

REDUCE

TP: Rs 470 | ▲ 4%

SUN PHARMA

Pharmaceuticals

27 May 2020

Q4 miss; near-term outlook subdued – REDUCE

Sun Pharma (SUNP) posted a 6% EBITDA miss on in-line sales, driven by higher staff cost (+7% QoQ), lower gross margins (-115bps QoQ) and lower R&D cost (6.4% of sales). The miss on US sales ex-Taro was offset by healthy India revenue (+8% YoY on adj. base). A 7% QoQ rise in Q4 global specialty sales to US\$ 126mn is positive and Ilumya booked US\$ 94mn in FY20 sales. SUNP expects softening of revenue in the near term due to Covid-19, and will give FY21 guidance in Q1-end. We cut FY21/FY22 EPS by 11% each and revise our TP to Rs 470 (vs. Rs 445).

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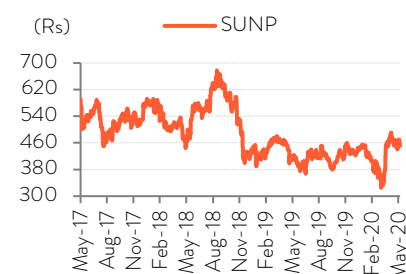
Higher cost fuels EBITDA miss: Q4 EBITDA stood at Rs 14bn (-15% QoQ) with margins at 17.3%. SUNP's ex-Taro margins have dropped 310bps QoQ to 14.5%. The sequential decline in EBITDA and margins is disappointing given better India sales, a higher specialty mix and cost control focus. Management stated that lower margins are an aberration and expects to exceed 21-22% levels in coming quarters. Further cuts in promotional spends for the US specialty business are unlikely and management retains its higher R&D guidance of <9% of sales for FY21 vs. 6.0% in FY20.

Ticker/Price	SUNP IN/Rs 451
Market cap	US\$ 14.3bn
Shares o/s	2,399mn
3M ADV	US\$ 80.5mn
52wk high/low	Rs 505/Rs 312
Promoter/FPI/DII	54%/17%/16%

Source: NSE

India strong, US a miss ex-Taro with no respite on generic pricing: US sales ex-Taro were flat QoQ, but majorly driven by higher contribution from Ilumya, Cequa and Yonsa, followed by seasonal products (Absorica, Levulan). Management sees no respite on US generic pricing for the portfolio, at least in the midterm. India and ROW grew 8% YoY led by pre-buying in chronic drugs, though prescription generation in the acute segment in India remains impacted.

STOCK PERFORMANCE



Source: NSE

Other takeaways: (1) Material savings in annual cost structure due to Covid-19 unlikely. (2) FY20 specialty R&D at US\$ 61mn (22% of R&D spends). (3) Halol OAI: SUNP believes FDA has guidelines in place to issue clearance if physical inspection is difficult. (4) Digitally engaging with doctors across key markets.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	260,680	286,906	323,880	359,378	401,176
EBITDA (Rs mn)	55,630	60,746	69,823	77,825	86,281
Adj. net profit (Rs mn)	33,666	36,484	40,453	49,485	55,981
Adj. EPS (Rs)	14.0	15.2	16.9	20.6	23.3
Adj. EPS growth (%)	(50.7)	8.4	10.9	22.3	13.1
Adj. ROAE (%)	8.1	8.4	8.7	9.8	10.2
Adj. P/E (x)	32.1	29.6	26.7	21.9	19.3
EV/EBITDA (x)	18.1	16.5	14.6	12.9	11.2

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	Q4FY20E	Var. (%)	FY20P	FY19	YoY (%)
Net Sales	80,780	70,443	14.7	80,386	0.5	81,774	(1.2)	323,246	286,854	12.7
EBITDA	13,997	9,521	47.0	16,434	(14.8)	14,930	(6.3)	64,636	58,405	10.7
Depreciation	5,753	4,540	-	5,469	-	4,900	-	20,525	17,531	-
EBIT	8,244	4,981	65.5	10,965	(24.8)	10,030	-	44,111	40,874	7.9
Interest	0	0	-	0	-	0	-	3,025	5,551	-
Other Income	1,574	2,511	-	1,731	-	1,785	-	11,480	14,047	-
PBT	9,818	7,492	-	12,696	-	11,815	(16.9)	52,566	49,370	-
Less: Taxation	830	(288)	-	3,276	-	1,772	-	8,226	6,248	-
Less: Minority interest	929	847	-	1,101	-	947	-	4,199	5,422	-
Recurring PAT	8,059	6,933	16.2	8,319	(3.1)	9,096	(11.4)	40,141	37,700	6.5
Exceptional items	(4,020)	(573)	-	818	-	0	-	(2,443)	(11,294)	-
Reported PAT	4,039	6,360	(36.5)	9,137	(55.8)	9,096	(55.6)	37,698	26,406	42.8
Key Ratios (%)										
Gross Margin	71.5	73.9	-	72.6	-	73.0	-	71.4	72.6	-
EBITDA Margin	17.3	13.5	-	20.4	-	18.3	-	20.0	20.4	-
Tax / PBT	8.5	(3.8)	-	25.8	-	15.0	-	15.6	12.7	-
NPM	10.0	9.8	-	10.3	-	11.1	-	12.4	13.1	-
EPS (Rs)	3.3	2.9	-	3.5	-	3.8	-	16.7	15.7	-

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	Q4FY20E	Var. (%)	FY20P	FY19	YoY (%)
Formulation	75,529	65,227	15.8	75,029	0.7	75,521	0.0	302,781	268,501	12.8
Domestic	23,648	11,010	114.8	25,169	(6.0)	23,305	1.5	97,104	73,483	32.1
Exports	51,881	54,217	(4.3)	49,860	4.1	52,216	(0.6)	205,678	195,018	5.5
US	27,129	31,238	(13.2)	24,924	8.8	26,250	3.3	105,425	106,696	(1.2)
ROW	24,752	22,979	7.7	24,936	(0.7)	25,966	(4.7)	100,253	88,322	13.5
APIs and others	5,251	5,211	0.8	5,655	(7.1)	6,253	(16.0)	20,770	17,968	15.6
Net Sales	80,780	70,438	14.7	80,684	0.1	81,774	(1.2)	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 llumya – 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 and a below-expected shift to new forms (low dosage), 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.

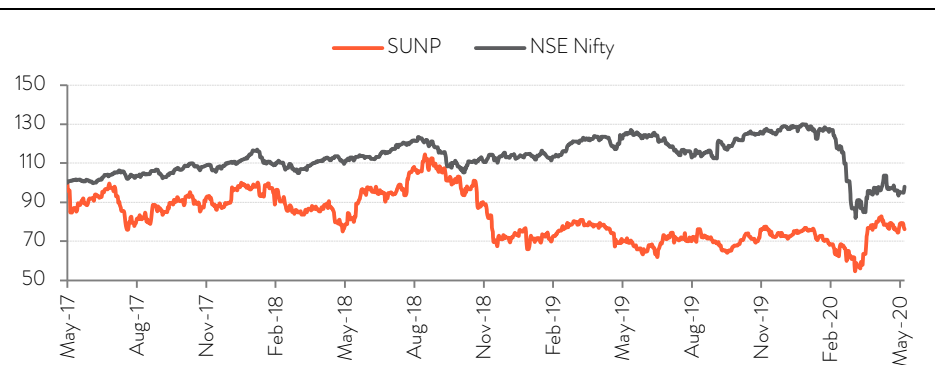
We lower FY21/FY22 EPS estimates by 11% each to Rs 21/Rs 23. This is to factor in FY20 margin disappointment, lower operating leverage in the US specialty business and a near-term soft quarter for India sales due to Covid-19 challenges. We maintain REDUCE with a revised Mar'21 target price of Rs 470 (earlier Rs 445), based on a higher 12x FY22E EV/EBITDA multiple (20x implied P/E) vs. 11x earlier. Our target multiple is in line with the earlier discount of 15% vis-à-vis other frontline stocks (Cipla, Dr Reddy's, Lupin).

FIG 3 – REVISED ESTIMATES

(Rs bn)	New			Old			Change (%)		
	FY20P	FY21E	FY22E	FY20P	FY21E	FY22E	FY20P	FY21E	FY22E
Sales	324	359	401	326	360	400	(0.6)	(0.1)	0.2
EBITDA	70	78	86	73	83	92	(4.6)	(6.2)	(6.1)
EBITDA margin (%)	21.6	21.7	21.5	22.5	23.1	22.9	(90bps)	(140bps)	(144bps)
EPS (Rs)	17	21	23	20	23	26	(14.8)	(10.9)	(10.6)

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)	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue	260,680	286,906	323,880	359,378	401,176
EBITDA	55,630	60,746	69,823	77,825	86,281
Depreciation	14,998	17,532	20,525	20,436	21,390
EBIT	40,632	43,214	49,298	57,389	64,891
Net interest income/(expenses)	(5,174)	(5,552)	(3,020)	(1,510)	(755)
Other income/(expenses)	8,388	10,255	6,371	7,678	7,960
Exceptional items	0	0	0	0	0
EBT	43,846	47,917	52,649	63,557	72,096
Income taxes	5,967	6,009	7,897	10,169	12,256
Extraordinary items	(12,050)	(9,823)	(2,600)	0	0
Min. int./Inc. from associates	4,213	5,424	4,299	3,904	3,860
Reported net profit	21,616	26,661	37,853	49,485	55,981
Adjustments	12,050	9,823	2,600	0	0
Adjusted net profit	33,666	36,484	40,453	49,485	55,981

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Accounts payables	47,662	41,479	52,272	58,001	64,747
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	478,791	521,476	569,208
Shareholders' fund	422,246	447,225	481,190	523,875	571,607
Total liabilities and equities	645,347	649,267	647,829	675,106	721,174
Cash and cash eq.	99,294	72,756	48,558	54,208	80,745
Accounts receivables	78,153	88,842	94,258	104,589	116,753
Inventories	68,807	78,859	78,750	92,483	103,240
Other current assets	112,168	94,978	94,978	94,978	94,978
Investments	71,427	79,024	99,002	99,002	99,002
Net fixed assets	93,912	102,607	100,082	97,646	94,257
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	647,829	675,106	721,174

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Net income + Depreciation	36,614	44,193	58,378	69,920	77,370
Interest expenses	5,174	5,552	3,020	1,510	755
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(20,324)	(21,269)	8,652	(14,853)	(12,345)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	21,464	28,477	70,050	56,577	65,781
Capital expenditures	(21,461)	(36,842)	(18,000)	(18,000)	(18,000)
Change in investments	(59,510)	(7,597)	(19,978)	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(80,971)	(44,438)	(37,978)	(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)	(3,020)	(1,510)	(755)
Dividends paid	(9,601)	(5,776)	(8,187)	(10,703)	(12,108)
Other financing cash flows	5,560	(664)	4,404	4,019	3,986
Cash flow from financing	7,393	(10,576)	(56,270)	(32,928)	(21,244)
Changes in cash and cash eq.	(52,115)	(26,538)	(24,198)	5,650	26,537
Closing cash and cash eq.	99,294	72,756	48,558	54,208	80,745

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
Reported EPS	9.0	11.1	15.8	20.6	23.3
Adjusted EPS	14.0	15.2	16.9	20.6	23.3
Dividend per share	4.0	2.4	3.4	4.5	5.0
Book value per share	159.8	172.6	185.0	201.1	219.4

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
EV/Sales	3.9	3.5	3.1	2.8	2.4
EV/EBITDA	18.1	16.5	14.6	12.9	11.2
Adjusted P/E	32.1	29.6	26.7	21.9	19.3
P/BV	2.8	2.6	2.4	2.2	2.1

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Tax burden (Net profit/PBT)	76.8	76.1	76.8	77.9	77.6
Interest burden (PBT/EBIT)	107.9	110.9	106.8	110.7	111.1
EBIT margin (EBIT/Revenue)	15.6	15.1	15.2	16.0	16.2
Asset turnover (Revenue/Avg TA)	10.4	11.1	12.5	13.6	14.4
Leverage (Avg TA/Avg Equity)	1.5	1.5	1.4	1.3	1.3
Adjusted ROAE	8.1	8.4	8.7	9.8	10.2

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
YoY growth (%)					
Revenue	(13.9)	10.1	12.9	11.0	11.6
EBITDA	(44.3)	9.2	14.9	11.5	10.9
Adjusted EPS	(50.7)	8.4	10.9	22.3	13.1
Profitability & Return ratios (%)					
EBITDA margin	21.3	21.2	21.6	21.7	21.5
EBIT margin	15.6	15.1	15.2	16.0	16.2
Adjusted profit margin	12.9	12.7	12.5	13.8	14.0
Adjusted ROAE	8.1	8.4	8.7	9.8	10.2
ROCE	7.4	7.6	7.9	9.3	9.9
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	1.2	1.3	1.4
Current ratio	2.9	3.3	2.7	2.7	2.9
Net interest coverage ratio	7.9	7.8	16.3	38.0	85.9
Adjusted debt/equity	(0.2)	(0.1)	(0.2)	(0.2)	(0.3)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

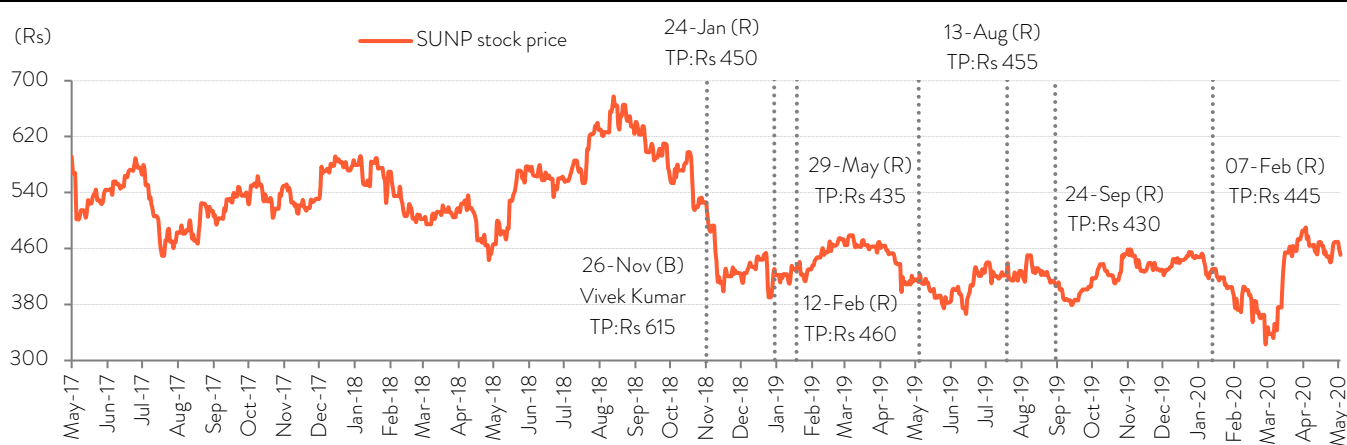
ADD – Expected return from >+5% to +15%

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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