# Sun Pharmaceutical Industries

## Shining quarter for Sun

| Pharmaceuticals | Sharekhan code: SUNPHARMA | Result Update |
|---|---|---|

**3R MATRIX**

| | + | = | - |
|---|---|---|---|
| Right Sector (RS) | ✓ | | |
| Right Quality (RQ) | ✓ | | |
| Right Valuation (RV) | ✓ | | |

\+ Positive = Neutral - Negative

| Reco/View | Change |
|---|---|
| Reco: **Buy** | ↑ |
| CMP: **Rs. 485** | |
| Price Target: **Rs. 612** | ↑ |

↑ Upgrade ↔ Maintain ↓ Downgrade

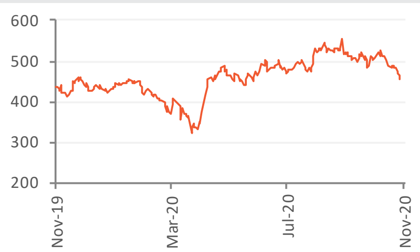
**Company details**

| | |
|---|---|
| Market cap: | Rs. 1,16,388 cr |
| 52-week high/low: | Rs. 565 / 315 |
| NSE volume: (No of shares) | 102 lakh |
| BSE code: | 524715 |
| NSE code: | SUNPHARMA |
| Free float: (No of shares) | 109.0 cr |

**Shareholding (%)**

| | |
|---|---|
| Promoters | 54.6 |
| FII | 14.3 |
| DII | 19.1 |
| Others | 12.1 |

**Price chart**




**Price performance**

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | -4.3 | -6.7 | 4.4 | 10.9 |
| Relative to Sensex | -8.3 | -15.7 | -15.1 | 10.6 |

*Sharekhan Research, Bloomberg*

**Summary**

- We upgrade our recommendation on Sun Pharmaceutical Industries from Hold to Buy with a revised PT of Rs. 612.
- Q2 performance was strong with revenue and earnings beating estimates.
- Management expects domestic formulations business to improve further led by new launches and a gradual improvement in the acute therapies, while the chronic segment is likely to grow strongly. Pick up in the specialty business and sturdy new product pipeline would enable US business growth.
- Improved growth prospects, healthy balance sheet, and improving return ratios would be key positives.

**Sun Pharmaceutical Industries (Sun Pharma) reported strong performance for the quarter with revenue and earnings coming ahead of estimates. Sales for the quarter stood at Rs. 8,553 crore, up 5.3% y-o-y, driven by 9% growth in exports while domestic revenue were flat on a y-o-y basis. However, sequentially, both India and US revenue posted growth of 6% and 17% respectively. Operating profit margin (OPM) for the quarter stood at 27%, translating into a 500 bps y-o-y expansion because of a 280 bps y-o-y expansion in gross margin (due to favourable mix). Low interest cost coupled with tax refund (as against tax outgo in Q2FY2020) resulted in adjusted PAT, growing strongly by 82% y-o-y to Rs. 1,929 crore and was ahead of estimates. India and US are the key markets for the company and constitute around 60% of the total topline. After four consecutive quarters of a decline, US revenue grew by 4% yoy for the quarter largely backed by improvement in the specialty business and growth in new product launches. The outlook for the US business has improved following a pick-up in the lucrative specialty business coupled with strong product pipeline, which would unfold going ahead. Moreover, price erosion is largely stable in the US generic business, which could also support growth. Domestic formulations business is on a strong footing backed by a a sturdy growth in the chronic segment while the performance of the acute segment has been weak. The management expects the same to improve going ahead as doctors return to OPDs and patient footfalls increase. Management sees the domestic formulations business to bounce back on account of new launches and gradual improvement in the prescriptions. Therefore, healthy growth outlook across both the key geographies and increasing penetration in other geographies would drive growth for Sun Pharma.**

**Key positives**

- After four consecutive quarters of decline, US revenue have registered of 4% y-o-y growth, driven by improvement in the specialty business.
- Gross margin expanded by 280 bps y-o-y, aided by better product mix.
- OPM expanded by sturdy 500 bps to 27%.

**Key negatives**

- Other expenses were lower in Q2FY2021 and management has stated that savings in other expenses would not be sustained going ahead as the marketing activity picks up with easing of the lockdown. Therefore, operating expenses could rise.

**Our Call**

**Valuation – Upgrade to Buy with a revised PT of Rs. 612:** Sun Pharma's key geographies, US and India are witnessing improved traction. Strong growth in chronic therapies along with likely improvement in acute therapies would fuel growth in the domestic formulations business. Moreover, a sturdy new product pipeline further provides visibility on India's revenue growth. Improvement in the US specialty business coupled with traction from new product launches would drive US revenue upwards. Moreover, geographic expansion/increasing penetration for existing products would grow the base business. Q2FY2021 was a strong quarter for Sun Pharma with revenue and earnings coming ahead of estimates. Favourable mix has resulted in OPM expanding by ~500 bps. Factoring in this, we have revised upwards our earnings estimates for FY2021 and FY2022 by 7% and 5%, respectively. We have also introduced FY2023 estimates in this note. At the CMP, the stock trades at 17.7x/15.8x its FY2022E/FY2023E EPS. Improved growth prospects, healthy balance sheet, and improving return ratios would be key positives. Therefore, we upgrade our recommendation on the stock from Hold to Buy with a revised PT of Rs. 612.

**Key risk**

1) Regulatory compliance risk including delay in product approvals. 2) Currency risk.

**Valuation (Consolidated)** Rs cr

| Particulars | FY2019 | FY2020 | FY2021E | FY2022E | FY2023E |
|---|---|---|---|---|---|
| Net sales | 29065.9 | 32837.5 | 35878.1 | 38919.7 | 42337.0 |
| Operating profit | 6307.6 | 6989.8 | 8610.7 | 9496.4 | 10457.2 |
| OPM (%) | 21.7% | 21.3% | 24.0% | 24.4% | 24.7% |
| Adj. PAT | 3879.8 | 4025.6 | 5532.7 | 6564.3 | 7346.7 |
| EPS (Rs.) | 16.2 | 16.8 | 23.1 | 27.4 | 30.6 |
| PER (x) | 30.0 | 28.9 | 21.0 | 17.7 | 15.8 |
| EV/EBIDTA (x) | 19.0 | 17.0 | 13.3 | 11.4 | 9.7 |
| ROCE (%) | 10.0 | 9.6 | 12.7 | 12.7 | 12.9 |
| RONW (%) | 9.4 | 8.9 | 11.9 | 12.5 | 12.4 |

*Source: Company; Sharekhan estimates*

**Strong quarter:** Sun Pharma reported a strong performance for the quarter with revenue and earnings coming ahead of estimates. Sales for the quarter stood at Rs. 8,553 crore, up 5.3% y-o-y. Growth was driven by 9% growth in exports revenue. The US business posted 17% growth sequentially, though it was flat y-o-y. Revenue from the RoW formulations segment also grew by 16% y-o-y. Overall revenue was marginally ahead of estimates. OPM for the quarter stood at 27%, translating to a 500 bps y-o-y expansion. A 280 bps y-o-y expansion in gross margin (due to favourable mix) to 74.9% drove OPM expansion. Operating profit for the quarter at Rs. 2309.6 crore grew by 29.7% y-o-y and was ahead of estimates. During the quarter, the company repaid debt of $300 million, thus leading to a 60% decline in interest cost. Further, the company reported tax refund in Q2FY2021 as compared to tax outgo in the corresponding quarter of the previous year. Consequently, adjusted PAT for the quarter stood at Rs. 1,929 crore as compared to Rs. 1,060 crore in Q2FY2021 and was ahead of estimates. Reported PAT for the quarter stood at Rs. 1,812 crore, up 70% y-o-y.

**US specialty business to pick up backed by new launches:** Sun Pharma's US business, which accounts for ~30% of total sales, has recorded 4% y-o-y growth to Rs. 2,492 crore. However, sequentially, revenue grew impressively by 17% y-o-y. Growth in US revenue can be attributed to improvement in the specialty business. The company's three specialty products – Ilumya, Cequa, and Lonza – have been gaining traction. During COVID-19 related lockdown, demand for these products was adversely impacted. However, current trends indicate pick up in demand for these products, which has bounced back to pre-COVID levels. Higher prescription due to doctors returning to OPDs and improving patient footfalls are the key reasons for growth. Going ahead, management expects the trend to improve further with higher patient footfalls. Following this, the company has increased its marketing activities, which would lead to higher prescriptions generated. Pick up in the specialty business in the US augurs well and will be a crucial growth factor. In addition to this, the company has an extensive product offering in the US consisting of approved ANDAs for 495 products. While it has filed for 92 ANDAs, which are awaiting approvals. Therefore, revival in the US specialty business coupled with a strong product pipeline would unfold going ahead, which would be the key growth driver for the US business.

**Domestic formulations business to pick up backed by strong growth in chronics and new launches:** Sun Pharma's India formulations business continued its growth trajectory in uncertain times as well. Revenue from India operations were at Rs. 2,531 crore, flat y-o-y, but up 6% q-o-q, comfortably outpacing the industry's growth. A strong presence in the chronics and sub-chronics segments resulted in q-o-q growth. Going ahead, management expects the domestic business to gain traction with the chronic segment being the key growth driver. Moreover, the company has launched 22 new products in the Indian markets during Q2FY2021, which would add to growth momentum. Further, the acute segment's performance has been muted during the quarter, attributable to lower infections. Moreover, patient footfalls were lower leading to lower prescriptions. Though sequentially there is visible improvement in OPD consultations as well as in patient footfalls. Thus, the acute segment's performance is expected to improve, though gradually. Overall management sees the domestic formulations business to grow strongly going ahead and has increased its field force during the previous quarter with an objective to expand its reach and deepen its penetration. Collectively, these factors would drive growth in the domestic business.

## Q2FY2021 Conference Call Highlights

- Sun Pharma's branded formulations business in India recorded revenue of Rs. 2,531 crore for Q2FY2021, up 0.6% y-o-y/6% q-o-q and accounted for ~30% of sales.
- Sun Pharma's market share in India stood at 8.1% as of Q2FY2021, as per AIOCD AWACS MAT report. The company has launched 22 new products in the Indian market during the quarter.
- US business sales stood at Rs. 2,492 crore, registering 4% growth y-o-y for Q2FY2020. Growth comes on the back of four consecutive quarters of decline in revenue. Improvement in the US specialty business and improving trend in doctor OPDs led to growth.
- Revenue of emerging markets stood at Rs. 1,558 crore, up 10% y-o-y. While revenue from Rest of the World (ROW) markets stood at Rs. 1,322 crore, up 16% y-o-y.

- Revenue from the active pharmaceutical ingredients (API) business stood at Rs. 510 crore, up 9% y-o-y. Management is looking to the API segment's growth, given the emerging opportunities in the sector.
- R&D spends during the quarter stood at Rs. 613 crore, 7.2% of sales. This compares with Rs. 450 crore in the corresponding quarter, translating to around 5.5% of sales.
- Sun Pharma has a strong product pipeline in US markets in the generic space with 92 ANDAs awaiting approval from USFDA (including 20 ANDAs with tentative approvals). In Q2FY2021, the company filed one ANDA and received approvals for four ANDAs. In addition to this, the company has 55 approved NDAs and six NDAs that are awaiting USFDA approval.
- Sun Pharma's Halol plant was classified as Official Action Indicated (OAI) by the USFDA. Following this, management has done the remediation process and has submitted the responses to the USFDA. A revert from the regulator is awaited.
- During 1HFY2021, the company has repaid debt of around $300 million.

**Results** Rs cr

| Particulars | Q2FY2021 | Q2FY2020 | YoY % | Q1FY2021 | QoQ % |
|---|---|---|---|---|---|
| Total sales | 8,553.1 | 8,123.4 | 5.3 | 7,585.3 | 12.8 |
| Operating profit | 2,309.6 | 1,781.2 | 29.7 | 1,764.7 | 30.9 |
| Other Income | 255.8 | 200.9 | 27.3 | 153.8 | 66.3 |
| EBITDA | 2,565.4 | 1,982.1 | 29.4 | 1,918.4 | 33.7 |
| Interest | 33.3 | 83.9 | -60.3 | 52.0 | -35.9 |
| Depreciation | 498.6 | 473.3 | 5.3 | 495.9 | 0.5 |
| PBT | 2,033.5 | 1,424.9 | 42.7 | 1,370.6 | 48.4 |
| Taxes | -31.2 | 266.0 | -111.7 | 245.9 | -112.7 |
| Adjusted PAT | 1,929.2 | 1,059.8 | 82.0 | 1,898.9 | 1.6 |
| Reported PAT | 1,812.8 | 1,064.1 | 70.4 | -1,655.3 | -209.5 |
| **Margins** | | | **BPS** | | **BPS** |
| OPM % | 27.0 | 21.9 | 508 | 23.3 | 374 |

*Source: Company; Sharekhan Research*

**Revenue Mix** Rs cr

| Particulars | Q2FY2021 | Q2FY2020 | YoY % | Q1FY2021 | QoQ % |
|---|---|---|---|---|---|
| **Formulations** | **7902.7** | **7453.1** | **6.0** | **6870.9** | **15.0** |
| India | 2531.0 | 2514.8 | 0.6 | 2388.4 | 6.0 |
| US | 2491.0 | 2389.7 | 4.2 | 2136.4 | 16.6 |
| Emerging Market | 1558.8 | 1411.7 | 10.4 | 1316.1 | 18.4 |
| ROW | 1322.0 | 1137.0 | 16.3 | 1030.0 | 28.3 |
| API | 510.4 | 468.1 | 9.0 | 553.7 | -7.8 |
| Others | 44.5 | 27.8 | 60.2 | 42.6 | 4.5 |
| **Total** | **8457.6** | **7949.0** | **6.4** | **7467.2** | **13.3** |
| Other Operating Income | 94.4 | 174.2 | -45.8 | 118.1 | -20.1 |
| **Total Sales** | **8552.0** | **8123.2** | **5.3** | **7585.3** | **12.7** |

*Source: Company; Sharekhan Research*

## Outlook and Valuation

### Sector View – Growth momentum to improve

Indian pharmaceutical companies are better placed to harness opportunities and post healthy growth going ahead. Indian companies are among the most competitive ones globally and hold a sizeable market share in most developed as well as other markets. Moreover, other factors such as easing of pricing pressures (especially in the US generics market), rise in product approvals, and plant resolutions by the USFDA coupled with strong growth prospects in domestic markets and emerging opportunities in the API space would be key growth drivers. This would be complemented by the strong capabilities developed by Indian companies (leading to shift towards complex molecules and biosimilars) and commissioning of expanded capacities by select players over the medium term. Collectively, this points towards a strong growth potential going ahead for pharma companies.

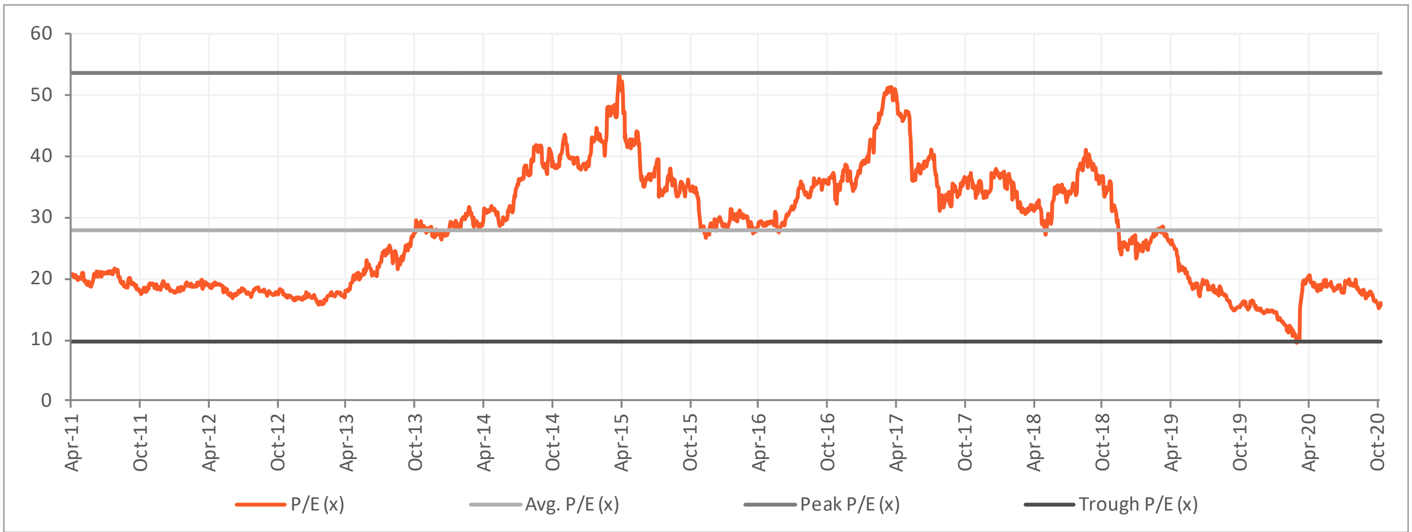
### Company Outlook – Improving growth prospects

Sun Pharma is a leading pharmaceutical company present across a broad spectrum of chronic and acute therapies, which include generics, branded generics, and complex drugs. India and US are the key markets for the company and constitute around 60% of the total topline. After four quarters of decline in US revenue, the company reported growth in Q2FY2021, largely backed by pick-up in the specialty business and likely pick-up in new product launches. Outlook for the US business has improved on account of a likely revival in the US specialty business coupled with a strong product pipeline, which would unfold going ahead, and would be the key growth driver for the US business. Moreover, price erosion is largely stable in the US generic business. Domestic formulations are on a strong footing as the chronic portfolio (50% of India sales) has reported healthy growth. The acute portion of the portfolio has been impacted, but it is showing signs of revival. Management sees the domestic formulations business to bounce back on account of new launches and gradual improvement. Therefore, improved outlook across both the key geographies and increasing penetration in other geographies would drive growth for Sun Pharma.

### Valuation – Upgrade to Buy with a revised PT of Rs. 612

Sun Pharma's key geographies, US and India are witnessing improved traction. Strong growth in chronic therapies along with likely improvement in acute therapies would fuel growth in the domestic formulations business. Moreover, a sturdy new product pipeline further provides visibility on India revenue growth. Improvement in the US specialty business coupled with traction from new product launches would drive US revenue upwards. Moreover, geographic expansion/increasing penetration for existing products would grow the base business. Q2FY2021 was a strong quarter for Sun Pharma with revenue and earnings coming ahead of estimates. Favourable mix has resulted in OPM expanding by ~500 bps. Factoring in this, we have revised upwards our earnings estimates for FY2021/FY2022 by 7% and 5%, respectively. We have also introduced FY2023 estimates in this note. At the CMP, the stock trades at 17.7x/15.8x its FY2022E/FY2023E EPS. Improved growth prospects, healthy balance sheet, and improving return ratios would be key positives. Therefore, we upgrade our recommendation on the stock from Hold to Buy with a revised PT of Rs. 612.

**One-year forward P/E (x) band**




*Source: Sharekhan Research*

**Peer Comparison**

| Particulars | CMP (Rs / Share) | O/S Shares (Cr) | MCAP (Rs Cr) | P/E (x) | | | EV/EBIDTA (x) | | | RoE (%) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | FY20 | FY21E | FY22E | FY20 | FY21E | FY22E | FY20 | FY21E | FY22E |
| Sun Pharma | 532.0 | 239.9 | 127,581 | 31.7 | 24.6 | 20.4 | 18.6 | 15.4 | 13.2 | 8.9 | 11.2 | 12.0 |
| AurobindoPharma | 875.0 | 58.6 | 51,243 | 17.6 | 16.6 | 15.7 | 11.1 | 9.9 | 8.6 | 19.0 | 16.9 | 15.4 |

*Source: Company, Sharekhan estimates*

## About company

Sun Pharma is the fourth largest specialty 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 include generics, branded generics, complex or difficult-to-make technology-intensive products, over-the-counter (OTC) products, anti-retroviral (ARVs), APIs, and intermediates. The company's global presence is supported by over 40 manufacturing facilities. India and the US are predominant markets, accounting for nearly 65% of revenue.

## Investment theme

Sun Pharma is a leading pharmaceutical company present across a broad spectrum of chronic and acute therapies, which include generics, branded generics, and complex drugs. India and US are the key markets for the company and constitute around 60% of the total topline. After four quarters of a decline in US revenue, the company reported growth in Q2FY2021, largely backed by pick-up in the specialty business and likely pick-up in new product launches. The outlook for the US business has improved on account of a likely revival in the US specialty business coupled with a strong product pipeline, which would unfold going ahead and would be the key growth driver for the US business. Moreover, the price erosion is largely stable in the US generic business. Domestic formulations are on a strong footing as the chronic portfolio (50% of India sales) has reported healthy growth. The acute portion of the portfolio has been impacted, but it is showing signs of revival. Management sees the domestic formulations business to bounce back on account of new launches and gradual improvement.

## 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 US with regards to price collusion.

## 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 |

*Source: Company Website*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | Life Insurance Corp of India | 5.88 |
| 2 | ICICI Prudential Asset Management | 3.22 |
| 3 | Vangaurd Group Plc | 1.62 |
| 4 | Reliance Capital Trustee Co Ltd | 1.46 |
| 5 | SBI Funds Management Pvt Ltd | 1.06 |
| 6 | Lakshdeep Investments and Finance | 1.31 |
| 7 | Republic of Singapore | 1.29 |
| 8 | BlackRock Inc | 1.01 |
| 9 | Norges Bank | 0.91 |
| 10 | Aditya Birla Sunlife Asset Management Co | 0.74 |

*Source: Bloomberg*

## Understanding the Sharekhan 3R Matrix

| | |
|---|---|
| **Right Sector** | |
| Positive | Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies |
| Neutral | Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies |
| Negative | Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability. |
| **Right Quality** | |
| Positive | Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance. |
| Neutral | Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable |
| Negative | Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet |
| **Right Valuation** | |
| Positive | Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment. |
| Neutral | Trading at par to historical valuations and having limited scope of expansion in valuation multiples. |
| Negative | Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple. |

*Source: Sharekhan Research*

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