

Sun Pharmaceuticals (SUNPHA)

₹ 458

Management tries to alleviate concerns...

The management of Sun Pharma conducted a conference call to address apprehension among investors after a recent publication by a brokerage regarding so called corporate governance issues and a complaint filed by a whistleblower with Sebi highlighting so called wrongdoings in the company. While the first issue was addressed with a case by case analysis, question marks remain over the whistleblower's complaint for want of management action plan as the management awaits Sebi correspondence. Following are the extracts of management explanations-

- **Subsidiary auditors (Valia and Timbadia) were allegedly involved in stock price rigging** – 20 years old matter. The firm audits some of the smaller subsidiaries (account for 0.6% of revenues in FY18)
- **Sudhir Valia owned Lakshdeep Investments** – It is a non-promoter company and has no material impact
- **Small firm Jermyn Capital appointed as manager for FCCBs** – 14-year old matter. JP Morgan Chase was lead and sole book runner while Jermyn Capital was just a co-manager
- **Loan to four individuals without security:** a very small loan was given > 20 years ago while the amount was already recovered
- **Insider trading involvement at the time of Ranbaxy acquisition** -- There was a technical issue as the company failed to notify about trading window closure on a holiday. Hence, Sebi fined the company and was duly settled
- **Bought share of Natco Pharma from Orange Mauritius:** The promoter bought Natco Pharma shares in personal capacity and provided appropriate disclosure at the time of purchase
- **Domestic business via related party (Aditya Medisales (AML):** It became a related party from FY18 due to consolidation of shareholding of investment companies, held by promoters. If required, the management is open to buying the distributor and discontinuing current arrangement to alleviate the concern
- **Loans to employees/others:** Total ₹ 2240 crore was invested in other pharma businesses. However, details were not provided
- **Suraksha Realty** – The company did not provide any guarantee
- **Lower tax rate** – Due to tax efficient measures and plants being in tax free zone
- **Whistleblower's complaint:** No query has come from Sebi as yet

"Corporate governance" overhang likely to overshadow fundamentals

While the first issue was addressed with a case by case analysis, question marks remain over the whistleblower's complaint for want of management action plan as the management awaits Sebi correspondence. Similarly, concerns regarding issues related to transactions with AML (related party distributor) and Loans and Advances to others (which witnessed a sharp spurt in FY18) are unlikely to settle down easily. These so-called CG issues are likely to weigh on the stock in the near to medium term, especially in a period where these issues are extensively scrutinised by investors. We reduce our multiple to 20x (from 28x). Hence, we arrive at our new target price of ₹ 460 based on 20x FY20E EPS of ₹ 21.1 and ₹ 38 NPV for Ilumnya.

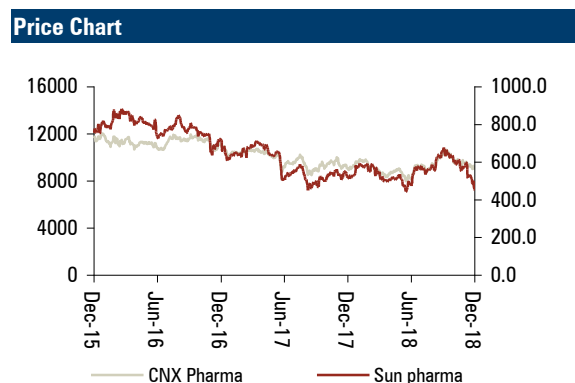
Rating matrix		
Rating	:	Hold
Target	:	₹ 460
Target Period	:	12-15 months
Potential Upside	:	0%

What's Changed?		
Target	Changed from ₹ 630 to ₹ 460	
EPS FY19E	Unchanged	
EPS FY20E	Unchanged	
Rating	Changed from Buy to Hold	

Key Financials				
(₹ Crore)	FY17	FY18	FY19E	FY20E
Net Sales	31578.4	26489.5	29336.9	33066.7
EBITDA	10089.3	5608.1	5983.6	7712.1
Adj. Profit	6964.4	3112.1	3520.0	5073.9
Adj. EPS (₹)	29.0	13.0	14.7	21.1

Valuation summary				
	FY17	FY18	FY19E	FY20E
PE (x)	15.8	22.2	47.7	21.7
EV to EBITDA (x)	10.3	11.9	17.3	13.1
Price to book (x)	3.0	3.5	2.7	2.5
RoNW (%)	19.0	18.0	8.8	11.5
RoCE (%)	20.3	18.6	10.2	13.3

Stock data	
Particular	Amount
Market Capitalisation	₹ 109946 crore
Debt (FY18)	₹ 9752 crore
Cash & Cash Equivalents (FY18)	₹ 21244 crore
EV (₹ Cr)	₹ 98454 crore
52 week H/L (₹)	679/435
Equity capital	₹ 239.9 crore
Face value	₹ 1



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Financial summary

Profit and loss statement					₹ Crore
(Year-end March)	FY17	FY18	FY19E	FY20E	
Revenues	31,578.4	26,489.5	29,336.9	33,066.7	
Growth (%)	10.6	-16.1	10.7	12.7	
Raw Material Expenses	8,130.7	7,424.7	8,265.3	8,928.0	
Employee Expenses	4,902.3	5,367.1	5,841.6	6,506.6	
Other Expenditure	8,456.1	8,089.6	9,246.4	9,920.0	
Total Operating Expenditure	21,489.2	20,881.3	23,353.3	25,354.6	
EBITDA	10,089.3	5,608.1	5,983.6	7,712.1	
Growth (%)	15.6	-44.4	6.7	28.9	
Depreciation	1,264.8	1,499.8	1,684.7	1,424.5	
Interest	399.8	517.6	519.5	444.4	
Other Income	623.2	838.8	1,030.3	1,126.2	
PBT	9,047.9	4,429.5	4,809.7	6,969.3	
Less: Exceptional Items	0.0	950.5	1,214.4	0.0	
Total Tax	1,211.6	845.2	780.5	1,254.5	
PAT	6,964.4	2,161.6	2,305.6	5,073.9	
Minority Interest	881.9	446.8	504.6	633.4	
Adjusted PAT	6,964.4	3,112.1	3,520.0	5,073.9	
Growth (%)	23.2	-55.3	13.1	44.1	
EPS (Adjusted)	29.0	13.0	14.7	21.1	

Source: Company, ICICI Direct Research

Cash flow statement					₹ Crore
(Year-end March)	FY17	FY18	FY19E	FY20E	
Profit/(Loss) after taxation	6964.4	2737.2	2305.6	5073.9	
Depreciation	1264.8	1499.8	1684.7	1424.5	
(Inc)/Dec in Current Assets	-1421.9	-893.3	1744.0	-1836.8	
(Inc)/Dec in Current Liabilities	453.3	681.0	-668.5	1016.7	
Others	-178.3	-117.6	519.5	444.4	
CF from operation	7082.2	3907.2	5585.4	6122.9	
Purchase of Fixed Assets	-3590.4	-1894.3	-1200.0	-1200.0	
(Inc)/Dec in Investments	-843.7	-5594.3	-2305.4	-2305.4	
Others	7044.9	-90.8	-56.8	32.7	
CF from Investing Activities	2610.8	-7579.4	-3562.2	-3472.7	
Inc / (Dec) in Loan Funds	837.1	-575.0	-366.5	-1000.0	
Inc / (Dec) in Equity Capital	-2730.8	0.0	0.0	0.0	
Dividend and dividend tax	-289.7	-960.5	-394.1	-867.3	
Other Financial Activities	-400.5	-3.8	-519.5	-444.4	
CF from Financing Activities	-2583.9	-1539.3	-1280.1	-2311.7	
Cash generation during the year	7109.2	-5211.5	743.1	338.5	
Op bal Cash & Cash equivalents	8031.7	15140.8	9929.4	10672.4	
Closing Cash/ Cash Equivalent	15140.8	9929.4	10672.4	11010.9	
Free Cash Flow	3491.8	2012.9	4385.4	4922.9	

Source: Company, ICICI Direct Research

Balance sheet					₹ Crore
(Year-end March)	FY17	FY18	FY19E	FY20E	
Equity Capital	239.9	239.9	239.9	239.9	
Reserve and Surplus	36,399.7	37,860.6	39,772.1	43,978.7	
Total Shareholders funds	36,639.7	38,100.6	40,012.0	44,218.7	
Total Debt	9,827.8	9,751.8	9,385.3	8,385.3	
Deferred Tax Liability	461.9	219.0	234.3	250.7	
Minority Interest	3,790.9	3,884.2	4,388.7	5,022.1	
Other LT Liabilities & LT Provision	1,341.8	462.7	495.1	529.8	
Total Liabilities	52,062.1	52,418.2	54,515.4	58,406.5	
Gross Block - Fixed Assets	22,154.5	21,342.1	22,542.1	23,742.1	
Accumulated Depreciation	10,015.5	8,096.2	9,780.9	11,205.4	
Net Block	12,138.9	13,245.9	12,761.2	12,536.7	
Capital WIP	2,801.4	2,465.2	2,465.2	2,465.2	
Total Fixed Assets	14,940.3	15,711.1	15,226.4	15,001.8	
Investments	1,191.9	7,142.9	9,448.3	11,753.7	
Deferred tax assets	5,617.8	2,193.8	2,347.3	2,511.7	
Goodwill on Consolidation	5,536.2	5,606.7	5,606.7	5,606.7	
LT Loans & Advances & Assets	1,401.2	6,103.1	6,530.3	6,987.4	
Cash	15,140.8	9,929.4	10,672.4	11,010.9	
Debtors	7,202.6	7,815.3	6,348.6	7,154.5	
Loans and Advances	1,019.1	91.4	97.8	104.7	
Inventory	6,832.8	6,880.7	6,398.9	7,211.1	
Other current assets	2,527.4	2,828.5	3,026.5	3,238.3	
Total Current Assets	32,722.8	27,545.3	26,544.3	28,719.5	
Creditors	4,395.4	4,766.2	3,571.1	4,024.4	
Provisions & other current liability	4,952.8	7,118.4	7,616.7	8,149.9	
Total Current Liabilities	9,348.2	11,884.6	11,187.8	12,174.3	
Net Current Assets	23,374.6	15,660.7	15,356.5	16,545.2	
Application of Funds	52,062.1	52,418.2	54,515.4	58,406.5	

Source: Company, ICICI Direct Research

Key ratios				
(Year-end March)	FY17	FY18	FY19E	FY20E
Per share data (₹)				
Adjusted EPS	29.0	13.0	14.7	21.1
BV per share	152.7	158.8	166.8	184.3
Dividend per share	1.2	2.0	1.6	3.6
Cash Per Share	63.1	41.4	44.5	45.9
Operating Ratios (%)				
Gross Margin	74.3	72.0	71.8	73.0
EBITDA Margin	31.9	21.2	20.4	23.3
PAT Margin	22.1	11.7	12.0	15.3
Inventory days	79.0	94.8	79.6	79.6
Debtor days	83.3	107.7	79.0	79.0
Creditor days	50.8	65.7	44.4	44.4
Asset Turnover	0.7	0.5	0.6	0.6
EBITDA Conversion rate	70.2	69.7	93.3	79.4
Return Ratios (%)				
RoE	19.0	8.2	8.8	11.5
RoCE	20.3	9.8	10.2	13.3
RoIC	31.2	12.2	12.7	17.3
Valuation Ratios (x)				
P/E	15.8	50.9	47.7	21.7
EV / EBITDA	10.3	18.8	17.3	13.1
EV / Net Sales	3.3	4.0	3.5	3.1
Market Cap / Sales	3.5	4.2	3.7	3.3
Price to Book Value	3.0	2.9	2.7	2.5
Solvency Ratios				
Debt / EBITDA	1.0	1.7	1.6	1.1
Debt / Equity	0.3	0.3	0.2	0.2
Current Ratio	1.9	1.5	1.4	1.5

Source: Company, ICICI Direct Research

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