

REDUCE

TP: Rs 530 | ▼ 0%

SUN PHARMA

Pharmaceuticals

01 August 2020

Mixed Q1; margin beat unlikely to sustain – REDUCE

Sun Pharma (SUNP) posted an 11% EBITDA beat but an 8% miss on sales. Operating margin at 22% beat estimates on higher gross margins (+210 QoQ) and a temporary drop in SGA (-18% YoY) and R&D cost (5.6% of sales). US sales ex-Taro were a miss due to weak specialty sales, while India revenue was healthy (+3% YoY). Q1 global specialty sales stood at US\$ 78mn (-38% QoQ). SGA savings should ebb with business activity picking up from Q3. Cost matrix across divisions remains unchanged. We roll to a new Sep'21 TP of Rs 530 (vs. Rs 470).

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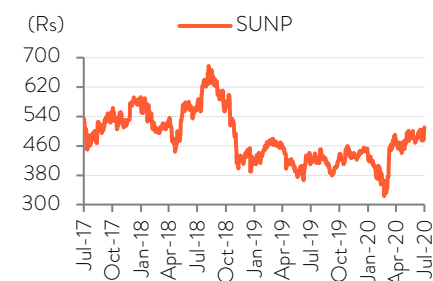
EBITDA beat on temporary cost decline: Q1 EBITDA stood at Rs 16.4bn, up 18% QoQ, with margins at 22% (est. 18%). SUNP's ex-Taro margins have increased 700bps QoQ to 21.6% due to better India chronic sales and lower SGA/R&D costs. With physical visits to doctors picking up (70% of normal levels now vs. 25% in Q1) and the likely restart of promotional spends on the US specialty business, the lower Q1 cost base would expand in coming quarters. Progress on clinical trials for new indications (Ilumya, Odomzo) have been affected, leading to lower R&D spends for Q1.

Ticker/Price	SUNP IN/Rs 532
Market cap	US\$ 17.1bn
Shares o/s	2,399mn
3M ADV	US\$ 69.3mn
52wk high/low	Rs 541/Rs 312
Promoter/FPI/DII	54%/17%/16%

Source: NSE

India strong, US (ex-Taro) and EM a miss: US sales ex-Taro declined 15% QoQ, mainly owing to weak specialty sales as doctors' clinics were shut. Ilumya and Levulan were the most impacted. Growth pick-up in specialty prescriptions was muted with some states in the US partly returning into lockdown after a spike in Covid cases. India sales growth was healthy on better chronic growth (+10% YoY) but the acute portfolio suffered (-22% YoY). EM sales declined 8% YoY.

STOCK PERFORMANCE



Source: NSE

Other takeaways: (1) Q1 specialty R&D at US\$ 22mn (39% of R&D spends). (2) Halol OAI: Remediation plan submitted, awaiting FDA inspection. (3) PLI scheme for a few antibiotics being evaluated. (4) No greater clarity on the impact of Trump's executive order. (5) Debt reduction at US\$ 200mn QoQ.

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20P	FY21E	FY22E	FY23E
Total revenue (Rs mn)	286,906	323,880	339,330	387,082	434,390
EBITDA (Rs mn)	60,746	69,823	77,841	86,139	98,213
Adj. net profit (Rs mn)	36,484	40,453	50,260	56,852	66,359
Adj. EPS (Rs)	15.2	16.9	21.0	23.7	27.7
Adj. EPS growth (%)	8.4	10.9	24.2	13.1	16.7
Adj. ROAE (%)	8.4	8.7	10.0	10.4	11.1
Adj. P/E (x)	35.0	31.5	25.4	22.4	19.2
EV/EBITDA (x)	19.7	17.4	15.4	13.5	11.4

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)	Q1FY21E	Var. (%)	FY20	FY19	YoY (%)
Net Sales	74,672	82,590	(9.6)	80,780	(7.6)	81,486	(8.4)	323,246	286,854	12.7
EBITDA	16,464	18,132	(9.2)	13,997	17.6	14,785	11.4	64,636	58,405	10.7
Depreciation	4,859	4,571	-	5,753	-	5,300	-	20,525	17,531	-
EBIT	11,605	13,561	(14.4)	8,244	40.8	9,485	-	44,111	40,874	7.9
Interest	0	0	-	0	-	0	-	3,025	5,551	-
Other Income	2,198	2,240	-	1,574	-	2,500	-	11,480	14,047	-
PBT	13,803	15,801	-	9,818	-	11,985	15.2	52,566	49,370	-
Less: Taxation	2,459	1,460	-	830	-	1,918	-	8,226	6,248	-
Less: Minority interest	(7,700)	1,138	-	929	-	881	-	4,199	5,422	-
Recurring PAT	19,044	13,203	44.2	8,059	136.3	9,186	107.3	40,141	37,700	6.5
Exceptional items	(35,539)	674	-	(4,020)	-	0	-	(2,443)	(11,294)	-
Reported PAT	(16,495)	13,877	(218.9)	4,039	(508.4)	9,186	(279.6)	37,698	26,406	42.8
Key Ratios (%)										
Gross Margin	73.6	70.2	-	71.5	-	71.0	-	71.4	72.6	-
EBITDA Margin	22.0	22.0	-	17.3	-	18.1	-	20.0	20.4	-
Tax / PBT	17.8	9.2	-	8.5	-	16.0	-	15.6	12.7	-
NPM	25.5	16.0	-	10.0	-	11.3	-	12.4	13.1	-
EPS (Rs)	7.9	5.5	-	3.3	-	3.8	-	16.7	15.7	-

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)	Q1FY21E	Var. (%)	FY20	FY19	YoY (%)
Formulation	68,709	77,688	(11.6)	75,529	(9.0)	76,238	(9.9)	302,781	268,501	12.8
Domestic	23,884	23,137	3.2	23,648	1.0	22,884	4.4	97,104	73,483	32.1
Exports	44,824	54,551	(17.8)	51,881	(13.6)	53,353	(16.0)	205,678	195,018	5.5
US	21,364	29,474	(27.5)	27,129	(21.2)	26,270	(18.7)	105,425	106,696	(1.2)
ROW	23,460	25,077	(6.4)	24,752	(5.2)	27,083	(13.4)	100,253	88,322	13.5
APIs and others	5,962	4,905	21.5	5,251	13.5	5,248	13.6	20,770	17,968	15.6
Net Sales	74,671	82,593	(9.6)	80,780	(7.6)	81,486	(8.4)	323,551	286,469	12.9

Source: Company, BOBCAPS Research

Valuation methodology

While we expect 17% growth in SUNP's core EPS over FY20-FY22, we remain cautious about ramp-up in specialty drugs such as Ilumya – which is tracking lower than estimates (both prescription count and value) – and Cequa. Other factors that could constrain valuation multiples in the medium term are further corporate governance issues linked to the SEBI-ordered forensic audit for 2016-18 financials, Absorica sales contraction, a below-expected shift to new forms (low dosage), a Rs 40.6bn contingent tax liability not provided for, and an anti-trust liability/adverse US Department of Justice ruling on generic price fixing for multiple Ranbaxy products.

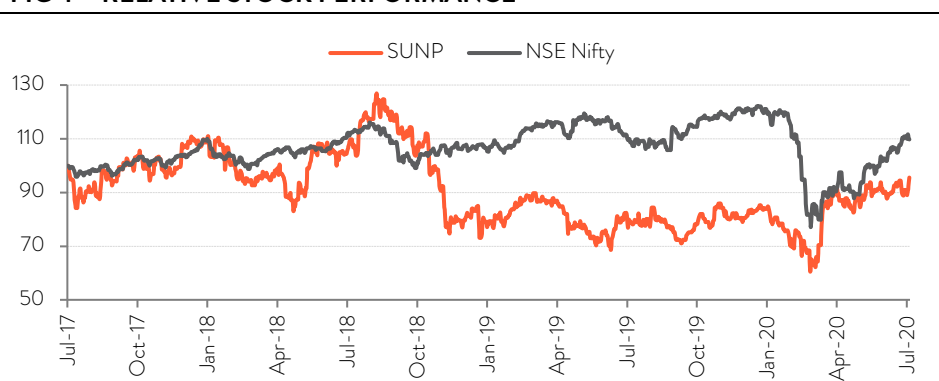
We marginally increase FY21/FY22 EPS estimates by 2% each to Rs 21/Rs 24. To factor in the weak Taro results and slower US specialty sales than expected amid Covid, we lower our revenue estimates. Cost saving in SGA has resulted in higher margin assumptions. We roll forward to a revised Sep'21 target price of Rs 530 (earlier Rs 470), based on an unchanged 12x one-year forward EV/EBITDA multiple (21x implied P/E). Our target multiple is in line with the earlier discount of 15% vis-à-vis other frontline stocks (Cipla, Dr Reddy's, Lupin). Maintain REDUCE.

FIG 3 – REVISED ESTIMATES

(Rs bn)	New		Old		Change (%)	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Sales	339.3	387.1	359.4	401.2	(5.6)	(3.5)
EBITDA	77.8	86.1	77.8	86.3	0.0	(0.2)
EBITDA margin (%)	22.9	22.3	21.7	21.5	128bps	75bps
EPS (Rs)	21	24	21	23	1.6	1.6

Source: Company, BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Upside risks to our estimates include:

- below-expected penalty in the ongoing US Department of Justice investigation on drug price collusion,
- a clean chit in the SEBI investigation,
- above-expected ramp-up of the specialty business, and
- easing of the price erosion in US generics.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20P	FY21E	FY22E	FY23E
Total revenue	286,906	323,880	339,330	387,082	434,390
EBITDA	60,746	69,823	77,841	86,139	98,213
Depreciation	17,532	20,525	20,436	21,390	22,503
EBIT	43,214	49,298	57,405	64,749	75,710
Net interest income/(expenses)	(5,552)	(3,020)	(1,510)	(755)	(378)
Other income/(expenses)	10,255	6,371	7,678	8,245	9,439
Exceptional items	0	0	0	0	0
EBT	47,917	52,649	63,573	72,239	84,771
Income taxes	6,009	7,897	10,172	12,281	15,259
Extraordinary items	(9,823)	(2,600)	0	0	0
Min. int./Inc. from associates	5,424	4,299	3,142	3,106	3,153
Reported net profit	26,661	37,853	50,260	56,852	66,359
Adjustments	9,823	2,600	0	0	0
Adjusted net profit	36,484	40,453	50,260	56,852	66,359

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20P	FY21E	FY22E	FY23E
Accounts payables	41,479	52,272	52,844	60,280	67,648
Other current liabilities	25,672	25,776	25,891	26,017	26,156
Provisions	35,958	39,124	42,606	46,436	50,649
Debt funds	98,933	49,467	24,733	12,367	6,183
Other liabilities	0	0	0	0	0
Equity capital	2,399	2,399	2,399	2,399	2,399
Reserves & surplus	444,826	478,791	521,322	568,984	624,144
Shareholders' fund	447,225	481,190	523,721	571,383	626,543
Total liabilities and equities	649,267	647,829	669,795	716,483	777,178
Cash and cash eq.	72,756	48,558	59,890	83,782	117,038
Accounts receivables	88,842	94,258	98,754	112,652	126,419
Inventories	78,859	78,750	87,324	99,613	111,787
Other current assets	94,978	94,978	94,978	94,978	94,978
Investments	79,024	99,002	99,002	99,002	99,002
Net fixed assets	102,607	100,082	97,646	94,257	95,754
CWIP	14,110	14,110	14,110	14,110	14,110
Intangible assets	118,091	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	649,267	647,829	669,795	716,483	777,178

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20P	FY21E	FY22E	FY23E
Net income + Depreciation	44,193	58,378	70,696	78,242	88,862
Interest expenses	5,552	3,020	1,510	755	378
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(21,269)	8,652	(9,017)	(14,919)	(14,362)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	28,477	70,050	63,189	64,078	74,878
Capital expenditures	(36,842)	(18,000)	(18,000)	(18,000)	(24,000)
Change in investments	(7,597)	(19,978)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(44,438)	(37,978)	(18,000)	(18,000)	(24,000)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	1,416	(49,467)	(24,733)	(12,367)	(6,183)
Interest expenses	(5,552)	(3,020)	(1,510)	(755)	(378)
Dividends paid	(5,776)	(8,187)	(10,871)	(12,297)	(14,353)
Other financing cash flows	(664)	4,404	3,257	3,232	3,293
Cash flow from financing	(10,576)	(56,270)	(33,857)	(22,186)	(17,621)
Changes in cash and cash eq.	(26,538)	(24,198)	11,332	23,892	33,256
Closing cash and cash eq.	72,756	48,558	59,890	83,782	117,038

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20P	FY21E	FY22E	FY23E
Reported EPS	11.1	15.8	21.0	23.7	27.7
Adjusted EPS	15.2	16.9	21.0	23.7	27.7
Dividend per share	2.4	3.4	4.5	5.1	6.0
Book value per share	172.6	185.0	201.4	220.0	241.6

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20P	FY21E	FY22E	FY23E
EV/Sales	4.2	3.7	3.5	3.0	2.6
EV/EBITDA	19.7	17.4	15.4	13.5	11.4
Adjusted P/E	35.0	31.5	25.4	22.4	19.2
P/BV	3.1	2.9	2.6	2.4	2.2

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20P	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	76.1	76.8	79.1	78.7	78.3
Interest burden (PBT/EBIT)	110.9	106.8	110.7	111.6	112.0
EBIT margin (EBIT/Revenue)	15.1	15.2	16.9	16.7	17.4
Asset turnover (Revenue/Avg TA)	11.1	12.5	12.9	14.0	14.5
Leverage (Avg TA/Avg Equity)	1.5	1.4	1.3	1.3	1.2
Adjusted ROAE	8.4	8.7	10.0	10.4	11.1

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20P	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	10.1	12.9	4.8	14.1	12.2
EBITDA	9.2	14.9	11.5	10.7	14.0
Adjusted EPS	8.4	10.9	24.2	13.1	16.7
Profitability & Return ratios (%)					
EBITDA margin	21.2	21.6	22.9	22.3	22.6
EBIT margin	15.1	15.2	16.9	16.7	17.4
Adjusted profit margin	12.7	12.5	14.8	14.7	15.3
Adjusted ROAE	8.4	8.7	10.0	10.4	11.1
ROCE	7.6	7.9	9.5	10.1	10.9
Working capital days (days)					
Receivables	106	106	106	106	106
Inventory	94	94	94	94	94
Payables	207	207	207	207	207
Ratios (x)					
Gross asset turnover	1.2	1.2	1.2	1.3	1.4
Current ratio	3.3	2.7	2.8	2.9	3.1
Net interest coverage ratio	7.8	16.3	38.0	85.8	200.6
Adjusted debt/equity	(0.1)	(0.2)	(0.3)	(0.3)	(0.3)

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

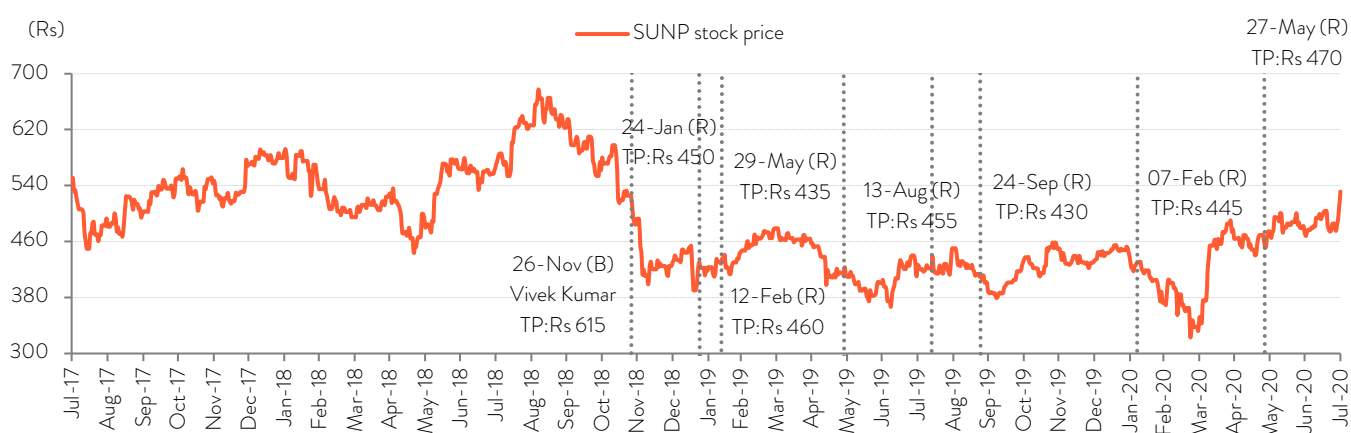
ADD – Expected return from >+5% to +15%

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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