

Dovish commentary but specialty shows promise

- Sun reported in-line sales in Q4 while higher bonus payouts, spend in Taro (believe related to higher volumes) and forex loss impacted EBITDA margins (18.4% vs our estimate of 21%) while one-offs related to litigation cost provision led to 20% miss in our PAT estimates. However, dip in margins remains an aberration and is expected to normalize in subsequent quarters.
- Global specialty portfolio recorded sales of US\$126mn (up from US\$118mn QoQ) led by seasonality in Levulan and Absorica coupled with Rx improvement in Ilumya, Cequa and Yonsa. Management indicated steady increase in patient/doctor prescription for Ilumya and Cequa, although Q1 will be impacted due to COVID.
- Pricing pressure in US remains unabated, R&D to inch up to 8%+ of sales subject to additional indication clinical trials for Ilumya and improving Rx for Cequa remain key highlights. Sun has deferred its annual guidance to Q1 due to uncertainties related to COVID. We believe the risk reward is favourable given the strong FCF generation of US\$365mn over FY20-22E and FCF/EBITDA at ~60%. Recommend BUY.

Valuation

Traction in Cequa Rx is positive and likely to result into higher promotional efforts to ramp up the brand. Further, investment in its growth pipeline will mean that specialty related costs are unlikely to plateau in the next few years. Therefore, EBITDA margins could remain under pressure despite the operating leverage from the ramp-up of its recent/upcoming launches. We assume EBITDA margins for FY21 (~22%) with ~80bps expansion in FY21 based on 8% growth in SG&A/R&D spend. Expansion of field force in India (market share improved to 8.4%) and improving Gx outlook in the US shall augur well for Sun. We build in 9%/22% CAGR for sales/PAT for FY20-22E. At CMP, stock trades at 19.6x FY22 EPS and 11.3x EV/EBITDA. Recommend BUY with a Target price of Rs530.

Q4FY20 Result (₹ Mn)

Particulars	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)
Revenue	81,849	71,639	14.3	81,549	0.4
Total Expense	66,799	60,923	9.6	63,953	4.5
EBITDA	15,051	10,716	40.4	17,596	(14.5)
Depreciation	5,754	4,541	26.7	5,470	5.2
EBIT	9,297	6,176	50.5	12,126	(23.3)
Other Income	1,022	2,815	(63.7)	1,199	(14.7)
Interest	518	1,500	(65.5)	630	(17.8)
EBT	5,774	6,942	(16.8)	13,513	(57.3)
Tax	831	(288)	(388.4)	3,276	(74.6)
RPAT	3,998	6,359	(37.1)	9,135	(56.2)
APAT	8,026	6,907	16.2	8,317	(3.5)
			(bps)		(bps)
Gross Margin (%)	71.8	74.3	(249)	73.0	(118)
EBITDA Margin (%)	18.4	15.0	343	21.6	(319)
NPM (%)	4.9	8.9	(399)	11.2	(632)
Tax Rate (%)	14.4	(4.1)	1854	24.2	(985)
EBIT Margin (%)	11.4	8.6	274	14.9	(351)

CMP	Rs 451
Target / Downside	Rs 530 / 17%
BSE Sensex	31,601
NSE Nifty	9,315

Script Details

Equity / FV	Rs 2,399mn / Rs 1
Market Cap	Rs 1,082bn
	USD 14bn
52-week High/Low	Rs 505/Rs 312
Avg. Volume (no)	14,124,200
NSE Symbol	SUNPHARMA
Bloomberg Code	SUNP IN

Shareholding Pattern Mar'20(%)

Promoters	54.7
MF/Banks/FIs	10.8
FII's	13.6
Public / Others	20.9

Valuation (x)

	FY20A	FY21E	FY22E
P/E	27.3	22.9	19.6
EV/EBITDA	15.0	13.2	11.3
ROE (%)	8.7	10.3	11.1
RoACE (%)	8.2	9.1	9.9

Estimates (₹ mn)

	FY20A	FY21E	FY22E
Revenue	328,375	362,714	392,535
EBITDA	69,742	79,195	89,253
PAT	39,671	47,340	55,113
EPS (Rs.)	16.5	19.7	23.0

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Q4FY20 Result Snapshot

Sales grew 15% YoY driven by India (adjusted growth 8% YoY) and US (US\$375mn, up 7% QoQ). Gross margins at 71.5% were lower both QoQ and YoY impacted by higher sales from Taro. Though the company continues to spend on promotional expenses on specialty portfolio the same was offset by lower R&D spend (6% of sales). Higher bonus payouts, spend in Taro (believe related to higher volumes) and forex loss impacted EBITDA margins (18.4% vs our estimate of 21%) while one-offs related to litigation cost provision led to 20% miss in our estimates at Rs7.8bn.

Exhibit 1: Revenue Mix

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
US	27,129	31,238	(13.2)	24,924	8.8	105,425	106,713	(1.2)
India	23,648	11,013	114.7	25,170	(6.0)	97,102	73,483	32.1
ROW	11,212	10,780	4.0	11,035	1.6	45,210	34,554	30.8
Emerging Markets	13,540	12,199	11.0	13,901	(2.6)	55,044	53,625	2.6
API	4,834	4,837	-0.1	5,032	(3.9)	19,159	17,303	10.7
Others	417	374	11.6	324	28.8	1,312	1,185	10.7
Total revenues	80,780	70,443	14.7	80,387	0.5	323,252	286,863	12.7

Source: Company, DART

Key Concall takeaways

- **COVID 19 impact and changes adopted:** Expect a soft Q1 for both India and US as pre-buying witnessed in these markets. Besides, currency impact in EM and lower specialty sales across globe along with continuous marketing and promotion spend shall impact margins. However, company has adopted various digital measures to get the business on track:
 - a. Digital engagement with doctors and patients
 - b. Supply chain protection for continuity of medicines
 - c. Focus on cash collection and cash conservation
 - d. No major cut back on promotional expenses barring some saving in traveling and allowances
- **Global specialty revenue:** Sun management disclosed that global specialty revenues stand at US\$126mn (up 7% QoQ), while R&D for specialty is 24% of total R&D spend in Q4.
 - e. **Ilumya:** Witnessing a strong uptick in prescriptions and holds a higher share of revenue in the specialty portfolio. Spend on DTC will continue, albeit in an optimized manner while marketing costs and additional trials to continue. Ilumya sales of US\$94mn for FY20 includes royalty sales from its European partner, Almirall, indicating large part of sales coming from US.
 - f. **Cequa:** It has recovered from declining phase and Rx seeing an uptick. Expect this trend to continue post COVID as well. We expect Cequa to contribute US\$50mn in FY21 and US\$80mn in FY22E.
 - g. **Levulan:** Seasonality led growth in 4Q.
 - h. **Absorica:** Higher growth when combined with its recently launched LD version.
- **No formal guidance but spend on marketing and R&D to continue:** Management did not give a guidance for FY21E given the uncertainties related to COVID. While management emphasized on cost saving measures being a key focus area, it expects margin improvement to be limited in FY21E led by 1) higher

R&D at 8%+ vs 6% in FY20, 2) investment in Ilumya promotions to continue, 3) Though major hiring on field force expansion in India is done, expect some increases over the year. While there will be no additional capex on greenfield expansion, company will continue to focus on modernization of its facilities.

- **US:** Ex-specialty business and Taro, the generic business continues to remain competitive for Sun. Management cited that Q1 had higher pre-buying in Taro vs its base portfolio.
- Specialty Pipeline Update:
 - i. **Absorica:** Per the management, Absorica is a meaningful contributor to specialty pipeline as Ilumya ramps up. Company has recently launched Absorica LD which has 20% reduction in dosage. Faster ramp up in Absorica LD remains essential for Sun's global specialty portfolio given that generic version of Absorica are expected from Dec'20.
 - j. **Ilumya:** According to the management, sales are gradually ramping up with an increase in patient numbers and doctors prescribing the drug. Besides, it also enjoys decent formulary coverage. While the market is competitive (5-6 players), company has not lost market share during the pandemic caused lockdown in the US. Sun indicated Ilumya has a good balance between efficacy and safety particularly with long-term efficacy data narrowing with competitor products despite lower initial efficacy (probably due to less frequent dosing vs. other products). We believe the traction over the next year will be crucial for Ilumya to see if Sun needs to review its strategy on the product. Sun highlighted continued investment in promoting Ilumya through direct to consumer spend which is seasonal in nature.
 - k. Per the management, progress on
 - (1) repeat prescribing metrics – has seen strong traction
 - (2) distribution of prescriptions across cohorts – gradual improvement
 - (3) conversion from EAP to paying patients – has increased gradually
 - l. **Cequa:** Sun launched the product in Oct'19 and is has witnessed steady uptick in Rx. In our view, the dry eye drug market is quite promotion sensitive. DTC investment by Cequa may not be as low as the market currently expects (impacts margins). In addition, Sun may need to ramp-up its ophthalmology field force beyond its current strength, as Restasis/Xiidra maintain a large sales force of 300-400 reps.

Profit and Loss Account

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
Revenue	290,659	328,375	362,714	392,535
Total Expense	226,651	258,634	283,519	303,282
COGS	78,690	92,305	100,506	107,516
Employees Cost	59,671	63,624	69,830	74,526
Other expenses	88,291	102,706	113,182	121,240
EBIDTA	64,008	69,742	79,195	89,253
Depreciation	17,533	20,528	21,989	23,248
EBIT	46,475	49,214	57,205	66,006
Interest	5,553	3,027	2,160	1,710
Other Income	10,255	6,360	7,300	7,657
Exc. / E.O. items	(12,144)	(2,606)	0	0
EBT	39,034	49,940	62,346	71,953
Tax	6,009	8,228	10,599	12,232
RPAT	27,586	37,493	47,340	55,113
Minority Interest	5,424	4,070	4,274	4,488
Profit/Loss share of associates	(15)	(148)	(133)	(120)
APAT	37,971	39,671	47,340	55,113

Balance Sheet

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
Sources of Funds				
Equity Capital	2,399	2,399	2,399	2,399
Minority Interest	33,135	38,602	38,602	38,602
Reserves & Surplus	411,691	450,245	467,744	517,435
Net Worth	414,091	452,645	470,143	519,834
Total Debt	98,934	75,783	71,994	68,394
Net Deferred Tax Liability	14,864	21,873	19,478	14,899
Total Capital Employed	561,024	588,903	600,217	641,730

Applications of Funds

Net Block	158,808	163,655	154,471	148,070
CWIP	73,669	77,018	75,018	73,018
Investments	44,602	58,658	58,658	58,658
Current Assets, Loans & Advances	344,311	351,441	376,207	424,877
Inventories	78,860	78,750	90,680	92,733
Receivables	88,842	94,212	105,959	112,724
Cash and Bank Balances	72,756	64,876	59,543	94,161
Loans and Advances	56,768	45,676	50,202	53,352
Other Current Assets	7,578	18,953	20,848	22,933
Less: Current Liabilities & Provisions	60,365	61,869	64,137	62,893
Payables	41,479	40,937	44,457	43,858
Other Current Liabilities	18,887	20,931	19,680	19,035
<i>sub total</i>				
Net Current Assets	283,946	289,572	312,070	361,983
Total Assets	561,024	588,903	600,217	641,730

E – Estimates

Important Ratios

Particulars	FY19A	FY20A	FY21E	FY22E
(A) Margins (%)				
Gross Profit Margin	72.9	71.9	72.3	72.6
EBIDTA Margin	22.0	21.2	21.8	22.7
EBIT Margin	16.0	15.0	15.8	16.8
Tax rate	15.4	16.5	17.0	17.0
Net Profit Margin	9.5	11.4	13.1	14.0
(B) As Percentage of Net Sales (%)				
COGS	27.1	28.1	27.7	27.4
Employee	20.5	19.4	19.3	19.0
Other	30.4	31.3	31.2	30.9
(C) Measure of Financial Status				
Gross Debt / Equity	0.2	0.2	0.2	0.1
Interest Coverage	8.4	16.3	26.5	38.6
Inventory days	99	88	91	86
Debtors days	112	105	107	105
Average Cost of Debt	5.7	3.5	2.9	2.4
Payable days	52	46	45	41
Working Capital days	357	322	314	337
FA T/O	1.8	2.0	2.3	2.7
(D) Measures of Investment				
AEPS (Rs)	15.8	16.5	19.7	23.0
CEPS (Rs)	23.1	25.1	28.9	32.7
DPS (Rs)	2.0	1.8	1.8	1.8
Dividend Payout (%)	12.6	10.6	8.9	7.6
BVPS (Rs)	172.6	188.7	196.0	216.7
RoANW (%)	6.9	8.7	10.3	11.1
RoACE (%)	9.1	8.2	9.1	9.9
RoAIC (%)	9.9	9.7	10.7	12.1
(E) Valuation Ratios				
CMP (Rs)	451	451	451	451
P/E	28.5	27.3	22.9	19.6
Mcap (Rs Mn)	1,081,844	1,081,844	1,081,844	1,081,844
MCap/ Sales	3.7	3.3	3.0	2.8
EV	1,068,515	1,043,778	1,045,322	1,007,104
EV/Sales	3.7	3.2	2.9	2.6
EV/EBITDA	16.7	15.0	13.2	11.3
P/BV	2.6	2.4	2.3	2.1
Dividend Yield (%)	0.4	0.4	0.4	0.4
(F) Growth Rate (%)				
Revenue	9.7	13.0	10.5	8.2
EBITDA	14.1	9.0	13.6	12.7
EBIT	13.1	5.9	16.2	15.4
PBT	12.2	27.9	24.8	15.4
APAT	40.4	4.5	19.3	16.4
EPS	40.4	4.5	19.3	16.4
Cash Flow				
(Rs Mn)	FY19A	FY20A	FY21E	FY22E
CFO	24,317	71,606	44,783	66,480
CFI	(40,361)	(46,990)	(10,805)	(14,847)
CFF	(10,494)	(32,497)	(39,310)	(17,015)
FCFF	(16,044)	24,616	33,977	51,632
Opening Cash	99,294	72,756	64,876	59,543
Closing Cash	72,756	64,876	59,543	94,161

E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	> 20%
Accumulate	10 to 20%
Reduce	0 to 10%
Sell	< 0%

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