

ADD

TP: Rs 630 | ▲ 7%

SUN PHARMA

Pharmaceuticals

30 January 2021

EBITDA beat ex-Taro; sustaining specialty recovery is key

Sun Pharma (SUNP) reported a healthy ex-Taro EBITDA beat of 5% in Q3FY21. Sequentially, EBITDA margin sustained higher at 26% despite 100bps gross margin dip (onetime charge in Taro), led by softness in SGA and R&D spends. US sales ex-Taro beat estimates due to strong specialty and India business. Global specialty sales hit a record high of US\$ 148mn (+37% QoQ). Higher SGA/R&D spends from Q4 and the generic threat in Absorica are key near-term risks. We raise FY22/ FY23 EPS 3% each and roll over to new Mar'22 TP of Rs 630.

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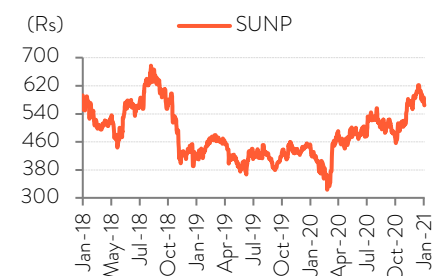
Best-ever specialty sales; India growth rebounds: US sales ex-Taro rose 19% QoQ due to record sales in the specialty segment (Ilumya, Cequa, Odomzo, Absorica). Per a new disclosure, global Ilumya sales for 9M have already crossed FY20 levels. Levulan has recovered from H1 levels but is yet to fully normalise. India business grew 9% YoY led by the chronic/semi-chronic portfolio while acute recovery remains weak. EM sales grew 12% YoY. With an improving doctor call rate and 25 launches per quarter, we expect SUNP to revert to 12-13% growth.

| | |
|------------------|----------------|
| Ticker/Price | SUNP IN/Rs 586 |
| Market cap | US\$ 19.3bn |
| Shares o/s | 2,399mn |
| 3M ADV | US\$ 75.4mn |
| 52wk high/low | Rs 628/Rs 312 |
| Promoter/FPI/DII | 54%/17%/16% |

Source: NSE

Uptick in marketing spends to reverse margin gains: Operating leverage in the US specialty business and subdued expenses aided healthy Q3 margins of 26% (25.6% est.). Other expenses have risen 2% QoQ but are still down 7% YoY. R&D was lower at 6.4% of sales (-6% QoQ). SUNP commented that savings on marketing spends (India+US specialty) and R&D are not structural and should normalise in the next 2-3 quarters as lockdowns ease. R&D should move to 7% of sales as clinical trials resume for new indications (Ilumya, Odomzo).

STOCK PERFORMANCE



Other takeaways: (1) Q3 specialty R&D cost at US\$ 19mn (-37% QoQ). (2) No visibility on generic competition in Absorica for now. (3) Face-to-face patient interaction at 40% of pre-covid levels for US brand market. (4) Net debt ex-Taro at US\$ 250mn; repaid US\$ 490mn in 9M. (5) Limited progress on Halol remediation.

KEY FINANCIALS

| Y/E 31 Mar | FY19A | FY20A | FY21E | FY22E | FY23E |
|-------------------------|---------|---------|---------|---------|---------|
| Total revenue (Rs mn) | 286,906 | 323,880 | 335,599 | 382,176 | 428,675 |
| EBITDA (Rs mn) | 60,746 | 69,823 | 87,404 | 91,181 | 103,795 |
| Adj. net profit (Rs mn) | 36,484 | 40,453 | 68,834 | 62,760 | 73,414 |
| Adj. EPS (Rs) | 15.2 | 16.9 | 28.7 | 26.2 | 30.6 |
| Adj. EPS growth (%) | 8.4 | 10.9 | 70.2 | (8.8) | 17.0 |
| Adj. ROAE (%) | 8.4 | 8.7 | 14.0 | 11.9 | 12.6 |
| Adj. P/E (x) | 38.5 | 34.8 | 20.4 | 22.4 | 19.2 |
| EV/EBITDA (x) | 21.9 | 19.2 | 15.2 | 14.3 | 12.3 |

Source: Company, BOBCAPS Research

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



FIG 1 – QUARTERLY PERFORMANCE

| (Rs mn) | Q3FY21 | Q3FY20 | YoY (%) | Q2FY21 | QoQ (%) | Q3FY21E | Var. (%) | 9MFY21 | 9MFY20 | YoY (%) |
|-------------------------|---------------|---------------|--------------|---------------|--------------|---------------|-------------|----------------|----------------|---------------|
| Net Sales | 87,818 | 80,386 | 9.2 | 84,587 | 3.8 | 87,847 | 0 | 247,077 | 242,466 | 1.9 |
| EBITDA | 22,796 | 16,434 | 38.7 | 22,156 | 2.9 | 22,514 | 1.3 | 61,416 | 50,639 | 21.3 |
| Depreciation | 5,319 | 5,469 | - | 4,986 | - | 5,584 | - | 15,164 | 14,772 | - |
| EBIT | 17,476 | 10,965 | 59.4 | 17,170 | 1.8 | 16,930 | - | 46,251 | 35,867 | 29.0 |
| Interest | 0 | 0 | - | 0 | - | 0 | - | 1,113 | 2,508 | - |
| Other Income | 3,438 | 1,731 | - | 3,167 | - | 3,167 | - | 9,916 | 9,389 | - |
| PBT | 20,914 | 12,696 | - | 20,337 | - | 20,097 | 4.1 | 55,054 | 42,748 | - |
| Less: Taxation | 2,449 | 3,276 | - | (311) | - | 4,019 | - | 4,597 | 7,396 | - |
| Less: Minority interest | 656 | 1,101 | - | 1,355 | - | 634 | - | (5,689) | 3,270 | - |
| Recurring PAT | 17,809 | 8,319 | 114.1 | 19,293 | (7.7) | 15,443 | 15.3 | 56,146 | 32,082 | 75.0 |
| Exceptional items | 716 | 818 | - | (1,163) | - | 0 | - | (35,986) | 1,577 | - |
| Reported PAT | 18,525 | 9,137 | 102.7 | 18,130 | 2.2 | 15,443 | 20.0 | 20,160 | 33,659 | (40.1) |
| Key Ratios (%) | | | (bps) | | (bps) | | | | | |
| Gross Margin | 73.4 | 72.6 | 80 | 74.6 | (120) | 73.0 | - | 73.9 | 71.4 | - |
| EBITDA Margin | 26.0 | 20.4 | 551 | 26.2 | (24) | 25.6 | - | 24.9 | 20.9 | - |
| Tax / PBT | 11.7 | 25.8 | - | (1.5) | - | 20.0 | - | 8.4 | 17.3 | - |
| NPM | 20.3 | 10.3 | - | 22.8 | - | 17.6 | - | 22.7 | 13.2 | - |
| EPS (Rs) | 7.4 | 3.5 | - | 8.0 | - | 6.4 | - | 23.4 | 13.4 | - |

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

| (Rs mn) | Q3FY21 | Q3FY20 | YoY (%) | Q2FY21 | QoQ (%) | Q3FY21E | Var. (%) | 9MFY21 | 9MFY20 | YoY (%) |
|------------------------|---------------|---------------|--------------|---------------|---------------|---------------|---------------|----------------|----------------|---------------|
| Formulation | 82,966 | 75,029 | 10.6 | 79,038 | 5.0 | 81,796 | 1.4 | 147,747 | 227,253 | (35.0) |
| Domestic | 27,528 | 25,169 | 9.4 | 25,311 | 8.8 | 27,589 | (0.2) | 49,196 | 73,456 | (33.0) |
| Exports | 55,438 | 49,860 | 11.2 | 53,727 | 3.2 | 54,206 | 2.3 | 98,552 | 153,797 | (35.9) |
| US | 27,609 | 24,924 | 10.8 | 24,920 | 10.8 | 25,530 | 8.1 | 46,284 | 78,296 | (40.9) |
| ROW | 27,829 | 24,936 | 11.6 | 28,807 | (3.4) | 28,676 | (3.0) | 52,268 | 75,501 | (30.8) |
| APIs and others | 4,853 | 5,357 | (9.4) | 5,548 | (12.5) | 6,051 | (19.8) | 11,510 | 15,220 | (24.4) |
| Net Sales | 87,818 | 80,386 | 9.2 | 84,587 | 3.8 | 87,847 | 0.0 | 159,258 | 242,473 | (34.3) |
| INR/US\$ | 74 | 71 | 4 | 74 | 0.4 | 74 | - | 74 | 71 | 5 |
| US in \$ terms | 374 | 351 | 7 | 339 | 10.4 | 347 | - | 623 | 1110 | (44) |

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 over the next 2-3 years given significant competition from two drugs coming in next year – Bimekizumab and Mirikizumab – which could intensify competition in the psoriasis market.

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, generic competition risk in Absorica, and an anti-trust liability/adverse US Department of Justice ruling on generic price fixing for multiple Ranbaxy products.

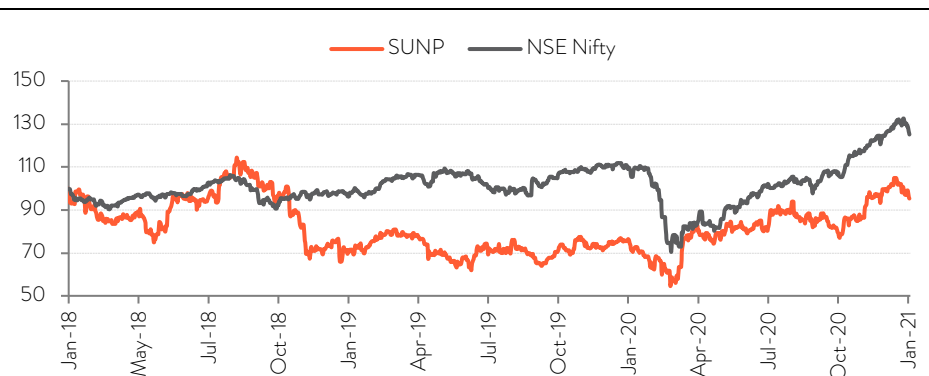
We raise FY22/FY23 EPS estimates by ~3% each to factor in cost optimisation in SGA, resulting in higher margin assumptions. Rolling over to Mar'23 valuations, we revise our target price to Rs 630 (earlier Rs 540). We have increased our one-year forward EV/EBITDA multiple to 13x from 12x (20x implied P/E) to account for above-expected operating leverage in the global specialty business. The stock is trading at fair valuations of 12x FY23E EBITDA. Our target multiple is at 20% discount to frontline peers – Cipla and Dr Reddy's. Retain ADD.

FIG 3 – REVISED ESTIMATES

| (Rs bn) | New | | | Old | | | Change (%) | | |
|-------------------|-------|-------|-------|-------|-------|-------|------------|-------|-------|
| | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E |
| Sales | 335.6 | 382.2 | 428.7 | 339.3 | 387.1 | 434.4 | (1.1) | (1.3) | (1.3) |
| EBITDA | 87.4 | 91.2 | 103.8 | 84.9 | 90.3 | 102.9 | 3.0 | 1.0 | 0.9 |
| EBITDA margin (%) | 26.0 | 23.9 | 24.2 | 25.0 | 23.3 | 23.7 | 104bps | 54bps | 54bps |
| EPS (Rs) | 29 | 26 | 31 | 24 | 26 | 30 | 18.1 | 2.5 | 2.8 |

Source: Company, BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Higher penalty in the ongoing US Department of Justice investigation on drug price collusion,
- Slow ramp up in the specialty business, and
- Higher than expected price erosion for US generics business.

FINANCIALS

Income Statement

| Y/E 31 Mar (Rs mn) | FY19A | FY20A | FY21E | FY22E | FY23E |
|--------------------------------|----------------|----------------|----------------|----------------|----------------|
| Total revenue | 286,906 | 323,880 | 335,599 | 382,176 | 428,675 |
| EBITDA | 60,746 | 69,823 | 87,404 | 91,181 | 103,795 |
| Depreciation | 17,532 | 20,525 | 20,436 | 21,390 | 22,503 |
| EBIT | 43,214 | 49,298 | 66,969 | 69,791 | 81,292 |
| Net interest income/(expenses) | (5,552) | (3,020) | (1,510) | (755) | (378) |
| Other income/(expenses) | 10,255 | 6,371 | 7,678 | 8,454 | 10,237 |
| Exceptional items | 0 | 0 | 0 | 0 | 0 |
| EBT | 47,917 | 52,649 | 73,137 | 77,489 | 91,151 |
| Income taxes | 6,009 | 7,897 | 9,508 | 11,623 | 14,584 |
| Extraordinary items | (9,823) | (2,600) | (35,986) | 0 | 0 |
| Min. int./Inc. from associates | 5,424 | 4,299 | (5,205) | 3,106 | 3,153 |
| Reported net profit | 26,661 | 37,853 | 32,848 | 62,760 | 73,414 |
| Adjustments | 9,823 | 2,600 | 35,986 | 0 | 0 |
| Adjusted net profit | 36,484 | 40,453 | 68,834 | 62,760 | 73,414 |

Balance Sheet

| Y/E 31 Mar (Rs mn) | FY19A | FY20A | FY21E | FY22E | FY23E |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|
| Accounts payables | 41,479 | 52,272 | 49,792 | 57,785 | 63,601 |
| 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 | 499,330 | 551,621 | 612,310 |
| Shareholders' fund | 447,225 | 481,190 | 501,729 | 554,020 | 614,709 |
| Total liabilities and equities | 649,267 | 647,829 | 644,750 | 696,624 | 761,298 |
| Cash and cash eq. | 72,756 | 48,558 | 36,892 | 66,614 | 104,292 |
| Accounts receivables | 88,842 | 94,258 | 97,668 | 111,224 | 124,756 |
| Inventories | 78,859 | 78,750 | 86,364 | 98,350 | 110,316 |
| 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 | 644,750 | 696,624 | 761,298 |

Source: Company, BOBCAPS Research

Cash Flows

| Y/E 31 Mar (Rs mn) | FY19A | FY20A | FY21E | FY22E | FY23E |
|-------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Net income + Depreciation | 44,193 | 58,378 | 53,284 | 84,150 | 95,917 |
| 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 | (10,023) | (13,719) | (15,469) |
| Other operating cash flows | 0 | 0 | 0 | 0 | 0 |
| Cash flow from operations | 28,477 | 70,050 | 44,771 | 71,186 | 80,825 |
| 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) | (7,105) | (13,575) | (15,879) |
| Other financing cash flows | (664) | 4,404 | (5,090) | 3,232 | 3,293 |
| Cash flow from financing | (10,576) | (56,270) | (38,438) | (23,464) | (19,147) |
| Changes in cash and cash eq. | (26,538) | (24,198) | (11,667) | 29,723 | 37,678 |
| Closing cash and cash eq. | 72,756 | 48,558 | 36,892 | 66,614 | 104,292 |

Per Share

| Y/E 31 Mar (Rs) | FY19A | FY20A | FY21E | FY22E | FY23E |
|----------------------|-------|-------|-------|-------|-------|
| Reported EPS | 11.1 | 15.8 | 13.7 | 26.2 | 30.6 |
| Adjusted EPS | 15.2 | 16.9 | 28.7 | 26.2 | 30.6 |
| Dividend per share | 2.4 | 3.4 | 3.0 | 5.7 | 6.6 |
| Book value per share | 172.6 | 185.0 | 195.7 | 216.2 | 240.2 |

Valuations Ratios

| Y/E 31 Mar (x) | FY19A | FY20A | FY21E | FY22E | FY23E |
|----------------|-------|-------|-------|-------|-------|
| EV/Sales | 4.6 | 4.1 | 4.0 | 3.4 | 3.0 |
| EV/EBITDA | 21.9 | 19.2 | 15.2 | 14.3 | 12.3 |
| Adjusted P/E | 38.5 | 34.8 | 20.4 | 22.4 | 19.2 |
| P/BV | 3.4 | 3.2 | 3.0 | 2.7 | 2.4 |

DuPont Analysis

| Y/E 31 Mar (%) | FY19A | FY20A | FY21E | FY22E | FY23E |
|---------------------------------|-------|-------|-------|-------|-------|
| Tax burden (Net profit/PBT) | 76.1 | 76.8 | 94.1 | 81.0 | 80.5 |
| Interest burden (PBT/EBIT) | 110.9 | 106.8 | 109.2 | 111.0 | 112.1 |
| EBIT margin (EBIT/Revenue) | 15.1 | 15.2 | 20.0 | 18.3 | 19.0 |
| Asset turnover (Revenue/Avg TA) | 11.1 | 12.5 | 13.0 | 14.2 | 14.7 |
| Leverage (Avg TA/Avg Equity) | 1.5 | 1.4 | 1.3 | 1.3 | 1.2 |
| Adjusted ROAE | 8.4 | 8.7 | 14.0 | 11.9 | 12.6 |

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

Ratio Analysis

| Y/E 31 Mar | FY19A | FY20A | FY21E | FY22E | FY23E |
|--|-------|-------|-------|-------|-------|
| YoY growth (%) | | | | | |
| Revenue | 10.1 | 12.9 | 3.6 | 13.9 | 12.2 |
| EBITDA | 9.2 | 14.9 | 25.2 | 4.3 | 13.8 |
| Adjusted EPS | 8.4 | 10.9 | 70.2 | (8.8) | 17.0 |
| Profitability & Return ratios (%) | | | | | |
| EBITDA margin | 21.2 | 21.6 | 26.0 | 23.9 | 24.2 |
| EBIT margin | 15.1 | 15.2 | 20.0 | 18.3 | 19.0 |
| Adjusted profit margin | 12.7 | 12.5 | 20.5 | 16.4 | 17.1 |
| Adjusted ROAE | 8.4 | 8.7 | 14.0 | 11.9 | 12.6 |
| ROCE | 7.6 | 7.9 | 13.1 | 11.5 | 12.3 |
| 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 | 1.3 |
| Current ratio | 3.3 | 2.7 | 2.7 | 2.8 | 3.1 |
| Net interest coverage ratio | 7.8 | 16.3 | 44.4 | 92.4 | 215.3 |
| Adjusted debt/equity | (0.1) | (0.2) | (0.2) | (0.3) | (0.3) |

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

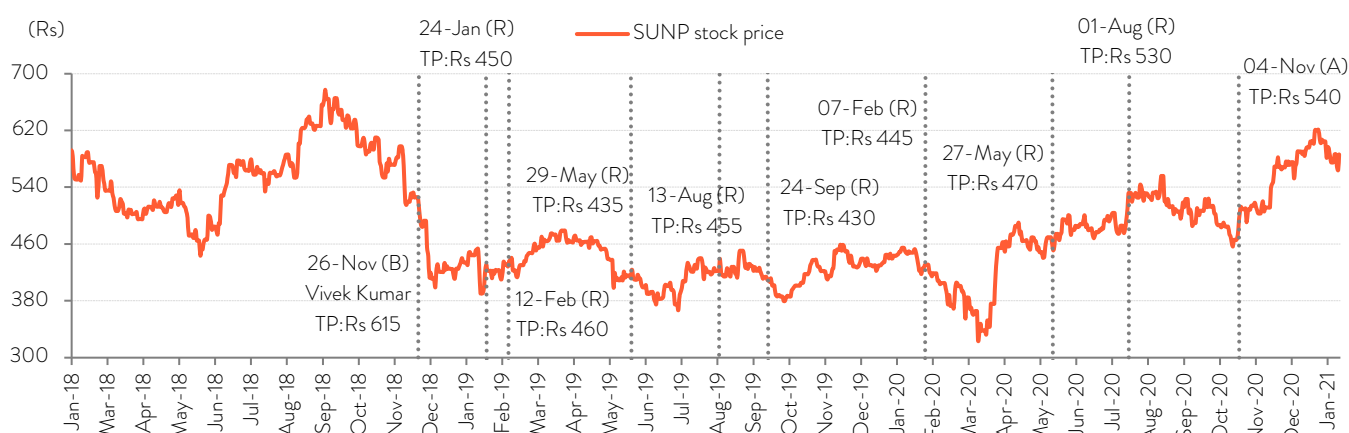
ADD – Expected return from >+5% to +15%

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)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): SUN PHARMA (SUNP IN)



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

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