

REDUCE

TP: Rs 455 | ▲ 4%

SUN PHARMA

Pharmaceuticals

13 August 2019

Adj. EBITDA miss, US base to normalise; retain REDUCE

Q1 EBITDA was in line despite a gross margin miss which was partly set off by low R&D expense (5% of sales vs. 8% guidance). Normalising for R&D, adj. EBITDA was Rs 16.6bn (6% miss). SUNP expects R&D spends to step up from Q2. Other highlights: Disclosure on global specialty with sales at US\$ 94mn and R&D at US\$9mn (low due to timing difference), limited concerns on Ilumya formulary coverage from Skyrizi, and a Q3 launch for Cequa. Improving efficiency and cost structure remain focus areas. We roll over to a Sep'20 TP of Rs 455 (vs. Rs 435).

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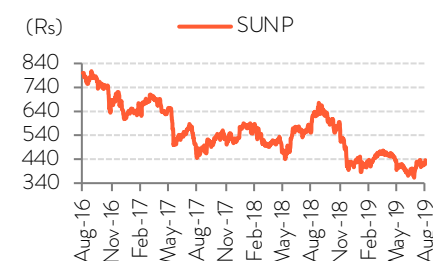
US ex-Taro base to normalise heron; Cequa Q3 launch: Ex-Taro, SUNP's US sales stood at US\$ 263mn (flat QoQ) – this includes US\$ 60mn of short-term supply, which should be discontinued from Q2, and better contribution from Ilumya (as the Rx trend continues to improve at 25% QoQ). Adjusted for these, we believe the US base business has declined sequentially despite five launches in Q1. SUNP highlighted that DTC spends for Ilumya could be lumpy which should pick up in Q2, while Cequa launch spend is in the Q1 base. We estimate US sales of US\$ 953mn ex-Taro for FY20 (US\$ 230mn over Q2-Q4).

Ticker/Price	SUNP IN/Rs 439
Market cap	US\$ 14.8bn
Shares o/s	2,399mn
3M ADV	US\$ 42.8mn
52wk high/low	Rs 679/Rs 345
Promoter/FPI/DII	54%/17%/16%

Source: NSE

Weak gross margins, in-line India, upbeat ROW: Gross margins fell 365bps QoQ to 70.2% due to provisioning in the India distribution change and a weak product mix across segments. At a secondary level, SUNP's growth was at 12% (vs. 7.5% YoY). ROW growth of 22% YoY was led by Pola Pharma.

STOCK PERFORMANCE



Source: NSE

Key earnings call takeaways: (1) Management changes: Kal Sundaram moved to head strategic initiatives, Japan & China business; Kirti Ganorkar to head India business; new hire expected for global branded business. (2) No improvement in US generic pricing for broad portfolio. (3) Skyrizi saw no impact to Ilumya formulary coverage. (4) Q1 drop in interest cost led by INR debt repayment. (5) Odomzo market share up from 10% in Q4 to 12%.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	33,666	36,484	47,500	55,534	62,602
Adj. EPS (Rs)	14.0	15.2	19.8	23.1	26.1
Adj. EPS growth (%)	(50.7)	8.4	30.2	16.9	12.7
Adj. ROAE (%)	8.1	8.4	10.1	10.8	11.1
Adj. P/E (x)	31.3	28.9	22.2	19.0	16.8
EV/EBITDA (x)	17.5	16.1	13.7	11.5	10.0

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)	Q1FY20E	Var. (%)
Net Sales	82,590	71,380	15.7	70,443	17.2	81,827	0.9
EBITDA	18,132	16,107	12.6	9,521	90.4	17,875	1.4
Depreciation	4,571	4,016	-	4,540	-	4,000	-
EBIT	13,561	12,091	12.2	4,981	172.3	13,875	-
Interest	0	0	-	0	-	0	-
Other Income	2,240	1,541	-	2,511	-	2,925	-
PBT	15,801	13,632	-	7,492	-	16,800	(5.9)
Less: Taxation	1,460	1,638	-	(288)	-	2,520	-
Less: Minority interest	1,138	1,285	-	847	-	1,233	-
Recurring PAT	13,203	10,709	23.3	6,933	90.4	13,047	1.2
Exceptional items	674	(899)		(573)	-	0	-
Reported PAT	13,877	9,810	41.5	6,360	118.2	13,047	6.4
Key Ratios (%)							
Gross Margin	70.2	70.5	-	73.9	-	73.0	-
EBITDA Margin	22.0	22.6	-	13.5	-	21.8	-
Tax / PBT	9.2	12.0	-	(3.8)	-	15.0	-
NPM	16.0	15.0	-	9.8	-	15.9	-
EPS (Rs)	5.5	4.4	-	2.9	-	5.4	-

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)	Q1FY20E	Var. (%)
Formulation	77,688	67,516	15.1	65,227	19.1	77,099	0.8
Domestic	23,137	21,520	7.5	11,010	110.1	23,000	0.6
Exports	54,551	45,996	18.6	54,217	0.6	54,099	0.8
US	29,474	25,460	15.8	31,238	(5.6)	30,893	(4.6)
ROW	25,077	20,536	22.1	22,979	9.1	23,206	8.1
APIs and others	4,905	3,940	24.5	5,211	(5.9)	4,728	3.7
Net Sales	82,593	71,456	15.6	70,438	17.3	81,827	0.9

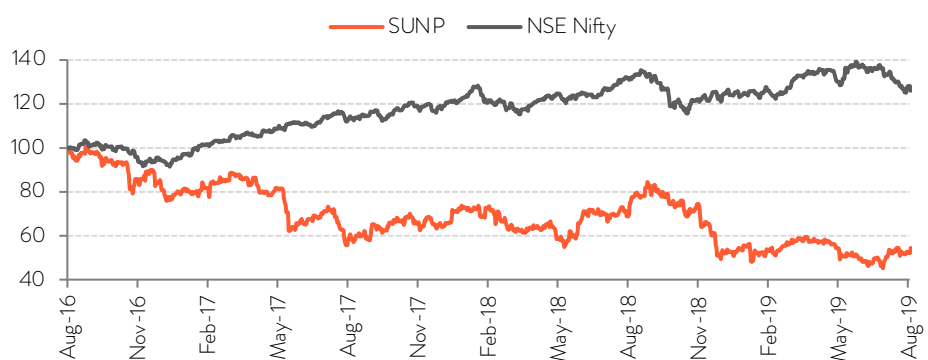
Source: Company, BOBCAPS Research

Valuation methodology

While our fundamental thesis of positive operating leverage in the US business and steady India/EM business dynamics remains intact and is expected to drive sustained earnings momentum for SUNP (+23% CAGR over FY19-FY21E), we believe the recent corporate governance issues limit scope for a valuation rerating in the medium term.

We retain our FY20/FY21 EPS estimates of Rs 20/Rs 23 and maintain REDUCE with a rollover to a Sep'20 target price of Rs 455 (earlier Rs 435). Our target EV/EBITDA multiple is unchanged at 11x (18x implied P/E).

FIG 3 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Adverse outcomes in the ongoing US Department of Justice investigation on drug price collusion
- Escalation of SEBI investigation
- Delays in US approval and ramp-up of the specialty business
- Higher-than-estimated initial upfront investments in R&D
- Above-expected price erosion in US generics

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	260,680	286,906	325,880	359,740	400,315
EBITDA	55,630	60,746	73,200	82,929	91,855
EBIT	40,632	43,214	54,821	63,650	71,676
Net interest income/(expenses)	(5,174)	(5,552)	(2,776)	(1,388)	(694)
Other income/(expenses)	8,388	10,255	9,410	9,167	9,783
Exceptional items	0	0	0	0	0
EBT	43,846	47,917	61,455	71,429	80,765
Income taxes	5,967	6,009	9,218	11,429	13,730
Extraordinary items	(12,050)	(9,823)	0	0	0
Min. int./Inc. from associates	4,213	5,424	4,737	4,466	4,433
Reported net profit	21,616	26,661	47,500	55,534	62,602
Adjustments	12,050	9,823	0	0	0
Adjusted net profit	33,666	36,484	47,500	55,534	62,602

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	47,662	41,479	50,256	56,089	62,415
Other current liabilities	22,782	25,672	25,776	25,891	26,017
Provisions	55,141	35,958	39,124	42,606	46,436
Debt funds	97,517	98,933	49,467	24,733	12,367
Other liabilities	0	0	0	0	0
Equity capital	2,399	2,399	2,399	2,399	2,399
Reserves & surplus	419,847	444,826	486,789	534,779	588,273
Shareholders' fund	422,246	447,225	489,188	537,178	590,672
Total liabilities and equities	645,347	649,267	653,811	686,496	737,907
Cash and cash eq.	99,294	72,756	66,677	82,074	113,414
Accounts receivables	78,153	88,842	94,840	104,694	116,503
Inventories	68,807	78,859	83,863	92,576	103,018
Other current assets	112,168	94,978	94,978	94,978	94,978
Investments	71,427	79,024	79,024	79,024	79,024
Net fixed assets	93,912	102,607	102,228	100,949	98,770
CWIP	24,650	14,110	14,110	14,110	14,110
Intangible assets	96,936	118,091	118,091	118,091	118,091
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	645,347	649,267	653,811	686,496	737,907

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	36,614	44,193	65,879	74,813	82,781
Interest expenses	5,174	5,552	2,776	1,388	694
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(20,324)	(21,269)	941	(9,253)	(12,094)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	21,464	28,477	69,596	66,949	71,381
Capital expenditures	(21,461)	(36,842)	(18,000)	(18,000)	(18,000)
Change in investments	(59,510)	(7,597)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(80,971)	(44,438)	(18,000)	(18,000)	(18,000)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	16,608	1,416	(49,467)	(24,733)	(12,367)
Interest expenses	(5,174)	(5,552)	(2,776)	(1,388)	(694)
Dividends paid	(9,601)	(5,776)	(10,274)	(12,012)	(13,540)
Other financing cash flows	5,560	(664)	4,842	4,582	4,560
Cash flow from financing	7,393	(10,576)	(57,675)	(33,551)	(22,041)
Changes in cash and cash eq.	(52,115)	(26,538)	(6,079)	15,397	31,340
Closing cash and cash eq.	99,294	72,756	66,677	82,074	113,414

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	9.0	11.1	19.8	23.1	26.1
Adjusted EPS	14.0	15.2	19.8	23.1	26.1
Dividend per share	4.0	2.4	4.3	5.0	5.6
Book value per share	159.8	172.6	188.1	206.3	226.7

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	3.7	3.4	3.1	2.7	2.3
EV/EBITDA	17.5	16.1	13.7	11.5	10.0
Adjusted P/E	31.3	28.9	22.2	19.0	16.8
P/BV	2.7	2.5	2.3	2.1	1.9

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	76.8	76.1	77.3	77.7	77.5
Interest burden (PBT/EBIT)	107.9	110.9	112.1	112.2	112.7
EBIT margin (EBIT/Revenue)	15.6	15.1	16.8	17.7	17.9
Asset turnover (Revenue/Avg TA)	10.4	11.1	12.5	13.4	14.1
Leverage (Avg TA/Avg Equity)	1.5	1.5	1.4	1.3	1.3
Adjusted ROAE	8.1	8.4	10.1	10.8	11.1

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	(13.9)	10.1	13.6	10.4	11.3
EBITDA	(44.3)	9.2	20.5	13.3	10.8
Adjusted EPS	(50.7)	8.4	30.2	16.9	12.7
Profitability & Return ratios (%)					
EBITDA margin	21.3	21.2	22.5	23.1	22.9
EBIT margin	15.6	15.1	16.8	17.7	17.9
Adjusted profit margin	12.9	12.7	14.6	15.4	15.6
Adjusted ROAE	8.1	8.4	10.1	10.8	11.1
ROCE	7.4	7.6	9.1	10.2	10.7
Working capital days (days)					
Receivables	105	106	106	106	106
Inventory	96	94	94	94	94
Payables	225	207	207	207	207
Ratios (x)					
Gross asset turnover	1.2	1.2	1.3	1.3	1.4
Current ratio	2.9	3.3	3.0	3.0	3.2
Net interest coverage ratio	7.9	7.8	19.7	45.9	103.3
Adjusted debt/equity	(0.2)	(0.1)	(0.2)	(0.3)	(0.3)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

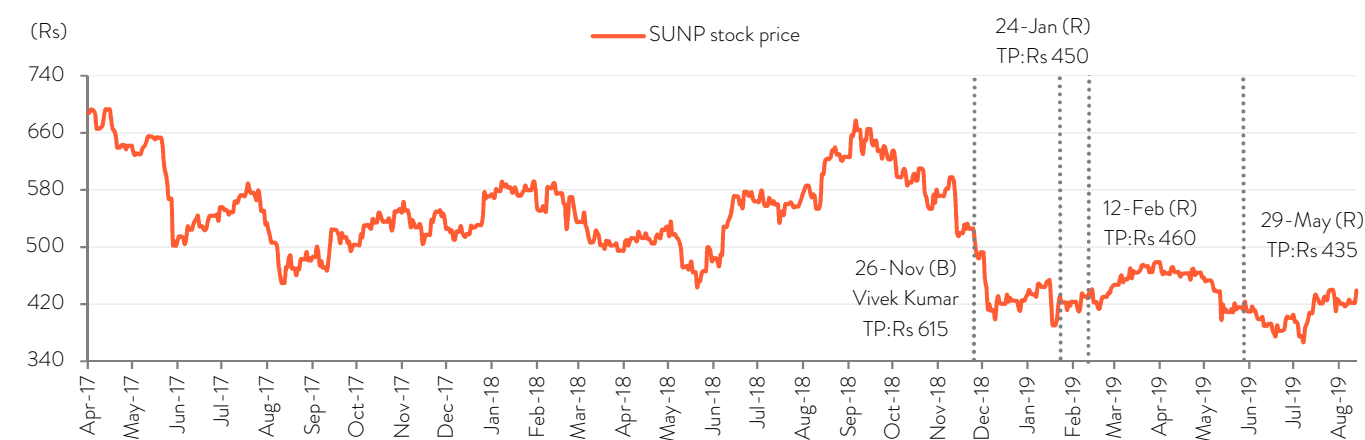
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: SUN PHARMA (SUNP IN)



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

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