

**ADD**

TP: Rs 540 | ▲ 11%

**SUN PHARMA**

Pharmaceuticals

04 November 2020

## Q2 beat led by specialty sales; margin beat not fully sustainable

Sun Pharma (SUNP) reported a healthy Q2 beat: 6% on sales, 32% on EBITDA. Operating margin were higher at 26% on higher GPM (+100bps QoQ) and temporary lower SGA, despite higher R&D (7.1% of sales vs. 5.6% in Q1). US sales ex-Taro beat estimates led by specialty sales segment recovery; India was muted YoY. Q2 global specialty sales returned to pre-Covid levels (US\$ 108mn, +38% QoQ). SGA spends should normalise from Q4. We raise FY22/FY23 EBITDA 5% with TP of Rs 540. Upgrade to 'Add' from Reduce on reasonable valuations.

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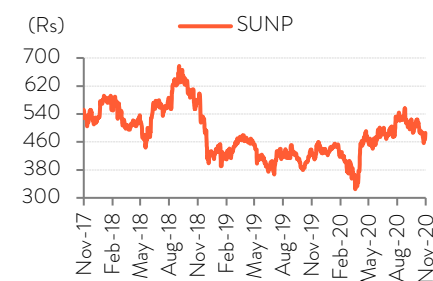
**Margin gains could be reversed; Upgrade to ADD:** Q2 EBITDA stood at Rs 22.1bn, up 35% QoQ, with margins at 26% (est. 21%). SUNP's ex-Taro margins have increased 420bps QoQ to 26% due specialty sales recovery and lower SGA costs. SUNP is likely restart promo spends on the US specialty business in Q3 but the cost base will fully normalise from Q4. R&D should stay at 7% with progress on resumption of clinical trials for new indications (Ilumya, Odomzo). Post the recent fall, valuation gap vs large cap peers has expanded (from 15% to 25%) turning valuation reasonable, hence we upgrade to ADD.

Ticker/Price	SUNP IN/Rs 486
Market cap	US\$ 15.7bn
Shares o/s	2,399mn
3M ADV	US\$ 65.6mn
52wk high/low	Rs 565/Rs 312
Promoter/FPI/DII	54%/17%/16%

Source: NSE

**Revenues (ex-India) beat estimates:** US sales ex-Taro increased 17% QoQ, mainly on specialty segment recovery even though patient flow remained low. Ilumya, Cequa and Odomzo have reverted to pre-Covid sales while Levulan is yet to fully recover. US generic sales have stabilised and grew YoY – expect 2-3 launches a quarter. EM sales grew 9% YoY/20% QoQ while India was muted YoY on depressed growth in the acute portfolio (chronic grew in high single digits). SUNP has launched 22 products in Q2 which should support a better Q3.

## STOCK PERFORMANCE



Source: NSE

**Other takeaways:** (1) Q2 specialty R&D at US\$ 30mn. (2) Good initial response for Ilumya Japan launch (US\$ 500mn market growing at >20% p.a.). (3) Shifted 20% of market to Absorica LD. (5) Debt reduced by US\$ 100mn QoQ.

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	286,906	323,880	339,330	387,082	434,390
EBITDA (Rs mn)	60,746	69,823	84,859	90,274	102,853
Adj. net profit (Rs mn)	36,484	40,453	58,273	61,247	71,435
Adj. EPS (Rs)	15.2	16.9	24.3	25.5	29.8
Adj. EPS growth (%)	8.4	10.9	44.1	5.1	16.6
Adj. ROAE (%)	8.4	8.7	11.5	11.0	11.7
Adj. P/E (x)	31.9	28.8	20.0	19.0	16.3
EV/EBITDA (x)	17.9	15.8	12.8	11.6	9.8

Source: Company, BOBCAPS Research

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**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	Q2FY21E	Var. (%)	H1FY21	H1FY20	YoY (%)
<b>Net Sales</b>	<b>84,587</b>	<b>79,490</b>	<b>6.4</b>	<b>74,672</b>	<b>13.3</b>	<b>80,006</b>	<b>5.7</b>	<b>159,259</b>	<b>162,080</b>	<b>(1.7)</b>
<b>EBITDA</b>	<b>22,156</b>	<b>16,073</b>	<b>37.8</b>	<b>16,464</b>	<b>34.6</b>	<b>16,841</b>	<b>31.6</b>	<b>38,620</b>	<b>34,205</b>	<b>12.9</b>
Depreciation	4,986	4,732	-	4,859	-	5,199	-	9,845	9,303	-
<b>EBIT</b>	<b>17,170</b>	<b>11,341</b>	<b>51.4</b>	<b>11,605</b>	<b>48.0</b>	<b>11,642</b>	<b>-</b>	<b>28,775</b>	<b>24,902</b>	<b>15.6</b>
Interest	0	0	-	0	-	0	-	852	1,879	-
Other Income	3,167	2,910	-	2,198	-	2,198	-	6,217	7,029	-
<b>PBT</b>	<b>20,337</b>	<b>14,251</b>	<b>-</b>	<b>13,803</b>	<b>-</b>	<b>13,840</b>	<b>46.9</b>	<b>34,140</b>	<b>30,052</b>	<b>-</b>
Less: Taxation	(311)	2,660	-	2,459	-	2,214	-	2,148	4,120	-
Less: Minority interest	1,355	1,031	-	(7,700)	-	538	-	(6,345)	2,169	-
<b>Recurring PAT</b>	<b>19,293</b>	<b>10,560</b>	<b>82.7</b>	<b>19,044</b>	<b>1.3</b>	<b>11,088</b>	<b>74.0</b>	<b>38,337</b>	<b>23,763</b>	<b>61.3</b>
Exceptional items	(1,163)	85	-	(35,539)	-	0	-	(36,702)	759	-
<b>Reported PAT</b>	<b>18,130</b>	<b>10,645</b>	<b>70.3</b>	<b>(16,495)</b>	<b>(209.9)</b>	<b>11,088</b>	<b>63.5</b>	<b>1,635</b>	<b>24,522</b>	<b>(93.3)</b>
<b>Key Ratios (%)</b>										
Gross Margin	74.6	71.5	-	73.6	-	72.3	-	74.2	70.8	-
EBITDA Margin	26.2	20.2	-	22.0	-	21.0	-	24.2	21.1	-
Tax / PBT	(1.5)	18.7	-	17.8	-	16.0	-	6.3	13.7	-
NPM	22.8	13.3	-	25.5	-	13.9	-	24.1	14.7	-
<b>EPS (Rs)</b>	<b>8.0</b>	<b>4.4</b>	<b>-</b>	<b>7.9</b>	<b>-</b>	<b>4.6</b>	<b>-</b>	<b>16.0</b>	<b>9.9</b>	<b>-</b>

Source: Company, BOBCAPS Research

**FIG 2 – REVENUE MIX**

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	Q2FY21E	Var. (%)	H1FY21	H1FY20	YoY (%)
<b>Formulation</b>	<b>79,038</b>	<b>74,536</b>	<b>6.0</b>	<b>68,709</b>	<b>15.0</b>	<b>74,701</b>	<b>5.8</b>	<b>147,747</b>	<b>152,224</b>	<b>(2.9)</b>
Domestic	25,311	25,150	0.6	23,884	6.0	26,273	(3.7)	49,196	48,287	1.9
Exports	53,727	49,386	8.8	44,824	19.9	48,428	10.9	98,552	103,937	(5.2)
US	24,920	23,898	4.3	21,364	16.6	22,940	8.6	46,284	53,372	(13.3)
ROW	28,807	25,488	13.0	23,460	22.8	25,488	13.0	52,268	50,565	3.4
<b>APIs and others</b>	<b>5,548</b>	<b>4,958</b>	<b>11.9</b>	<b>5,962</b>	<b>(6.9)</b>	<b>5,305</b>	<b>4.6</b>	<b>11,510</b>	<b>9,863</b>	<b>16.7</b>
<b>Net Sales</b>	<b>84,587</b>	<b>79,494</b>	<b>6.4</b>	<b>74,671</b>	<b>13.3</b>	<b>80,006</b>	<b>5.7</b>	<b>159,258</b>	<b>162,087</b>	<b>(1.7)</b>
INR/US\$	74	70	4.4	75	(2.0)	74	-	74	70	5.6
US in \$ terms	339	339	(0.1)	285	19.0	312	-	623	759	(17.9)

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.

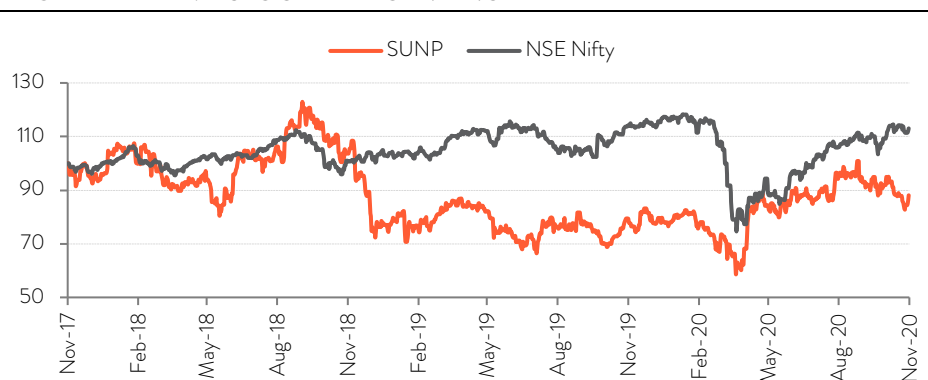
We raise FY22/FY23 EBITDA estimates by ~5% each to factor cost optimisation in SGA, resulting in higher margin assumptions. We raise our Sep'21 target price to Rs 540 (earlier Rs 530), based on an unchanged 12x one-year forward EV/EBITDA multiple (20x implied P/E). Following the recent stock fall, SUNP is trading at reasonable valuation of 12x FY22 EBITDA. Also, the valuation discount has expanded from 15% to 25% discount to other front line stocks – Cipla, Dr Reddy's and Lupin turning the mid-term valuation in favor. Hence we upgrade to ADD from Reduce as we retain our target multiple.

**FIG 3 – REVISED ESTIMATES**

(Rs bn)	New			Old			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Sales	339.3	387.1	434.4	339.3	387.1	434.4	0.0	0.0	0.0
EBITDA	84.9	90.3	102.9	77.8	86.1	98.2	9.0	4.8	4.7
EBITDA margin (%)	25.0	23.3	23.7	22.9	22.3	22.6	207bps	107bps	107bps
EPS (Rs)	24	26	30	21	24	28	15.9	7.7	7.6

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	FY20A	FY21E	FY22E	FY23E
<b>Total revenue</b>	<b>286,906</b>	<b>323,880</b>	<b>339,330</b>	<b>387,082</b>	<b>434,390</b>
EBITDA	60,746	69,823	84,859	90,274	102,853
Depreciation	17,532	20,525	20,436	21,390	22,503
EBIT	43,214	49,298	64,423	68,884	80,350
Net interest income/(expenses)	(5,552)	(3,020)	(1,510)	(755)	(378)
Other income/(expenses)	10,255	6,371	7,678	8,482	9,892
Exceptional items	0	0	0	0	0
EBT	47,917	52,649	70,591	76,611	89,865
Income taxes	6,009	7,897	9,177	12,258	15,277
Extraordinary items	(9,823)	(2,600)	0	0	0
Min. int./Inc. from associates	5,424	4,299	3,142	3,106	3,153
<b>Reported net profit</b>	<b>26,661</b>	<b>37,853</b>	<b>58,273</b>	<b>61,247</b>	<b>71,435</b>
Adjustments	9,823	2,600	0	0	0
<b>Adjusted net profit</b>	<b>36,484</b>	<b>40,453</b>	<b>58,273</b>	<b>61,247</b>	<b>71,435</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	41,479	52,272	51,306	59,623	65,679
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	527,602	578,708	637,845
Shareholders' fund	447,225	481,190	530,001	581,107	640,244
<b>Total liabilities and equities</b>	<b>649,267</b>	<b>647,829</b>	<b>674,537</b>	<b>725,549</b>	<b>788,912</b>
Cash and cash eq.	72,756	48,558	64,632	92,848	128,772
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
<b>Total assets</b>	<b>649,267</b>	<b>647,829</b>	<b>674,537</b>	<b>725,549</b>	<b>788,912</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	44,193	58,378	78,708	82,637	93,937
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	(10,554)	(14,040)	(15,672)
Other operating cash flows	0	0	0	0	0
<b>Cash flow from operations</b>	<b>28,477</b>	<b>70,050</b>	<b>69,664</b>	<b>69,353</b>	<b>78,643</b>
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
<b>Cash flow from investing</b>	<b>(44,438)</b>	<b>(37,978)</b>	<b>(18,000)</b>	<b>(18,000)</b>	<b>(24,000)</b>
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)	(12,604)	(13,247)	(15,451)
Other financing cash flows	(664)	4,404	3,257	3,232	3,293
<b>Cash flow from financing</b>	<b>(10,576)</b>	<b>(56,270)</b>	<b>(35,590)</b>	<b>(23,137)</b>	<b>(18,719)</b>
<b>Changes in cash and cash eq.</b>	<b>(26,538)</b>	<b>(24,198)</b>	<b>16,074</b>	<b>28,216</b>	<b>35,923</b>
<b>Closing cash and cash eq.</b>	<b>72,756</b>	<b>48,558</b>	<b>64,632</b>	<b>92,848</b>	<b>128,772</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	11.1	15.8	24.3	25.5	29.8
Adjusted EPS	15.2	16.9	24.3	25.5	29.8
Dividend per share	2.4	3.4	5.3	5.5	6.4
Book value per share	172.6	185.0	204.0	224.0	247.4

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	3.8	3.4	3.2	2.7	2.3
EV/EBITDA	17.9	15.8	12.8	11.6	9.8
Adjusted P/E	31.9	28.8	20.0	19.0	16.3
P/BV	2.8	2.6	2.4	2.2	2.0

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	76.1	76.8	82.5	79.9	79.5
Interest burden (PBT/EBIT)	110.9	106.8	109.6	111.2	111.8
EBIT margin (EBIT/Revenue)	15.1	15.2	19.0	17.8	18.5
Asset turnover (Revenue/Avg TA)	11.1	12.5	12.8	13.8	14.3
Leverage (Avg TA/Avg Equity)	1.5	1.4	1.3	1.3	1.2
Adjusted ROAE	8.4	8.7	11.5	11.0	11.7

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

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	10.1	12.9	4.8	14.1	12.2
EBITDA	9.2	14.9	21.5	6.4	13.9
Adjusted EPS	8.4	10.9	44.1	5.1	16.6
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	21.2	21.6	25.0	23.3	23.7
EBIT margin	15.1	15.2	19.0	17.8	18.5
Adjusted profit margin	12.7	12.5	17.2	15.8	16.4
Adjusted ROAE	8.4	8.7	11.5	11.0	11.7
ROCE	7.6	7.9	10.9	10.7	11.5
<b>Working capital days (days)</b>					
Receivables	106	106	106	106	106
Inventory	94	94	94	94	94
Payables	207	207	207	207	207
<b>Ratios (x)</b>					
Gross asset turnover	1.2	1.2	1.2	1.3	1.4
Current ratio	3.3	2.7	2.9	3.0	3.2
Net interest coverage ratio	7.8	16.3	42.7	91.2	212.8
Adjusted debt/equity	(0.1)	(0.2)	(0.3)	(0.3)	(0.3)

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

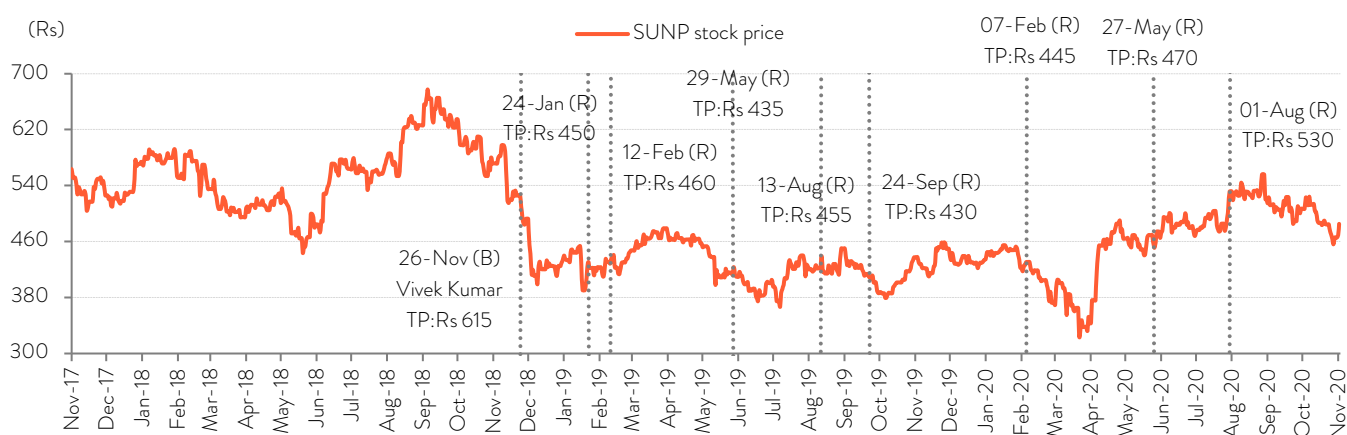
**ADD** – Expected return from >+5% to +15%

**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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