

Sector: Pharmaceuticals
Result Update

	Change
Reco: Hold	↔
CMP: Rs. 412	
Price Target: Rs. 460	↓

↑ Upgrade
 ↔ No change
 ↓ Downgrade

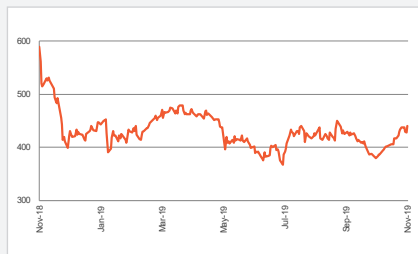
Company details

Market cap:	Rs. 98,779 cr
52-week high/low:	Rs. 601 / 350
NSE volume: (No of shares)	74.8 lakh
BSE code:	524715
NSE code:	SUNPHARMA
Sharekhan code:	SUNPHARMA
Free float: (No of shares)	109 cr

Shareholding (%)

Promoters	54.6
FII	15.1
DII	18.5
Others	11.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	9.1	0.5	-3.1	-29.0
Relative to Sensex	3.0	-6.5	-10.8	-38.8

Sharekhan Research, Bloomberg

Sun Pharmaceuticals Limited (Sun Pharma) Q2FY2020 results are in line with estimates. Sales for the quarter grew by 17% y-o-y to Rs. 8123 crore and were broadly in line with estimates. Operating profit at Rs. 1,781 crore increased by 4% y-o-y. Operating margin stood at 21.9% and are slightly ahead of our estimate of 21.1%. Adjusted PAT at Rs. 1,158.9 crore dropped by 6% y-o-y and was in line with our estimate. Going ahead, staggered penetration of specialty portfolio, higher specialty promotional spends, increasing R&D, and continued pricing issues in the U.S. are likely to be the key challenges to earnings growth. We expect Sun Pharma's topline/ PAT to report and CAGR of 14%/22% over FY2019-FY2021.

Key positives

- Revenue grew strongly by 17% y-o-y.
- Domestic formulations business grew by 35% for Q2FY2020. Industry growth for the quarter stood at 12%.
- Launched Cequa in U.S. markets in October 2019.

Key negatives

- R&D spends for the quarter stood at 6% of sales. Management has guided for higher R&D spends for FY2020 at 7-8% of sales. Major chunk of the spends would be towards the specialty business.
- Increased R&D spend could impact profitability.

Our Call

Valuation - Maintain Hold with an upward revised PT of Rs. 460: The stock has corrected by almost 30% from its high and is currently trading at 17.1x its FY2021E earnings. We expect the company to report sales and profit CAGR of 14% and 22%, respectively, over the next two years. The quarter's performance was in line with expectations. Sun Pharma still faces pending litigation case in the U.S. for pricing collusion. This coupled with higher specialty promotional spends and increased R&D spends are likely to pose challenges to earnings growth. We feel FY2020 will reflect full impact of increased cost structure (on account of specialty pipeline build-up). We have tweaked our estimates for FY2020/FY2021 to factor in the above concerns. We maintain our Hold rating on the stock with a revised PT of Rs. 460.

Key Risks

- Regulatory compliance risk;
- Delay in product approvals;
- Currency risk; and
- Negative outcome of ongoing litigations in the U.S. with regard to price collusion.

Valuation (Consolidated)

Particulars	FY2018	FY2019	FY2020E	FY2021E
Net sales	26605.8	29065.9	32903.9	37663.3
OPM(%)	21.5%	21.7%	22.6%	23.9%
Adj. PAT	3228.4	3879.8	4596.3	5778.8
EPS (Rs)	13.5	16.2	19.2	24.1
PER (x)	30.6	25.5	21.5	17.1
EV/Ebitda (x)	17.5	16.3	12.2	9.4
ROCE (%)	9.5	10.0	11.0	12.8
RONW (%)	8.4	9.4	10.1	11.4

Source: Company, Sharekhan Estimates

Q2FY2020 results broadly in line: Sun Pharma's Q2FY2020 results are in line with estimates. Sales for the quarter at Rs. 8,123 crore increased by 17% y-o-y and were broadly in line with our estimate of Rs. 7,971 crore. Operating profit at Rs. 1,781 crore increased 4% y-o-y as against estimated Rs. 1,680 crore. Operating margin for the quarter stood at 21.9% and slightly ahead of our estimate of 21.1% Adjusted PAT at Rs. 1,158 crore dropped 6% y-o-y was broadly in line with estimates of Rs. 1,117.7 crore.

U.S. business muted, Ramp-up in specialty business remains a key monitorable: Sun Pharma has stated that although Ilumya has started gaining traction, the pace is slower (as compared to other IL – 23 inhibitors) despite investments in campaigns such as Direct-to-Consumers. Moreover, the company has launched Cequa in the U.S. markets in October 2019. Cequa is used in the treatment of dry eye disease, which was approved by the USFDA in August 2018 and would compete with Restasis and Xiidra. Given the erosion in the base business and closure of the one-time supply contract, growth in the U.S. business is now dependent on faster ramp-up in the specialty portfolio. Considering flat sequential growth in the specialty business, ramp-up of the same would determine growth in the U.S. markets and remains a key monitorable.

Q2FY2020 Conference Call Highlights:

- ♦ Sun Pharma's specialty business revenue for the quarter stood at \$91 million (8% of sales). R&D spends towards the specialty business were on the higher side and stood at 24% of sales.
- ♦ The domestic formulations business reported 35% growth for the quarter on a low base. Sun Pharma has outpaced the industry's growth of 12%, by substantial margin.
- ♦ R&D spends during the quarter stood at 6% of sales due to delay in some projects. For 1HFY2020, R&D spends stood at 5.5% of sales. Management has guided for higher spends in 2HFY2020 and has guided for 7-8% (% of sales) of R&D spends for FY2020. A chunk of this would be towards the specialty business.
- ♦ Sun Pharma has out licensed two molecules – Ilumya and Cequa – and eight generic drugs to China Medical Systems Holdings (CMS) for marketing in Greater China.
- ♦ Sun Pharma has just tied-up with AstraZeneca to market few of its oncology products in China. Further, the company expects to build differentiated portfolio for China as well as Japan market. The company expects the financial implication from these to be very staggered due to the regulatory approval process.

Results	Rs cr				
Particulars	Q2FY2020	Q2FY2019	YoY %	Q1FY2020	QoQ %
Total sales	8,123.4	6,937.6	17.1	8,374.4	-3.0
Expenditure	6,342.1	5,230.8	21.2	6,446.1	-1.6
Operating profit	1,781.2	1,706.8	4.4	1,928.2	-7.6
Other Income	200.9	351.2	-42.8	213.0	-5.7
EBITDA	1,982.1	2,058.0	-3.7	2,141.3	-7.4
Interest	83.9	129.5	-35.2	104.1	-19.3
Depreciation	473.3	426.5	11.0	457.1	3.5
PBT	1,424.9	1,502.0	-5.1	1,580.1	-9.8
Taxes	266.0	269.6	-1.3	146.1	82.1
Adjusted PAT	1,158.9	1,232.4	-6.0	1,434.0	-19.2
MI+OCI+Excep Item	94.8	1,501.9	-93.7	46.5	103.7
Reported PAT	1,064.1	-269.5	-494.8	1,387.5	-23.3
EPS	4.4	-1.1	-494.8	5.8	-23.3
Margins			BPS		BPS
OPM %	21.9	24.6	-268	23.0	-110

Source: Company; Sharekhan Research

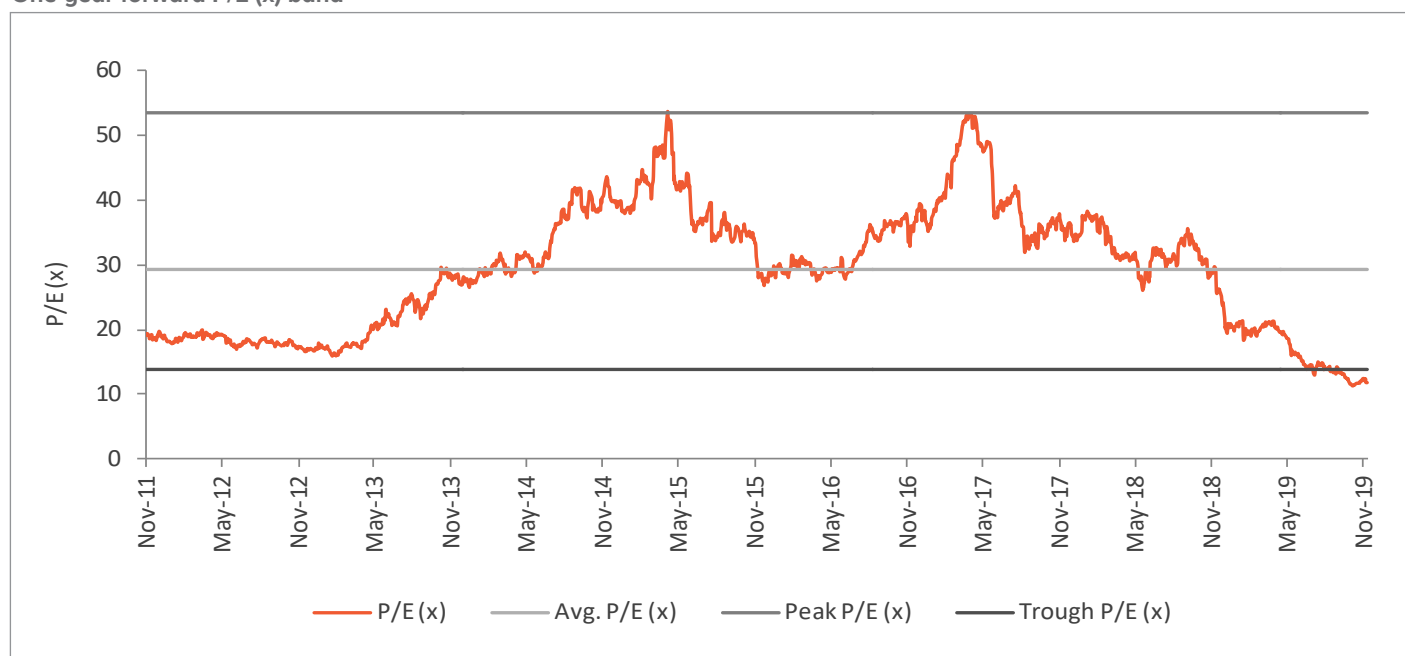
Outlook

Sun Pharma's Q2FY2020 results are broadly in line with estimates. Going ahead, staggered penetration of the specialty portfolio, continued higher specialty promotional spend, increasing R&D, and continued pricing issues in the U.S. are likely to be key challenges to earnings estimates. We expect Sun Pharma's topline/PAT to report a CAGR of 14%/22% over FY2019-FY2021.

Valuation

Maintain Hold with an upward revised PT of Rs. 460: The stock has corrected by almost 30% from its high and is currently trading at 17.1x its FY2021E earnings. We expect the company to report sales and profit CAGR of 14% and 22%, respectively, over the next two years. The quarter's performance was in line with expectations. Sun Pharma still faces pending litigation case in the U.S. for pricing collusion. This coupled with higher specialty promotional spends and increased R&D spends are likely to pose challenges to earnings growth. We feel FY2020 will reflect full impact of increased cost structure (on account of specialty pipeline build-up). We have tweaked our estimates for FY2020/FY2021 to factor in the above concerns. We maintain our Hold rating on the stock with a revised PT of Rs. 460.

One-year forward P/E (x) band



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. The company's 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 30% 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. Sun Pharma still faces pending litigation case in the U.S. for pricing collusion. This coupled with higher specialty promotional spends and increased R&D spends is likely to pose challenges to earnings growth. We feel FY2020 will reflect full impact of increased cost structure (on account of speciality pipeline build-up).

Key Risks

- ♦ Regulatory compliance risk;
- ♦ Delay in product approvals;
- ♦ Currency risk;
- ♦ Worsening of corporate governance issues; and
- ♦ 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	40.17
2	Shanghvi Dilip Shantilal	9.60
3	Life Insurance Corp of India	5.88
4	ICICI Prudential Asset Management	3.58
5	Aditya Medisales Ltd	1.67
6	Vanguard Group Inc/The	1.64
7	Reliance Capital Trustee Co Ltd	1.46
8	Valia Raksha Sudhir	1.41
9	Lakshdeep Investments and Finance	1.31
10	BlackRock Inc	1.30

Source: Bloomberg

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