

Compelling valuations

We maintain BUY on SUNP following a miss to our estimates owing to a one-off. Our TP is revised to Rs 600/sh (22x FY21E EPS + Rs 40/sh for specialty). Hopes are hinged on a ramp up in specialty business.

HIGHLIGHTS OF THE QUARTER

- Revenue growth was muted during the quarter due to a one-time impact of Rs 11bn on domestic sales with the shift to direct distribution (from AML earlier). Adjusting for this, sales would stand at Rs 85bn (+18/7% YoY/QoQ).
- India sales at Rs 11bn were down 44% YoY. Adjusting for the one-off, sales grew 11% YoY. The co launched 4 new products during the quarter and continues to hold the highest market share in IPM (~8.2%). We expect the co to grow at 9-10% CAGR over FY19-21E driven by its strong branded franchise. The impact of change in distributor has been borne and won't persist.
- US sales at US\$ 443mn grew 22% QoQ boosted by a new contract for certain generics as well as traction gained in Taro. With the new DTC marketing ongoing for Ilumya and field force ready for Cequa's launch (2QFY20), the mgmt. is confident in ramping up its specialty segment consistently over the next few years. We expect the segment to breakeven by FY22E.

Financial Summary (Consolidated)

(Rs mn)	4QFY19	4QFY18	YoY (%)	3QFY19	QoQ (%)	FY18	FY19P	FY20E	FY21E
Net Sales	71,639	69,771	2.7	77,402	(7.4)	264,895	290,659	332,698	370,741
EBITDA	10,168	16,835	(39.6)	18,433	(44.8)	56,081	59,980	75,589	89,891
APAT	6,359	13,090	(51.4)	9,322	(31.8)	30,462	35,702	45,953	61,140
Diluted Adj EPS (Rs)	2.7	5.5	(51.4)	3.9	(31.8)	12.7	14.9	19.2	25.5
P/E (x)						32.5	27.8	21.6	16.2
RoE (%)						8.2	9.0	10.6	12.8

Source: Company, HDFC sec Inst Research

Expenditure on front-end will remain unabsorbed until then, thereby denting overall profitability.

- EBITDA was at Rs 10.2bn with margin at 14.2% (-994/962bps YoY/QoQ). The one-time hit on sales due to change in distributor impacted profitability severely during 4Q. PAT stood at Rs 6.4bn (-51/32% YoY/QoQ).
- Near-term outlook:** Expect the stock to recover.

STANCE

SUNP is likely to be in an investment phase for its US specialty business over FY20, with 7-8 products in the US, slow ramp up and heightened promotional spend (300-400bps margin impact). Meanwhile, the growth in the domestic biz is expected to return to double-digits while the co is also initiating cost control measures to improve margins. We model a 13% revenue CAGR and ~350bps margin expansion to ~24% EBITDA margin over FY19-21E, resulting in PAT growth of 31% over the period. The stock has taken a beating following recently resurfaced corporate governance issues and is trading at 16x FY21E EPS. However, the mgmt has addressed all investor concerns and taken corrective actions for the same. Return of investor confidence and ramp up in specialty will drive re-rating of the stock.

INDUSTRY	PHARMA
CMP (as on 28 May 2019)	Rs 413
Target Price	Rs 600
Nifty	11,929
Sensex	39,750
KEY STOCK DATA	
Bloomberg	SUNP IN
No. of Shares (mn)	2,399
MCap (Rs bn) / (\$ mn)	991/14,222
6m avg traded value (Rs mn)	5,023
STOCK PERFORMANCE (%)	
52 Week high / low	Rs 679/345
	3M 6M 12M
Absolute (%)	(7.2) (15.0) (17.4)
Relative (%)	(18.1) (26.3) (30.4)
SHAREHOLDING PATTERN (%)	
	Dec-18 Mar-19
Promoters	54.38 54.38
FIs & Local MFs	17.65 17.32
FPIs	14.88 15.54
Public & Others	13.09 12.76
Pledged Shares*	4.10 5.97
Source : BSE, % of total	

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Adjusted for the one-time impact of Rs 11bn due to a change in distributor for the domestic business, revenue grew 18% YoY

Employee cost is higher due to field force for the specialty business in the US and consolidation of Pola Pharma entity

The exceptional item in 3Q pertains to forex gains (~4% of sales)

The management has guided for double-digit top-line growth in FY20E, and for capex of ~Rs 14bn

Net cash stood at Rs 13bn (v/s Rs 43bn YoY) owing to a dividend payout of US\$ 500mn by Taro

Quarterly Financials Snapshot (Consolidated)

Particulars (Rs mn)	4QFY19	4QFY18	YoY (%)	3QFY19	QoQ (%)
Net Sales	71,639	69,771	2.7	77,402	(7.4)
Material Expenses	18,388	17,701	3.9	21,657	(15.1)
Employee Expenses	15,688	13,413	17.0	14,950	4.9
R&D Expenses	5,670	6,155	(7.9)	4,515	25.6
Other Operating Expenses	21,726	15,668	38.7	17,847	21.7
EBITDA	10,168	16,835	(39.6)	18,433	(44.8)
Depreciation	4,541	4,552		4,711	
EBIT	5,627	12,283	(54.2)	13,722	(59.0)
Other Income	2,815	3,028	(7.0)	1,931	
Interest Cost	1,500	1,554		1,448	
Exceptional item	-	-		3,096	
PBT	6,942	13,756	(49.5)	17,301	(59.9)
Tax	(288)	(1,767)		2,709	
Minority Interest + Share of profit/loss of Asso.	(872)	(2,434)		(2,173)	
RPAT	6,359	13,090	(51.4)	12,419	(48.8)
EO Items (Adj For Tax)	-	-		(3,096)	
APAT	6,359	13,090	(51.4)	9,322	(31.8)

Source: Company, HDFC sec Inst Research

Margin Analysis

	4QFY19	4QFY18	YoY (bps)	3QFY19	QoQ (bps)
Material Expenses % Net Sales	25.7	25.4	30	28.0	(231)
Employee Expenses % Net Sales	21.9	19.2	267	19.3	258
R&D Expenses % Net Sales	7.9	8.8	(91)	5.8	208
Other Operating Expenses % Net Sales	30.3	22.5	787	23.1	727
EBITDA Margin (%)	14.2	24.1	(994)	23.8	(962)
Tax Rate (%)	(4.1)	(12.8)	869	6.1	(1024)
APAT Margin (%)	8.9	18.8	(988)	12.0	(317)

Source: Company, HDFC sec Inst Research

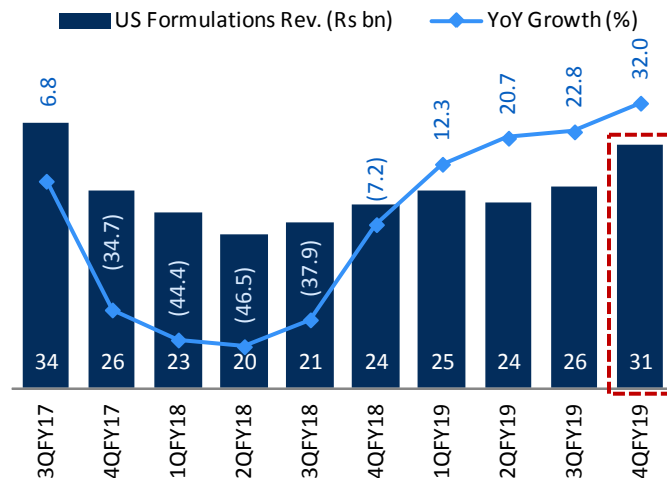
Growth in the US was driven by a new 6 month contract for generics. Supplies could extend beyond 6 months as well

Adjusting for the one-time distribution impact, domestic sales grew 11% YoY during the quarter, driven by the chronic portfolio

The nosedive in EBITDA margin was owing to the one-time impact of change in distribution to the top-line. The co doesn't expect any further impact from this going ahead

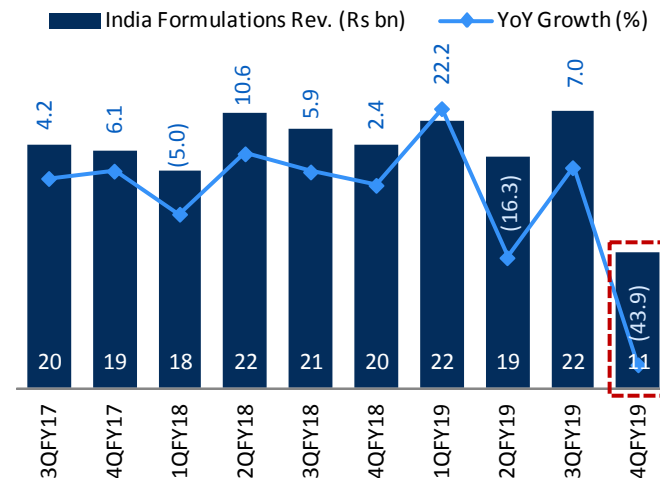
R&D will scale up on the back of specialty and differentiated products. Expect it to remain in the range of 8-9% of sales

US Business: Strong Ramp Up



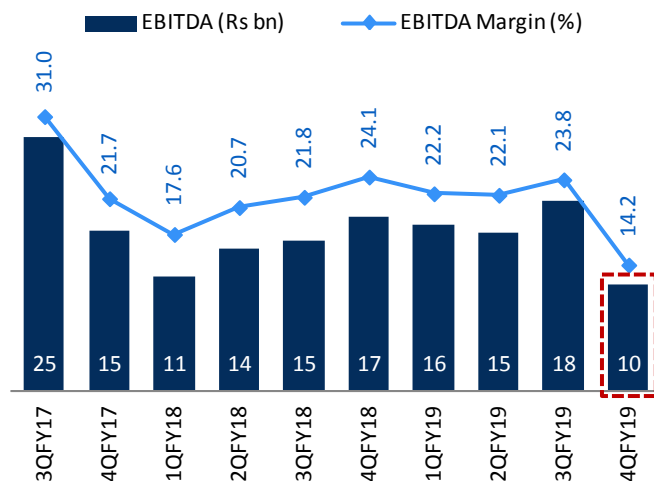
Source: Company, HDFC sec Inst Research

India Business: Impacted By Change In Distributor



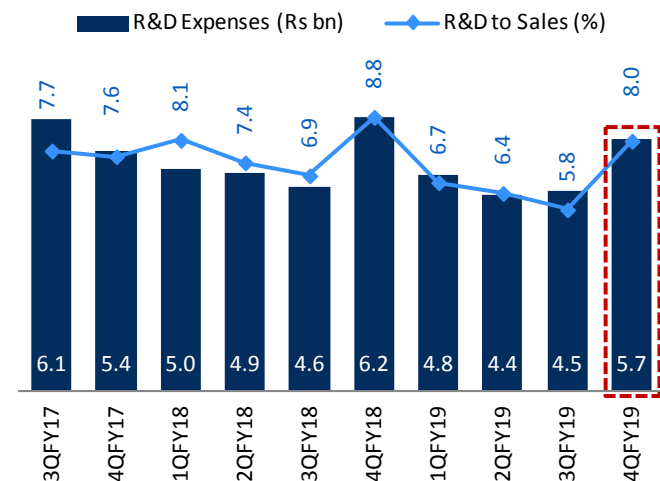
Source: Company, HDFC sec Inst Research

EBITDA Margin: Nosedive Due To One-off Impact



Source: Company, HDFC sec Inst Research

R&D: Focus On Specialty Continues



Source: Company, HDFC sec Inst Research

The co remains in investment phase for its US specialty segment. With the Illumina DTC campaign, Sun expects ramp up in the product to continue. Cequa will be launched in CY19, while Xelpros won't be a blockbuster in US. The co has achieved 10.5% market share in Odomzo

Sun doesn't expect the change in distributor to have an impact on domestic sales going ahead. The co has leading presence in 11 therapies and has 8 inlicensed products which are growing faster than the overall top-line

EM was down during the quarter due to de-growth in South Africa. Japan sales grew as Pola Pharma got consolidated with the co during 4Q

Segmental Quarterly Performance

(Rs mn)	4QFY19	4QFY18	YoY (%)	3QFY19	QoQ (%)
India	11,010	19,626	(43.9)	22,303	(50.6)
USA	31,311	23,716	32.0	26,078	20.1
RoW	23,042	20,230	13.9	23,629	(2.5)
API	4,840	3,324	45.6	4,260	13.6
Other	239	213	11.9	296	(19.4)
Total	70,442	67,109	5.0	76,567	(8.0)

Source: HDFC sec Inst Research

Assumptions

Key Segments (Rs mn)	FY17	FY18	FY19P	FY20E	FY21E
India	77,491	80,293	73,480	90,339	99,523
Growth (%)	6.4	3.6	(8.5)	22.9	10.2
USA	137,588	87,466	106,789	118,074	130,101
Growth (%)	0.0	(36.4)	22.1	10.6	10.2
RoW	71,131	78,132	88,245	97,097	111,856
Growth (%)	23.0	9.8	12.9	10.0	15.2
API	13,609	13,993	17,300	18,689	20,761
Growth (%)	(3.0)	2.8	23.6	8.0	11.1
Other	750	775	1,050	1,000	1,000
Total	300,568	260,659	286,864	325,198	363,241
Growth (%)	6.2	(13.3)	10.1	13.4	11.7

Source: HDFC sec Inst Research

Peer Set Comparison

	Mcap (Rs bn)	CMP (Rs/sh)	Reco	TP/FV	Adj EPS (Rs/sh)				P/E (x)				RoE (%)			
					FY18	FY19P	FY20E	FY21E	FY18	FY19P	FY20E	FY21E	FY18	FY19P	FY20E	FY21E
Sun Pharma	991	413	BUY	600	12.7	14.9	19.2	25.5	32.5	27.8	21.6	16.2	8.2	9.0	10.6	12.8
Cipla	465	578	BUY	625	18.6	19.1	21.1	28.4	31.1	30.3	27.3	20.3	11.2	10.5	10.7	12.9
Dr Reddy's Labs	440	2,652	BUY	3,320	59.2	104.9	125.8	147.0	44.8	25.3	21.1	18.0	7.8	13.1	13.9	14.1
Divi's Labs	429	1,618	SELL	1,445	32.4	48.8	56.7	65.6	50.0	33.2	28.6	24.7	15.2	20.1	20.4	20.8
Aurobindo Pharma	395	675	NEU	800	41.4	42.2	54.1	53.2	16.3	16.0	12.5	12.7	23.0	19.2	20.4	16.8
Lupin	336	744	BUY	930	38.2	16.4	27.3	42.1	19.5	45.2	27.3	17.7	12.8	5.4	8.7	12.3
Cadila Healthcare	264	258	NEU	315	13.0	11.0	13.2	17.7	19.9	23.5	19.5	14.6	17.0	11.9	12.6	14.9
Torrent Pharma	258	1,526	NEU	1,745	37.0	40.1	52.9	72.8	41.3	38.0	28.8	21.0	14.0	14.5	17.7	20.9
Alkem Laboratories	207	1,730	BUY	2,240	57.6	63.4	80.9	101.9	30.0	27.3	21.4	17.0	14.8	14.7	16.6	18.3
Abbott India	164	7,697	NR	8,950	188.8	211.9	248.6	299.6	40.8	36.3	31.0	25.7	26.1	24.3	24.1	24.5
Glenmark	157	557	BUY	835	17.5	27.0	33.9	43.7	31.9	20.7	16.4	12.8	9.4	12.7	14.0	15.7
Alembic Pharma	100	533	NEU	570	21.9	25.8	25.1	31.6	24.3	20.6	21.2	16.9	20.0	19.7	16.4	18.1
Jubilant Life Sciences	82	512	BUY	1,005	45.5	53.8	60.2	76.2	11.2	9.5	8.5	6.7	19.3	19.3	18.3	19.6
Dishman Carbogen Amcis	40	245	BUY	400	13.2	16.7	20.5	26.5	18.6	14.7	12.0	9.3	14.6	15.4	15.7	17.2
Strides Pharma	38	429	BUY	570	13.2	6.9	29.3	35.7	32.6	62.4	14.6	12.0	2.9	2.3	9.5	10.7
Laurus Labs	38	360	BUY	535	15.8	10.7	17.0	29.4	22.7	33.6	21.1	12.2	11.9	6.2	10.8	16.7
Suven Life Sciences	34	266	NR	465	9.7	6.8	9.1	10.7	27.4	39.0	29.3	24.8	17.2	10.9	13.2	13.9
J B Chemicals & Pharmaceuticals	31	384	NR	470	16.6	24.1	28.8	34.6	23.2	15.9	13.3	11.1	9.9	13.3	14.7	15.6
Granules India	29	115	BUY	170	5.2	9.3	11.4	13.9	22.0	12.3	10.1	8.2	12.0	16.7	17.5	18.5
Neuland Labs	8	622	BUY	920	10.8	12.8	32.1	65.8	57.5	48.5	19.4	9.5	2.2	2.6	5.7	10.9

Source: HDFC sec Inst Research

Change In Estimates (Consolidated)

Rs mn	Previous			New			% Chg		
	FY19P	FY20E	FY21E	FY19P	FY20E	FY21E	FY19P	FY20E	FY21E
Net Sales	293,368	335,564	377,242	290,659	332,698	370,741	(0.9)	(0.9)	(1.7)
EBITDA	65,818	81,591	96,713	59,980	75,589	89,891	(8.9)	(7.4)	(7.1)
APAT	36,639	49,685	65,343	35,702	45,953	61,140	(2.6)	(7.5)	(6.4)

Source: HDFC sec Inst Research

Income Statement (Consolidated)

Year ending March (Rs mn)	FY17	FY18	FY19P	FY20E	FY21E
Net Revenues	315,784	264,895	290,659	332,698	370,741
Growth (%)	10.9	(16.1)	9.7	14.5	11.4
Material Expenses	81,307	74,247	78,690	89,430	98,075
Employee Expenses	49,023	53,671	59,671	64,876	68,958
SG&A Expenses	29,210	25,430	29,647	33,270	37,074
Other Operating Expenses	55,351	55,466	62,671	69,534	76,743
EBITDA	100,893	56,081	59,980	75,589	89,891
EBITDA Margin (%)	31.9	21.2	20.6	22.7	24.2
EBITDA Growth (%)	23.7	(44.4)	7.0	26.0	18.9
Depreciation	12,648	14,998	17,533	18,716	19,474
EBIT	88,245	41,083	42,447	56,873	70,417
Other Income (Including EO Items)	6,232	4,013	1,207	7,750	9,500
Interest	3,998	5,176	5,553	4,500	3,500
PBT	90,479	39,920	38,102	60,123	76,417
Tax (Incl Deferred)	12,116	14,241	6,009	9,620	12,227
Minority Interest	(8,719)	(4,722)	(5,439)	(4,550)	(3,050)
RPAT	69,644	20,957	26,654	45,953	61,140
EO (Loss) / Profit (Net Of Tax)	7,316	(9,505)	(9,048)	-	-
APAT	62,327	30,462	35,702	45,953	61,140
APAT Growth (%)	37.4	-51.1	17.2	28.7	33.0
Adjusted EPS (Rs)	26.0	12.7	14.9	19.2	25.5

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

As at March (Rs mn)	FY17	FY18	FY19P	FY20E	FY21E
SOURCES OF FUNDS					
Share Capital - Equity	2,399	2,399	2,399	2,399	2,399
Reserves	363,997	378,606	411,691	449,925	503,346
Total Shareholders Funds	366,397	381,006	414,091	452,324	505,745
Minority Interest	37,909	38,842	33,135	37,685	40,735
Long Term Debt	14,361	17,721	15,226	12,181	9,745
Short Term Debt	66,549	79,797	83,708	66,966	53,573
Total Debt	80,910	97,518	98,934	79,147	63,318
Net Deferred Taxes	(21,780)	(19,748)	(24,506)	(24,506)	(24,506)
Other Non-current Liabilities & Provns	13,418	4,045	4,304	4,627	5,089
TOTAL SOURCES OF FUNDS	476,853	501,662	525,958	549,277	590,381
APPLICATION OF FUNDS					
Net Block	84,953	91,590	100,274	96,355	96,716
CWIP	19,619	17,676	13,468	19,990	20,061
Goodwill	104,165	107,243	123,095	122,298	121,463
Investments	9,610	30,523	39,518	39,518	39,518
Other Non-current Assets	41,291	57,699	34,343	30,508	28,051
Total Non-current Assets	259,638	304,731	310,698	308,669	305,810
Cash & Equivalents	153,717	140,200	112,263	140,265	173,058
Inventories	68,328	68,807	78,860	80,854	88,671
Debtors	72,026	78,153	88,842	91,150	101,573
Other Current Assets	35,465	29,199	30,727	31,597	35,287
Total Current Assets	175,819	176,159	198,429	203,601	225,531
Creditors	43,954	47,662	41,479	44,715	49,038
Other Current Liabilities & Provns	68,367	71,767	53,953	58,543	64,980
Total Current Liabilities	112,321	119,429	95,432	103,258	114,017
Net Current Assets	63,498	56,730	102,997	100,343	111,513
TOTAL APPLICATION OF FUNDS	476,853	501,662	525,958	549,277	590,381

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March (Rs mn)	FY17	FY18	FY19P	FY20E	FY21E
Reported PBT	90,479	34,790	38,102	60,123	76,417
Non-operating & EO items	(11,849)	(5,653)	(8,500)	(9,500)	(9,500)
Interest expenses	3,998	5,176	5,553	4,500	3,500
Depreciation	12,648	14,998	17,533	18,716	19,474
Working Capital Change	(4,092)	(2,123)	(23,679)	6,181	(8,821)
Tax Paid	(20,571)	(7,417)	(10,767)	(9,620)	(12,227)
OPERATING CASH FLOW (a)	70,612	39,771	18,241	70,400	68,843
Capex	(35,904)	(18,943)	(46,786)	(19,892)	(18,500)
Free cash flow (FCF)	34,708	20,828	(28,544)	50,508	50,343
Investments	(10,108)	(19,386)	(7,597)	-	-
Non-operating Income	3,796	5,475	(9,596)	9,500	9,500
INVESTING CASH FLOW (b)	(42,216)	(32,853)	(63,978)	(10,392)	(9,000)
Debt Issuance/(Repaid)	10,721	5,876	1,401	(19,787)	(15,829)
Interest Expenses	(3,338)	(4,765)	(5,553)	(4,500)	(3,500)
FCFE	42,091	21,939	(32,696)	26,221	31,013
Share Capital Issuance	(27,317)	(6,898)	(11,145)	0	0
Dividend	(2,889)	(9,605)	(7,720)	(7,720)	(7,720)
Others	(385)	(1,626)	3,005	0	0
FINANCING CASH FLOW (c)	(23,208)	(17,018)	(20,011)	(32,006)	(27,049)
NET CASH FLOW (a+b+c)	5,187	(10,101)	(65,748)	28,002	32,794
Add Equivalents (As At Year End)	2,309	40,906	85,204	39,507	39,507
Closing Cash & Equivalents	139,313	182,214	118,750	140,265	173,058

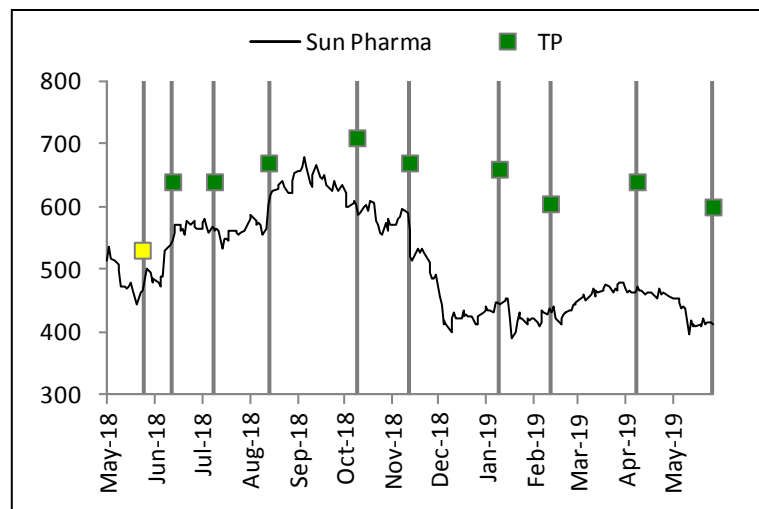
Source: Company, HDFC sec Inst Research

Key Ratios

	FY17	FY18	FY19P	FY20E	FY21E
PROFITABILITY (%)					
GPM	74.3	72.0	72.9	73.1	73.5
EBITDA Margin	31.9	21.2	20.6	22.7	24.2
APAT Margin	19.7	11.5	12.3	13.8	16.5
RoE	17.9	8.2	9.0	10.6	12.8
RoIC (or Core RoCE)	28.4	9.7	11.7	14.1	17.2
RoCE	14.3	6.9	7.9	9.3	11.2
EFFICIENCY					
Tax Rate (%)	13.4	35.7	15.8	16.0	16.0
Fixed Asset Turnover (x)	2.4	1.8	1.7	1.8	1.9
Inventory (days)	79.0	94.8	99.0	88.7	87.3
Debtors (days)	83.3	107.7	111.6	100.0	100.0
Other Current Assets (days)	41.0	40.2	38.6	34.7	34.7
Payables (days)	50.8	65.7	52.1	49.1	48.3
Other Current Liab & Provns (days)	79.0	98.9	67.8	64.2	64.0
Cash Conversion Cycle (days)	73.4	78.2	129.3	110.1	109.8
Debt/EBITDA (x)	0.8	1.7	1.6	1.0	0.7
Net D/E (x)	(0.2)	(0.1)	(0.0)	(0.1)	(0.2)
Interest Coverage (x)	22.1	7.9	7.6	12.6	20.1
PER SHARE DATA (Rs)					
EPS	26.0	12.7	14.9	19.2	25.5
Dividend	3.5	2.0	2.8	2.8	2.8
Book Value	152.7	158.8	172.6	188.5	210.8
VALUATION					
P/E (x)	15.9	32.5	27.8	21.6	16.2
P/BV (x)	2.7	2.6	2.4	2.2	2.0
EV/EBITDA (x)	9.1	16.9	16.3	12.3	9.8
EV/Revenues (x)	2.9	3.6	3.4	2.8	2.4
OCF/EV (%)	7.7	4.2	1.9	7.6	0.0
FCF/EV (%)	3.8	2.2	(2.9)	5.4	5.7
FCFE/Mkt Cap (%)	4.2	2.2	(3.3)	2.6	3.1
Dividend Yield (%)	0.8	0.5	0.7	0.7	0.7

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
27-May-18	466	NEU	530
13-Jun-18	540	BUY	640
10-Jul-18	569	BUY	640
16-Aug-18	602	BUY	670
10-Oct-18	604	BUY	710
14-Nov-18	562	BUY	670
10-Jan-19	445	BUY	660
13-Feb-19	437	BUY	605
9-Apr-19	471	BUY	640
29-May-19	413	BUY	600

Rating Definitions

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