

BSE SENSEX

37,121

S&P CNX

11,234


Stock Info

| | |
|-----------------------|-------------|
| Bloomberg | SUNP IN |
| Equity Shares (m) | 2,399 |
| M.Cap.(INRb)/(USDb) | 1553 / 21.4 |
| 52-Week Range (INR) | 679 / 435 |
| 1, 6, 12 Rel. Per (%) | 6/15/11 |
| 12M Avg Val (INR M) | 3363 |
| Free float (%) | 45.6 |

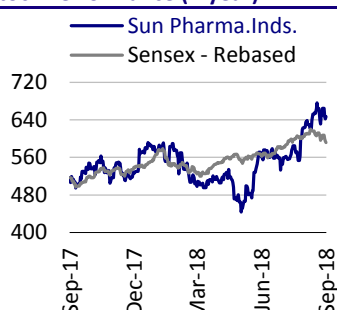
Financials Snapshot (INR b)

| Y/E Mar | 2018 | 2019E | 2020E |
|-------------|-------|-------|-------|
| Net Sales | 260.7 | 311.7 | 361.6 |
| EBITDA | 51.8 | 68.6 | 92.2 |
| PAT | 32.4 | 44.8 | 63.3 |
| EPS (INR) | 13.5 | 18.6 | 26.3 |
| Gr. (%) | -48.5 | 38.6 | 41.2 |
| BV/Sh (INR) | 158.4 | 170.0 | 189.3 |
| RoE (%) | 8.7 | 11.4 | 14.6 |
| RoCE (%) | 8.1 | 11.3 | 15.0 |
| P/E (x) | 48.1 | 34.7 | 24.6 |
| P/BV (x) | 4.1 | 3.8 | 3.4 |

Shareholding pattern (%)

| As On | Jun-18 | Mar-18 | Jun-17 |
|----------|--------|--------|--------|
| Promoter | 54.4 | 54.4 | 54.4 |
| DII | 16.6 | 16.2 | 12.9 |
| FII | 16.4 | 16.3 | 19.7 |
| Others | 12.6 | 13.1 | 13.0 |

FII Includes depository receipts

Stock Performance (1-year)

CMP: INR647
TP: INR790 (+22%)
Buy

Mohali 483–Product approval or EIR key for compliance

- The USFDA conducted an inspection at SUNP's Mohali plant during 10-14 September 2018, and issued Form 483 with two observations.
- We believe SUNP will be able to address these observations with a strong response, and subsequently take a corrective and preventive action (CAPA) plan on the same. Following this, we await product approvals and/or the Establishment Inspection Report (EIR) for regulatory compliance at Mohali.
- We remain positive on SUNP on the back of better traction in specialty portfolio, healthy growth in the generics business after offsetting the decline in base business, and better-than-industry growth in domestic formulations.
- Maintain 'Buy' with a price target of INR790 at 27x 12M forward earnings (unchanged).

Observations related to in-process materials/drug products and stability testing program

The USFDA has issued Form 483 with two observations with respect to its inspection conducted during 10-14 September 2018 at SUNP's Mohali plant. **(a)** The first observation is related to approval/rejection of in-process materials and drug products. Specifically, the USFDA inspector highlighted that exhibit batches, which failed the in-process sampling were not rejected. The root cause analysis related to out of specification (OOS) results was not adequate, but results were still submitted in support of drug application. **(b)** The second observation is related to the stability testing program. The inspector observed that: (i) the stability data is not a representative of intended manufacturing process for particular tablets; and (ii) the manufacture of the feasibility/optimization batches on two different compression machines after the exhibit batches were manufactured. Overall, we believe these observations are product specific which can be resolved with a strong corrective and preventive action plan, so that it does not impact product approvals or good manufacturing practices (GMP) compliance.

Second USFDA inspection at Mohali post-merger of Ranbaxy

In 2013, the USFDA had banned the import of drugs from four Ranbaxy units, including the one at Mohali, for violation of good manufacturing practices. Ranbaxy had then signed a consent decree, promising to take corrective measures. Post-merger of Ranbaxy, SUNP implemented remedial measures resulting in the lifting of import alert from this facility in March 2017. The recent inspection is the second to occur, post-merger of Ranbaxy. The US business from this facility is yet to pick up.

Valuation and view

We maintain our estimates and value SUNP at 27x (unchanged) 12M forward earnings arriving at a price target of INR790. We believe that discount to its 3-year average P/E should narrow going forward as: (a) share of its specialty portfolio increases; (b) downside in base business erosion reduces; (c) healthy pipeline of ANDAs is pending for approval; and (d) there is a sustained outperformance in the domestic formulation market. Re-iterate 'Buy'.

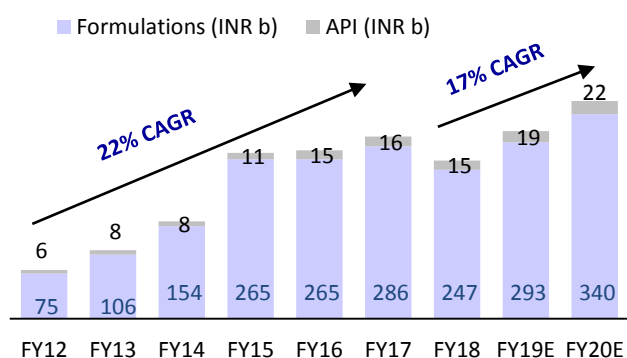
Exhibit 1: Recent Inspection History

| Location | Type | Inspection End Date | Classification |
|-------------------------|--|---------------------|-------------------|
| Panoli, Gujarat | ❖ API | May-18 | NAI |
| Ahmednagar, Maharashtra | ❖ API | Apr-18 | VAI |
| Malanpur, MP | ❖ API | Mar-18 | NAI |
| Vadodara, Gujarat | ❖ R&D | Mar-18 | NAI |
| Cranbury (US) | ❖ Formulation (Injectables) | Mar-18 | VAI |
| Vadodara, Gujarat | ❖ R&D | Mar-18 | NAI |
| Halol, Gujarat | ❖ Formulation (Oral solids, Inj. and Nasals) | Aug-18 | Yet to be updated |
| Vadodara, Gujarat | ❖ R&D | Feb-18 | NAI |
| Gurugram, Haryana | ❖ R&D | Jan-18 | NAI |

Source: US FDA

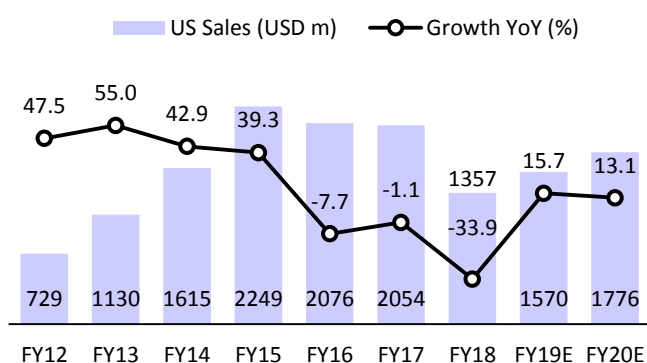
Story in charts

Exhibit 2: Revenues to grow at ~17% CAGR from FY18-20E



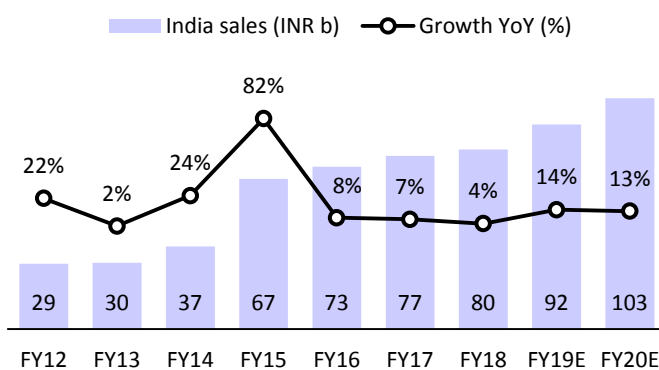
Source: Company, MOSL

Exhibit 3: US sales to improve FY19 onwards



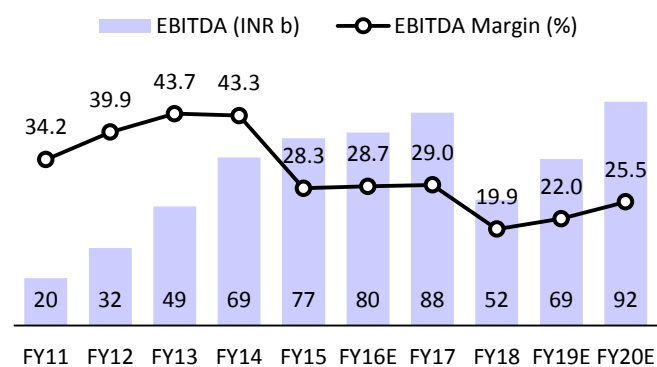
Source: Company, MOSL

Exhibit 4: India biz to grow at 13% CAGR from FY18-20E



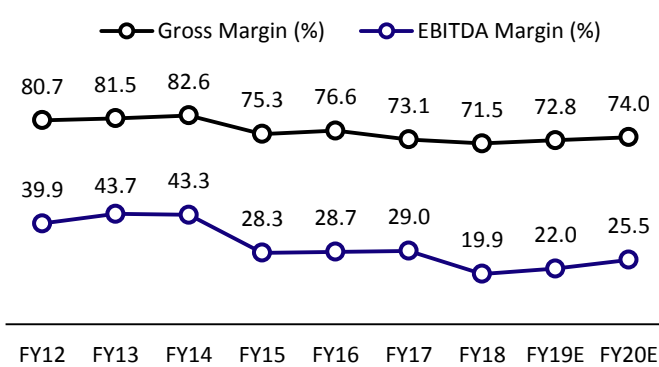
Source: Company, MOSL

Exhibit 5: Margins to gradually improve



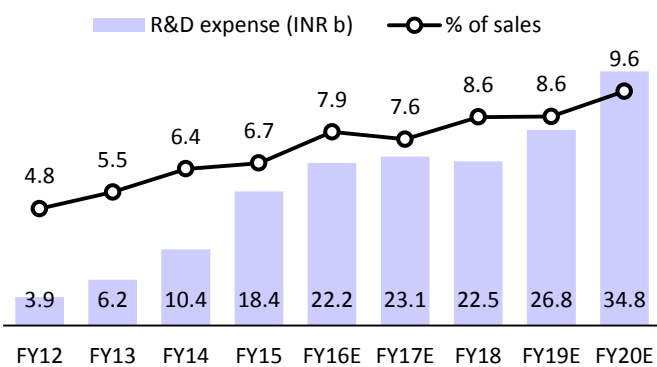
Source: Company, MOSL

Exhibit 6: EBITDA to improve with a rise in gross margin



Source: Company, MOSL

Exhibit 7: R&D expense to increase going forward



Source: Company, MOSL

Financials and valuations

| Income Statement | | | | | | (INR Million) | |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Y/E March | 2014 | 2015 | 2016 | 2017 | 2018 | 2019E | 2020E |
| Net Sales | 160,044 | 272,865 | 277,442 | 302,642 | 260,659 | 311,739 | 361,608 |
| Total Expenditure | 90,787 | 195,667 | 197,881 | 214,892 | 208,813 | 243,107 | 269,384 |
| % of Sales | 56.7 | 71.7 | 71.3 | 71.0 | 80.1 | 78.0 | 74.5 |
| EBITDA (INR b) | 69,257 | 77,198 | 79,561 | 87,751 | 51,846 | 68,632 | 92,224 |
| Margin (%) | 43.3 | 28.3 | 28.7 | 29.0 | 19.9 | 22.0 | 25.5 |
| Depreciation | 4,092 | 11,947 | 10,135 | 12,648 | 14,998 | 15,000 | 15,500 |
| EBIT | 65,165 | 65,250 | 69,426 | 75,103 | 36,848 | 53,632 | 76,724 |
| Int. and Finance Charges | 442 | 5,790 | 4,769 | 3,998 | 5,176 | 4,000 | 3,300 |
| Other Income - Rec. | 6,282 | 6,946 | 9,848 | 19,374 | 12,623 | 12,000 | 12,500 |
| Extra-ordinary Exp | 25,174 | 2,378 | 6,852 | 0 | 9,505 | 0 | 0 |
| PBT | 45,831 | 64,029 | 67,653 | 90,479 | 34,790 | 61,632 | 85,924 |
| Tax | 7,022 | 9,147 | 9,349 | 12,116 | 8,452 | 10,786 | 14,607 |
| Tax Rate (%) | 15.3 | 14.3 | 13.8 | 13.4 | 24.3 | 17.5 | 17.0 |
| Profit after Tax | 38,809 | 54,882 | 58,304 | 78,363 | 26,338 | 50,847 | 71,317 |
| Change (%) | 11.9 | 41.4 | 6.2 | 34.4 | -66.4 | 93.1 | 40.3 |
| Margin (%) | 24 | 20 | 21 | 26 | 10 | 16 | 20 |
| Less: Mionrity Interest | 7375 | 9488 | 11145 | 8719 | 4722 | 6000 | 8000 |
| Reported PAT | 31,434 | 45,394 | 47,159 | 69,644 | 21,616 | 44,847 | 63,317 |
| Adjusted PAT (excl. Ex. Items) | 52,813 | 47,415 | 47,069 | 62,890 | 32,362 | 44,847 | 63,317 |

| Balance Sheet | | | | | | (INR Million) | |
|------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Y/E March | 2014 | 2015 | 2016 | 2017 | 2018 | 2019E | 2020E |
| Equity Share Capital | 2,071 | 2,406 | 2,407 | 2,399 | 2,399 | 2,399 | 2,399 |
| Total Reserves | 183,178 | 253,826 | 327,418 | 363,997 | 378,606 | 406,610 | 453,084 |
| Net Worth | 185,249 | 256,232 | 329,825 | 366,397 | 381,006 | 409,009 | 455,483 |
| Minority Interest | 19,212 | 28,661 | 40,853 | 37,909 | 38,842 | 44,842 | 52,842 |
| Deferred Liabilities | -9110 | -17516 | -30462 | -21780 | -19748 | -19748 | -19748 |
| Total Loans | 24,982 | 77,827 | 83,164 | 80,910 | 97,518 | 70,035 | 50,442 |
| Capital Employed | 220,333 | 345,203 | 423,379 | 463,435 | 497,617 | 504,137 | 539,018 |
| Gross Block | 63,886 | 130,369 | 123,033 | 133,994 | 155,630 | 180,630 | 210,630 |
| Less: Accum. Deprn. | 28,904 | 60,617 | 47,201 | 49,041 | 64,040 | 79,040 | 94,540 |
| Net Fixed Assets | 34,982 | 69,752 | 75,831 | 84,953 | 91,590 | 101,590 | 116,090 |
| Capital WIP | 8,415 | 20,386 | 12,035 | 15,648 | 14,345 | 15,779 | 17,357 |
| Goodwill | 33,191 | 57,073 | 92,611 | 104,165 | 107,243 | 107,243 | 107,243 |
| Investments | 27,860 | 27,163 | 11,161 | 9,610 | 30,523 | 30,523 | 30,523 |
| Curr. Assets | 177,393 | 297,403 | 332,175 | 374,799 | 377,390 | 400,635 | 437,053 |
| Inventory | 31,230 | 56,680 | 64,225 | 68,328 | 68,807 | 69,385 | 76,934 |
| Account Receivables | 22,004 | 53,123 | 67,757 | 72,026 | 78,153 | 53,463 | 62,188 |
| Cash and Bank Balance | 75,902 | 109,980 | 131,817 | 151,408 | 99,294 | 146,651 | 159,876 |
| L & A and Others | 48,257 | 77,619 | 68,377 | 83,036 | 131,136 | 131,136 | 138,055 |
| Curr. Liability & Prov. | 61,509 | 126,574 | 100,434 | 125,739 | 123,473 | 151,632 | 169,247 |
| Account Payables | 15,887 | 59,198 | 51,741 | 73,469 | 68,332 | 74,484 | 82,587 |
| Provisions | 45,622 | 67,376 | 48,693 | 52,270 | 55,141 | 77,148 | 86,660 |
| Net Current Assets | 115,884 | 170,828 | 231,742 | 249,060 | 253,916 | 249,002 | 267,806 |
| Appl. of Funds | 220,333 | 345,203 | 423,379 | 463,435 | 497,617 | 504,137 | 539,018 |

Financials and valuations

Ratios

| Y/E March | 2014 | 2015 | 2016 | 2017 | 2018 | 2019E | 2020E |
|-------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Reported EPS | 13.1 | 18.9 | 19.6 | 28.9 | 9.0 | 18.6 | 26.3 |
| Adjusted EPS | 22.0 | 19.7 | 19.6 | 26.1 | 13.5 | 18.6 | 26.3 |
| Cash EPS | 14.8 | 23.8 | 23.8 | 34.2 | 15.2 | 24.9 | 32.8 |
| BV/Share | 77.0 | 106.5 | 137.1 | 152.3 | 158.4 | 170.0 | 189.3 |
| DPS | 2.6 | 3.0 | 1.0 | 3.5 | 3.5 | 6.0 | 6.0 |
| Payout (%) | 18.7 | 15.4 | 4.8 | 12.5 | 37.3 | 33.1 | 23.6 |
| Valuation (x) | | | | | | | |
| P/E | | 32.8 | 33.1 | 24.8 | 48.1 | 34.7 | 24.6 |
| P/BV | | 6.1 | 4.7 | 4.2 | 4.1 | 3.8 | 3.4 |
| EV/Sales | | 5.1 | 5.0 | 4.5 | 5.4 | 4.3 | 3.6 |
| EV/EBITDA | | 17.9 | 17.4 | 15.5 | 27.2 | 19.5 | 14.1 |
| Dividend Yield (%) | | 0.5 | 0.2 | 0.5 | 0.5 | 0.9 | 0.9 |
| Return Ratios (%) | | | | | | | |
| RoE | 31.5 | 21.5 | 16.1 | 18.1 | 8.7 | 11.4 | 14.6 |
| RoCE | 33.4 | 22.7 | 18.3 | 19.0 | 8.1 | 11.3 | 15.0 |
| RoIC | 55.5 | 37.8 | 26.2 | 23.4 | 8.7 | 13.3 | 19.8 |
| Working Capital Ratios | | | | | | | |
| Fixed Asset Turnover (x) | 4.8 | 5.2 | 3.8 | 3.8 | 3.0 | 3.2 | 3.3 |
| Debtor (Days) | 50 | 71 | 89 | 87 | 109 | 63 | 63 |
| Creditor (Days) | 209 | 321 | 291 | 330 | 336 | 321 | 321 |
| Inventory (Days) | 71 | 76 | 84 | 82 | 96 | 81 | 78 |
| Leverage Ratio | | | | | | | |
| Debt/Equity (x) | 0.2 | 0.3 | 0.3 | 0.2 | 0.3 | 0.2 | 0.1 |

Cash Flow Statement

(INR Million)

| Y/E March | 2014 | 2015 | 2016 | 2017 | 2018 | 2019E | 2020E |
|------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| OP/(Loss) bef. Tax | 44,083 | 74,820 | 72,709 | 87,751 | 42,341 | 68,632 | 92,224 |
| Int./Dividends Recd. | 6,282 | 6,946 | 9,848 | 19,374 | 12,623 | 12,000 | 12,500 |
| Direct Taxes Paid | -9,010 | -17,553 | -22,295 | -3,434 | -6,420 | -10,786 | -14,607 |
| (Inc)/Dec in WC | -5,589 | -20,865 | -39,077 | 2,274 | -56,971 | 52,271 | -5,578 |
| CF from Operations | 35,767 | 43,348 | 21,185 | 105,964 | -8,427 | 122,117 | 84,539 |
| (inc)/dec in FA | -18,580 | -82,570 | -43,401 | -36,936 | -23,411 | -26,434 | -31,578 |
| Free Cash Flow | 17,187 | -39,223 | -22,216 | 69,028 | -31,838 | 95,683 | 52,961 |
| (Pur)/Sale of Invest. | -3,745 | 697 | 16,002 | 1,551 | -20,913 | 0 | 0 |
| CF from investments | -22,324 | -81,873 | -27,399 | -35,385 | -44,324 | -26,434 | -31,578 |
| Change in network | 6,674 | 33,994 | 30,296 | -34,910 | -971 | 0 | 0 |
| (Inc)/Dec in Debt | 22,910 | 52,845 | 5,337 | -2,254 | 16,608 | -27,483 | -19,593 |
| Interest Paid | -442 | -5,790 | -4,769 | -3,998 | -5,176 | -4,000 | -3,300 |
| Dividend Paid | -7,270 | -8,445 | -2,816 | -9,825 | -9,825 | -16,843 | -16,843 |
| CF from Fin. Activity | 21,872 | 72,605 | 28,049 | -50,987 | 636 | -48,326 | -39,736 |
| Inc/Dec of Cash | 35,315 | 34,079 | 21,836 | 19,592 | -52,115 | 47,356 | 13,225 |
| Add: Beginning Balance | 40,587 | 75,902 | 109,980 | 131,817 | 151,408 | 99,294 | 146,651 |
| Closing Balance | 75,902 | 109,981 | 131,816 | 151,408 | 99,294 | 146,651 | 159,876 |

Note: Cash flows do not tally due to acquisition

| Explanation of Investment Rating | |
|----------------------------------|--|
| Investment Rating | Expected return (over 12-month) |
| BUY | >=15% |
| SELL | < - 10% |
| NEUTRAL | < - 10 % to 15% |
| UNDER REVIEW | Rating may undergo a change |
| NOT RATED | We have forward looking estimates for the stock but we refrain from assigning recommendation |

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