

Sector: Pharmaceuticals  
Result Update

	Change
Reco: <b>Hold</b>	↔
CMP: <b>Rs. 438</b>	
Price Target: <b>Rs. 500</b>	↑

↑ Upgrade ↔ No change ↓ Downgrade

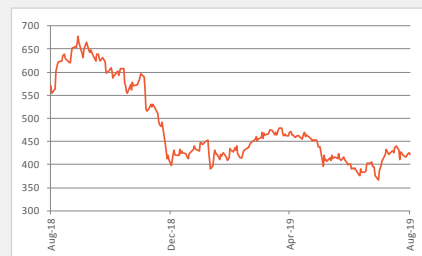
## Company details

Market cap:	Rs. 105,089 cr
52-week high/low:	Rs. 679 / 350
NSE volume: (No of shares)	67.8 lakh
BSE code:	524715
NSE code:	SUNPHARMA
Sharekhan code:	SUNPHARMA
Free float: (No of shares)	109.5 cr

## Shareholding (%)

Promoters	54.4
FII	15.3
DII	18.0
Others	12.3

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	9.2	-3.9	-2.1	-25.9
Relative to Sensex	12.2	-4.7	-5.6	-26.0

Sharekhan Research, Bloomberg

Sun Pharmaceuticals Limited (Sun Pharma) reported strong quarterly performance. Sales for the quarter reported strong 15.9% y-o-y growth to Rs. 8,374.4 crore (10.5% above our estimate). Gross margin for the quarter stood at 70.7%. Operating profit grew by 13.7% y-o-y to Rs. 1,928.2 crore (17.5% above our estimate). Operating profit margin (OPM) for the quarter stood at 23% (137 BPS above our estimate). R&D spend for the quarter was Rs. 422 crore (5.1% of sales). Reported profit for the quarter grew by 31.4% y-o-y to Rs. 1,387.5 crore (21.5% above our estimate). Low interest cost (due to reduction in debt) along with low tax rate aided profitability growth. Moreover, the company reported Rs. 67.38 crore of forex gain vs. loss of Rs. 89.9 crore in Q1FY2019. Strong growth in geographies such as RoW, U.S. and India drove sales growth. Management is confident of achieving double-digit sales growth for FY2020. The company has planned launch of Cequa in Q3FY2020, impact of which shall be visible significantly from FY2021.

## Key positives

- ♦ OPM of 23% was better than expectation.
- ♦ Management maintains double-digit business growth for FY2020.
- ♦ Specialty drug, Cequa launch planned for Q3FY2020.
- ♦ Debt reduction led to a decline in interest cost for the quarter.

## Key negatives

- ♦ Increased R&D spend and overall tax rate in the upcoming quarters could impact profitability.

## Our Call

## Valuation - Maintain Hold with an upward revised PT of Rs. 500

The stock has corrected by almost 35%+ from its high and is currently trading at 14.2x its FY2021E earnings. We expect the company to report sales and profit CAGR of 20% and 38%, respectively, over the next two years. Although the quarter's performance was better than expectation, the company still faces pending litigation case in the U.S. for pricing collusion. We feel FY2020 will reflect full impact of increased cost structure (on account of speciality pipeline build up); and from FY2021 due to new launches, OPM could see significant improvement. Although valuation seems reasonable, we would like to monitor the sustainability of Q1 performance before taking a constructive view to upgrade the stock rating. We maintain our earnings estimates for FY2020E and FY2021E. We also maintain our Hold rating on the stock. However, we have revised the PT upward to Rs. 500.

## Key Risks

1) Regulatory compliance risk; 2) Delay in product approvals; 3) Currency risk; 4) Worsening of corporate governance issues; and 5) Negative outcome of ongoing litigations in the U.S. with regard to price collusion (DOJ investigation and 44 State Coalition).

## Valuation (Consolidated)

Particulars	Rs cr			
	FY2018	FY2019	FY2020E	FY2021E
Net sales	26488.8	29065.9	34051.2	41841.8
OPM (%)	21.2%	21.7%	24.0%	26.0%
Adj. PAT	3111.4	3879.8	5428.7	7375.1
EPS (Rs.)	13.0	16.2	22.6	30.7
PER (x)	33.8	27.1	19.4	14.2
EV/EBITDA (x)	19.0	17.2	11.8	8.2
D: E	0.29	0.26	0.24	0.21
ROCE (%)	9.2	10.0	12.5	15.4
RONW (%)	8.1	9.4	11.7	13.9

Source: Company, Sharekhan Estimates

**FY2020 product launches to pick pace in FY2021:** Management stated that Ilumya has started gaining traction and Ceqa launch is expected in Q3FY2020. All costs related to marketing of Ceqa are already being reflected into current numbers. Hence, upon the launch of the product and post its ramp up, we will see improvement in OPM and profitability. Currently, for the quarter, global speciality product sales stood at \$94 million.

**Guidance maintained:** Management guidance for FY2020 is as follows: 1) Sales to grow in low-to-mid digit teens (on reported FY2019 sales numbers); 2) Capex to be \$200 million for FY2020; and 3) Tax rate to increase progressively in the upcoming years. With better product mix and cost-control measures, management expects margin expansion over the next two years.

Results					Rs cr
Particulars	Q1FY2020	Q1FY2019	YoY %	Q4FY2019	QoQ %
Total sales	8,374.4	7,224.2	15.9	7,163.9	16.9
Expenditure	6,446.1	5,527.6	16.6	6,095.1	5.8
Operating profit	1,928.2	1,696.6	13.7	1,068.8	80.4
Other Income	213.0	199.8	6.6	281.5	-24.3
EBITDA	2,141.3	1,896.4	12.9	1,350.3	58.6
Interest	104.1	130.9	-20.5	150.0	-30.6
Depreciation	457.1	401.6	13.8	454.1	0.7
PBT	1,580.1	1,363.8	15.9	746.2	111.7
Taxes	146.1	89.1	64.0	-28.8	-607.0
Adjusted PAT	1,434.0	1,274.7	12.5	775.1	85.0
MI + OCI + Excep. Item	46.5	218.5		139.2	
Reported PAT	1,387.5	1,056.3	31.4	635.9	118.2
EPS (Rs.)	5.8	4.4		2.6	
<b>Margins</b>			<b>BPS</b>		<b>BPS</b>
OPM %	23.0	23.5	-46	14.9	811
EBIDTA %	25.6	26.3	-68	18.8	672
PATM %	16.6	14.6	195	8.9	769
Tax rate %	9.2	6.5	271	-3.9	1310

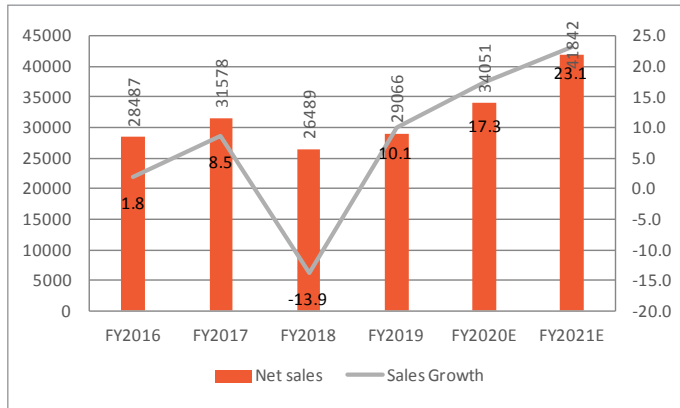
Source: Company; Sharekhan Research

Geographical Sales Break-Up – Quarterly					Rs cr
Revenue break-up	Q1FY2020	Q1FY2019	YoY %	Q4FY2019	QoQ %
<b>Formulations</b>	<b>7768.8</b>	<b>6722.2</b>	<b>15.6</b>	<b>6523.1</b>	<b>19.1</b>
India	2313.7	2152.0	7.5	1101.3	110.1
U.S.	2947.4	2543.7	15.9	3123.8	-5.6
Emerging Market	1348.6	1308.7	3.0	1219.9	10.5
ROW	1159.1	717.8	61.5	1078.0	7.5
API	461.2	394.2	17.0	483.7	-4.7
Others	29.3	22.5	30.4	37.4	-21.6
<b>Total</b>	<b>8259.3</b>	<b>7138.8</b>	<b>15.7</b>	<b>7044.3</b>	<b>17.2</b>
<b>Other Op Inc</b>	<b>115.1</b>	<b>85.3</b>	<b>34.8</b>	<b>119.7</b>	<b>-3.8</b>
<b>Total Sales</b>	<b>8374.4</b>	<b>7224.2</b>	<b>15.9</b>	<b>7163.9</b>	<b>16.9</b>

Source: Company; Sharekhan Research, Industry Reports

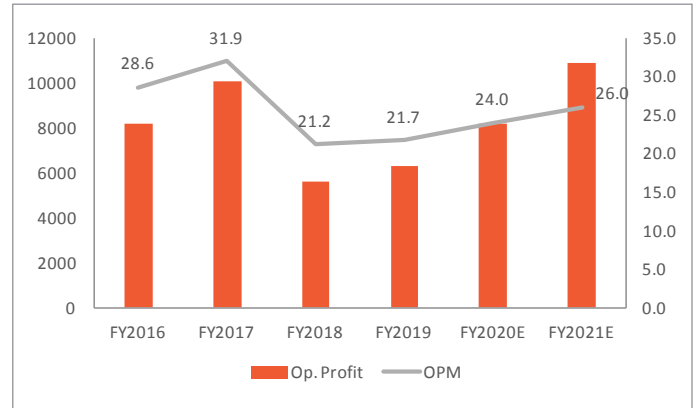
## Financials in charts

### Sales and Sales Growth



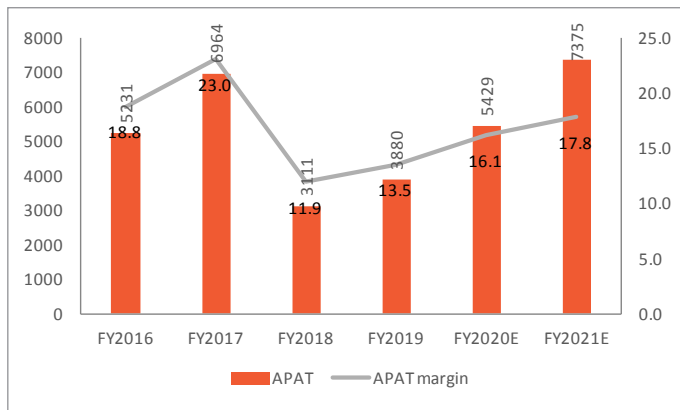
Source: Company, Sharekhan Research

### Operating Profit and OPM - Improving



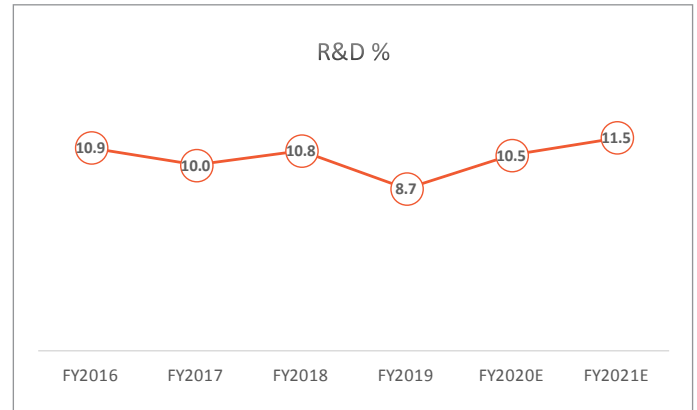
Source: Company, Sharekhan Research

### APAT and APAT Margin - Improving



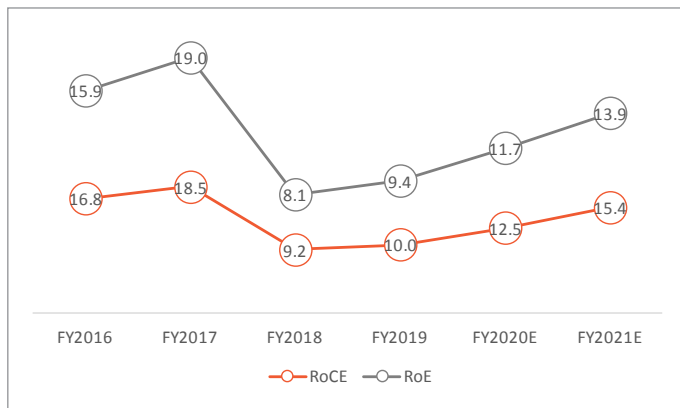
Source: Company, Sharekhan Research

### R&D Spend - Increasing



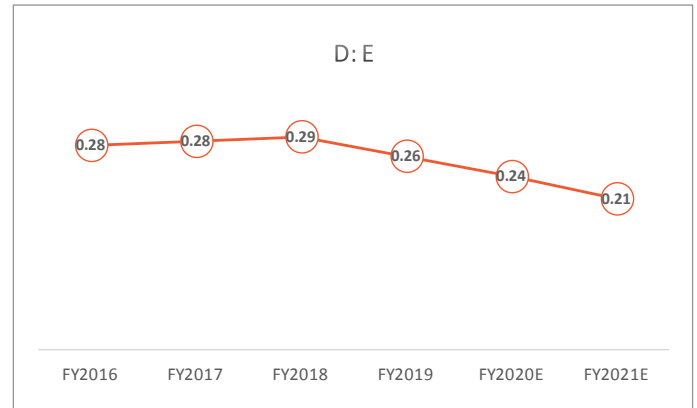
Source: Company, Sharekhan Research

### Return Ratios - Improving



Source: Company, Sharekhan Research

### Debt: Equity Ratio - Declining



Source: Company, Sharekhan Research

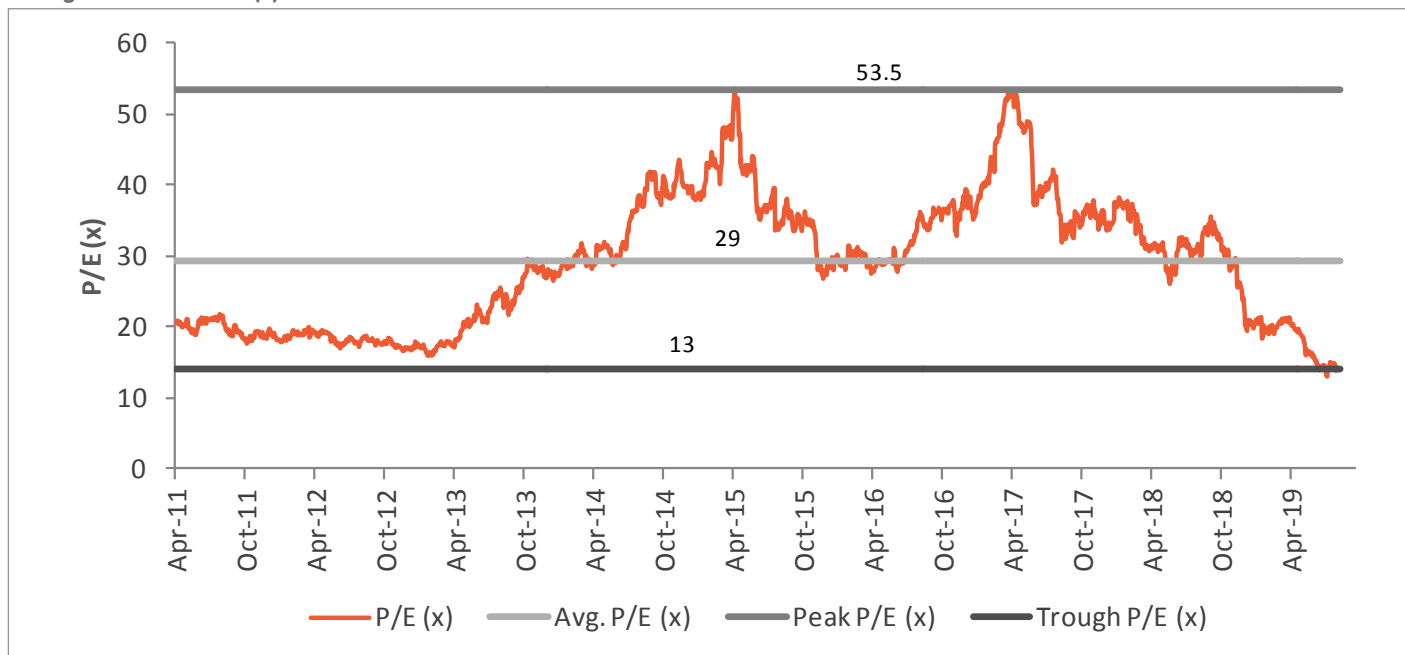
## Outlook

The company is favourably progressing in its efforts of building a global speciality portfolio, which should start delivering from FY2021 and reduce Sun Pharma's dependence on limited competition assets in the U.S. for its earnings. Moreover, improvement in OPM and in-turn profitability will also be visible from FY2021E. We believe FY2020 should show a peak in spending on U.S. specialty development and marketing. Additionally, we expect growth to normalise in its base business, especially India business (after internal restructuring).

## Valuation - Maintain Hold with an upward revised PT of Rs. 500

The stock has corrected by almost 35%+ from its high and is currently trading at 14.2x its FY2021E earnings. We expect the company to report a sales and profit CAGR of 20% and 38%, respectively, over the next two years. Although the quarter's performance was better than expectation, the company still faces pending litigation case in the U.S. for pricing collusion. We feel FY2020 will reflect full impact of increased cost structure (on account of speciality pipeline build-up); and from FY2021 due to new launches, OPM could see significant improvement. Although valuation seems reasonable, we would like to monitor the sustainability of Q1 performance before taking a constructive view to upgrade the stock rating. We maintain our earnings estimates for FY2020E and FY2021E. We also maintain our Hold rating on the stock. However, we have revised out PT to Rs. 500.

One-year forward P/E (x) band



Source: Sharekhan Research

## Peer Comparison

Particulars	P/E (x)		EV/EBIDTA (x)		RoE (%)		D: E	
	FY2020E	FY2021E	FY2020E	FY2021E	FY2020E	FY2021E	FY2020E	FY2021E
Aurobindo	11.0	9.4	7.2	6.3	20.7	19.8	0.50	0.40
Cadila	12.2	10.7	9.2	7.9	15.8	15.8	0.66	0.58
Cipla	18.4	13.2	10.9	7.9	12.8	15.4	0.25	0.18
Lupin	26.6	21.3	9.9	8.0	7.2	8.2	0.54	0.48
Sun Pharma	19.4	14.2	11.8	8.2	11.7	13.9	0.24	0.21
Torrent Pharma	27.8	17.4	14.7	10.9	19.5	25.3	0.95	0.61

Source: Sharekhan Research

## About company

Sun Pharma is the fourth largest speciality generic pharmaceutical company in the world. Founded in 1983, Sun Pharma has grown to become India's largest pharmaceutical company with global revenue of over \$4 billion. The company manufactures and markets a large basket of pharmaceutical formulations covering a broad spectrum of chronic and acute therapies which includes generics, branded generics, complex or difficult to make technology intensive products, over-the-counter (OTC) products, anti-retrovirals (ARVs), active pharmaceutical ingredients (APIs) and intermediates. Its global presence is supported by over 40 manufacturing facilities. India and the U.S. are predominant markets, accounting for nearly 65% of revenue.

## Investment theme

Sun Pharma has corrected by almost 35%+ from its high. The decline in the stock price was driven by competitive pressures in the U.S. (especially in core business and key products) and higher research/marketing expenditure on U.S. specialty business. Moreover, lack of a major product approval for the U.S. generic market led to significant erosion in earnings. These factors coincided with corporate governance challenges – i.e., a whistleblower complaint with SEBI and U.S. industry-wide generic price collusion investigation. However, we expect FY2020 to reflect the full impact of its elevated cost structure and high R&D spend. We expect business sales growth in FY2021 to be in low double digit, with tepid cost increase leading to improvement in OPM.

## Key Risks

1) Regulatory compliance risk; 2) Delay in product approvals; 3) Currency risk; and 4) Worsening of corporate governance issues; and 5) Negative outcome of ongoing litigations in the U.S. with regard to price collusion (DOJ investigation and 44 State Coalition).

## Additional Data

### Key management personnel

Israel Makov	Chairman
Dilip S. Shanghvi	Managing Director
Sudhir V. Valia	Whole-time Director
Abhay Gandhi	CEO, North America
C. S. Muralidharan	Chief Financial Officer
S. Kalyanasundaram	Head - India and Emerging Markets

Source: Company Website

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Shanghvi Finance Pvt Ltd	40.0
2	Shanghvi Dilip Shantilal	9.6
3	Life Insurance Corp of India	5.9
4	ICICI Prudential Asset Management	3.6
5	Aditya Medisales Ltd	1.7
6	Vanguard Group Inc/The	1.6
7	Lakshdeep Investments and Finance	1.5
8	Valia Raksha Sudhir	1.4
9	Republic of Singapore	1.4
10	BlackRock Inc	1.4

Source: Bloomberg

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by BNP PARIBAS

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