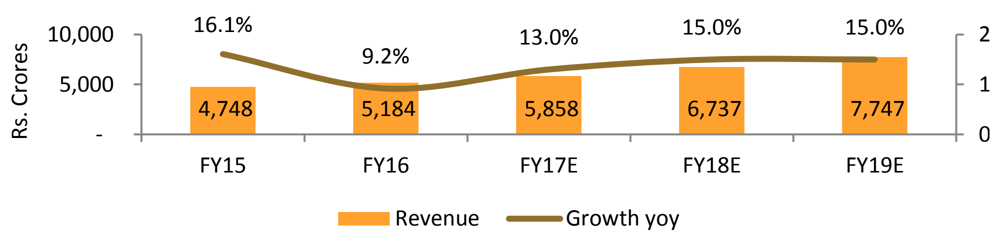
Source: Company, In-house research

Domestic business to grow at 14.3% CAGR over FY16-19E

Cipla is one of the largest players in the domestic formulations market and its Indian business contributed 39% to the overall revenue in FY16.It has 5.3% market share in the branded generics in key therapies such as respiratory and anti-infectives. During FY16, the company posted a growth of 9.2% driven by prescription business (81% of India business). The company grew faster than the market in Anti-infectives, Gastrointestinal and Urology while the respiratory business saw strong uptake with over 20% growth in the COPD (Chronic Obstructive Pulmonary Disease) portfolio.

It has 23 brands in the top 300 list in the domestic market. Cipla is focusing on building high-value specialty portfolio through a mix of in-licensing and in-house development of products. The company has successfully launched generic drug sofosbuvir meant for the treatment of hepatitis-C in FY16. Further, it continues to build upon its Hepatitis franchise in order to improve its presence in breakthrough therapies for patients with HepCvir + Ledipasvir / Daclatasvir combinations. Besides, the company is working on enhancing the depth of its portfolio in priority therapy areas such as oncology and anti-arthritis to strengthen its leadership position in the domestic market.

Domestic business to outperform IPM growth



Source: Company, In-house research

We expect the company's domestic formulation business to post a CAGR of 14.3% over FY2016-19E on account of new product launches in the branded segment and higher contribution from chronic therapies.

Strong Inhalation portfolio to drive growth

Cipla is among a handful of innovators in the inhalation space globally. The company's overall respiratory business is close to USD350mn p.a. and it aims to triple the revenues from this segment over the next couple of years. While 50% of this growth will come from increasing market share in existing markets (India, South Africa and emerging markets), the rest will be driven by new product launches in the developed markets (US, Europe).

Late entrant in the largest global generics market

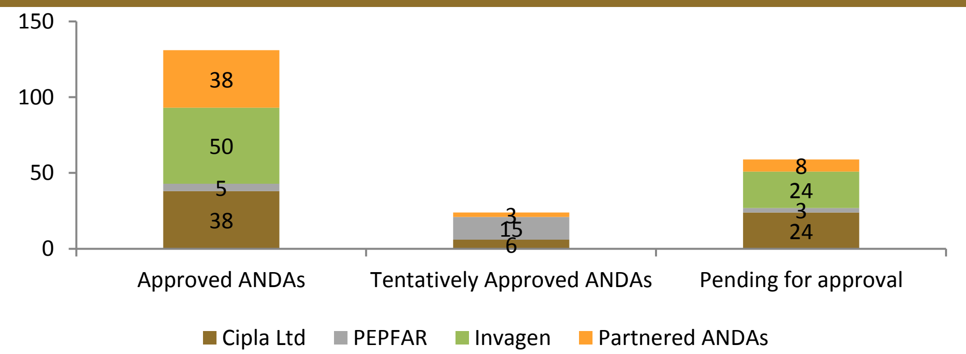
North America contributed 15% to the total revenue in FY16 (8% in FY15) and registered a growth of 117% YoY primarily driven by the company's partnership with Teva for Nexium, successful launch of new products and Invagen acquisition. Currently, Cipla has a strong product pipeline of 214 ANDAs, out of which, 131 are approvedand 83 ANDAs are pending for approval. This includes key complex generic filings from InvaGen portfolio. Going forward, the company expects to file 20-25 ANDA's and to launch 15 products every year in the respiratory, oncology and anti-infective space with more focus on limited competition opportunities. It has already filed Paclitaxel (cancer medication with a market size of USD700mn). Importantly, the long term growth driver for the company will be the launch of the CFC-free inhalers (high value respiratory inhalers) in the regulated markets with potential market size of around USD3bn p.a.

Cipla gains scale in the US generics market through InvaGen acquisition

In FY16, Cipla acquired US based InvaGen Pharmaceuticals and Exelan Pharmaceuticals Inc. (CY15 revenue of USD225mn revenue) in a transaction valued at USD550mn. Invagen was incorporated in 2003 and is engaged in the business of manufacturing and distribution of generic pharmaceuticals. It focuses on a wide range of therapeutic areas including cardiovascular, anti-infective, CNS, anti-inflammatory, anti-diabetic and anti-depressants. Exelan was incorporated in the year 2011 and is engaged in the business of marketing generic pharmaceuticals to the government and institutional market.

The acquisition (InvaGen&Exelan) will not only strengthen Cipla's overall presence in the US but also enhance its product portfolio and manufacturing capabilities. Additionally, this will also provide access to US institutional business. InvaGen currently has 50 approved ANDAs and a pipeline of 24 pending ANDAs.

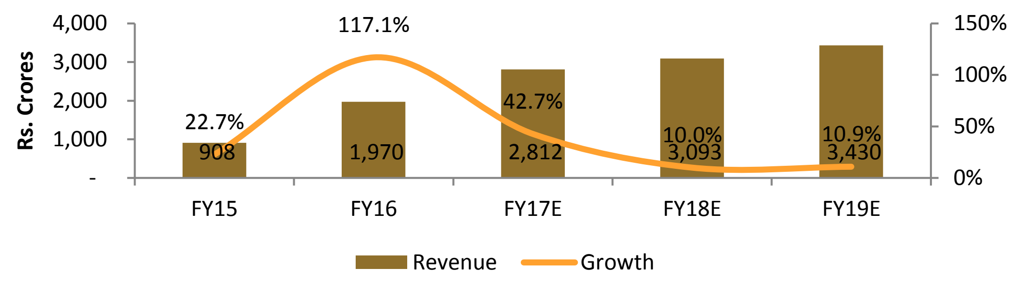
ANDAs pipeline



Source: Company, In-house research

We expect Cipla's US business to grow at a CAGR of 20.3% over FY16-19E on account of scale up in revenue from acquisition, key launches (Fosrenol, Renvela) and monetization of oncology product pipeline.

US sales to grow at 20.3% CAGR over FY16-19E

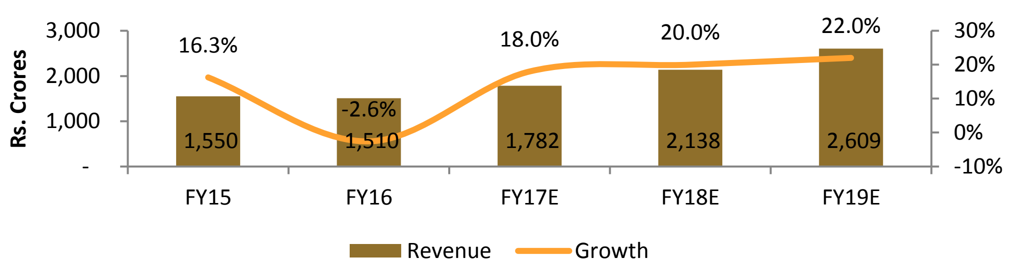


Source: Company, In-house research

South Africa: Increasing healthcare access to drive growth

Cipla acquired South Africa based Medpro in FY13. This acquisition strengthened its presence in the African continent by managing a frontend sales force. As one of the largest pharmaceutical companies in South Africa, Cipla Medpro has a market share of more than 5% and contributes 11.5% to the overall revenues on a consolidated basis in FY16.Cipla's private market business (60% of revenue) has grown at 14% in FY16 with market leadership in the Respiratory, CNS and Oncology segments. Further, Medpro Pharmaceuticals Pvt. Ltd. (a Subsidiary of Cipla Medpro) entered into sales and distribution agreement with Teva Pharmaceuticals Ltd. to focus on oncology, central nervous system, women's health, cardiovascular and other specialty therapies. In FY16, South Africa business reported de-growth of 2.6% due to currency fluctuation, although in local currency terms revenue grew by ~25%.

SA sales to grow at 20% CAGR over FY16-19E



Source: Company, In-house research

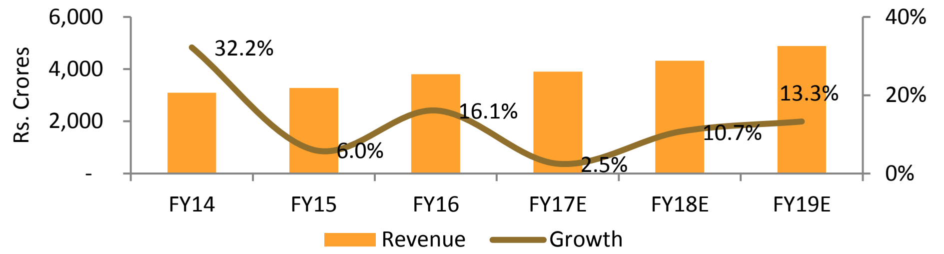
We expect South Africa business to grow at a CAGR of 23% over FY15-18E on account of increased sales from tender and private business.

International (ROW market): Momentum to pickup

International markets include all export markets excluding North America and South Africa. It has 150 global partners across 100 countries and spans across Middle East, Latin America, Europe, China and Russia. International business contributed 29% to the top line in FY16 and grew by 16.1% YoY. In order to strengthen its front-end presence the company changed its business strategy in select markets and adopted direct- to-market approach. This will not only improve the top line growth but also aid in margin improvement going forward.

Europe accounted for 4% of the overall revenues (15% of RoW revenue) and posted 30% growth in FY16 supported by growth in both front-end and B2B segments. The company has further strengthened its respiratory platform with the launch of Fluticasone, Salbutamol respules and Ipratropium MDI (Metered Dose Inhalers) across multiple European markets. Moreover, Cipla is focusing on adding innovative elements to its inhaler products and currently has more than seven different products in a single market. We expect ROW business to grow at a CAGR of 8.7% over FY16-19E on account of gSeretide launch in UK (Market size USD400mn) in H2FY17and monetization of other inhalation portfolio.

ROW business to grow at 8.7% CAGR over FY16-19E



Source: Company, In-house research

APIs: Captive consumption to increase

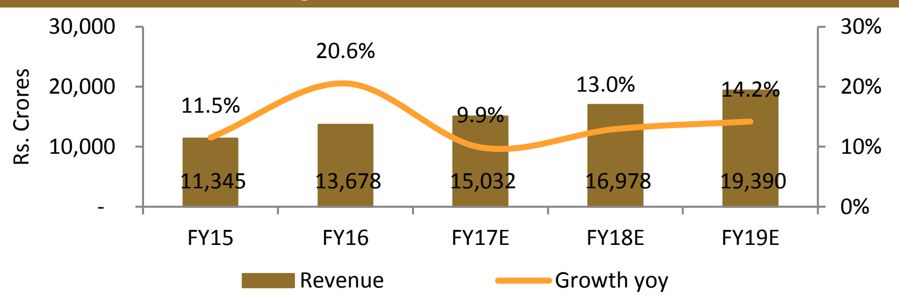
Cipla manufactures APIs for more than 300 partners globally with major contribution coming from ARVs, gastroenterology, respiratory, neurology and oncology segments. The company has a robust portfolio selection process enabling it to build future pipeline of complex products and thus providing early launch capabilities. A substantial portion of the APIs manufactured by the company is consumed internally due to new launches. APIs contributed 5% to the total revenue and grew by 7% in FY16. We expect API business growth to remain subdued (CAGR of 1% over FY16-19E) due to increasing captive consumption.

Revenue to grow at moderate CAGR of 12.3%

Cipla's revenue grew at a robust CAGR of 18.1% over FY12-16 driven largely by new launches and in-licensing products in the domestic, North America and ROW markets. Domestic business grew at modest pace of 12.7% CAGR owing to NLEM price regulations while exports grew at a CAGR of 17.7% led by expansion into new geographies.

We expect Cipla's revenue to grow at a CAGR of 13%, led by growth in domestic business, scale up of revenues from InvaGen's acquisition and improvement in revenues from other subsidiaries.

Revenue to grow at CAGR 12.3% over FY16-FY19E

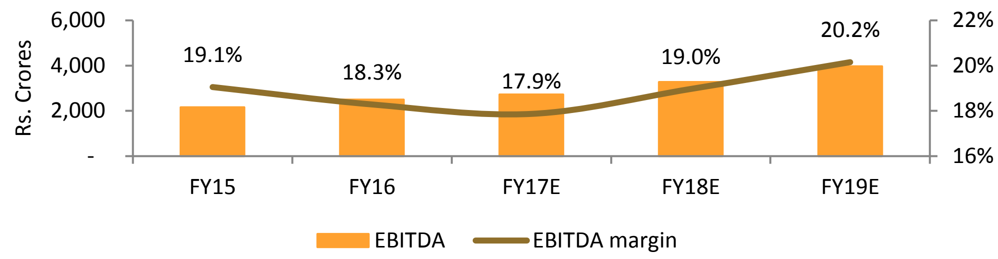


Source: Company, In-house research

EBITDA Margins to improve by 190bps....

In FY16, EBITDA margin stood at 18.3%, a decline of 530bps over FY12-16. This reduction is on account of huge investment towards building front-end presence across markets, NLEM pricing regulations in the domestic market and higher research and development spend. We expect EBITDA margin to expand by 190bps over FY16-19E led by launch of oncology and inhalation products.

EBITDA to grow at 16.6% CAGR over FY16-19E

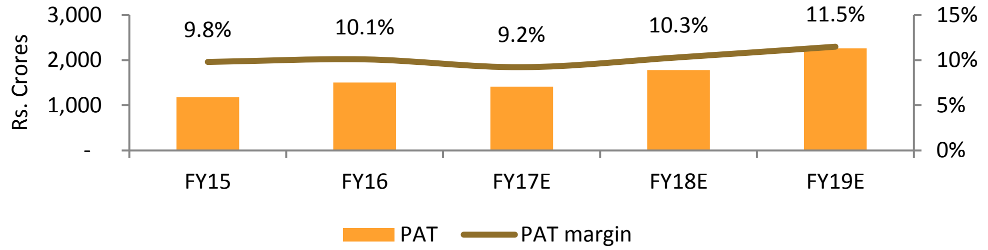


Source: Company, In-house research

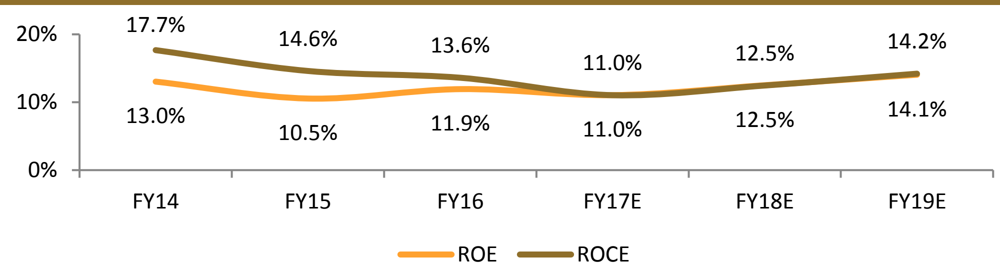
Improvement in EBITDA to lead to better PAT margin

PAT grew at a muted CAGR of 7.1% over FY12-16 owing to dismal operating performance and currency volatility in emerging markets. Going forward, we expect PAT to grow at a CAGR of 19.9% with 100bps improvement over FY16-19E.

PAT to grow at 19.9% CAGR over FY16-19E



Return ratios trend



Source: Company, In-house research

Key Risks:

- USFDA scrutiny against company's manufacturing plants 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	**13,678**	**15,289**	**17,253**	**19,684**
Raw Material cost	5,118	5,742	6,299	7,077
Employee cost	2,447	2,781	3,141	3,548
Other operating expenses	3,612	4,035	4,540	5,091
EBITDA	**2,501**	**2,732**	**3,273**	**3,967**
Depreciation	542	851	959	1,049
EBIT	**1,959**	**1,881**	**2,314**	**2,918**
Interest cost	161	135	135	135
Other Income	82	100	104	104
Profit before tax	**1,880**	**1,846**	**2,283**	**2,887**
Tax	440	388	457	577
Profit after tax	**1,440**	**1,458**	**1,826**	**2,309**
Minority Interests	49	49	49	49
P/L from Associates	(12)	-	-	-
Adjusted PAT	**1,379**	**1,409**	**1,777**	**2,260**
E/o income / (Expense)	127	-	-	-
Reported PAT	**1,506**	**1,409**	**1,777**	**2,260**

Balance Sheet (Consolidated)

Y/E (Rs. Cr)	FY16	FY17E	FY18E	FY19E
Paid up capital	161	161	161	161
Reserves and Surplus	11,697	12,912	14,496	16,562
Net worth	**11,857**	**13,073**	**14,656**	**16,723**
Minority interest	270	319	368	418
Total Debt	5,191	5,191	5,191	5,191
Other non-current liabilities	554	635	635	635
Total Liabilities	**17,872**	**19,218**	**20,851**	**22,966**
Total fixed assets	4,826	5,266	5,507	5,458
Capital WIP	741	600	400	400
Goodwill	5,511	5,511	5,511	5,511
Investments	757	757	757	757
Net Current assets	5,322	6,369	7,961	10,126
Other non-current assets	715	715	715	715
Total Assets	**17,872**	**19,218**	**20,851**	**22,966**

Cash Flow Statement (Consolidated)

Y/E (Rs. Cr)	FY16	FY17E	FY18E	FY19E
Pretax profit	**2,007**	**1,846**	**2,283**	**2,887**
Depreciation	542	851	959	1,049
Chg. in Working Capital	(424)	(516)	(587)	(785)
Others	(3,326)	-	-	-
Tax paid	(508)	(388)	(457)	(577)
Cash flow from operating activities	**(1,709)**	**1,793**	**2,198**	**2,573**
Capital expenditure	(1,077)	(1,150)	(1,000)	(1,000)
Chg. in investments	(160)	-	-	-
Cash flow from investing activities	**(1,237)**	**(1,150)**	**(1,000)**	**(1,000)**
Equity raised/(repaid)	3	-	-	-
Debt raised/(repaid)	3,442	(0)	-	-
Dividend paid	(181)	(193)	(193)	(193)
Other financing activities	-	-	-	-
Cash flow from financing activities	**3,264**	**(194)**	**(193)**	**(193)**
Net chg in cash	317	450	1,005	1,380

Key Ratios (Consolidated)

Y/E	FY16	FY17E	FY18E	FY19E
Growth (%)				
Net Sales	22.7	11.9	13.0	14.2
EBITDA	15.7	9.2	19.8	21.2
Net profit	24.0	2.2	26.1	27.2
Margin (%)				
EBITDA	18.3	17.9	19.0	20.2
EBIT	14.9	13.0	14.0	15.4
NPM	10.1	9.2	10.3	11.5
Return Ratios (%)				
RoE	11.9	11.0	12.5	14.1
RoCE	13.6	11.0	12.5	14.2
Per share data (Rs.)				
EPS	18.7	17.5	22.1	28.1
DPS	2.0	2.0	2.0	2.0
Valuation(x)				
P/E	33.0	32.3	25.6	20.1
EV/EBITDA	19.8	18.0	14.7	11.8
EV/Net Sales	3.7	3.3	2.8	2.4
P/B	3.8	3.4	3.0	2.7
Turnover Ratios (x)				
Net sales/ GFA	1.8	1.7	1.7	1.7
Sales/ Total assets	0.7	0.7	0.7	0.8

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.

* CIPLA.is a large-cap company.

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