MOTILAL OSWAL

Cipla

STOCK INFO.	BLOOMBERG
BSE Sensex: 17,331	CIPLA IN
	REUTERS CODE
S&P CNX: 5,194	CIPL.BO

10 May 2010

Buy

Previous Recommendation: Buy

Rs320

Equity Shares (m)	802.9
52-Week Range (Rs)	363/211
1,6,12 Rel. Perf. (%)	-1/2/-5
M.Cap. (Rs b)	256.9
M.Cap. (US$ b)	5.7

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GR. (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
03/09A	52,343	7,768	10.0	10.6	32.0	5.7	17.9	17.1	5.1	21.8
03/10A	56,300	10,193	12.7	26.8	25.2	4.4	17.3	20.8	4.5	17.9
03/11E	62,898	11,705	14.6	14.7	22.0	3.8	17.3	21.1	4.0	15.5
03/12E	71,459	14,003	17.4	19.4	18.3	3.3	17.9	20.2	3.4	13.6

Cipla's 4QFY10 performance was disappointing. Key highlights are:

- Net sales grew 3.3% YoY to Rs13.7b (v/s our estimate of Rs14.6b), EBITDA declined 6% YoY to Rs2.8b (v/s our estimate of Rs4.1b) and PAT declined 18% YoY to Rs2.1b (v/s our estimate of Rs3b). Revenue growth was lower than we had estimated due to lower than expected growth for domestic formulations, INR appreciation against the US$ and the management's conscious decision of not participating in some of the non-remunerative ARV tenders.
- EBITDA margin declined 200bp to 20.4% as against our estimate of 28% mainly due to lower than expected topline growth, significant drop in OOI (which directly adds to EBITDA) and higher than expected staff and other expenses.
- Reported PAT grew 6% YoY to Rs2.8b despite weak operational performance due to one-time income of Rs950m from sale of the I-Pill brand to Piramal Healthcare. Adjusted PAT, however, declined 18% YoY to Rs2.1b.

We believe that Cipla has one of the strongest generics pipelines among Indian companies. 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 could come through over the next two years (our estimates do not include these upsides). Its large manufacturing infrastructure, strong chemistry skills and huge inhaler capacity make it a partner of choice for global MNCs that are ramping up their generics and emerging market presence. This coupled with its low-risk strategy and one of the strongest capex in the company's history should ensure good long-term potential. Temporary slow-down in overall growth, US FDA compliance and increasing working capital requirements remain our key concerns for the company. We expect Cipla to record EPS of Rs14.6 for FY11 and Rs17.4 for FY12, translating into 17% CAGR for FY10-12. The stock quotes at 22x FY11E and 18.3x FY12E earnings. We have lowered our target price to Rs350 (20x FY12E EPS). We maintain **Buy**.

QUARTERLY PERFORMANCE (Rs Million)

Y/E MARCH	FY09				FY10				FY09	FY10
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Net Revenues	**12,071**	**13,547**	**13,420**	**13,305**	**13,760**	**14,408**	**14,385**	**13,747**	**52,343**	**56,300**
YoY Change (%)	*33.9*	*23.3*	*21.5*	*21.1*	*14.0*	*6.4*	*7.2*	*3.3*	*24.5*	*7.6*
Total Expenditure	9,371	10,392	10,035	10,326	10,075	10,695	10,346	10,946	40,124	42,063
EBITDA	**2,701**	**3,155**	**3,385**	**2,978**	**3,685**	**3,713**	**4,039**	**2,801**	**12,219**	**14,237**
Margins (%)	*22.4*	*23.3*	*25.2*	*22.4*	*26.8*	*25.8*	*28.1*	*20.4*	*23.3*	*25.3*
Depreciation	382	406	412	318	458	478	457	495	1,518	1,888
Interest	37	56	110	127	105	84	44	5	329	237
Other Income	-576	-876	-241	335	-150	203	-62	251	-1,359	242
Profit before Tax	**1,705**	**1,817**	**2,622**	**2,869**	**2,972**	**3,354**	**3,477**	**2,552**	**9,013**	**12,355**
Extra-Ord expense								-950		-950
PBT after EO expense	**1,705**	**1,817**	**2,622**	**2,869**	**2,972**	**3,354**	**3,477**	**3,502**	**9,013**	**13,305**
Tax	305	303	388	250	555	618	587	726	1,245	2,485
Rate (%)	*17.9*	*16.6*	*14.8*	*8.7*	*18.7*	*18.4*	*16.9*	*28.4*	*13.8*	*20.1*
Reported PAT	**1,400**	**1,514**	**2,234**	**2,619**	**2,417**	**2,737**	**2,890**	**2,776**	**7,768**	**10,820**
Adj PAT	**1,400**	**1,514**	**2,234**	**2,619**	**2,417**	**2,737**	**2,890**	**2,149**	**7,768**	**10,193**
YoY Change (%)	16.9	-20.6	6.1	85.1	72.6	80.7	29.4	-17.9	17.3	31.2
Margins (%)	*11.6*	*11.2*	*16.6*	*19.7*	*17.6*	*19.0*	*20.1*	*15.6*	*14.8*	*18.1*

Nimish Desai (NimishDesai@MotilalOswal.com); Tel: +91 22 3982 5406 / **Amit Shah** (Amit.Shah@MotilalOswal.com) + 91 22 3982 5423

Topline growth impacted by lower licensing income, INR appreciation and slowdown in India

Net sales grew 3.3% YoY to Rs13.7b (v/s our estimate of Rs14.6b), EBITDA declined 6% YoY to Rs2.8b (v/s our estimate of Rs4.1b) and PAT declined 18% YoY to Rs2.1b (v/s our estimate of Rs3b).

Revenue growth was lower than we had estimated due to lower than expected growth for domestic formulations (9% growth v/s estimate of 14%), INR appreciation against the US$ (7.7% YoY and 1.5% QoQ) and the management's conscious decision of not participating in some of the non-remunerative ARV tenders.

Lower other operating income (OOI) at Rs572m v/s our estimate of Rs848m (mainly due to 86% drop in tech licensing income to Rs135m) and tightening credit terms also tempered topline growth.

SALES MIX (RS M)

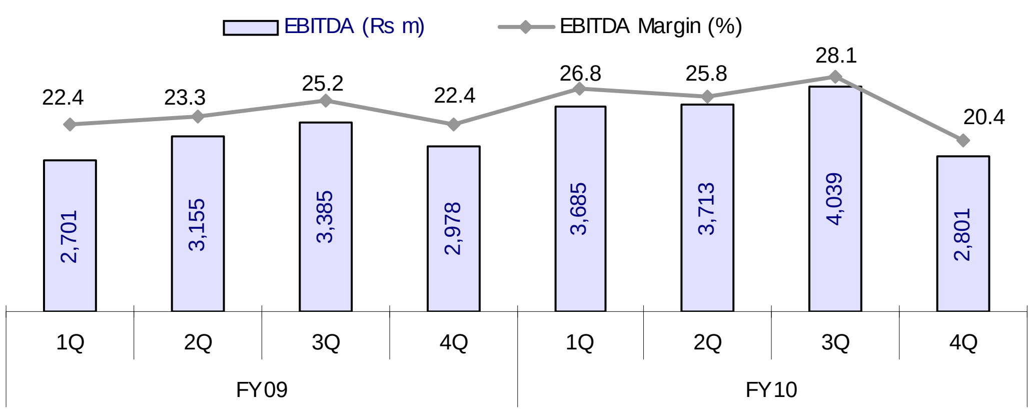
	4QFY10	4QFY09	YOY (%)	3QFY10	QOQ (%)
Domestic	5,573	5,103	9.2	6,455	(13.7)
% of Revenues	*41*	*38*		*45*	
Exports	7,602	7,128	6.7	6,987	8.8
% of Revenues	*55*	*54*		*49*	
Formulations	6,139	5,463	12.4	5,758	6.6
APIs	1,463	1,665	(12.1)	1,229	19.0
Other Operating Income	572	1,074	(46.8)	943	(39.4)
% of Revenues	*4*	*8*		*7*	
Total Net Revenues	**13,747**	**13,305**	**3.3**	**14,385**	**-4.4**

Source: Company

EBITDA and PAT significantly lower than estimates

EBITDA declined 6% YoY to Rs2.8b, significantly below our estimate of Rs4b mainly due to lower than expected topline growth, significant drop in OOI (which directly adds to EBITDA) and higher than expected staff and other expenses. EBITDA margin declined 200bp YoY and 770bp QoQ to 20.4%.

EBITDA AND MARGIN TREND



Source: Company/MOSL

Reported PAT grew 6% YoY to Rs2.8b despite weak operational performance due to one-time income of Rs950m from sale of the I-Pill brand to Piramal Healthcare. Adjusted PAT, however, declined 18% YoY to Rs2.1b, lower than our estimate of Rs3b.

Muted guidance for FY11

Cipla management has given a muted guidance for FY11.

FY11E GUIDANCE

BUSINESS	GROWTH (%)	REMARKS
Domestic	10-12	FY10 growth was 10%. Has increased MR strength to 4500. Future focus will be on improving MR productivity
Exports	12	FY10 growth was only 6% due to conscious decision to recude the low-margin ARV supplies to Africa. Appreciating currency has also impacted growth for FY10
OOI (Rs b)	2.5-3.0	OOI was Rs2.7b in FY10.
Capex (Rs b)	6.0	FY10 capex was Rs6.25b

OOI - Other Operating Income including tech licensing income *Source: Company/MOSL*

Cutting estimates

Given the significantly lower than expected 4QFY10 numbers coupled with a muted guidance, we have cut our revenue and EPS estimates. We have reduced our revenue estimates by 6.4% for FY11 and by 8.2% for FY12. Our EPS estimates have been revised downwards by 16.7% for FY11 and 14.4% for FY12.

Our revised EPS estimates are Rs14.6 (14.7% growth) for FY11 and Rs17.4 (19.4% growth) for FY12, translating into 17% EPS CAGR for FY10-12. Our estimates do not include any upsides from potential MNC contracts and new inhaler launches in Europe.

Continues to be under-hedged

Management continues with its policy of hedging net exposure on monthly basis. Current forex hedges are at US$200m (up from US$110m as of December 2009) which we believe will be inadequate if the INR were to appreciate significantly against the US$. We believe that Cipla is currently under-hedged given its annual net exposure of US$270-300m plus some exposure to the Euro.

Acquires promoter's manufacturing units for Rs820m

Cipla has acquired two manufacturing units (belonging to the promoter group) for Rs820m. These units currently manufacture exclusively for Cipla. One of the acquired units is a formulations facility in Sikkim and is eligible for income tax benefits beginning FY10. The other unit is a US FDA-approved API/intermediates facility located at Kurkumbh (Maharashtra).

Potential MNC contracts can upgrade earnings estimates

Cipla has indicated that it is negotiating with MNCs like Pfizer, GSK, and Boehringer for long-term supply agreements. Generally, such deals span across many products and multiple markets. These potential contracts are likely to raise earnings for FY12 (as of now not included in our estimates). We believe Cipla is strongly positioned to emerge as a key supplier of generic products to global MNCs due to large manufacturing infrastructure, strong chemistry skills and large capacity for inhalers.

CFC-free inhalers remain key long-term trigger

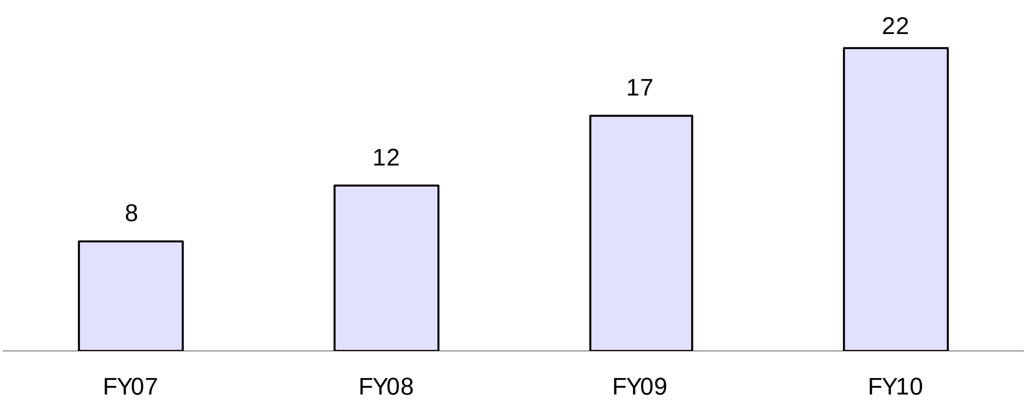
Launch of CFC-free inhalers in EU and US remains a key long-term trigger for Cipla. The company is developing 8 different inhalers and has the third largest inhaler manufacturing capacity globally. It has already commercialized some of its inhalers in UK, Germany, Spain and Portugal. While launch of these inhalers remains a key trigger in the long-term, as of now the visibility on the launch timelines is poor. The management expects its full range of 8 inhalers to be commercialized in Europe over the next 3-4 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.

Through its partner, Neo Labs, Cipla has filed for regulatory approval of a generic Seretide inhaler (GSK's US$6.5b global brand with US$250m sales in the UK) in September 2008 in UK, post expiry of GSK's data exclusivity. The management expects this approval to come through in CY10/CY11. Our estimates do not include the upsides from these supplies.

Strong generics pipeline

In the US, Cipla has entered into partnership for 118 products with 22 partners. We note that the number of partners has increased from 17 to 22 over the last 12 months. Of the pipeline of ~100 ANDAs filed till date, 57 have been approved (35 commercialized) while 41 ANDAs are awaiting approval.

US PARTNERS (NO)



Source: Company/MOSL

Valuation and view

We believe that Cipla has one of the strongest generics pipelines among Indian companies. 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 could come through over the next two years (our estimates do not include these upsides). Its large manufacturing infrastructure, strong chemistry skills and huge inhaler capacity make it a partner of choice for global MNCs that are ramping up their generics and emerging market presence. This coupled with its low-risk strategy and one of the strongest capex in the company's history should ensure good long-term potential. Temporary slow-down in overall growth, US FDA compliance and increasing working capital requirements remain our key concerns for the company.

We expect Cipla to record EPS of Rs14.6 for FY11 and Rs17.4 for FY12, translating into 17% CAGR for FY10-12. The stock quotes at 22x FY11E and 18.3x FY12E earnings. Given the lower than expected 4QFY10 performance and consensus EPS downgrade, we expect some correction in the stock price in the near-term. We have lowered our target price to Rs350 (20x FY12E EPS). However, we remain positive on Cipla's long-term prospects (especially on upsides from MNC contracts and commercialization of CFC-inhalers). We note that Cipla management has officially confirmed that it is negotiating supply contracts with Pfizer. As and when details of such contracts are made public, we expect an upgrade in earnings estimates.

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 21 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 is 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 FY11/12.

Key investment risks

- NPPA liability of Rs.15b (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.

Valuation and view

- Revenue and EPS CAGR of 13% and 17% respectively expected over FY10-12.
- One of the strongest generic pipelines coupled with de-risked strategy and large under-utilized capacities should bring in long-term benefits.

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)	FY11E	22.0	22.4	-66.3
	FY12E	18.3	19.8	50.1
P/BV (x)	FY11E	3.8	4.6	3.1
	FY12E	3.3	4.0	2.8
EV/Sales (x)	FY11E	4.0	2.9	2.8
	FY12E	3.4	2.5	2.4
EV/EBITDA (x)	FY11E	15.5	17.6	49.2
	FY12E	13.6	15.8	27.0

EPS: MOST FORECAST V/S CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY11	14.6	15.8	-7.5
FY12	17.4	17.8	-2.1

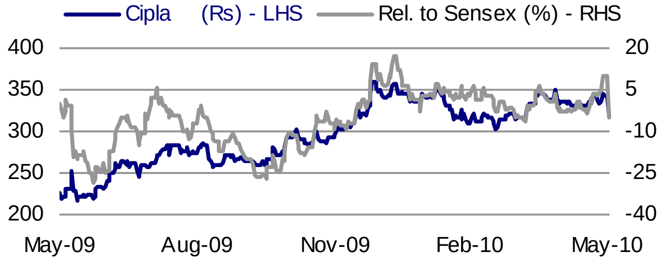
TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
320	350	9.4	Buy

SHAREHOLDING PATTERN (%)

	MAR-10	DEC-09	MAR-09
Promoter	36.8	36.8	39.4
Domestic Inst	16.6	16.7	18.4
Foreign	21.0	21.6	17.9
Others	25.6	25.0	24.3

STOCK PERFORMANCE (1 YEAR)



Financials and Valuation

INCOME STATEMENT					(Rs Million)
Y/E MARCH	**2008**	**2009**	**2010E**	**2011E**	**2012E**
Gross Sales	**40,886**	**50,216**	**54,103**	**60,594**	**69,074**
Change (%)	*15.7*	*22.8*	*7.7*	*12.0*	*14.0*
Exports	21,103	27,430	28,989	32,467	37,291
Net Domestic Sales	18,876	22,176	24,592	27,711	31,314
Other Operating Income	2,054	2,737	2,719	2,719	2,855
Net Income	**42,033**	**52,343**	**56,300**	**62,898**	**71,459**
Change (%)	*17.7*	*24.5*	*7.6*	*11.7*	*13.6*
Total Expenditure	33,723	40,124	42,063	46,568	53,355
EBITDA	**8,310**	**12,219**	**14,237**	**16,330**	**18,105**
Margin (%)	*19.8*	*23.3*	*25.3*	*26.0*	*25.3*
Depreciation	1,163	1,518	1,888	2,368	2,709
Int. and Finance Charges	113	329	237	2	2
Other Income - Rec.	1,349	-1,359	242	671	738
PBT before EO Items	**8,384**	**9,013**	**12,355**	**14,631**	**16,132**
Extra Ordinary Expense	0	0	-950	0	0
PBT but after EO Exp.	**8,384**	**9,013**	**13,305**	**14,631**	**16,132**
Tax	1,369	1,245	2,485	2,926	2,129
Tax Rate (%)	*16.3*	*13.8*	*18.7*	*20.0*	*13.2*
Reported PAT	**7,014**	**7,768**	**10,820**	**11,705**	**14,003**
Adj PAT	**7,014**	**7,768**	**10,193**	**11,705**	**14,003**
Change (%)	*3.7*	*10.7*	*31.2*	*14.8*	*19.6*
Margin (%)	*16.7*	*14.8*	*18.1*	*18.6*	*19.6*

BALANCE SHEET					(Rs Million)
Y/E MARCH	**2008**	**2009**	**2010E**	**2011E**	**2012E**
Equity Share Capital	1,555	1,555	1,606	1,606	1,606
Reserves	35,914	41,863	57,306	66,085	76,587
Revaluation Reserves	90	90	90	90	90
Net Worth	**37,558**	**43,508**	**59,002**	**67,781**	**78,283**
Loans	5,405	9,402	28	28	28
Deferred Liabilities	1492	1642	1442	1442	1603
Capital Employed	**44,454**	**54,551**	**60,472**	**69,250**	**79,913**
Gross Block	22,018	26,933	33,433	39,433	43,933
Less: Accum. Deprn.	5,404	7,008	8,896	11,264	13,973
Net Fixed Assets	**16,614**	**19,925**	**24,537**	**28,169**	**29,960**
Capital WIP	2,331	3,663	3,663	3,663	3,663
Investments	948	813	813	813	813
Curr. Assets	**37,440**	**44,196**	**48,373**	**56,463**	**68,191**
Inventory	11,205	13,983	16,882	18,960	21,615
Account Receivables	13,939	18,372	16,305	18,261	20,817
Cash and Bank Balance	793	530	1,776	3,936	10,537
Others	11,503	11,311	13,410	15,306	15,221
Curr. Liability & Prov.	**12,878**	**14,046**	**16,915**	**19,858**	**22,713**
Account Payables	12,878	14,046	16,915	19,858	22,713
Net Current Assets	**24,562**	**30,150**	**31,458**	**36,605**	**45,477**
Appl. of Funds	**44,454**	**54,551**	**60,472**	**69,250**	**79,913**

E: MOSL Estimates

RATIOS					
Y/E MARCH	**2008**	**2009**	**2010E**	**2011E**	**2012E**
Basic (Rs)					
EPS	**9.0**	**10.0**	**12.7**	**14.6**	**17.4**
Cash EPS	10.5	11.9	15.0	17.5	20.8
BV/Share	48.2	55.9	73.4	84.3	97.4
DPS	4.0	4.0	4.4	6.2	7.5
Payout (%)	25.9	23.4	19.3	25.0	25.0
Valuation (x)					
P/E	35.5	32.0	25.2	22.0	18.3
Cash P/E	30.4	26.8	21.3	18.3	15.4
P/BV	6.6	5.7	4.4	3.8	3.3
EV/Sales	6.2	5.1	4.5	4.0	3.4
EV/EBITDA	31.5	21.8	17.9	15.5	13.6
Dividend Yield (%)	1.3	1.3	1.4	1.9	2.3
Return Ratios (%)					
RoE	18.7	17.9	17.3	17.3	17.9
RoCE	19.1	17.1	20.8	21.1	20.2
Working Capital Ratios					
Fixed Asset Turnover (x)	2.8	2.9	2.5	2.4	2.5
Debtor (Days)	121	128	106	106	106
Inventory (Days)	97	98	109	110	110
Working Capital (Days)	206	207	192	190	178
Leverage Ratio (x)					
Current Ratio	2.9	3.1	2.9	2.8	3.0
Debt/Equity	0.1	0.2	0.0	-0.1	-0.1

CASH FLOW STATEMENT					(Rs Million)
Y/E MARCH	**2008**	**2009**	**2010E**	**2011E**	**2012E**
Op. Profit/(Loss) before Tax	8,310	12,219	14,237	16,330	18,105
Interest/Dividends Recd.	1,349	-1,359	242	671	738
Direct Taxes Paid	-710	-1,095	-2,685	-2,926	-1,968
(Inc)/Dec in WC	-6,144	-5,851	-62	-2,987	-2,271
CF from Operations	**2,805**	**3,914**	**11,733**	**11,087**	**14,604**
EO expense	0	0	-950	0	0
CF from Oper. incl EO E	**2,805**	**3,914**	**12,683**	**11,087**	**14,604**
(inc)/dec in FA	-5,495	-6,161	-6,500	-6,000	-4,500
(Pur)/Sale of Investments	231	134	0	0	0
CF from Investments	**-5,264**	**-6,027**	**-6,500**	**-6,000**	**-4,500**
Issue of Shares	0	0	6,760	0	0
Inc/(Dec) in Debt	4,169	3,998	-9,374	0	0
Interest Paid	-113	-329	-237	-2	-2
Dividend Paid	-1,819	-1,819	-2,086	-2,926	-3,501
CF from Fin. Activity	**2,237**	**1,850**	**-4,937**	**-2,928**	**-3,502**
Inc/Dec of Cash	**-222**	**-263**	**1,246**	**2,159**	**6,602**
Add: Beginning Balance	1,015	793	530	1,776	3,936
Closing Balance	**793**	**530**	**1,776**	**3,936**	**10,537**

For more copies or other information, contact
Institutional: Navin Agarwal. **Retail:** Manish Shah
Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: reports@motilaloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

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1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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