

Xelpros-no major upside, maintain Hold

We maintain our Hold rating on Sun Pharma (SPIL) with TP of Rs580 (earlier Rs580) based on 26x March'20E EPS of Rs22.4. SPIL has developed a strong pipeline of specialty products for the US. It has received US FDA approval for Xelpros used in the treatment of glaucoma and ocular hypertension. We expect \$22mn (Rs1.58bn) revenues from Xelpros in FY20. Key upside risks to our assumption include higher revenues from the US market and key downside risk includes regulatory risks for its manufacturing facilities catering to the global markets. We recommend a switch to Aurobindo or Cipla.

- **Xelpros revenues at \$22mn in FY20:** SPIL has received approval from US FDA for its proprietary product Xelpros (latanoprost). We expect this product to generate revenues of \$22mn (Rs1.58bn) in FY20, the first full year of operation. There are two branded and seven generic competing products of latanoprost. Hence, SPIL product is likely to face stiff competition in the US market. The clinical trial of Xelpros has indicated certain side effects which are likely to impact the revenues. The branded products are at a large premium of ~16x the generic products resulting in switch to generic products. The product will be manufactured at SPIL's Halol facility, which is currently under US FDA scanner.
- **EBIDTA margin expected at 30%:** SPIL has in-licensed Xelpros from SPARC-the research arm of SPIL and will pay milestone payments and royalty to SPARC. We expect Xelpros to generate EBIDTA margin of ~30%. We expect SPIL to pay double-digit royalty to SPARC. We expect SPIL to generate EBIDTA of Rs475mn in FY20. We expect SPIL to price the product @20% discount to the existing brands in order to garner the market share.
- **Net profit expected at Rs275mn:** we expect SPIL to generate additional net profit of Rs275mn from Xelpros in FY20 which would enhance EPS to Rs22.4 from Rs22.3. Hence, there is no appreciable upside for SPIL from this development. Moreover, Xelpros has indicated certain side effects during its clinical trials. This is likely to restrict Xelpros usage by patients. We expect the side effects to impact sales and profitability of the product.
- **Recommendation and view:** We maintain our Hold rating on SPIL and maintain TP to Rs580 based on 26x March'20 EPS of Rs22.4 and downside of 12.8% from the CMP. Key positive risks to our assumptions would be higher growth in the US market and key negative risk would be regulatory risks for its manufacturing facilities. We recommend a switch to Aurobindo or Cipla.

Target Price	Rs580	Key Data	
CMP*	Rs665	Bloomberg Code	SUNP IN
Downside	12.8%	Curr Shares O/S (mn)	2,399.3
Previous Target	Rs580	Diluted Shares O/S(mn)	2,399.3
Previous Rating	Hold	Mkt Cap (Rsbn/USDbn)	1596.1/22
Price Performance (%)*		52 Wk H / L (Rs)	679.3/434.8
		5 Year H / L (Rs)	1200.8/432.7
SUNP IN	6.7	Daily Vol. (3M NSE Avg.)	7590598
Nifty	(0.6)		13.1

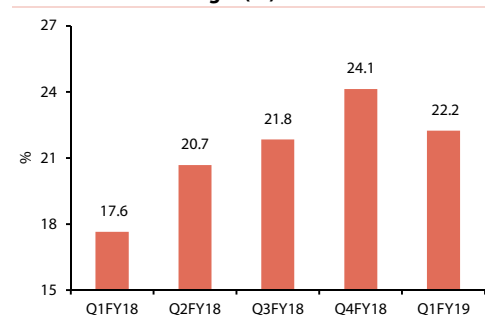
*as on 14th September 2018 Source: Bloomberg, Centrum Research

Shareholding pattern (%)*

	Jun-18	Mar-18	Dec-17	Sept-17
Promoter	54.4	54.4	54.4	54.4
FIs	16.4	16.3	17.2	18.2
DIs	16.6	16.2	14.0	13.8
Others	12.6	13.1	14.4	13.6

Source: BSE, *as on 14th September 2018

Trend in EBIDTA margin (%)*



Source: Company, Centrum Research

Earning Revision

Particulars (Rs mn)	FY19E			FY20E		
	New	Old	Chg (%)	New	Old	Chg (%)
Sales	2,98,216	2,98,216	0.0	3,35,064	3,33,480	0.5
EBITDA	65,767	65,767	0.0	79,655	79,180	0.6
EBITDA Margin (%)	22.1	22.1	0bps	23.8	23.7	10bps
PAT	42,998	42,998	0.0	53,825	53,549	0.5

Source: Centrum Research Estimates

Centrum vs. Bloomberg Consensus*

Particulars (Rs mn)	FY19E			FY20E		
	Centrum	BBG	Var (%)	Centrum	BBG	Var (%)
Sales	2,98,216	3,02,322	(1.4)	3,35,064	3,42,471	(2.2)
EBITDA	65,767	68,778	(4.4)	79,655	86,248	(7.6)
PAT	42,998	43,177	(0.4)	53,824	57,755	(6.8)

Bloomberg Consensus*				Centrum Target Price (Rs)	Variance (%)
BUY	SELL	HOLD	Target Price (Rs)		
18	10	13	603	580	(3.7)

*as on 14th September 2018, Source: Bloomberg, Centrum Research Estimates

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Y/E March (Rs mn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Net profit	YoY (%)	DEPS Rs	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY16	2,84,870	3.8	81,584	28.6	63,436	32.8	26.4	21.6	17.7	32.5	24.8
FY17	3,15,784	10.9	1,00,892	31.9	78,462	23.7	32.7	22.5	18.5	22.4	16.8
FY18	2,64,894	-16.1	56,080	21.2	35,589	-54.6	14.8	9.5	8.3	37.1	23.5
FY19E	2,98,216	12.6	65,767	22.1	42,998	20.8	17.9	10.7	9.1	37.1	24.1
FY20E	3,35,064	12.4	79,655	23.8	53,824	25.2	22.4	12.1	10.6	29.6	19.6

Source: Company, Centrum Research Estimates

In the interest of timeliness, this document is not edited.

Centrum Equity Research is available on Bloomberg, Thomson Reuters and FactSet

Xelpros approval

US FDA approves Xelpros

SPIL has received approval from US FDA for its New Drug application (NDA) Xelpros used in the treatment of glaucoma and ocular hypertension. Xelpros (latanoprost 0.005% emulsion) is the first benzalkonium chloride-free form of latanoprost. The approval is from SPIL's Halol facility which is currently under US FDA scanner. SPIL in-licensed Xelpros from Sun Pharma Advanced Research Centre (SPARC) in June'15. SPARC would be eligible for milestone payments and royalty from SPIL on commercialization of this product. Xelpros is developed using SPARC's proprietary Swollen Micelle microemulsion (SMM) technology. Xelpros will be commercialized by Sun Ophthalmics-branded ophthalmology division of SPIL.

Clinical trials indicate side effects

Across Xelpros clinical trials, the most frequently reported ocular adverse reactions were eye pain/stinging and ocular redness reported in 55% and 41% of the cases treated with Xelpros respectively. Less than 1% of patients discontinued the therapy due to intolerance of adverse effects. The most common ocular adverse reaction reported in the clinical trials (incidence >5%) for Xelpros are: eye pain/stinging, ocular hyperemia, conjunctival hyperemia, eye discharge, growth of eyelashes and eyelash thickening.

Competition-Branded and Generics

Xelpros faces stiff competition from branded and generic products. The two branded products marketed in the US market are: Xalatan-Pharmacia & Upjohn priced at \$221 for 2.5ml pack and Vyzulta-Bausch & Lomb priced at \$196 for 2.5ml pack. The average branded price works out to be \$208 for 2.5ml pack. The recommended dose of Xelpros is one drop in each eye once daily in the evening. Hence, the patient would require one pack/month or 12 packs per annum.

Currently, there are seven generic players and one tentative approval (Par Pharma) for generic latanoprost 0.005%. These are: Akron, Sandoz, Amring Pharma, Bausch & Lomb, Mylan, Dr. Reddy's Lab and FDC. The generic product is available at Walmart at \$12.5 per 2.5ml pack.

Financials

We expect SPIL to generate revenues of \$22.5mn (Rs1.58bn) in FY20 (the first full year of operation) from Xelpros with EBIDTA margin of 30%. We expect Xelpros would generate Rs275mn net profit in FY20. The details are indicated in the following table:

Exhibit 1: Xelpros Revenue Assumptions

Particulars	Number million	in \$	\$ @Rs72
No .of patients	2.25		
Pricing-Branded product		208	14,976
Pricing-generic product		12.5	900
No. of dosages/annum	12		
Branded patients @10%	0.225		
Generic patients @90%	2.025		
SPIL price at discount @20%		166.4	11,981
SPIL market share@5%	0.01125		
SPIL unit sales	0.135		
SPIL Revenues-\$ mn		22.5	

Source: Company, Centrum Research

We have assumed the branded products currently constitute 10%MS and the generic products constitute 90%MS. We expect SPIL to generate 5%MS in the branded segment in FY20. We assume SPIL Xelpros price at \$166.4 per pack @20% discount to the branded players in order to gain the MS.

Recommendation and view

At the CMP of Rs665, SPIL trades at 37.1x FY19E EPS of Rs17.9 and 29.6x FY20E EPS of Rs22.4. We maintain our Hold rating on SPIL with TP of Rs580 based on 26x March'20 EPS of Rs22.4 with a downside of 12.8% from the CMP. We do not expect any major upside from Xelpros approval as there is enough competition and reported side effects during clinical trials. The management has guided Xelpros revenues of \$50-75mn (Rs3.60-5.40bn) over the next 2-3 years. SPIL is facing pricing pressure in the US generic market for its existing products. Key positive risks to our assumptions would be higher growth in the US market and key negative risk would be regulatory risks for its manufacturing facilities. We recommend a switch to Aurobindo or Cipla.

Earning Revision

Based on the above developments, we have revised our FY20E EPS upwards by 0.5% due to Xelpros approval by US FDA and maintained our FY19E EPS. The Xelpros approval is from SPIL's Halol facility which is under US FDA scanner.

Exhibit 2: Earning Revision

Particulars (Rsmn)	FY19E			FY20E		
	New	Old	Chg (%)	New	Old	Chg (%)
Sales	2,98,216	2,98,216	0.0	3,35,064	3,33,480	0.5
EBITDA	65,767	65,767	0.0	79,655	79,180	0.6
EBITDA Margin (%)	22.1	22.1	0bps	23.8	23.7	10bps
PAT	42,998	42,998	0.0	53,825	53,549	0.5

Source: Centrum Research Estimates

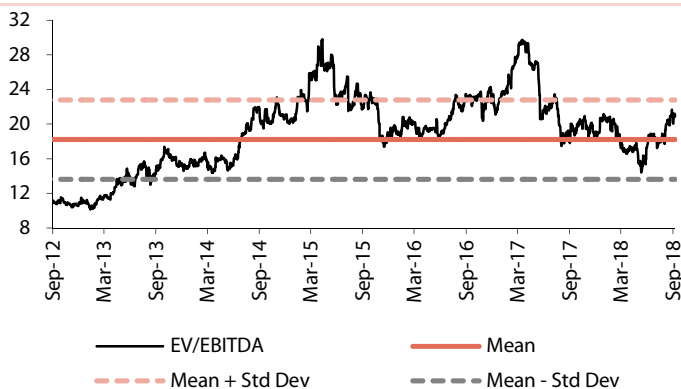
Valuation and key risks

Exhibit 3: Sensitivity Analysis

Sensitivity to key variables – FY19E	% change	% impact on EBITDA	% impact on EPS
Sales	1	4.5	6.9
Material cost	1	(1.3)	(2.0)

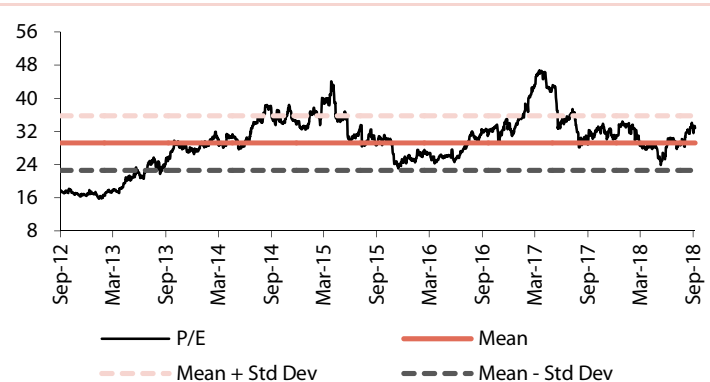
Source: Company, Centrum Research Estimates

Exhibit 4: 1 year forward EV/EBITDA chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 5: 1 year forward P/E chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 6: Comparative Valuations

Sector	Mkt Cap (Rs mn)	CAGR FY18-FY20E (%)			EBITDA Margin (%)			PE (x)			EV/EBITDA (x)			RoE (%)			Div Yield (%)		
		Rev.	EBITDA	PAT	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E
Sun Pharma	15,95,335	12.5	19.2	23.0	21.2	22.1	23.8	37.1	37.1	29.6	23.5	24.1	19.6	9.5	10.7	12.1	0.4	0.5	0.6
Cipla	5,35,325	16.6	24.4	29.2	18.6	19.6	21.2	31.1	28.9	21.4	17.1	16.0	12.7	10.6	12.3	14.9	0.6	0.6	0.7
Dr. Reddy's Labs	4,28,612	8.9	17.8	35.4	16.5	18.0	19.3	41.9	31.5	24.7	18.9	17.1	14.3	7.6	10.5	12.4	1.0	1.2	1.4
Lupin	4,37,988	8.6	10.6	2.6	19.9	19.0	20.6	26.6	30.6	24.2	16.2	15.6	12.7	1.9	10.1	11.6	0.6	0.7	0.9

Source: Company, Centrum Research Estimates Prices as on 14th September 2018

Quarterly financials, Operating Metrics and Key Performance Indicators

Exhibit 7: Quarterly Financials -consolidated

PARTICULARS (Rs mn)	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19
P & L								
Revenues	82,601	79,251	71,370	62,088	66,504	66,532	69,771	72,242
Material cost	18,399	22,487	21,951	16,774	18,775	20,998	17,701	21,069
Personnel cexpenses	11,991	12,151	12,488	13,299	13,233	13,726	13,413	14,330
Other Expenses	20,534	20,082	21,455	21,059	20,739	17,275	21,823	20,776
Total Expenses	50,924	54,720	55,894	51,132	52,747	51,999	52,937	56,175
EBIDTA	31,677	24,531	15,476	10,956	13,757	14,533	16,834	16,067
Other income	1,194	1,222	2,245	1,520	2,548	1,292	3,028	1,998
PBDIT	32,871	25,753	17,721	12,476	16,305	15,825	19,862	18,065
Interest	537	1,665	450	1,094	1,574	953	1,554	1,309
Depreciation	3,038	3,068	3,382	3,466	3,587	3,393	4,552	4,016
Profit before tax	29,296	21,020	13,889	7,916	11,144	11,479	13,756	12,740
Tax provision	4,417	3,729	443	1,618	1,114	7,487	(1,767)	1,639
Net profit before minority	24,879	17,291	13,446	6,298	10,030	3,992	15,523	11,101
Share of profit of ass./minority	(168)	(72)	411	1,042	(12)	10	2,433	1,276
Net profit before EO items	24,711	17,219	13,857	5,256	10,018	4,002	13,090	9,825
EO items	-	-	-	9,505	-	-	-	-
Net profit after EO items	24,711	17,219	13,857	(4,249)	10,018	4,002	13,090	9,825
Growth (%)								
Revenues	20.2	11.3	(6.8)	(24.8)	(19.5)	(16.0)	(2.2)	16.4
EBIDTA	69.1	9.2	(31.9)	(62.5)	(56.6)	(40.8)	8.8	46.7
Net profit before EO items	140.2	11.5	(16.7)	(76.8)	(59.5)	(76.8)	(5.5)	86.9
Margin (%)								
EBIDTA	38.3	31.0	21.7	17.6	20.7	21.8	24.1	22.2
Profit before tax	35.5	26.5	19.5	12.7	16.8	17.3	19.7	17.6
Net margin before EO	29.9	21.7	19.4	8.5	15.1	6.0	18.8	13.6

Source: Company, Centrum Research

Exhibit 8: Key performance indicators

Key performance indicator	FY16	FY17	FY18	FY19E	FY20E
Domestic-Sales Growth %	6.4	8.4	3.6	14.0	13.0
US-sales growth %	(3.8)	(0.5)	(33.4)	11.0	11.6
RoW-sales growth %	(7.3)	19.5	15.1	5.0	6.0
Material cost %	22.2	25.7	28.0	29.2	28.5

Source: Centrum Research Estimates

Financials -consolidated

Exhibit 9: Income Statement

Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Revenues	2,84,870	3,15,784	2,64,894	2,98,216	3,35,064
Material cost	63,303	81,308	74,247	87,059	95,344
% of revenues	22.2	25.7	28.0	29.2	28.5
Employee cost	47,723	49,023	53,671	59,100	64,900
% of revenues	16.8	15.5	20.3	19.8	19.4
Other Expenses	92,260	84,561	80,896	86,290	95,165
% of revenues	32.4	26.8	30.5	28.9	28.4
EBIDTA	81,584	1,00,892	56,080	65,767	79,655
EBIDTA margin (%)	28.6	31.9	21.2	22.1	23.8
Depreciation & Amortisation	10,375	12,647	14,998	16,080	17,410
EBIT	71,209	88,245	41,082	49,687	62,245
Interest Expenses	5,232	3,998	5,176	5,200	5,400
PBT from operations	65,977	84,247	35,906	44,487	56,845
Other income	6,582	6,232	8,388	9,141	10,250
PBT	72,559	90,479	44,294	53,628	67,095
Tax provision	9,138	12,116	8,451	10,750	13,400
Effective tax rate (%)	12.6	13.4	19.1	20.0	20.0
Net profit	63,421	78,363	35,843	42,878	53,695
Minority interest	(15)	(99)	254	(120)	(130)
Reported net profit	63,436	78,462	35,589	42,998	53,824
Adj. Net profit	63,436	78,462	35,589	42,998	53,824

Source: Company, Centrum Research Estimates

Exhibit 10: Key Ratios

Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Growth Ratios (%)					
Revenues	3.8	10.9	(16.1)	12.6	12.4
EBIDTA	3.7	23.7	(44.4)	17.3	21.1
Adj. Net Profit	32.8	23.7	(54.6)	20.8	25.2
Margin Ratios (%)					
EBIDTA margin	28.6	31.9	21.2	22.1	23.8
PBT from operations margin	23.2	26.7	13.6	14.9	17.0
Adj. PAT margin	22.3	24.8	13.4	14.4	16.1
Return Ratios (%)					
RoCE	17.7	18.5	8.3	9.1	10.6
RoE	21.6	22.5	9.5	10.7	12.1
RoIC	23.7	25.3	9.4	9.7	11.4
Turnover ratios (days)					
Gross Block Turnover (x)	1.6	1.5	1.1	1.2	1.3
Debtors	87	83	108	106	104
Creditors	46	51	66	67	57
Inventory	82	79	95	102	93
Cash Conversion Cycle	123	111	137	141	141
Solvency Ratio					
Debt-Equity	0.3	0.2	0.3	0.2	0.2
Net Debt-Equity	(0.1)	(0.2)	(0.0)	(0.0)	(0.1)
Current Ratio	3.2	3.0	2.7	3.0	3.2
Interest Coverage Ratio	0.1	0.0	0.1	0.1	0.1
Gross Debt/EBIDTA	1.0	0.8	1.7	1.4	1.1
Per Share (Rs)					
FDEPS (adjusted)	26.4	32.7	14.8	17.9	22.4
CEPS	30.8	38.0	21.1	24.6	29.7
Book Value	154.0	168.5	175.0	191.7	210.7
Dividend	4.0	3.5	2.0	2.5	3.0
Dividend Payout (%)	18.2	12.8	16.2	16.7	16.0
Valuations (x) (Avg Mkt Cap)					
PER	32.5	22.4	37.1	37.1	29.6
P/BV	5.6	4.3	3.1	3.5	3.2
EV/EBIDTA	24.8	16.8	23.5	24.1	19.6
Dividend Yield (%)	0.6	0.6	0.4	0.5	0.5
5-yr Avg AOCF/EV yield(%)	2.2	3.5	4.5	3.6	3.6

Source: Company, Centrum Research Estimates

Exhibit 11: Balance Sheet

Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Share capital	2,407	2,399	2,399	2,399	2,399
Reserves & surplus	3,27,418	3,63,996	3,78,606	4,18,495	4,63,685
Total shareholders Funds	3,29,825	3,66,395	3,81,005	4,20,894	4,66,084
Total Debt	83,164	80,910	97,518	93,675	84,785
Minority interest	40,853	37,909	38,842	39,000	39,500
Deferred tax Liab.	(30,462)	(21,780)	(19,748)	(21,960)	(23,180)
Total Liabilities	4,23,380	4,63,435	4,97,617	5,31,609	5,67,189
Gross Block	1,95,390	2,29,299	2,51,845	2,58,850	2,70,250
Less: Acc. Depreciation	83,297	95,113	1,09,081	1,23,861	1,39,611
Net Block	1,12,093	1,34,186	1,42,764	1,34,989	1,30,639
Capital WIP	12,035	15,648	14,345	15,000	15,900
Net Fixed Assets	1,24,128	1,49,834	1,57,109	1,49,989	1,46,539
Investments	18,300	11,487	71,429	71,700	79,900
Inventory	64,225	68,328	68,807	83,650	85,300
Debtors	67,757	72,026	78,153	86,600	95,700
Loans & Advances	11,789	10,889	23,339	25,800	27,600
Cash & Bank Balance	1,31,816	1,51,408	99,294	1,06,867	1,18,137
Other assets	49,450	69,839	66,892	75,600	82,000
Total Current Assets	3,25,037	3,72,490	3,36,485	3,78,517	4,08,737
Trade payable	35,829	43,954	47,662	55,000	52,000
Other current Liabilities	15,910	29,514	20,670	19,100	19,950
Provisions	48,693	52,270	55,141	51,797	54,536
Net Current Assets	2,24,605	2,46,752	2,13,012	2,52,620	2,82,251
Total Assets	4,23,380	4,63,435	4,97,617	5,31,609	5,67,190

Source: Company, Centrum Research Estimates

Exhibit 12: Cash Flow

Y/E March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
CF before WC changes	65,038	99,792	52,620	56,868	70,018
Working Capital Changes	2,656	(2,555)	(18,374)	(32,035)	(18,361)
CF from Operations	67,694	97,237	34,246	24,833	51,658
Adj OCF (OCF-Interest)	69,803	97,237	34,246	24,833	51,658
Change in fixed assets	(33,119)	(37,522)	(21,243)	(7,660)	(12,300)
Adj. FCF (AOCF-Capex)	36,685	59,715	13,003	17,173	39,358
CF from Investing	(40,110)	(29,724)	(81,891)	(9,164)	(21,700)
CF from Financing	(19,243)	(15,282)	11,783	(10,882)	(17,026)
Net change in Cash	8,341	52,232	(35,861)	4,787	12,931

Source: Company, Centrum Research Estimates

Appendix A

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Sun Pharma price chart



Source: Bloomberg, Centrum Research

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Rating	Market cap < Rs20bn	Market cap > Rs20bn but < 100bn	Market cap > Rs100bn
Buy	Upside > 20%	Upside > 15%	Upside > 10%
Hold	Upside between -20% to +20%	Upside between -15% to +15%	Upside between -10% to +10%
Sell	Downside > 20%	Downside > 15%	Downside > 10%

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