

**REDUCE**

TP: Rs 430 | ▲ 0%

**SUN PHARMA**

Pharmaceuticals

07 November 2019

## Headline beat on low R&D, US base ex-Taro weaker; REDUCE

Sun Pharma (SUNP) delivered a 10% EBITDA beat largely driven by lower R&D (6% of sales vs. 8-9% guided). Normalising for R&D, adj. EBITDA was Rs 15bn, a marginal beat but 10% lower than consensus. The US ex-Taro sales miss was offset by higher India sales (+35% YoY; underlying growth trending at 12% YoY). H2 R&D should be higher, and the Absorica lifecycle extension product launch is likely in Q4. Global specialty sales were flat QoQ at US\$ 91mn. H1 adj. EPS is Rs 10; we retain FY20/FY21 estimates of Rs 20/23 and our Sep'20 TP of Rs 430.

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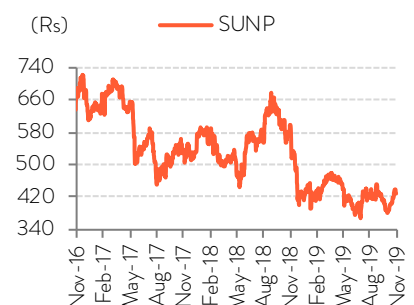
**Adj. EBITDA margins ex-Taro down QoQ:** SUNP's ex-Taro EBITDA margins for Q2 were flat QoQ at 17.1%, excluding one-time US sales of US\$ 70mn booked in Q1 at 50% assumed margins. But normalising for the lower R&D spends in Q2 (roughly Rs 1bn lower than estimates), the base margin is 16%, down 100bps sequentially. Adj. EBITDA for Q2 was Rs 15bn, a marginal beat on our estimates but 10% lower than consensus.

|                  |                |
|------------------|----------------|
| Ticker/Price     | SUNP IN/Rs 428 |
| Market cap       | US\$ 14.5bn    |
| Shares o/s       | 2,399mn        |
| 3M ADV           | US\$ 40.5mn    |
| 52wk high/low    | Rs 605/Rs 345  |
| Promoter/FPI/DII | 54%/17%/16%    |

Source: NSE

**US ex-Taro sales weakness compensated by strong India/ROW:** US sales ex-Taro fell by US\$ 80mn QoQ (vs. +US\$ 50mn est.). The quantum decline even after stripping away one-time sales in Q1 suggests the base business has moderated by 5% QoQ, in contrast to SUNP's commentary of a steady base. Management mentioned that US generic pricing for the broad portfolio has not improved. Weakness in the US was masked by a solid India/ROW beat (+35%/20% YoY). Q2/Q3 has seen some positive seasonality of anti-infectives in India. Specialty sales are likely to improve in H2 led by Ilumya, Cequa & Odomzo.

## STOCK PERFORMANCE



Source: NSE

**Other takeaways:** (1) OOI includes Rs 500mn of out-licensing fees. (2) Specialty R&D spend was US\$ 17mn (\$9mn in Q1). (3) Net debt reduced Rs 13bn from Mar-Sep. (4) FY20 R&D is slightly lowered from 8-9% (1H 5.6%).

## KEY FINANCIALS

| Y/E 31 Mar              | FY18A   | FY19A   | FY20E   | FY21E   | FY22E   |
|-------------------------|---------|---------|---------|---------|---------|
| Total revenue (Rs mn)   | 260,680 | 286,906 | 325,880 | 359,740 | 400,315 |
| EBITDA (Rs mn)          | 55,630  | 60,746  | 73,200  | 82,929  | 91,855  |
| 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)            | 30.5    | 28.1    | 21.6    | 18.5    | 16.4    |
| EV/EBITDA (x)           | 17.0    | 15.7    | 13.3    | 11.2    | 9.7     |

Source: Company, BOBCAPS Research

**BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda**

Important disclosures, including any required research certifications, are provided at the end of this report.



**FIG 1 – QUARTERLY PERFORMANCE**

| (Rs mn)                 | Q2FY20        | Q2FY19         | YoY (%)        | Q1FY20        | QoQ (%)       | Q2FY20E       | Var. (%)    |
|-------------------------|---------------|----------------|----------------|---------------|---------------|---------------|-------------|
| <b>Net Sales</b>        | <b>79,490</b> | <b>68,464</b>  | <b>16.1</b>    | <b>82,590</b> | <b>(3.8)</b>  | <b>76,097</b> | <b>4.5</b>  |
| <b>EBITDA</b>           | <b>16,073</b> | <b>14,401</b>  | <b>11.6</b>    | <b>18,132</b> | <b>(11.4)</b> | <b>14,584</b> | <b>10.2</b> |
| Depreciation            | 4,732         | 4,265          | -              | 4,571         | -             | 4,400         | -           |
| <b>EBIT</b>             | <b>11,341</b> | <b>10,136</b>  | <b>11.9</b>    | <b>13,561</b> | <b>(16.4)</b> | <b>10,184</b> | <b>-</b>    |
| Interest                | 0             | 0              | -              | 0             | -             | 0             | -           |
| Other Income            | 2,910         | 3,127          | -              | 2,240         | -             | 2,705         | -           |
| <b>PBT</b>              | <b>14,251</b> | <b>13,263</b>  | <b>-</b>       | <b>15,801</b> | <b>-</b>      | <b>12,889</b> | <b>10.6</b> |
| Less: Taxation          | 2,660         | 2,189          | -              | 1,460         | -             | 1,933         | -           |
| Less: Minority interest | 1,031         | 1,099          | -              | 1,138         | -             | 1,240         | -           |
| <b>Recurring PAT</b>    | <b>10,560</b> | <b>9,975</b>   | <b>5.9</b>     | <b>13,203</b> | <b>(20.0)</b> | <b>9,715</b>  | <b>8.7</b>  |
| Exceptional items       | 85            | (12,143)       | -              | 674           | -             | 0             | -           |
| <b>Reported PAT</b>     | <b>10,645</b> | <b>(2,168)</b> | <b>(591.0)</b> | <b>13,877</b> | <b>(23.3)</b> | <b>9,715</b>  | <b>9.6</b>  |
| <b>Key Ratios (%)</b>   |               |                |                |               |               |               |             |
| Gross Margin            | 71.5          | 74.3           | -              | 70.2          | -             | 73.0          | -           |
| EBITDA Margin           | 20.2          | 21.0           | -              | 22.0          | -             | 19.2          | -           |
| Tax / PBT               | 18.7          | 16.5           | -              | 9.2           | -             | 15.0          | -           |
| NPM                     | 13.3          | 14.6           | -              | 16.0          | -             | 12.8          | -           |
| <b>EPS (Rs)</b>         | <b>4.4</b>    | <b>4.1</b>     | <b>-</b>       | <b>5.5</b>    | <b>-</b>      | <b>4.0</b>    | <b>-</b>    |

Source: Company, BOBCAPS Research

**FIG 2 – REVENUE MIX**

| (Rs mn)                | Q2FY20        | Q2FY19        | YoY (%)     | Q1FY20        | QoQ (%)      | Q2FY20E       | Var. (%)     |
|------------------------|---------------|---------------|-------------|---------------|--------------|---------------|--------------|
| <b>Formulation</b>     | <b>74,536</b> | <b>63,750</b> | <b>16.9</b> | <b>77,688</b> | <b>(4.1)</b> | <b>70,985</b> | <b>5.0</b>   |
| Domestic               | 25,150        | 18,600        | 35.2        | 23,137        | 8.7          | 21,033        | 19.6         |
| Exports                | 49,386        | 45,150        | 9.4         | 54,551        | (9.5)        | 49,951        | (1.1)        |
| US                     | 23,898        | 23,940        | (0.2)       | 29,474        | (18.9)       | 25,984        | (8.0)        |
| ROW                    | 25,488        | 21,210        | 20.2        | 25,077        | 1.6          | 23,967        | 6.3          |
| <b>APIs and others</b> | <b>4,958</b>  | <b>4,260</b>  | <b>16.4</b> | <b>4,905</b>  | <b>1.1</b>   | <b>5,112</b>  | <b>(3.0)</b> |
| <b>Net Sales</b>       | <b>79,494</b> | <b>68,010</b> | <b>16.9</b> | <b>82,593</b> | <b>(3.8)</b> | <b>76,097</b> | <b>4.5</b>   |

Source: Company, BOBCAPS Research

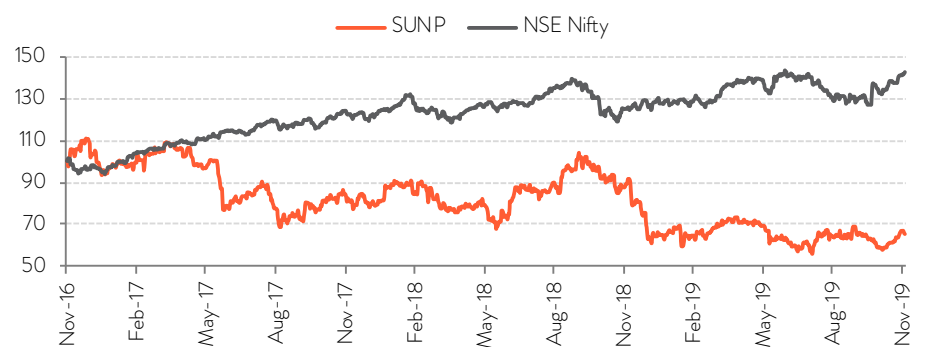
## Valuation methodology

While we expect 20% growth in SUNP's EPS over FY19-FY22, we remain cautious about the Ilumya ramp-up which is tracking lower than our expectations (both Rx and value). We note that Ilumya prescriptions are tapering and volumes are down 25% MoM.

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 given generic competition expected in Dec'20, Rs 40.6bn contingent tax liability not provided for, and anti-trust liability/adverse US Department of Justice ruling on generic price fixing for multiple products.

We retain our FY20/FY21/FY22 EPS estimates of Rs 20/Rs 23/Rs.26 and maintain REDUCE with a Sep'20 target price of Rs 430. Our target EV/EBITDA multiple is unchanged at 11x (17x 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          |
|--------------------------------|----------------|----------------|----------------|----------------|----------------|
| <b>Total revenue</b>           | <b>260,680</b> | <b>286,906</b> | <b>325,880</b> | <b>359,740</b> | <b>400,315</b> |
| EBITDA                         | 55,630         | 60,746         | 73,200         | 82,929         | 91,855         |
| Depreciation                   | 14,998         | 17,532         | 18,379         | 19,279         | 20,179         |
| 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          |
| <b>Reported net profit</b>     | <b>21,616</b>  | <b>26,661</b>  | <b>47,500</b>  | <b>55,534</b>  | <b>62,602</b>  |
| Adjustments                    | 12,050         | 9,823          | 0              | 0              | 0              |
| <b>Adjusted net profit</b>     | <b>33,666</b>  | <b>36,484</b>  | <b>47,500</b>  | <b>55,534</b>  | <b>62,602</b>  |

### 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        |
| <b>Total liabilities and equities</b> | <b>645,347</b> | <b>649,267</b> | <b>653,811</b> | <b>686,496</b> | <b>737,907</b> |
| 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              |
| <b>Total assets</b>                   | <b>645,347</b> | <b>649,267</b> | <b>653,811</b> | <b>686,496</b> | <b>737,907</b> |

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               |
| <b>Cash flow from operations</b>    | <b>21,464</b>   | <b>28,477</b>   | <b>69,596</b>   | <b>66,949</b>   | <b>71,381</b>   |
| 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               |
| <b>Cash flow from investing</b>     | <b>(80,971)</b> | <b>(44,438)</b> | <b>(18,000)</b> | <b>(18,000)</b> | <b>(18,000)</b> |
| 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           |
| <b>Cash flow from financing</b>     | <b>7,393</b>    | <b>(10,576)</b> | <b>(57,675)</b> | <b>(33,551)</b> | <b>(22,041)</b> |
| <b>Changes in cash and cash eq.</b> | <b>(52,115)</b> | <b>(26,538)</b> | <b>(6,079)</b>  | <b>15,397</b>   | <b>31,340</b>   |
| <b>Closing cash and cash eq.</b>    | <b>99,294</b>   | <b>72,756</b>   | <b>66,677</b>   | <b>82,074</b>   | <b>113,414</b>  |

**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       | 3.6   | 3.3   | 3.0   | 2.6   | 2.2   |
| EV/EBITDA      | 17.0  | 15.7  | 13.3  | 11.2  | 9.7   |
| Adjusted P/E   | 30.5  | 28.1  | 21.6  | 18.5  | 16.4  |
| 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 |
|--|--------|-------|-------|-------|-------|
| <b>YoY growth (%)</b>                        |        |       |       |       |       |
| 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  |
| <b>Profitability &amp; Return ratios (%)</b> |        |       |       |       |       |
| 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  |
| <b>Working capital days (days)</b>           |        |       |       |       |       |
| Receivables                                  | 105    | 106   | 106   | 106   | 106   |
| Inventory                                    | 96     | 94    | 94    | 94    | 94    |
| Payables                                     | 225    | 207   | 207   | 207   | 207   |
| <b>Ratios (x)</b>                            |        |       |       |       |       |
| 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%

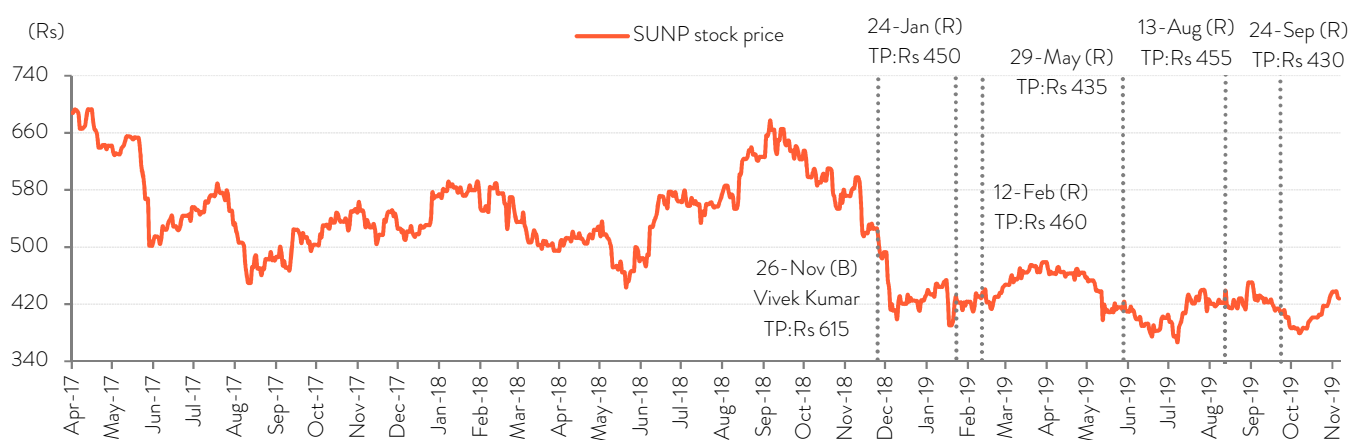
**ADD** – Expected return from >+5% to +15%

**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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