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Ajcon's Xpress idea: Cipla Ltd. - "BUY"

27th Nov., 2014

CMP: 632 | Target: Rs. 800 | Upside: 28% | Market Cap: Rs. 510 bn | Face Value: Rs. 2

About the Company

- a) Cipla continues to maintain its leadership in respiratory, paediatric and urology therapies. Legacy brands continue to perform well.
- b) In FY14, Revenues grew 26.7% YoY to Rs 24.3bn, led by robust performance in domestic formulations.
- c) Domestic formulations business in FY14 witnessed a growth of 19.3% YoY to Rs 9.1bn owing to growth driven by anti-retroviral, anti-asthma and anti-allergic segments.
- d) Despite the challenges, Cipla's domestic branded generics business revenues in FY14 grew 15.5% versus industry growth of 9%.
- e) Export formulations business in FY14 grew by 34.4% YoY to Rs 12.8bn, despite lack of Lexapro sales, full quarter realisation of Cipla- Medpro acquisition and growth in anti-retroviral, anti-asthma and anti-allergic segments.
- f) European, International and API businesses also demonstrated very strong growth.
- g) Expect operating leverage to pick up in 2HFY15E (post commencement of combination inhalers). For FY15E, management has guided for 21-22% operating margins.
- h) The Company has strengthened its position in India and South Africa. In both regions, it has outperformed market growth and gained market share.
- i) Its European, International and API businesses also demonstrated very strong growth. In the past year, the Company completed the acquisition and integration of companies in South Africa, Uganda and Croatia
- j) The Company will further strengthen its position in India and South Africa (Africa contributes 25% of overall revenues), and build a front end presence in select international markets
- k) In FY14, filed 60 products and received 13 approvals for the US market.
- l) The Company's focus will be on European respiratory launches and proactive exploration of partnership opportunities to monetise its assets.
- m) Cipla has agreed to market paediatric vaccines made by Serum Institute of India in Europe, in a move that marks India's fourth-largest drugmaker's entry into the vaccines space. Financial details of the deal with Serum Institute, one of India's largest makers of vaccines, were not disclosed.
- n) Cipla, which exports to over 170 countries, is working on expanding its presence in Europe, a region that contributed 5.7 per cent to the company's total revenue in the year to March 2013.
- o) As part of this strategy, Cipla has launched multiple respiratory products in Europe this year, and launch of some key inhalers is expected in 2015. The Company's management considers vaccines as one of the critical components of its offering to European patients.

Outlook

With the global respiratory market expected to grow to US\$50 billion by 2018 from current US\$36 billion, Cipla would be able to generate about US\$500 million in net profit over the next 5-7 years from its respiratory portfolio

In the near term, the trigger will be the launch of asthma drug, Seretide, the generic version of GSK's Advair (metered dose inhaler) in the UK in the current fiscal. The company had launched Seretide in Sweden and Germany in September 2014 at half the price of the innovator drug and could see an upside when it launches the drug in the UK.

There is a high probability of Cipla being the first generic company to launch Seretide in the UK given that Mylan has filed for the same in December quarter of FY14 and it takes at least two and a half



years as a norm to get approval in such markets. In fact, it was the launch of Seretide which has made so bullish on the earnings of Cipla. The launch of the drug in the UK market is key given that it is a US\$400 million product which is more than half of the overall EU market size for the drug. The launch of Advair (variations) coupled with Symbicort in various markets is expected to boost the company's revenues and profits.

However, expect some bit of volatility in the company's margins and profits over the medium-term given that it is in the midst of expanding its front-end operations in various global markets. The recently concluded quarter is evidence of things that could come, going ahead.

Unlike the overseas markets where it is on an expansion phase, results of which will unfold over the next few years, in India the company is on a strong wicket. The company's domestic business continues to outperform the industry with a 20 per cent growth in the September 2014 quarter as against 11 per cent by the industry. The 15-20 per cent growth has been on the back of new product launches and marketing network of 7,500 medical representatives.

While the September quarter has been a disappointment, the management has indicated that the second half is expected to be better than the first on the back of strong India business growth, respiratory product launches in Europe and increased institutional business as capacity constraints are sorted out. Margins are expected to recover with full year FY15 margins at 21-22 per cent.

At CMP, the stock is trading at a P/E of 36x FY14 EPS. We recommend a "BUY" on the stock with a price target of Rs. 800 (36x at street estimated FY16 EPS of Rs. 22.2) an upside of 28%, over a period of 3 to 6 months.

Stock Holding Disclosure under SEBI regulations:

- a) Analyst holding: Yes**
- b) Company holding: No**
- c) Directors holding: No**
- d) Group/Associates Position: No**
- e) Relationship with management: No**

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