Sun Pharmaceuticals

Buy

DOLAT ANALYSIS & RESEARCH THEMES
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Result Update

Strong show from India, break-even in specialty to drive operating leverage

Sun reported in-line sales in Q1 (down 10% YoY), however sharp cut in opex, lower R&D spend and improved product mix (partially aided by currency) aided EBITDA margins at 23.3% (we saw 18%) while one-offs related to Taro's settlement with DOJ and additional provision for ongoing US states litigation restricted PAT. While large part of the operating improvement will taper in ensuing quarters, management's commentary on 2 aspects (1) Some portion of costs savings in India might be permanent in nature – digital product launches and (2) some products in the specialty segment to achieve break-even by FY22; could drive operating leverage by ~100-150bps going ahead.

Though specialty portfolio and Taro were down ~38% and 30% respectively QoQ, we witnessed 7% QoQ improvement in base generic business in 1Q which is encouraging. Sun's US generic segment has been a disappointment from past several quarters owing to lack of a big ticket launch. However, we believe that Sun holds a strong franchise of domestic formulations (heavy chronic portfolio and market leader) and branded exports with an improving operating base. We value the company on SOTP basis and increase the multiple of the India business (65% of total profit contribution) at 20x EV/EBITDA, while we value the US business (ex specialty) at 7x EV/EBITDA and branded exports at 10x EV/EBITDA. The specialty pipeline is valued at Rs34. Thus our TP stands increased at Rs570 Vs Rs530 earlier. Maintain BUY.

Our Assumptions:

- While COVID-19 has impacted the traction seen in Cequa and Ilumya market share, we believe the incremental revenue from these opportunities will be reflected in sustainable margin expansion. While there are skeptics on Ilumya in a competitive market, we see scope for higher revenue supported by the increase of IL-23 treatment for psoriasis. While 1H would be lower specialty revenue, we believe recovery in market share trends for both its products will be key trigger.
- We factor an increase in Specialty R&D from US$64mn in FY20 to US$117mn in FY22E (35% CAGR) while generic R&D is likely to increase by ~10%, thereby adding to operating leverage. Q1 R&D spend was inclined in favour of specialty (39% of total R&D spend vs 24% earlier).

Q1FY21 Result (Rs Mn)

Particulars	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Revenue	75,853	83,744	(9.4)	81,849	(7.3)
Total Expense	58,209	64,461	(9.7)	66,799	(12.9)
EBITDA	17,644	19,282	(8.5)	15,051	17.2
Depreciation	4,959	4,571	8.5	5,754	(13.8)
EBIT	12,684	14,711	(13.8)	9,297	36.4
Other Income	1,538	2,130	(27.8)	1,022	50.4
Interest	520	1,041	(50.1)	518	0.3
EBT	(21,839)	16,474	(232.6)	5,774	(478.2)
Tax	2,459	1,461	68.4	831	196.0
RPAT	(16,556)	13,875	(219.3)	3,998	(514.1)
APAT	18,986	13,201	43.8	8,026	136.6
			(bps)		(bps)
Gross Margin (%)	74.0	70.7	338	71.8	219
EBITDA Margin (%)	23.3	23.0	23	18.4	487
NPM (%)	(21.8)	16.6	(3839)	4.9	(2671)
Tax Rate (%)	(11.3)	8.9	(2013)	14.4	(2565)
EBIT Margin (%)	16.7	17.6	(84)	11.4	536

CMP	Rs 532
Target / Upside	Rs 571 / 7%
BSE Sensex	37,660
NSE Nifty	11,074

Scrip Details

Equity / FV	Rs 2,399mn / Rs 1
Market Cap	Rs 1,276bn
	US$ 17bn
52-week High/Low	Rs 541/Rs 312
Avg. Volume (no)	10,762,700
NSE Symbol	SUNPHARMA
Bloomberg Code	SUNP IN

Shareholding Pattern Jun'20(%)

Promoters	54.7
MF/Banks/FIs	10.8
FIIs	13.6
Public / Others	20.9

Valuation (x)

	FY20A	FY21E	FY22E
P/E	32.2	26.9	23.0
EV/EBITDA	17.7	15.6	13.4
ROE (%)	8.7	10.3	11.2
RoACE (%)	8.2	9.1	9.9

Estimates (Rs mn)

	FY20A	FY21E	FY22E
Revenue	328,375	363,082	392,715
EBITDA	69,742	79,328	89,549
PAT	39,671	47,451	55,359
EPS (Rs.)	16.5	19.8	23.1

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DOLAT CAPITAL

Exhibit 1: Revenue Mix

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)	FY20	FY19	YoY (%)
US	21,364	29,474	(27.5)	27,129	(21.2)	105,425	106,713	(1.2)
India	23,884	23,137	3.2	23,648	1.0	97,102	73,483	32.1
ROW	10,300	11,591	(11.1)	11,212	(8.1)	45,210	34,554	30.8
Emerging Markets	13,161	13,486	(2.4)	13,540	(2.8)	55,044	53,625	2.6
API	5,537	4,612	20.1	4,834	14.5	19,159	17,303	10.7
Others	426	293	45.2	417	2.0	1,312	1,185	10.7
Total revenues	**74,672**	**82,593**	**(9.6)**	**80,780**	**(7.6)**	**323,252**	**286,863**	**12.7**

Source: Company, DART

Key Concall takeaways

- **Global specialty revenue:** Sun management disclosed that global specialty revenues declined to US$78mn (down 38% QoQ), impacted by lockdown as Ilumya and Levulan are clinically administered drugs. Though key point being that market share is intact in both these products. Additionally, management highlighted that it has started to observe M-o-M Rx improvements in the branded portfolio.

  a. **Absorica:** Ramp up in Absorica's LD version is gradual, few specialty products are expected to break-even by FY22.

  b. **Ilumya:** It has received approval for launch in Japan. This shall aid Ilumya's global sales

- **US:** Ex-specialty business and Taro, the generic business improved by 7% QoQ (in US$ terms) which is encouraging. Although the company reiterated that generic market continues to remain competitive led by price erosion.
- **Lower R&D spend:** The R&D spend for the quarter stood at 5.6% of sales at Rs4.2bn. Of this, the specialty R&D was at 39%, higher than a run-rate of 24% earlier.
- **India formulations:** Domestic formulations grew 3% YoY, marginally ahead of our 2% growth assumption on the back of 10% growth in chronic led portfolio. While acute segment declined by ~20%, Sun's strong brands in chronic saved the day. With MRs back on the field, large part of the expenditure is expected to return back from 2Q onwards. However, Sun launched ~10 new products in Q1 through its digital platform and indicated that this route could add to some structural savings in the business.
- **Other branded markets:** Emerging markets declined 2% YoY due to lower tender business in South Africa. Adjusted to the tender sales, EM were flat YoY. RoW markets declined 11% YoY due to lower sales in Japan and decline in Taro sales (derma portfolio suffered major decline).

Profit and Loss Account

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
Revenue	**290,659**	**328,375**	**363,082**	**392,715**
Total Expense	**226,651**	**258,634**	**283,753**	**303,166**
COGS	78,690	92,305	100,565	107,316
Employees Cost	59,671	63,624	69,902	74,560
Other expenses	88,291	102,706	113,287	121,290
EBIDTA	**64,008**	**69,742**	**79,328**	**89,549**
Depreciation	17,533	20,528	21,989	23,248
EBIT	**46,475**	**49,214**	**57,339**	**66,301**
Interest	5,553	3,027	2,160	1,710
Other Income	10,255	6,360	7,301	7,657
Exc. / E.O. items	(12,144)	(2,606)	0	0
EBT	**39,034**	**49,940**	**62,480**	**72,248**
Tax	6,009	8,228	10,622	12,282
RPAT	27,586	37,493	47,451	55,359
Minority Interest	5,424	4,070	4,274	4,488
Profit/Loss share of associates	**(15)**	**(148)**	**(133)**	**(120)**
APAT	**37,971**	**39,671**	**47,451**	**55,359**

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	19,487	14,902
Total Capital Employed	**561,024**	**588,903**	**600,226**	**641,733**
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**	**376,251**	**424,879**
Inventories	78,860	78,750	90,772	92,666
Receivables	88,842	94,212	106,068	112,777
Cash and Bank Balances	72,756	64,876	59,335	94,153
Loans and Advances	56,768	45,676	50,254	53,376
Other Current Assets	7,578	18,953	20,848	22,933
Less: Current Liabilities & Provisions	**60,365**	**61,869**	**64,172**	**62,893**
Payables	41,479	40,937	44,473	43,850
Other Current Liabilities	18,887	20,931	19,698	19,043
sub total				
Net Current Assets	283,946	289,572	312,079	361,987
Total Assets	**561,024**	**588,903**	**600,226**	**641,733**

E – Estimates

Important Ratios

Particulars	FY19A	FY20A	FY21E	FY22E
(A) Margins (%)				
Gross Profit Margin	72.9	71.9	72.3	72.7
EBIDTA Margin	22.0	21.2	21.8	22.8
EBIT Margin	16.0	15.0	15.8	16.9
Tax rate	15.4	16.5	17.0	17.0
Net Profit Margin	9.5	11.4	13.1	14.1
(B) As Percentage of Net Sales (%)				
COGS	27.1	28.1	27.7	27.3
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	38.8
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	336
FA T/O	1.8	2.0	2.4	2.7
(D) Measures of Investment				
AEPS (Rs)	15.8	16.5	19.8	23.1
CEPS (Rs)	23.1	25.1	28.9	32.8
DPS (Rs)	2.0	1.8	1.8	1.8
Dividend Payout (%)	12.6	10.6	8.8	7.6
BVPS (Rs)	172.6	188.7	196.0	216.7
RoANW (%)	6.9	8.7	10.3	11.2
RoACE (%)	9.1	8.2	9.1	9.9
RoAIC (%)	9.9	9.7	10.8	12.2
(E) Valuation Ratios				
CMP (Rs)	532	532	532	532
P/E	33.6	32.2	26.9	23.0
Mcap (Rs Mn)	1,275,708	1,275,708	1,275,708	1,275,708
MCap/ Sales	4.4	3.9	3.5	3.2
EV	1,262,378	1,237,642	1,239,393	1,200,975
EV/Sales	4.3	3.8	3.4	3.1
EV/EBITDA	19.7	17.7	15.6	13.4
P/BV	3.1	2.8	2.7	2.5
Dividend Yield (%)	0.4	0.3	0.3	0.3
(F) Growth Rate (%)				
Revenue	9.7	13.0	10.6	8.2
EBITDA	14.1	9.0	13.7	12.9
EBIT	13.1	5.9	16.5	15.6
PBT	12.2	27.9	25.1	15.6
APAT	40.4	4.5	19.6	16.7
EPS	40.4	4.5	19.6	16.7

Cash Flow

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
CFO	24,317	71,606	44,677	66,932
CFI	(40,361)	(46,990)	(10,805)	(14,847)
CFF	(10,494)	(32,497)	(39,412)	(17,266)
FCFF	(16,044)	24,616	33,872	52,085
Opening Cash	99,294	72,756	64,876	59,335
Closing Cash	72,756	64,876	59,335	94,153

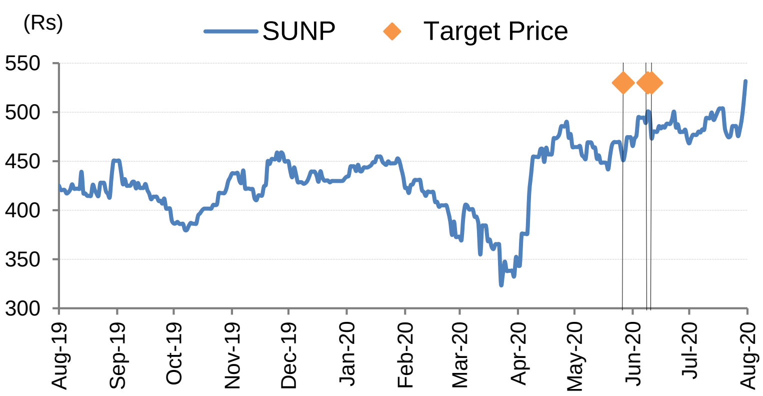
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

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

Rating and Target Price History



Month	Rating	TP (Rs.)	Price (Rs.)
May-20	Buy	530	451
Jun-20	Buy	530	501
Jun-20	Buy	530	474

*Price as on recommendation date

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