Profile

Founded in 1935 by Khwaja Abdul Hamied, Cipla has established itself as a reliable and reputable pharmaceutical company in the home markets of India, South Africa and North America. Cipla's product portfolio spans complex generics as well as drugs in the respiratory, anti-retroviral, urology, cardiology, anti-infective, CNS, and various other key therapeutic segments. Its products are distributed in more than 80 countries worldwide. Cipla is the third-largest pharma company in the domestic formulations market, which contributes ~40% of its total revenue. Cipla is developing a comprehensive portfolio of respiratory products across varied dosage forms (MDI, DPI and nasal sprays) for the regulated markets of EU and the US.

Investment Rationale

**US growth driven by Cipla’s DTM business:** Cipla’s US business has grown at 10% cc CAGR over FY18-21, as launches of complex generics and respiratory products enabled it to ramp-up its DTM (own front-end) business, from ~USD80m in FY18 (20% of US sales) to ~USD305m in FY21 (56% of US sales). Cipla’s respiratory portfolio (Albuterol, Budesonide) has crossed the USD100m sales-mark, accounting for 18% of its overall US business. Although most Indian peers saw significant QoQ decline in US sales during 1QFY22, market-share ramp-up in Albuterol has allowed Cipla to maintain steady US sales.

**Focussed on outperforming market growth in India and South Africa (SA)**

While the Covid portfolio led to 14% growth in Cipla’s India branded Rx business (78% of India sales) in FY21, the One-India strategy has also led to strong performance in the trade generics and CHL portfolio. Cipla’s trade generics business (17% of domestic sales) grew 8% on a reported basis in FY21 and by 18% adjusted for brands transferred to the CHL business. Cipla’s SA business also saw growth of 10% in ZAR terms in FY21, while the overall pharma market in SA declined by 1%. Mgmt. intends to build further scale in India & SA markets through focus on the chronic, consumer healthcare, OTC and private segments, and hence evolve into a holistic wellness player in these markets.

**Entering the new frontier markets of China and Brazil**

Cipla’s Emerging Markets (EMs) business accounts for 10% of its overall revenue, with the business growing a solid 21% cc in FY21 to clock revenue of USD250m. Cipla has signed various deals worth USD10m of annualised revenue to strengthen its presence in existing EMs. These agreements include a) the first biosimilar deal of Bevacizumab in Europe, 2) partnership with Ferring in Australia to promote its specialty Urology-Oncology drug portfolio, and 3) partnership with Alvotech for marketing and distribution of four biosimilars in the Australia and New Zealand markets.

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Strong reduction in working capital

Cipla’s overall NWC cycle has improved from 156 days in FY19 to 121 days in FY21, with ~75% of the improvement being driven by lower receivables and the remaining from lower other current assets. Reduced working capital intensity has led to EBITDA-to-OCF conversion improving from ~53% in FY18/19 to ~92% in FY20/21.

Well Defined Strategy for the near term

Cipla has defined 10 Strategic Business Objectives in its FY21 AR. They are as follows: (1) Become a global lung leader across the care continuum; (2) Demonstrate organisational agility; (3) Grow Cipla India and South Africa OTC; (4) Focus on complex generics and respiratory pipeline in the US; (5) Continue to build scale and depth in branded home markets of India and South Africa; (6) Strengthen presence in existing emerging markets; (7) Focus on digital and patient-centric initiatives; (8) Continuous improvement: cost efficiencies with targets to deliver fuel for growth; (9) Invest in quality 4.0 to change the quality paradigm; (10) Strengthen the talent pipeline and improve productivity.

Sale of trade receivables has driven two-thirds of the improvement in Cipla’s receivable days during FY20 & FY21: Cipla has securitized part of its trade receivables over the past 3 years, by entering into an arrangement with a bank for sale of its trade receivables at a certain discount. Cipla sold-off trade receivables worth Rs4.5/4.7bn in FY20/21, representing ~11/14% of its outstanding receivables, respectively. Cipla’s receivable days have declined from 93 in FY19 to 66 in FY21, with two-thirds of the improvement in receivable days being driven by the sale/factoring of receivables.
RoE and RoIC (post-tax) expanded 400-500bps in FY21; RoIC will likely improve to >20% by FY23ii: Strong EBITDA growth of 33% in FY21 (driven by 12% overall revenue growth and ~350bps EBITDA margin expansion), along with higher asset turnover, led to Cipla's RoE improving from ~10% in FY20 to ~14% in FY21. RoIC also expanded, from ~12% (pre-tax)/~9% (post-tax) in FY20 to ~19%/14%, respectively, in FY21. We believe the strong new-product launch momentum in the US market will enable Cipla to further improve its RoIC (post-tax) to ~20%/26% by FY23/24ii.
Risks

Rejection of Applications: Cipla’s pending ANDA pipeline includes 3 inhalations and 9 injectables assets. If some of these get rejected, there might be some impact on the projected Cash flows.

Outlook & Valuation:
Cipla has defined 10 Strategic Business Objectives in its FY21 AR, with the company maintaining focus on superior execution across its branded home markets of India & SA and portfolio expansion in the US respiratory & complex generics space. While Albuterol market-share ramp-up has allowed Cipla to maintain steady US sales as against the sharp erosion witnessed by peers, the recent Brovana launch along with upcoming launches (Qvar, Abraxane & Advair) will drive further traction in the US business over the next 2-3 years. Factoring of trade receivables has driven significant reduction in WCap intensity, thereby enabling Cipla to generate USD680m cumulative FCF during FY20 & FY21. We expect the strong US product launch momentum to drive cumulative FCF of USD1.3bn over FY22-24ii and RoIC to improve to 20/26% in FY23/24ii. Cipla remains our top-pick among large-cap pharma and we initiate a Buy with a TP of Rs1,127.
### Financial Summary

<table>
<thead>
<tr>
<th>Consolidated (INR in mn)</th>
<th>FY20</th>
<th>FY21</th>
<th>FY22ii</th>
<th>FY23ii</th>
<th>FY24ii</th>
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<tbody>
<tr>
<td>Total Income</td>
<td>171,320</td>
<td>191,596</td>
<td>219,492</td>
<td>236,455</td>
<td>268,401</td>
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<td>YoY growth (%)</td>
<td>4.7</td>
<td>11.8</td>
<td>14.6</td>
<td>7.7</td>
<td>13.5</td>
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<td>EBITDA margin (%)</td>
<td>18.7</td>
<td>22.2</td>
<td>22.8</td>
<td>25.2</td>
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<td>Pre-exceptional PAT</td>
<td>15,465</td>
<td>24,049</td>
<td>29,195</td>
<td>35,819</td>
<td>46,022</td>
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<td>PAT margin (%)</td>
<td>9.0</td>
<td>12.5</td>
<td>12.7</td>
<td>15.1</td>
<td>17.1</td>
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<td>ROE (%)</td>
<td>9.9</td>
<td>13.9</td>
<td>14.8</td>
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<td>P/B (x)</td>
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<td>3.9</td>
<td>3.5</td>
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<tr>
<td>EV/EBITDA (x)</td>
<td>22.9</td>
<td>16.6</td>
<td>13.7</td>
<td>11.0</td>
<td>8.3</td>
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<tr>
<td>Net Debt/Equity (x)</td>
<td>0.0</td>
<td>(0.1)</td>
<td>(0.2)</td>
<td>(0.3)</td>
<td>(0.4)</td>
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Recommendation Parameters for Fundamental/Technical Reports:

**Buy** – Absolute return of over +10%
**Accumulate** – Absolute return between 0% to +10%
**Reduce** – Absolute return between 0% to -10%
**Sell** – Absolute return below -10%

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