

December 13, 2013

BSE Code: 532321 **NSE Code:** CADILAH **Reuters Code:** CADI.NS **Bloomberg Code:** CDH:IN

Cadila Healthcare Ltd (CHL), the Ahmedabad based Indian pharmaceutical company, founded in 1952. CHL is a well-known research-oriented, technology-driven pharmaceutical company focused on the research areas of biotechnology, formulations and Active Pharmaceutical Ingredients (APIs). With 20 discovery research programmes under various stages of clinical development, the group invests over 7% of its turnover in research. It markets its products for various therapeutic applications, including cardiovascular, gastrointestinal, and women's healthcare, as well as for respiratory, pain management, central nervous system, anti-infectives, oncology, neurosciences, dermatology, and nephrology. Internationally, the drug-maker's operations are extended over the United States, Europe and Japan.

Investor's Rationale

We expect CHL's revenues to grow at a CAGR of ~17% during FY13-FY'15E on the back of the ramp up in approvals in the US, improved launch guidance of more than 20 in the next 12-15 months in the US coupled with recovery in Brazil (market growth of 12-14% in FY'13) and expected launches from Neshar will more than offset the growth challenges in India due to pricing policy changes. The company is also planning to launch new variants in Wellness business and is aiming to maintain double digit growth over the next few quarters.

To further strengthen the presence in the domestic formulations market, CHL has launched its patented diabetes drug, Lipaglyn (in September 2013) in India to treat diabetic dyslipidemia. The company is aiming to launch this product in different markets in the next three-five years. With such a unique discovery, the company is well poised among its peers and it expects over US\$1bn sales when sold globally.

US formulations business is also the key growth driver for the company as it contributes around 25% to the revenues. CHL is well poised to grow in the world's largest US drug market on the back of new product launches coupled with a healthy market share in existing products and pending ANDAs approval will augment growth over FY'13-FY'15E. CHL has a strong product pipeline with ~100 ANDAs are pending for approval with the USFDA. Further, a recovery in economic growth in the US will also help CHL to sustain the growth momentum.

CHL posted a 13% YoY rise in net income to ₹17.46 bn in Q2FY'14 as the exports formulations recorded a 28.1% YoY surge led by strong growth across the markets - US (29%), Europe (24%), Brazil (28%) and Emerging Markets (32%). Further, net profit grew robustly by 93.4% YoY on a consolidated basis to ₹1.83 bn during the quarter. With such a healthy performance in Q2FY'14, we expect the company to do even better in the coming quarters on the back of its robust product pipeline, strong presence in the US and pending approvals.

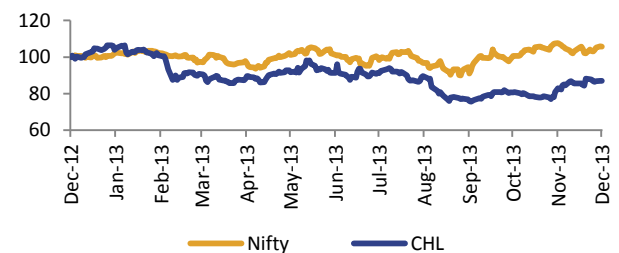
Market Data

Rating	BUY
CMP (₹)	738
Target (₹)	850
StopLoss (₹)	686
Potential Upside	~15.2%
Duration	Long Term
Face Value (₹)	5
52 week H/L (₹)	913.3/629
Adj. all time High (₹)	986.8
Decline from 52WH (%)	19.2
Rise from 52WL (%)	17.3
Beta	0.02
Mkt. Cap (₹bn)	151.1
Enterprise Value	160.7

Fiscal Year Ended

Y/E	FY12A	FY13A	FY14E	FY15E
Revenue (₹bn)	53.1	63.9	75.4	87.5
EBITDA (₹bn)	11.3	11.6	13.9	16.1
Net Profit (₹bn)	6.5	6.5	8.0	9.5
Adj EPS (₹)	31.9	31.9	38.9	46.6
P/E (x)	23.2	23.1	19.0	15.8
P/BV (x)	5.8	5.1	4.0	3.1
EV/EBITDA (x)	14.1	13.8	11.6	10.0
ROCE (%)	23.1	20.8	21.0	20.5
ROE (%)	25.2	22.2	21.0	19.6

One year Price Chart



Shareholding Pattern

	Sep'13	Jun'13	Diff.
Promoters	74.8	74.8	-
FII	5.7	5.4	0.3
DII	9.0	9.9	(0.9)
Others	10.5	9.9	0.6

With focus on cardiovasculars, gastro intestinal, respiratory and women's healthcare, CHL is among the five largest companies in the domestic pharmaceutical market.

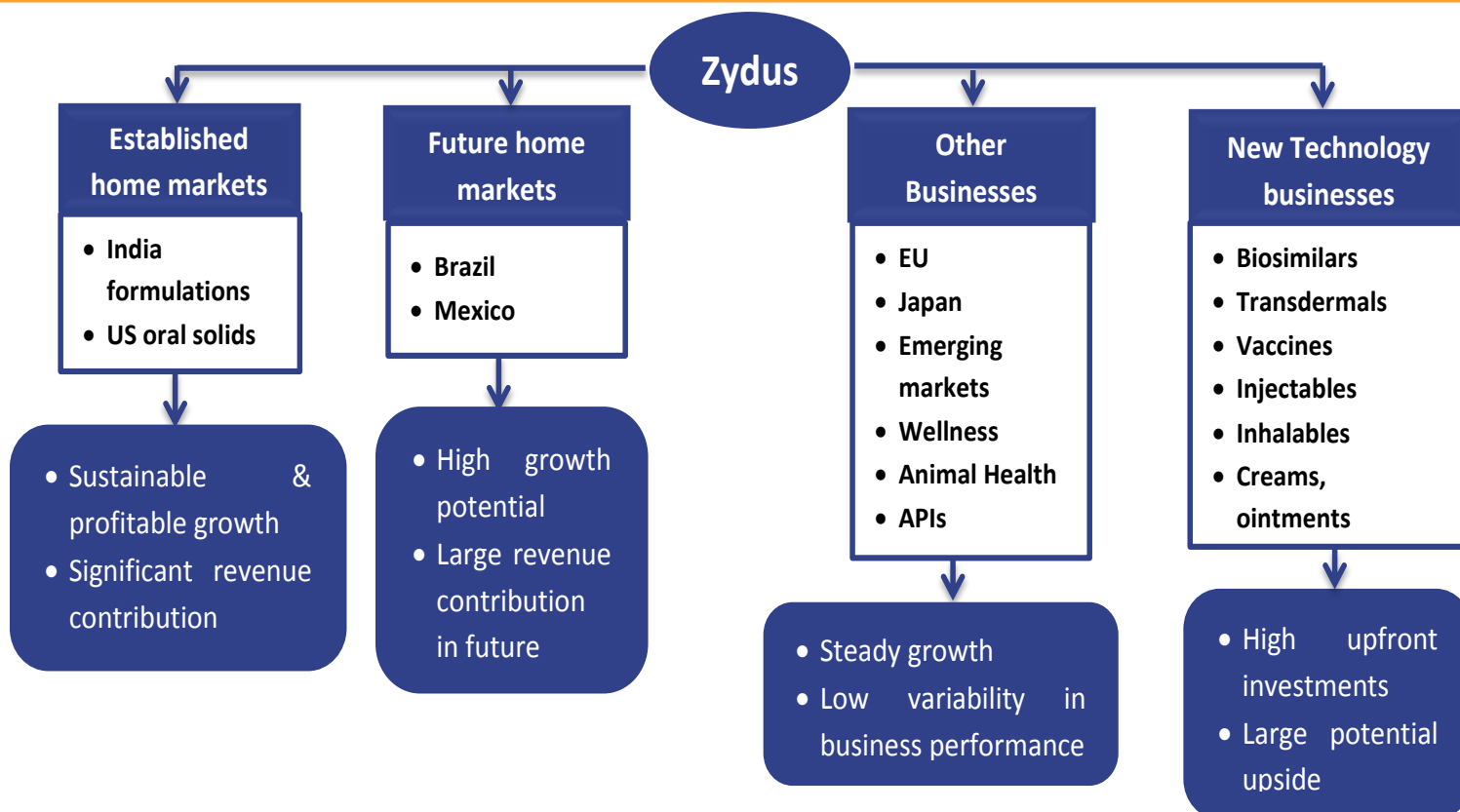
CHL aspires to achieve sales of over US\$3bn by 2015 and to become a research-driven pharmaceutical company by 2020.

Cadila Healthcare - one of the largest privately held pharmaceutical companies in India

Headquartered in Ahmedabad, Cadila Healthcare Ltd (CHL), is one of the largest privately held pharmaceutical companies in India. After the split of the global healthcare provider, Zydus Cadila in 1995, the group restructured its business and now it operates as CHL. With a focus on cardiovascular, gastro intestinal, respiratory and women's healthcare, the company is among the five largest companies in the domestic pharmaceutical market. The chronic segment accounts for ~23% of total domestic business. CHL is among the top pharmaceutical companies in India with about 15,000+ employees across the globe and is the 10th largest generic company in the US in terms of prescriptions. Currently, the company has 19 biosimilars in the pipeline including two novel biologics. Zydus Cadila is a partner of choice for several global pharma majors such as Abbott, Boehringer Ingelheim, Bayer Pharma, Madaus AG, Nycomed, and Hospira. The company is also present in the consumer wellness segment through its subsidiary, Zydus Wellness Ltd., which has been a niche and significant player with its portfolio of wellness brands viz. Sugar Free, EverYuth, Nutralite and Actilife.

One of the most reputed pharma companies globally, Zydus Cadila aims to be a leading global healthcare provider with a robust product pipeline. With 20 discovery research programmes under various stages of clinical development, the group invests over 7% of its turnover in research. It aims to be a leading global healthcare provider with a robust product pipeline and aspires to achieve sales of over US\$3 bn by 2015 and be a research-based pharmaceutical company by 2020.

Well integrated pharma player with global footprints



Posted healthy performance in Q2FY'14 backed by robust export growth

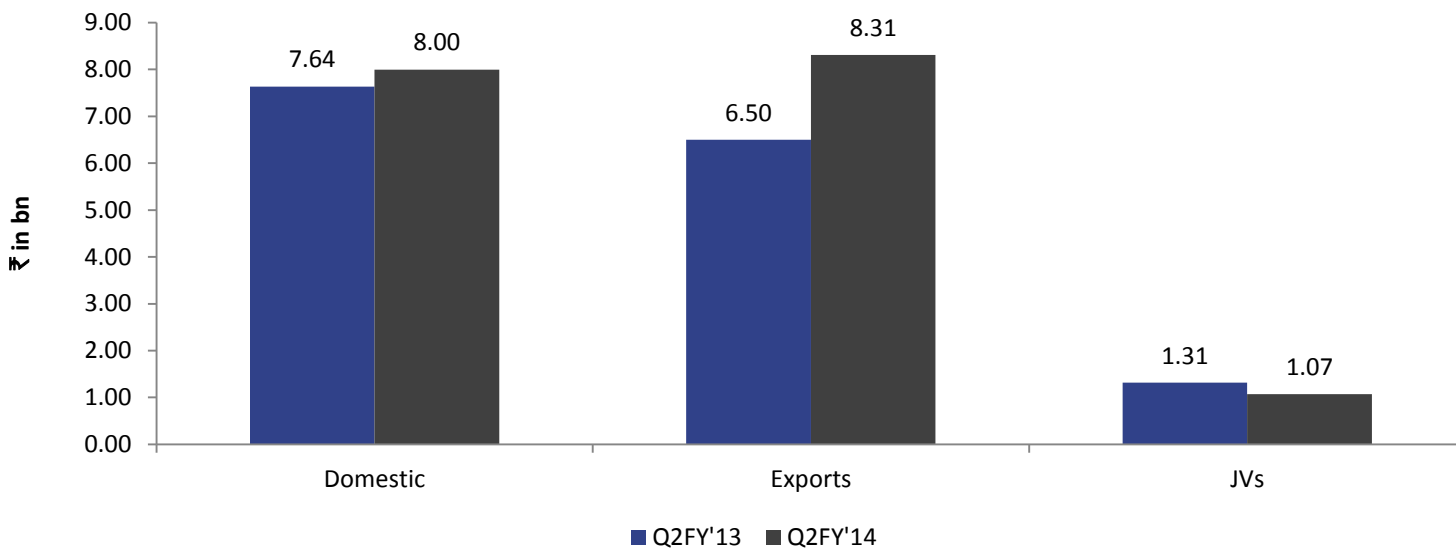
Strong export formulations performance boosted net sales by 13% YoY to ₹17.46 bn in Q2FY'14.

Lower financial expenses resulted in a robust bottom-line, up by 93.4% YoY to ₹1.83 bn.

CHL witnessed an increase in net income by 13% YoY to ₹17.46 bn on account of a rise in revenue from its Export business. Export formulations recorded a growth of 28.1% led by strong growth across the markets - US (29%), Europe (24%), Brazil (28%) and Emerging Markets (32%). The domestic business, however, witnessed a sluggish growth of around 4% due to the adverse impact of new drug pricing policy, slower performance in the anti-infective segment and trade related issues. New launches along with price increases in few products during the quarter triggered growth in the US business.

Further, net profit during the quarter under consideration grew robustly by 93.4% YoY on a consolidated basis to ₹1.83 bn on the back of lower tax outgo and interest burden. In addition to this, good growth in international business also assisted the bottom-line growth. The company's interest cost declined sharply by 52.3% YoY to ₹193 mn, while the tax provision declined by ~80% to ₹101 mn. Further, a sharp 89% growth in other income to ₹122 mn, also contributed to the bottom-line growth. However, the EBITDA margin stayed flat at 14.9% YoY during the quarter due to fall in consumption cost and other expenses, which fell by 40 bps and 70 bps respectively as a percentage of sales. As a result, operating profit grew by 13% YoY to ₹2.61 mn. We expect accelerated growth in India and the US will give a boost to the margin over the next few quarters.

Strong growth from exports offset slow domestic growth and de-growth in JV



Cadila expects to launch 20 products over the next 12-15 months. This will help the company to maintain growth momentum in this market.

Targets new drug launches and product approvals in US

CHL is the 10th largest generic company in the US in terms of prescriptions. The US formulations business contributes around 25% to the company's revenue and is the key driver for the profitability. For about two-third of the products marketed in the US, the company is ranked amongst the top three players. The improving growth prospects in the US will help CHL to sustain growth momentum in this market. With around 100 products awaiting approval in the US, CHL expects to launch 20 products over the next 12-15 months. This will help the company to maintain growth momentum in this market. In the US, it is also eyeing on limited

The management remain hopeful for maintaining its ANDA filings of 25-30 per year in the US market along with more than 20 approvals in the next 12-15 months.

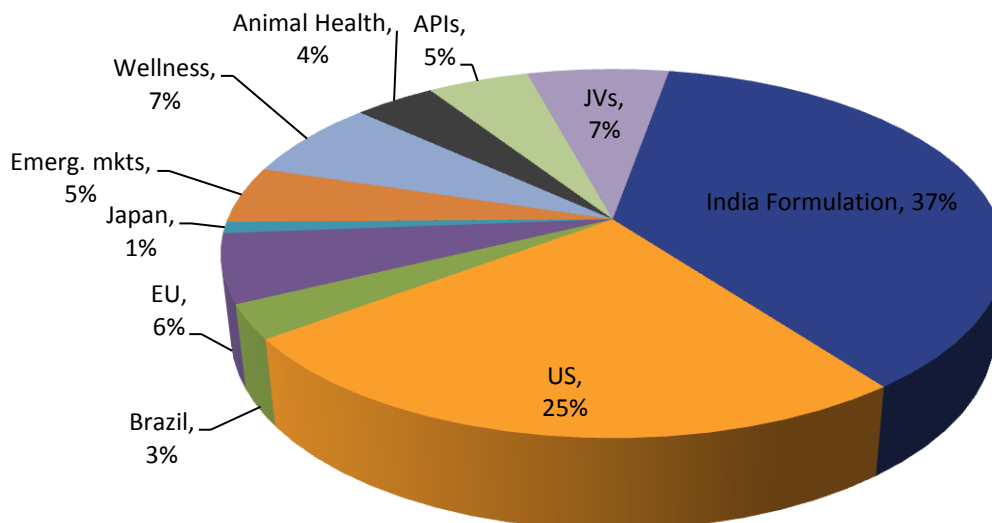
The company guided for 22 approvals in FY'14E and expects 2 new launches from Neshar in FY'14E.

competition products and focusing on launching niche products under chronic segments. Going forward, the company's growth momentum in the US market will continue with the launch of value added generic products that will drive incremental sales and margins. As the momentum of product approval and launches pick ups, revenues from US to grow at a faster pace over the next two years. US business to further scale up on the back of a strong product pipeline as ~100 ANDAs are pending for approval with the USFDA. We believe healthy market share in existing products, recent products launched and pending ANDAs approval to augment growth over FY13-F15E.

Well focused on strengthening its regulatory pipeline

CHL is well focused on strengthening its regulatory pipeline in order to enhance the profitability. The company has filed 12 additional ANDAs with the USFDA, including two filings for injectable products during Q2FY'14. Further, it has received approval for two products in the US markets and 4 new product dossiers were approved for the European market in Q2FY'14. In line with strengthening its regulatory pipeline, the management remains hopeful for maintaining its ANDA filing of 25-30 per year in the US market along with more than 20 approvals in the next 12-15 months. Apart from this, the company has launched three new products in Mexico during the quarter, taking the cumulative number of launches to four. The company has made four filings with Mexican regulatory authority Cofepris and received the approval for one more product, taking total approvals to six. Exports to emerging markets grew by 32% with 20 new product launches in different market during the quarter. The company's API business grew by 22% during the quarter under review. Further, in Q2FY'14, the company has launched its pioneering drug Lipaglyn to treat diabetic dyslipidemia. Besides Lipaglyn, the group has launched 19 new products, including line extensions in India of which, four were first in India. The company guided for 22 approvals in FY'14E and expects 2 new launches from Neshar in FY'14E.

Segment-wise Gross Sales in H1FY'14



Lipaglyn is the first Glitazar to be approved in the world and the first NCE discovered and developed indigenously by an Indian Pharma Company.

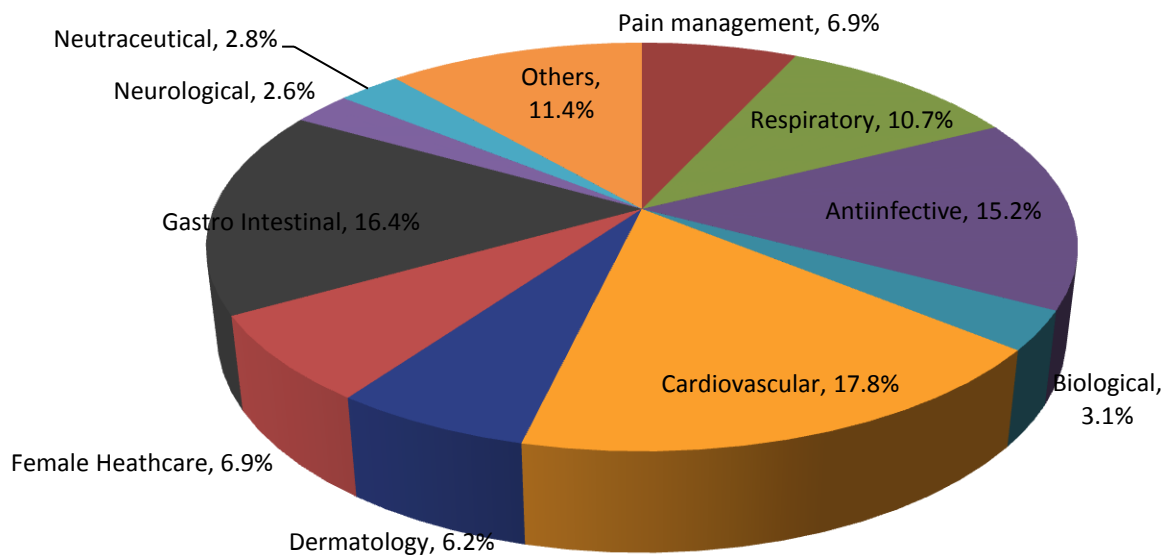
Followed by the launch of Lipaglyn in India, CHL expects this product to be launched in different markets in the next three-five years.

Pioneered a breakthrough with the launch of India's First NCE

The company has pioneered a breakthrough with the launch of LIPAGLYN, a novel drug targeted at treating Diabetic Dyslipidemia or Hypertriglyceridemia in Type II diabetes. The company has launched this patented diabetes drug in Indian market in order to strengthen its presence in the domestic formulation market. This is for the very first time that an Indian pharma company has appeared in the glitazar class across the world. Lipaglyn is the first Glitazar to be approved in the world and the first NCE (New Chemical Entity) discovered and developed indigenously by an Indian Pharma Company.

CHL's domestic formulations business is currently the largest contributor to the company's revenues. The company continued to maintain its strong position in the cardiovascular, gastro intestinal, respiratory and women's healthcare segments during the year. Twenty of the company's brands now feature amongst the top 300 pharmaceutical brands in India. The company generates more than 50% of its revenues from the chronic segment with overall formulations business in India posted sales of ₹23,232 mn, up by 23% in FY'13. The company continued its focus on new product introductions and launched over 40+ in H1FY'14 (incl. line extensions), with 9 First-in-India. The company now plans to partner MNCs for its marketing in developed markets such as the US, Europe and Japan. It has already spent around US\$250mn and it further plans to spend another US\$150-200 mn for additional indications and also for approvals in other markets. Followed by the launch of Lipaglyn in India, the company expects this product to be launched in different markets in the next three-five years. With such a unique discovery, the company is well poised among its peers and it expects over US\$1bn sales when sold globally.

Branded formulations sales in India during FY'13

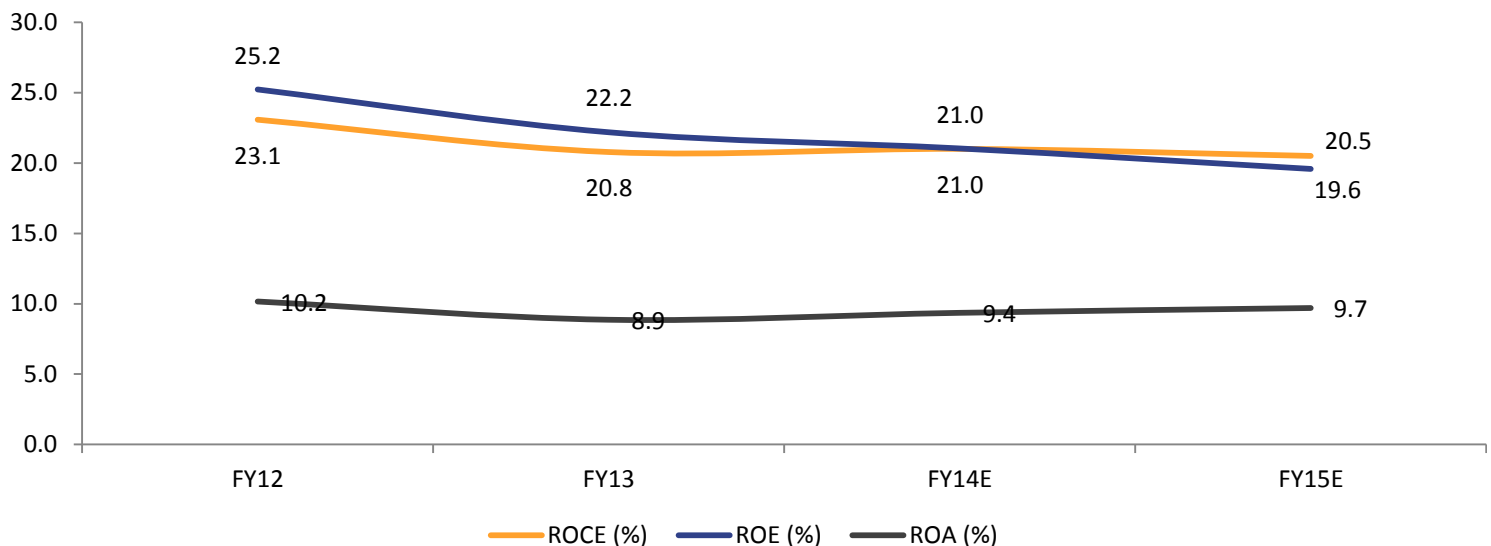


The impact of the new drug pricing policy in the domestic market will be mitigated by the accelerated growth from the US and its diversified international presence.

New Drug Policy to strain the profitability of domestic firms

The new drug Pricing Policy 2013 announced by the government under which 348 medicines in the National List of Essential Medicines have been brought under price control, may have a significant impact on the company's profitability and the company is likely to face slowdown in the domestic market. Though this move of the industry regulator to mark a change from cost-based to market-based pricing methodology has cheered the end consumers, the same will hamper the sales realization and margins of domestic pharmaceutical firms in India. Cadila that generates more than 30% of the revenue from the domestic formulation business and currently the domestic formulations business being the largest contributor to the company, revenues are expected to take a hit in this fiscal on account of the changes implemented due to the new pricing policy.

Key Ratios



As a global player, R&D is a necessity as CHL aims to be a research-driven pharmaceuticals company by 2020.

Key Concerns

- ✓ High competition remains a major concern in the Indian pharmaceutical market due to the entry of new players and constantly puts pressure on the prices of the company's products and poses threat of losing market share.
- ✓ Developing new medicines is becoming an increasingly expensive business and a long gestation period, with low chances of success due to various factors, remains a concern.
- ✓ Some other concerns such as delay in regulatory approvals, weak seasonal demand, the adverse impact of inflationary pressures on disposable incomes coupled with the implementation of the new pricing policy is further going to impact the industry's growth momentum.

Balance Sheet (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Share Capital	1,024	1,024	1,024	1,024
Reserve and surplus	24,835	28,421	36,861	47,652
Net Worth	25,859	29,445	37,885	48,675
Minority Interest	904	1,193	1,193	1,193
Loan funds (Long Term)	13,223	14,260	14,545	14,691
Provisions (Long Term)	756	645	709	794
Other Liabilities	426	470	493	518
Current Liabilities	21,916	26,704	29,374	31,431
Deferred Tax Liabilities	1,146	1,005	1,005	1,005
Capital Employed	64,230	73,721	85,205	98,307
Fixed assets	33,410	37,612	44,006	51,267
Investments	212	212	212	212
Loans & Advances (Long Term)	2,478	3,981	4,698	5,308
Current Assets	28,130	31,917	36,290	41,520
Capital Deployed	64,230	73,721	85,205	98,307

Key Ratios (Consolidated)

Y/E	FY12A	FY13A	FY14E	FY15E
EBITDA Margin (%)	21.4	18.2	18.4	18.4
EBIT Margin (%)	18.4	15.3	15.6	15.7
NPM (%)	12.3	10.2	10.6	10.9
ROCE (%)	23.1	20.8	21.0	20.5
ROE (%)	25.2	22.2	21.0	19.6
Adj EPS (₹)	31.9	31.9	38.9	46.6
P/E (x)	23.2	23.1	19.0	15.8
BVPS (₹)	126.3	143.8	185.0	237.7
P/BVPS (x)	5.8	5.1	4.0	3.1
EV/Operating Income (x)	3.1	2.5	2.2	1.9
EV/EBITDA (x)	14.1	13.8	11.6	10.0

Profit & Loss Account (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Operating Income	53,143	63,947	75,428	87,475
Operating Expenses	41,795	52,326	61,517	71,360
EBITDA	11,348	11,621	13,911	16,115
Depreciation	1,579	1,847	2,179	2,397
EBIT	9,769	9,774	11,731	13,718
Interest	1,827	1,687	1,822	1,858
PBT	7,942	8,087	9,909	11,860
Tax	1,130	1,188	1,536	1,838
Minority Interest	286	364	401	487
Net Profit	6,526	6,535	7,972	9,534

Valuation and view

Q2FY'14 been a challenging quarter for Cadila with pressure on margins on QoQ basis on account of low growth & contribution from domestic business, and de-growth of the high margin JV business. We expect the domestic business to recover with the resolution of trade related issues. Further, with the expected ramp up in approval rates from the USFDA, and approvals guidance of more than 20 over the next 12-15 months in the US, improves the revenue visibility in FY'15E. Accelerated growth in India and the US would aid in the margin recovery in the coming few quarters.

At a current market price (CMP) of ₹738, the stock trades at P/E of 19.0x FY14E and of 15.8x FY15E, earnings. We recommend 'BUY' with a target price of ₹850, which implies potential upside of ~15.2% to the CMP from 1 year perspective.



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