

HOLD

TP: Rs 1,200 | ▲ 8%

SUN PHARMA

| Pharmaceuticals

| 02 November 2023

Healthy quarter; better mix supports gross margin

- Q2 revenue/PAT grew 11%/5% YoY to Rs 122bn/Rs 24bn, largely in line with consensus
- Gross margin strong at 77% but higher opex led to 285bps YoY EBITDA margin contraction to 26.4%
- We tweak EBITDA estimates and maintain HOLD with a revised TP of Rs 1,200 (vs. Rs 1,160)

Saad Shaikh

research@bobcaps.in

Strong domestic uptick despite industry slowdown: SUNP reported 11% YoY topline growth in Q2FY24 to Rs 122bn led by broad-based growth across markets and therapies. India business grew at a healthy 11% YoY amid an industrywide slowdown in acute and related therapies, and management expects to continue growing ahead of the market. The company launched eight new products during the quarter, including Sovateltide for strokes.

Specialty business on a firm footing: The global specialty business grew 19% YoY (+3% QoQ) to US\$ 240mn backed by Ilumya, Cequa and Winlevi. US generic business remained subdued due to lower Taro sale, which was down 7% QoQ to US\$ 148mn. Ex-Taro, the US business fell 10% QoQ, implying pressure in the generics segment, with lower contribution from gRevlimid. Management expects gRevlimid contribution to remain episodic. Supplies from the Halol plant have begun while Mohali is guided to gradually inch toward normalcy.

Robust gross margin...: Gross margin expanded 190bps YoY to 77.1% in Q2 on account of favourable API and raw material prices as well as a higher share of specialty products in the mix.

...but higher opex and tax constrain PAT growth: Gross margin gains were negated by higher operating expenses as the company is running clinical trial studies on six specialty assets in the pipeline. R&D investment for Q2 stood at 6.2% of revenue vs. 5.6%/5.1% in Q1FY24/Q2FY23, with specialty spends at 38% of the total and guided to rise further. EBITDA margin thus fell 285bps YoY to 26.4%. The effective tax rate for Q2 came in at 14% vs. 5.7% in the year-ago quarter, which further limited PAT growth to 5% YoY (still in line with consensus).

Retain HOLD; TP revised to 1,200: We raise our FY24-FY25 EBITDA estimates slightly by 1-2% to capture the stronger H1FY24 margins. Based on an unchanged 19x FY25E EV/EBITDA multiple – which is 1SD above the stock’s 5Y average – our TP stands revised to Rs 1,200 (vs. Rs 1,160) and offers 8% upside potential. We therefore maintain our HOLD rating.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	SUNP IN/Rs 1,116
Market cap	US\$ 32.6bn
Free float	45%
3M ADV	US\$ 28.9mn
52wk high/low	Rs 1,170/Rs 922
Promoter/FPI/DII	54%/16%/20%

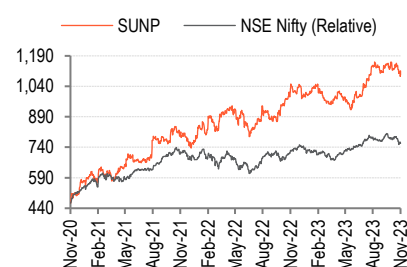
Source: NSE | Price as of 1 Nov 2023

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	432,789	485,385	535,246
EBITDA (Rs mn)	116,468	125,087	145,204
Adj. net profit (Rs mn)	86,451	97,086	112,861
Adj. EPS (Rs)	36.0	40.5	47.0
Consensus EPS (Rs)	36.0	38.5	45.1
Adj. ROAE (%)	15.7	15.3	15.7
Adj. P/E (x)	31.0	27.6	23.7
EV/EBITDA (x)	21.8	20.2	17.3
Adj. EPS growth (%)	12.5	12.3	16.2

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)	H1FY24	H1FY23	YoY (%)
Net Sales	121,924	109,523	11.3	119,408	2.1	241,333	217,140	11.1
EBITDA	32,135	31,980	0.5	33,297	(3.5)	65,432	59,367	10.2
Depreciation	6,328	6,100	3.7	6,513	(2.8)	12,841	11,980	-
EBIT	25,807	25,881	(0.3)	26,784	(3.6)	52,591	47,388	11.0
Interest	493	194	154.2	809	(39.1)	1,302	331	-
Other Income	2,936	852	244.5	2,044	43.6	4,981	874	-
PBT	28,250	26,539	6.4	28,020	0.8	56,269	47,931	-
Less: Taxation	3,901	1,523	-	4,681	-	8,582	3,413	-
Less: Minority Interest	253	(21)	-	(95)	-	158	329	-
Recurring PAT	24,096	25,037	(3.8)	23,434	2.8	47,530	44,189	7.6
Exceptional items	(341)	(2,415)	-	(3,208)	-	(3,549)	(958)	-
Reported PAT	23,755	22,622	5.0	20,225	17.5	43,981	43,231	1.7
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	77.1	75.3	187	76.9	24	77.0	74.2	285
EBITDA Margin	26.4	29.2	(284)	27.9	(153)	27.1	27.3	(23)
Tax / PBT	13.8	5.7	-	16.7	-	15.3	7.1	-
NPM	19.8	22.9	-	19.6	-	19.7	20.4	-
EPS (Rs)	10.0	10.4	-	9.8	-	19.8	18.4	-

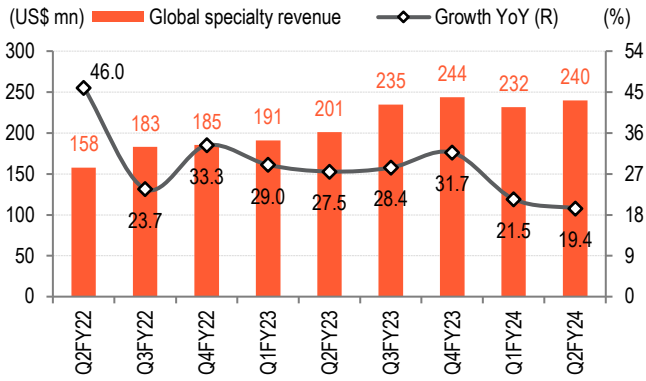
Source: Company, BOBCAPS Research

Fig 2 – Revenue mix

(Rs mn)	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)	H1FY24	H1FY23	YoY (%)
Formulation	114,379	102,658	11.4	111,805	2.3	226,184	202,555	11.7
Domestic	38,425	34,600	11.1	35,604	7.9	74,029	68,471	8.1
Exports	75,953	68,058	11.6	76,202	(0.3)	152,155	134,084	13.5
US	35,504	32,913	7.9	38,709	(8.3)	74,213	65,350	13.6
EM	23,449	20,704	13.3	21,452	9.3	44,901	39,615	13.3
ROW	17,000	14,441	17.7	16,041	6.0	33,041	29,119	13.5
APIs and others	5,653	5,434	4.0	6,046	(6.5)	11,699	11,977	(2.3)
Net Sales	120,031	108,092	11.0	117,852	1.8	237,883	214,532	10.9
Other operating income	1,893	1,431	32.3	1,557	21.6	3,450	2,609	32.2
Revenue	121,924	109,523	11.3	119,408	2.1	241,333	217,140	11.1
USDINR	82.7	79.8	3.5	82.2	0.6	82.4	78.5	5.0
US revenue (US\$ mn)	430	412	4.2	471	(8.8)	900	833	8.2

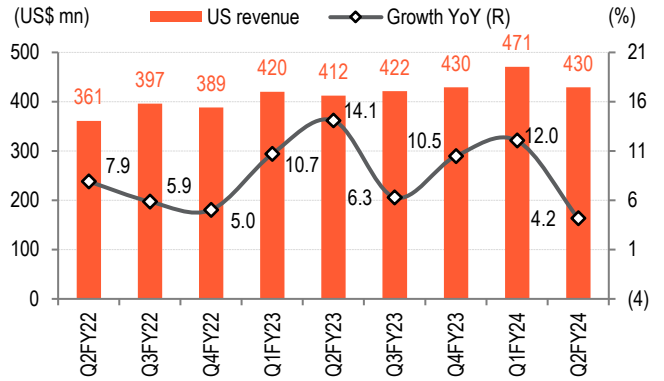
Source: Company, BOBCAPS Research

Fig 3 – Global specialty revenue



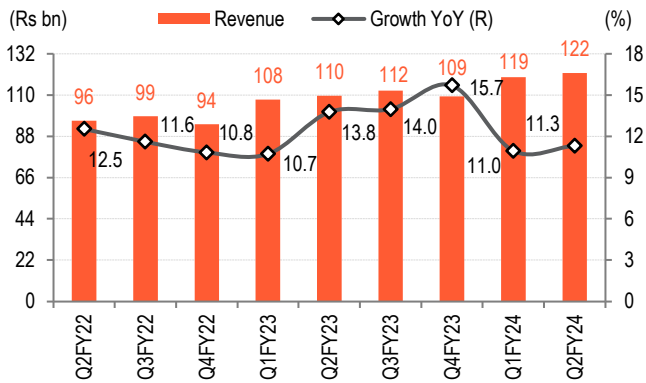
Source: Company, BOBCAPS Research

Fig 4 – US market revenue



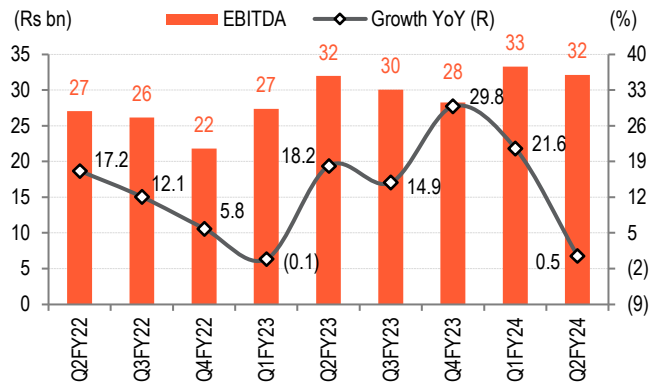
Source: Company, BOBCAPS Research

Fig 5 – Revenue



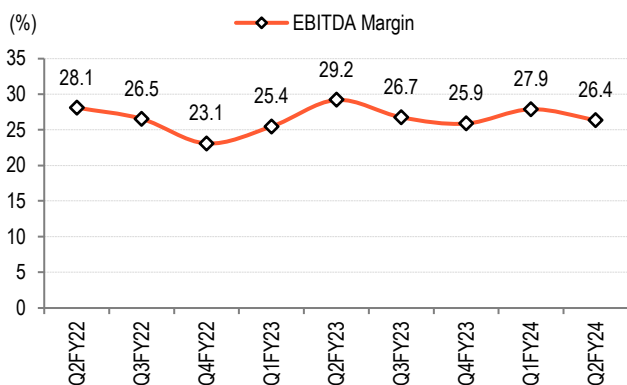
Source: Company, BOBCAPS Research

Fig 6 – EBITDA



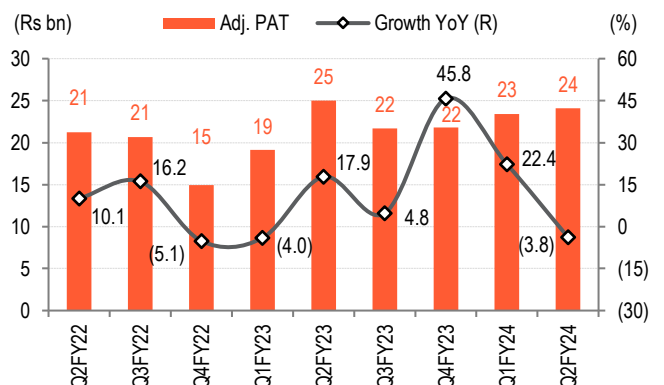
Source: Company, BOBCAPS Research

Fig 7 – EBITDA margin



Source: Company, BOBCAPS Research

Fig 8 – Adj. PAT



Source: Company, BOBCAPS Research

Earnings call highlights

- **Opex:** SUNP's operating expense climbed in Q2FY24 due to R&D investments as well as higher staff cost and overheads following merit increases and consolidation of Concert Pharma. Opex was also higher due to a US\$ 6.1mn one-off fee at Taro for the work of a special committee appointed by the company.
- **Forex loss:** Forex loss for the quarter was Rs 341mn (vs. Rs 2.4bn in Q2FY23).
- **India:** SUNP grew higher than the Indian pharma market and did well across its major therapy areas. The company launched eight new products, including Tyvalzi (Sovateltide)
- **Global specialty business:** SUNP had submitted an 8mg twice-daily regimen of alopecia drug Deuruxolitinib for FDA review and the new drug application was accepted by the agency.
- **US:** Revenue from US business grew 4% YoY to US\$ 430mn driven by the specialty business, including Ilumya, Cequa and Winlevi, but offset by the impact of Halol and Mohali facility issues.
 - **US specialty business:** The US specialty business has continued to do well and grew YoY, with management seeing strong underlying business and prescription trends.
 - **Taro:** Excluding the impact of one-time gross to net adjustments in Q2FY24 and Q2FY23, sales growth was in mid-single-digits YoY.
 - **Ex-Taro US generic business:** The company launched three generic products in the US on an ex-Taro basis.
- **R&D spend:** R&D investment is guided to remain elevated given ongoing clinical studies.
- **Tax rate:** The effective tax rate in Q2FY24 was 13.8% compared to 16.7%/5.7% in Q1FY24/Q2FY23 and is guided to inch up as compared to earlier years.

Valuation methodology

We raise our FY24-FY25 EBITDA estimates slightly by 1-2% to capture the stronger H1FY24 margins, and also introduce FY26 forecasts in this note. Based on an unchanged 19x FY25E EV/EBITDA multiple – which is 1SD above the stock's five-year average – our TP stands revised to Rs 1,200 (vs. Rs 1,160) and offers 8% upside potential. We therefore maintain our HOLD rating.

Fig 9 – Revised estimates

(Rs bn)	New			Old			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Sales	485	535	585	483	533	NA	0.5	0.5	NA
EBITDA	125	145	162	125	143	NA	0.5	1.8	NA
EBITDA margin (%)	26	27	28	26	27	NA	0bps	36bps	NA
EPS (Rs)	41	47	53	40	46	NA	1.4	1.6	NA

Source: BOBCAPS Research

Fig 10 – Key assumptions

Revenue (Rs bn)	FY23	FY24E	FY25E	FY26E
Formulation	410.8	460.8	508.1	556.4
Domestic	136.0	150.1	165.9	179.9
Exports	274.8	310.7	342.3	376.4
US	135.4	155.2	172.9	193.6
EM	79.0	88.5	97.3	107.0
ROW	60.4	67.0	72.1	75.8
API	19.7	22.1	24.3	25.3
Others	2.3	2.5	2.8	3.1

Source: Company, BOBCAPS Research

Key risks

Key upside risks to our estimates are:

- regulatory clearance of the Halol and Mohali plants,
- positive results from pipeline drugs, especially Deuruxolitinib, and
- higher gRevlimid sales.

Key downside risks to our estimates are:

- continued regulatory hindrances to plants under USFDA scrutiny,
- deterioration in the US generic pricing environment, and
- reduced market share and heightened competition for gRevlimid.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.8	1,828	2,070	BUY
Alembic Pharma	ALPM IN	1.7	713	615	HOLD
Alkem Labs	ALKEM IN	5.4	3,723	3,300	SELL
Aurobindo Pharma	ARBP IN	6.1	859	880	HOLD
Cipla	CIPLA IN	11.8	1,201	1,360	BUY
Divi's Labs	DIVI IN	10.8	3,346	3,200	HOLD
Dr Reddy's Labs	DRRD IN	10.8	5,346	5,500	HOLD
Eris Lifesciences	ERIS IN	1.4	864	955	BUY
Glenmark Life Sciences	GLS IN	0.9	619	620	HOLD
Laurus Labs	LAURUS IN	2.3	359	340	HOLD
Lupin	LPC IN	6.3	1,133	800	SELL
Sun Pharma	SUNP IN	32.6	1,116	1,200	HOLD

Source: BOBCAPS Research, NSE | Price as of 1 Nov 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Total revenue	384,265	432,789	485,385	535,246	584,755
EBITDA	102,438	116,468	125,087	145,204	161,559
Depreciation	21,437	25,294	26,663	28,032	29,401
EBIT	81,001	91,174	98,424	117,172	132,158
Net interest inc./(exp.)	(1,274)	(1,720)	(2,299)	(2,194)	(2,094)
Other inc./(exp.)	9,215	6,345	16,749	16,864	18,424
Exceptional items	0	0	0	0	0
EBT	88,942	95,799	112,874	131,841	148,487
Income taxes	10,755	8,476	14,109	17,139	19,303
Extraordinary items	(44,129)	(1,715)	0	0	0
Min. int./Inc. from assoc.	1,331	873	1,678	1,841	2,085
Reported net profit	32,728	84,736	97,086	112,861	127,099
Adjustments	44,129	1,715	0	0	0
Adjusted net profit	76,856	86,451	97,086	112,861	127,099

Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Accounts payables	44,793	56,815	48,554	52,449	54,913
Other current liabilities	34,479	31,628	31,660	31,695	31,733
Provisions	95,169	56,973	62,327	68,217	74,696
Debt funds	12,903	68,859	65,696	62,691	59,836
Other liabilities	0	0	0	0	0
Equity capital	2,399	2,399	2,399	2,399	2,399
Reserves & surplus	508,263	590,755	671,547	765,435	871,238
Shareholders' fund	510,662	593,154	673,946	767,834	873,637
Total liab. and equities	698,005	807,429	882,183	982,886	1,094,816
Cash and cash eq.	50,333	57,930	118,063	199,348	293,401
Accounts receivables	105,929	114,385	124,132	136,883	149,545
Inventories	89,968	105,131	113,645	125,319	136,911
Other current assets	85,817	87,984	87,984	87,984	87,984
Investments	128,486	148,301	148,301	148,301	148,301
Net fixed assets	103,721	103,670	100,030	95,023	88,646
CWIP	12,868	49,732	49,732	49,732	49,732
Intangible assets	120,884	140,297	140,297	140,297	140,297
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	698,005	807,429	882,183	982,886	1,094,816

Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Cash flow from operations	83,401	59,617	104,881	128,446	143,284
Capital expenditures	(27,712)	(81,520)	(23,024)	(23,024)	(23,024)
Change in investments	(32,361)	(19,815)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(60,073)	(101,335)	(23,024)	(23,024)	(23,024)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(25,783)	55,956	(3,163)	(3,005)	(2,855)
Interest expenses	(1,274)	(1,720)	(2,299)	(2,194)	(2,094)
Dividends paid	(23,990)	(15,268)	(17,493)	(20,336)	(22,901)
Other financing cash flows	13,597	10,347	1,231	1,397	1,644
Cash flow from financing	(37,450)	49,315	(21,725)	(24,137)	(26,206)
Chg in cash & cash eq.	(14,122)	7,597	60,132	81,285	94,054
Closing cash & cash eq.	50,333	57,930	118,063	199,348	293,401

Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24E	FY25E	FY26E
Reported EPS	13.6	35.3	40.5	47.0	53.0
Adjusted EPS	32.0	36.0	40.5	47.0	53.0
Dividend per share	10.0	6.4	7.3	8.5	9.5
Book value per share	200.1	233.4	266.6	305.2	348.6

Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24E	FY25E	FY26E
EV/Sales	6.7	5.9	5.2	4.7	4.2
EV/EBITDA	25.1	21.8	20.2	17.3	15.1
Adjusted P/E	34.8	31.0	27.6	23.7	21.1
P/BV	5.6	4.8	4.2	3.7	3.2

DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23A	FY24E	FY25E	FY26E
Tax burden (Net profit/PBT)	86.4	90.2	86.0	85.6	85.6
Interest burden (PBT/EBIT)	109.8	105.1	114.7	112.5	112.4
EBIT margin (EBIT/Revenue)	21.1	21.1	20.3	21.9	22.6
Asset turnover (Rev./Avg TA)	14.0	14.4	14.4	14.3	14.1
Leverage (Avg TA/Avg Equity)	1.4	1.4	1.3	1.3	1.3
Adjusted ROAE	15.3	15.7	15.3	15.7	15.5

Ratio Analysis

Y/E 31 Mar	FY22A	FY23A	FY24E	FY25E	FY26E
YoY growth (%)					
Revenue	15.6	12.6	12.2	10.3	9.2
EBITDA	20.6	13.7	7.4	16.1	11.3
Adjusted EPS	6.6	12.5	12.3	16.2	12.6
Profitability & Return ratios (%)					
EBITDA margin	26.7	26.9	25.8	27.1	27.6
EBIT margin	21.1	21.1	20.3	21.9	22.6
Adjusted profit margin	20.0	20.0	20.0	21.1	21.7
Adjusted ROAE	15.3	15.7	15.3	15.7	15.5
ROCE	14.6	14.8	14.1	14.5	14.6
Working capital days (days)					
Receivables	93	93	93	93	93
Inventory	85	85	85	85	85
Payables	149	149	149	149	149
Ratios (x)					
Gross asset turnover	1.3	1.3	1.4	1.4	1.5
Current ratio	1.9	2.5	3.1	3.6	4.1
Net interest coverage ratio	63.6	53.0	42.8	53.4	63.1
Adjusted debt/equity	(0.3)	(0.2)	(0.3)	(0.4)	(0.4)

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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Registered office Address: **1704, B Wing, Parinee Crescenzo, G Block, BKC, Bandra East, Mumbai 400051**

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BUY – Expected return >+15%

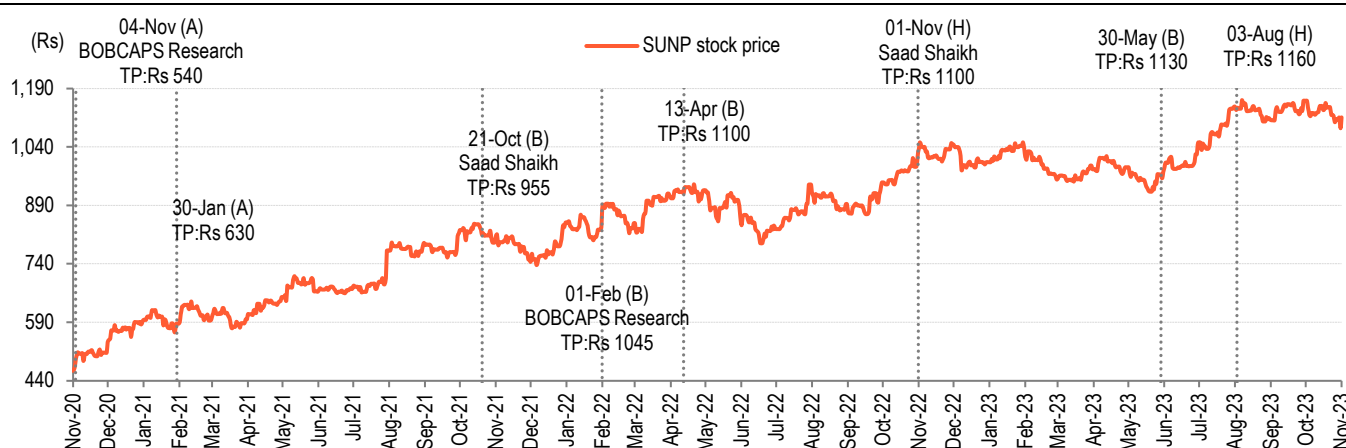
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): SUN PHARMA (SUNP IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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