

REDUCE

TP: Rs 445 | ▲ 3%

SUN PHARMA

Pharmaceuticals

07 February 2020

Q3 a tad lower – US (ex-Taro) ramp-up subdued; REDUCE

Sun Pharma (SUNP) reported a 6% EBITDA miss, largely driven by higher other expense (up 8% QoQ) and despite better gross margins (up 110bps QoQ) & lower R&D (6.4% of sales). The US ex-Taro sales miss was offset by stronger India sales (+12.6% YoY). SUNP expects higher R&D cost in FY21 (but <9% of sales) due to trials for new indications (psoriatic arthritis) in Ilumya. Global specialty sales rose 30% QoQ to US\$ 118mn on increased contribution from Absorica & Levulan. We retain FY21/FY22 EPS of Rs 23/Rs 26 and roll to a TP of Rs 445 (vs. Rs 430).

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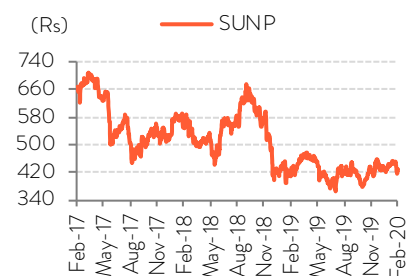
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Higher opex sets off gross margin gains: Promotion spends on the specialty business largely shaved off benefits from better gross margins (healthy India business), leading to 20.4% EBITDA margins (70bps miss) for Q3. However, SUNP's ex-Taro margins improved marginally by 50bps QoQ to 17.6% following better seasonality and Cequa launch, in our view. Given challenges in the generics market, SUNP will continue to focus on cost control across businesses. Also, it now expects to spend <8% on R&D for FY20 (6.1% in 9M).

Ticker/Price	SUNP IN/Rs 431
Market cap	US\$ 14.5bn
Shares o/s	2,399mn
3M ADV	US\$ 33.2mn
52wk high/low	Rs 484/Rs 345
Promoter/FPI/DII	54%/17%/16%

Source: NSE

India strong, US ex-Taro falls short: US sales ex-Taro increased by US\$ 25mn QoQ, slightly lower than expected. SUNP commented that this was led by higher contribution from seasonal products (Absorica, Levulan), followed by Ilumya/Cequa stocking. India/ROW grew 13%/6% YoY. The company is evaluating DTC promotion on Cequa to reach a fair share of the market. Management stated that the US generic market remains competitive.

STOCK PERFORMANCE

Source: NSE

Other takeaways: (1) Specialty R&D spend was US\$ 18mn (\$26mn in H1). (2) Net debt ex-Taro stood at US\$ 410mn. (3) Some of the complex generic filings have seen progress with the FDA review. (4) SUNP has already responded to the SEBI forensic audit and no fresh query has been raised so far.

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)	30.7	28.3	21.8	18.6	16.5
EV/EBITDA (x)	17.2	15.7	13.3	11.6	10.0

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	Q3FY20E	Var. (%)	9MFY20	9MFY19	YoY (%)
Net Sales	80,386	76,567	5.0	79,490	1.1	82,565	(2.6)	242,466	216,411	12.0
EBITDA	16,434	18,376	(10.6)	16,073	2.2	17,459	(5.9)	50,639	48,884	3.6
Depreciation	5,469	4,710	-	4,732	-	4,800	-	14,772	12,991	-
EBIT	10,965	13,666	(19.8)	11,341	(3.3)	12,659	-	35,867	35,893	(0.1)
Interest	0	0	-	0	-	0	-	2,508	4,051	-
Other Income	1,731	1,317	-	2,910	-	2,525	-	9,389	10,036	-
PBT	12,696	14,983	-	14,251	-	15,184	(16.4)	42,748	41,878	-
Less: Taxation	3,276	2,709	-	2,660	-	2,278	-	7,396	6,536	-
Less: Minority interest	1,101	2,191	-	1,031	-	1,029	-	3,270	4,575	-
Recurring PAT	8,319	10,083	(17.5)	10,560	(21.2)	11,877	(30.0)	32,082	30,767	4.3
Exceptional items	818	2,321	-	85	-	0	-	1,577	(10,721)	-
Reported PAT	9,137	12,404	(26.3)	10,645	(14.2)	11,877	(23.1)	33,659	20,046	67.9
Key Ratios (%)										
Gross Margin	72.6	71.7	-	71.5	-	72.5	-	71.4	72.1	-
EBITDA Margin	20.4	24.0	-	20.2	-	21.1	-	20.9	22.6	-
Tax / PBT	25.8	18.1	-	18.7	-	15.0	-	17.3	15.6	-
NPM	10.3	13.2	-	13.3	-	14.4	-	13.2	14.2	-
EPS (Rs)	3.5	4.2	-	4.4	-	4.9	-	13.3	12.8	-

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	Q3FY20E	Var. (%)	9MFY20	9MFY19	YoY (%)
Formulation	75,029	72,008	4.2	74,536	0.7	77,096	(2.7)	227,253	203,274	11.8
Domestic	25,169	22,353	12.6	25,150	0.1	24,417	3.1	73,456	62,473	17.6
Exports	49,860	49,655	0.4	49,386	1.0	52,679	(5.4)	153,797	140,801	9.2
US	24,924	26,058	(4.4)	23,898	4.3	26,250	(5.1)	78,296	75,458	3.8
ROW	24,936	23,597	5.7	25,488	(2.2)	26,429	(5.6)	75,501	65,343	15.5
APIs and others	5,655	4,557	24.1	4,958	14.1	5,468	3.4	15,518	12,757	21.6
Net Sales	80,684	76,565	5.4	79,494	1.5	82,565	(2.3)	242,771	216,031	12.4

Source: Company, BOBCAPS Research

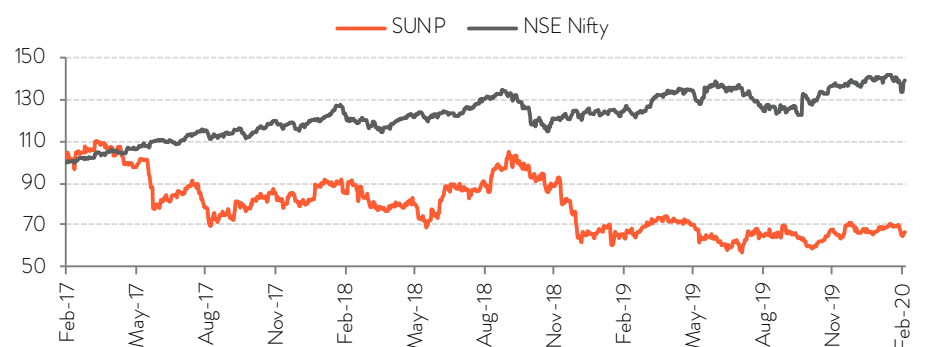
Valuation methodology

While we expect 20% growth in SUNP's EPS over FY19-FY22, we remain cautious about Ilumya ramp-up which is tracking lower than estimates (both prescription count and value). We note that Ilumya prescriptions are tapering and quarterly Total Sales (TRx) ramp-up remains subdued at US\$ 15mn (incl. rebates).

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, a 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 revised Mar'21 target price of Rs 445 (earlier Rs 430) as we roll valuations over. Our target FY22E EV/EBITDA multiple stays 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, and
- 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
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
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	3.3	3.0	2.7	2.3
EV/EBITDA	17.2	15.7	13.3	11.6	10.0
Adjusted P/E	30.7	28.3	21.8	18.6	16.5
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

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

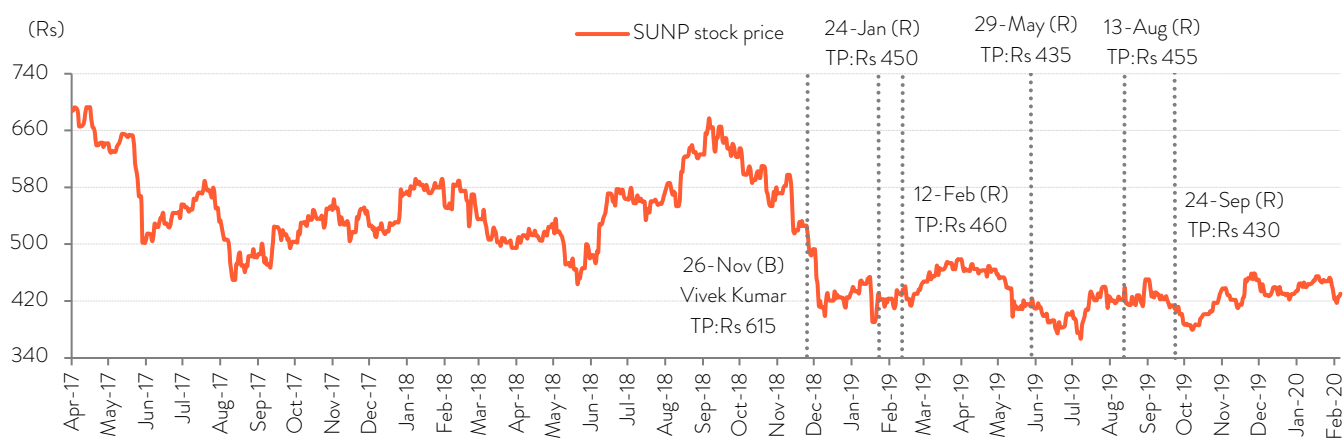
ADD – Expected return from >+5% to +15%

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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