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Q4FY20 result review
and estimate change

Pharmaceuticals

Target price Rs528

Earnings revision

(%)	FY21E	FY22E
Sales	0.6	0.6
EPS	(4.8)	(1.3)

Target price revision

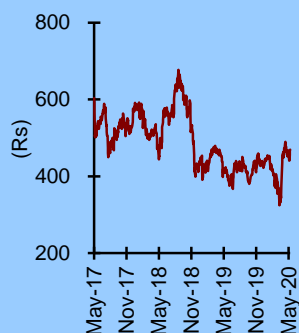
Rs528 from Rs535

Shareholding pattern

	Sep '19	Dec '19	Mar '20
Promoters	54.6	54.6	54.7
Institutional investors	33.2	33.0	32.4
MFs and others	10.4	10.6	10.8
FIs/Bank/Ins	8.0	8.2	8.5
FII	14.8	14.1	13.1
Others	12.2	12.4	12.9

Source: BSE India

Price chart



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INDIA



Sun Pharmaceutical Industries

BUY

Maintained

Specialty gaining traction

Rs451

Sun Pharmaceutical Industries' (Sun) reported Q4FY20 performance was below our estimates due to higher operating costs and forex loss, although revenue was higher than estimated. Revenue grew 14.3% YoY to Rs81.8bn (I-Sec: Rs79.0bn) and adjusted PAT grew 3.9% to Rs6.6bn. EBITDA margin at 16.7% missed our estimates by 310bps due to forex loss (170bps) and lower gross margin (110bps), caused the lower profitability. The company is focusing on cost rationalisation measures and improving product mix. Continued scale-up in global specialty sales is positive and we believe loss in *Absorica* sales post generic competition in H2FY21 could be compensated by ramp-up of *Ilumya* and *Cequa*. We remain positive on long-term outlook considering strong India business, pick-up in specialty sales and attractive valuations. Maintain BUY.

- ▶ **Steady revenue growth led by India and Emerging markets:** India business adjusted growth stood at 8.0% YoY (reported growth was 114.7% due to low base). Emerging market revenues grew 8.1% YoY to US\$187mn led by double digit growth in non-tender business. US revenues improved 7.1% QoQ to US\$375mn led by 18% jump in Taro sales. Ex-Taro, revenue stood flattish. Specialty revenue stood strong at US\$126mn growing 6.8% QoQ. Company reported *Ilumya* sales of US\$94mn for FY20. We expect US revenues to remain flattish over FY20-22E with decline in *Absorica* sales in H2FY21 and generic price erosion. RoW grew 1.3% to US\$155mn.
- ▶ **Margins impacted by increased costs and forex loss:** Reported EBITDA margin dropped 590bps QoQ to 16.7% (up 250bps YoY) due to lower gross margins, higher forex loss and S,G&A expenses. We believe EBITDA margin would revert to normal levels (21-22%) in the ensuing quarters with continuity of strong growth in India, scale-up in specialty sales and cost control initiatives. We largely maintain our margin estimates and expect EBITDA margin to improve 220bps over FY20-FY22 to 23.3% driven by operating leverage and improving revenue mix.
- ▶ **Outlook:** We expect US revenue growth to remain low in the near term with gradual ramp-up in the specialty portfolio offset by likely generic competition in *Absorica* in H2FY21. Overall, we expect 7.9% revenue and 20.9% adjusted PAT CAGRs over FY20-FY22E with EBITDA margin expansion of 220bps. Management refrained from giving guidance for FY21 because of COVID-19 related uncertainty but expects near-term sales to be soft.
- ▶ **Valuations and risks:** We marginally revise our estimates and maintain **BUY** rating with a revised target price of Rs528/share based on 22x FY22E EPS (earlier: Rs535/share). Key downside risks are: higher than expected pricing pressures in the US, and regulatory hurdles.

Market Cap	Rs1082bn/US\$14.3bn
Reuters/Bloomberg	SUN.BO / SUNP IN
Shares Outstanding (mn)	2,399.3
52-week Range (Rs)	490/325
Free Float (%)	45.3
FII (%)	13.1
Daily Volume (USD/000)	54,368
Absolute Return 3m (%)	16.1
Absolute Return 12m (%)	10.2
Sensex Return 3m (%)	(20.3)
Sensex Return 12m (%)	(19.5)

Year to Mar	FY19	FY20	FY21E	FY22E
Revenue (Rs mn)	290,659	327,875	355,909	381,784
Net Income (Rs mn)	26,683	37,946	48,322	57,874
EPS (Rs)	15.4	16.4	20.0	24.0
% Chg YoY	21.1	6.9	21.9	19.9
P/E (x)	29.3	27.5	22.5	18.8
CEPS (Rs)	21.8	25.0	28.8	33.0
EV/E (x)	17.0	15.0	12.6	10.6
Dividend Yield (%)	0.6	0.5	0.7	0.8
RoCE (%)	7.7	7.4	8.3	9.4
RoE (%)	9.3	9.1	10.2	11.2

Highlights of Q4FY20 result and earnings call

Net sales grew 14.3% YoY (+0.4% QoQ) in Q4FY20 to Rs81.8bn.

- **Domestic formulation sales** grew 114.7% YoY to Rs23.6bn. The high growth is on a low base last year due to a one-time impact of Rs10.9bn related to the change in distribution business. Adjusting for it the growth stood at 8.0% YoY. Sequentially revenue declined 6.0%. Company has increased its field force by 7-8%. Company is reaching out to the HCPs digitally to maintain connect and market newer products. Chronic segment witnessed some stockpiling but new acute prescriptions have reduced. Patient footfalls have declined 75% at the clinics due to lockdown but there has been some improvement in May.
- **US formulation sales** grew 7.1% QoQ to US\$375mn (-15.4% YoY). Breakdown: Taro (-2.8% YoY, +18.5% QoQ) and non-Taro (-24.0% YoY, -1.1 % QoQ). Large decline YoY in non-Taro segment is due to one-time supplies of six generics last year. Company had some supply challenges in March and could not execute all the received orders.

Sun filed six ANDAs and received two approvals during the quarter. For FY20, the company has filed 18 ANDAs and received 31 approvals. Cumulative approved ANDAs are 483 while 98 are pending approval (including 20 tentative approvals).

Company's specialty product sales were US\$126mn globally. Company deployed ~24% of its R&D expenditure towards this segment. Sun's strong growth was driven by *Ilumya*, *Cequa* and *Yonsa* despite seasonal decline in *Absorica* and *Levulan*.

Ilumya ramp-up has been healthy with company recording an annual sales of US\$94mn for FY20. Phase 3 study for alternate indications has been delayed due to COVID-19.

Cequa witnessed a declining trend due to the lockdown but its improving slowly. *Cequa* DTC promotion will be hit in Q1FY21.

Company is promoting both forms of *Absorica* but due to less time of marketing for the lower dosage form has reduced the conversion.

- **Emerging markets** grew 12.7% YoY (flat QoQ) to US\$195mn. The decline was due to loss of tender business in S.Africa. Adjusted growth was double digit.
- **RoW formulation** markets grew 1.3% YoY (flat QoQ) to US\$155mn. This was partly driven by the acquisition of Pola Pharma in Japan.
- **APIs and others** remained flat YoY at Rs5.3bn during the quarter with the company's increasing focus on maximising captive use of APIs in key products.
- Reported **EBITDA margin** grew 250bps YoY to 16.7% on a low base despite lower **gross margin** (-250bps YoY). Sequentially, nearly 50% of the EBITDA fall of 590bps was due to adverse forex movement (forex loss of Rs1.4bn in Q4FY20 vs forex gain of Rs0.8bn in Q3FY20).
- **R&D expenses** in Q4FY20 stood at Rs5.2bn (6.4% of net sales), down 150bps YoY. This cost head would elevate with expenses related to the specialty portfolio in the coming months.
- **Adjusted PAT** declined 2.0% YoY to Rs6.2bn. Company has reported an exception expense of Rs2.6bn in Q4FY20 owing to reversal of central excise funds (Rs1bn) and resolution of litigation of Dusa Pharma with US D.O.J for two products *Levulan* and *Blu-u* (Rs1.6bn).

Table 1: Q4FY20 result review*(Rs mn, year ending March 31)*

	Q4FY20	Q4FY19	YoY % Chg	Q3FY20	QoQ % Chg
Net Sales	81,849	71,639	14.3	81,549	0.4
EBITDA	13,630	10,168	34.1	18,414	(26.0)
Other income	1,022	2,815	(63.7)	1,199	(14.7)
PBIDT	14,652	12,983	12.9	19,613	(25.3)
Depreciation	5,754	4,541	26.7	5,470	5.2
Interest	518	1,500	(65.5)	630	(17.8)
PBT	5,774	6,942	(16.8)	13,513	(57.3)
Tax	831	(288)	(388.4)	3,276	(74.6)
Minority Interest	945	872	8.4	1,102	(14.2)
Adjusted PAT	6,605	6,359	3.9	9,135	(27.7)
Extra ordinary income/ (exp.)	(2,606)	-	-	-	-
Reported PAT	3,998	6,359	(37.1)	9,135	(56.2)
EBITDA margins (%)	16.7	14.2	250bps	22.6	(590)bps

Source: Company data, I-Sec research

Table 2: Revenue mix*(Rs mn, year ending March 31)*

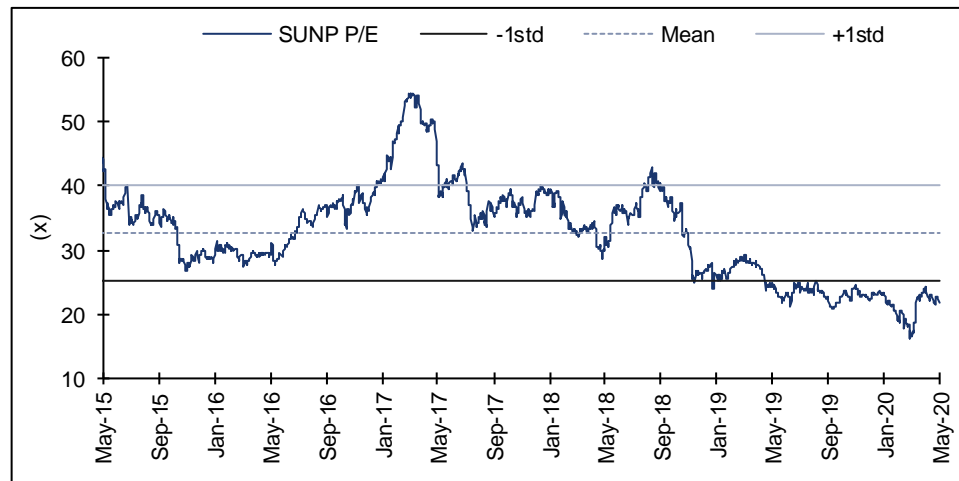
	Q4FY20	Q4FY19	YoY % Chg	Q3FY20	QoQ % Chg
Formulations	75,529	65,231	15.8	75,031	0.7
India	23,648	11,013	114.7	25,170	(6.0)
US	27,129	31,238	(13.2)	24,924	8.8
Emerging Markets	13,540	12,199	11.0	13,901	(2.6)
ROW	11,212	10,780	4.0	11,035	1.6
APIs & Others	5,252	5,211	0.8	5,356	(1.9)
Other Op. Income	1,069	1,197	(10.7)	1,162	(8.0)
Total Sales	81,849	71,639	14.3	81,549	0.4

Source: Company data, I-Sec research

Valuations

The stock currently trades at 22.5x FY21E and 18.8x FY22E earnings and EV/EBITDA multiple of 12.6x FY21E and 10.6x FY22E. It has traded at an average P/E of 32.6x 1-year forward earnings over the past five years and below mean over the past one year. We remain positive on the stock considering: i) ramp-up in revenues from branded/specialty business in the US, ii) recovery in India business growth, iii) potential to buy inorganic growth based on strong balance sheet, and iv) expected continued margin recovery leading to 20.9% earnings CAGR over FY20-FY22E. We maintain our **BUY** rating with a revised target price of Rs528 based on 22x FY22E EPS (earlier: Rs535/share).

Chart 1: 1-year forward P/E



Source: Company data, I-Sec research

Summary financials (consolidated)

Table 3: Profit & Loss statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
Formulations	268,375	302,780	329,856	354,726
India	73,483	97,102	105,841	117,484
US	106,713	105,425	109,849	112,592
Emerging Mkts	53,625	55,044	63,166	69,483
ROW & Japan	34,554	45,210	51,000	55,166
APIs & Others	18,488	20,471	21,429	22,435
Other Operating Inc	3,796	4,623	4,623	4,623
Total Gross Sales	290,659	327,875	355,909	381,784
Excise duty	-	-	-	-
Total Net Revenue	290,659	327,875	355,909	381,784
yoy Growth%	10.3	12.8	8.6	7.3
Total Op. Exp.	227,583	258,477	276,739	292,676
EBITDA	63,076	69,398	79,170	89,107
Margins %	21.7	21.2	22.2	23.3
yoy Growth%	15.1	10.0	14.1	12.6
Depreciation	17,533	20,528	21,145	21,582
EBIT	45,543	48,870	58,025	67,525
Other Income	10,255	6,360	7,377	8,798
Interest	5,553	3,027	2,457	1,870
EO Items	(12,144)	(2,106)	-	-
PBT	38,102	50,096	62,945	74,453
Tax	6,009	8,228	10,701	12,657
Tax Rate (%)	15.8	16.4	17.0	17.0
Minority Interest	5,410	3,922	3,922	3,922
Reported PAT	26,683	37,946	48,322	57,874
Adj PAT	36,883	39,410	48,026	57,577
Net Margins (%)	12.7	12.0	13.5	15.1

Source: Company data, I-Sec research

Table 4: Balance sheet

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
Paid-up Capital	2,399	2,399	2,399	2,399
Reserves & Surplus	411,691	450,245	489,600	536,783
Total Equity	414,091	452,645	492,000	539,182
Minority Interest	33,135	38,602	42,673	46,743
Total Debt	104,795	75,783	70,783	40,783
Deferred Liabilities	(24,506)	(31,172)	(31,172)	(31,172)
Capital Employed	527,515	535,858	574,284	595,537
Current Liabilities	93,875	114,913	123,809	132,156
Total Liabilities	621,389	650,772	698,093	727,693
Net Fixed Assets	232,477	240,673	229,528	217,945
Investments	40,306	53,506	53,506	53,506
Inventory	78,860	78,750	84,314	89,169
Debtors	88,842	94,212	102,268	109,703
Other Current Assets	68,642	69,782	72,324	74,671
Cash and Equivalents	112,263	113,849	156,153	182,698
Total Cur. Assets	348,607	356,593	415,059	456,241
Total Assets	621,389	650,772	698,093	727,693

Source: Company data, I-Sec research

Table 5: Cashflow statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
PBT	38,087	49,948	62,797	74,304
Depreciation	17,533	20,528	21,145	21,582
Net Chg in WC	(24,213)	(2,539)	(10,345)	(9,131)
Taxes	(8,864)	(13,459)	(10,701)	(12,657)
Others	(6,131)	8,043	3,078	2,841
CFO	16,412	62,520	65,975	76,940
Capex	(31,852)	(14,500)	(10,000)	(10,000)
Net Investments made	(1,887)	(13,834)	-	-
Others	26,926	2,445	-	-
CFI	(6,813)	(25,888)	(10,000)	(10,000)
Change in Share capital	(6,084)	(6,375)	-	-
Change in Debts	8,902	(31,230)	(5,000)	(30,000)
Div. & Div Tax	(5,787)	(6,797)	(8,671)	(10,395)
Others	(33,168)	(111)	-	-
CFF	(36,137)	(44,513)	(13,671)	(40,395)
Total Cash Generated	(26,538)	(7,881)	42,304	26,545
Cash Opening Balance	99,294	72,756	64,876	107,180
Cash Closing Balance	72,756	64,876	107,180	133,725

Source: Company data, I-Sec research

Table 6: Key ratios

(Year ending March 31)

	FY19	FY20	FY21E	FY22E
Adj EPS	15.4	16.4	20.0	24.0
YoY Growth%	21.1	6.9	21.9	19.9
Cash EPS	21.8	25.0	28.8	33.0
EBITDA - Core (%)	21.7	21.2	22.2	23.3
NPM (%)	12.7	12.0	13.5	15.1
Net Debt to Equity (x)	(0.0)	(0.1)	(0.2)	(0.3)
P/E (x)	29.3	27.5	22.5	18.8
EV/EBITDA Core (x)	17.0	15.0	12.6	10.6
P/BV (x)	2.6	2.4	2.2	2.0
EV/Sales (x)	3.7	3.2	2.8	2.5
RoCE (%)	7.7	7.4	8.3	9.4
RoE (%)	9.3	9.1	10.2	11.2
RoIC (%)	8.6	8.3	9.8	11.6
Book Value (Rs)	172.6	188.7	205.1	224.7
DPS (Rs)	2.8	2.4	3.0	3.6
Dividend Payout (%)	24.8	15.0	15.0	15.0
Div Yield (%)	0.6	0.5	0.7	0.8
Asset Turnover Ratio	0.6	0.6	0.6	0.6
Avg. Collection days	107	103	102	103
Avg. Inventory days	118	111	108	108

Source: Company data, I-Sec research

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