Sharekhan by BNP PARIBAS

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Stock Update

Sun Pharmaceutical Industries Ltd

Strong Q1; growth outlook stays bright

Pharmaceuticals	Sharekhan code: SUNPHARMA	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 774**	
Price Target: **Rs. 900**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 1,85,704 cr
52-week high/low:	Rs. 780 / 453
NSE volume: (No of shares)	83.6 lakh
BSE code:	524715
NSE code:	SUNPHARMA
Free float: (No of shares)	109.2 cr

Shareholding (%)

Promoters	54.5
FII	12.0
DII	21.6
Others	11.9

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	14.6	18.2	31.2	51.8
Relative to Sensex	14.4	10.4	23.0	12.4

Sharekhan Research, Bloomberg

Summary

- Sun Pharma's Q1FY2022 results were strong driven by an impressive performance from the India, RoW and US businesses.
- A strong growth in chronic therapies, including the sub chronics along with new product launches would fuel growth in the domestic formulations business.
- Growth in the US business would be driven by a pick-up in specialty business coupled with traction from new product launches coupled with geographic expansion / increasing penetration.
- Improved growth prospects across business and full resolution of all matters by the Department of Justice antitrust and civil division in the US generic markets would be key positives. we retain Buy recommendation with a revised PT of Rs. 900.

Sun Pharma's Q1FY2022 results were strong driven by an impressive performance from the India, RoW and US businesses. Growth in the US business was largely attributable to strong show by the specialty portfolio. Overall Sales grew 28% y-o-y Rs. 9,718.7 crore, while OPM grew by 494 bps y-o-y to 28.2% attributable to benefits of operating leverage and lower cost. The company reported a one-time expenses amounting to Rs. 631 crore, towards provision for settlement of legal claims at subsidiary company, impairments and write down of assets. Consequently, adjusted PAT stood at Rs. 1,995 crore, as compared to Rs. 1898 crore in Q1FY21 (adjusted for exceptional expenses), which is a growth of 5% y-o-y but was ahead of estimates. India and the US are the company's key markets and constitute ~60% of total topline. India sales rose by 38.5% y-o-y led by strong growth in the base business, new product launches and complemented by COVID-led opportunities, which constituted 8-10% of India sales. Going ahead, the management expects the growth momentum to sustain, backed by product launches and expected traction in existing businesses – chronics and sub-chronics. Sun Pharma launched 13 products in India in Q1FY22 which would boost topline growth. The US business's topline too reported a strong growth of 30.9% y-o-y driven by growth in the specialty portfolio. The outlook for the US business has improved, following a pick-up in the lucrative specialty business with sales of specialty products - Illumya, Cequa and Absorica improving and the company expects further market share gains to accrue. Moreover, Sun is expecting the base business to grow backed by a strong product portfolio. Therefore, a healthy growth outlook across both key geographies and increasing penetration in other regions would drive the overall growth. Additionally, the settlement with Department of Justice Antitrust division and Civil Division by Subsidiary company would result in resolution of all multi year investigations in the US pharmaceutical generic industry is positive and could remove the overhang on the stock.

Key positives

- Domestic revenues grew strong by 38.5% y-o-y, while US sales grew 30.9% backed by an improvement in the specialty portfolio.
- OPM expanded by a sturdy 494 bps y-o-y to 28.2% due to low expenses.
- Resolution of all matters relating to multi year investigations by Department of Justice, Antitrust and Civil divisions in the US generics industry

Key negatives

- Delay in USFDA resolution for Halol plant.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 900: Sun Pharma's key geographies, US and India, are witnessing improved traction. A strong growth in chronic therapies, including the sub chronics along with likely growth in acute therapies and product launches would fuel growth in the domestic formulations business. Growth in the US business would be driven by a pick-up in specialty business coupled with traction from new product launches. Moreover, geographic expansion/increasing penetration for existing products would also add to the growth of the US base business. Q1FY2022 results were ahead of estimates and considering this, we have revised upwards our estimates for FY22E and FY23E. At the CMP, the stock trades at 26.3x/22.6x its FY2022E/FY2023E EPS, which is lower than the long-term historical average multiple. Improved growth prospects, healthy balance sheet position are the key positives, while resolution of all legal matters by subsidiary with Department of Justice antitrust and civil division in the US generic markets is positive and would remove the overhang on the stock. We retain Buy recommendation on the stock with a revised PT of Rs. 900.

Key risk

1) Regulatory compliance risk including delay in product approvals; 2) Currency risk; and 3) Delay in resolution of USFDA observations.

Valuation (Consolidated) Rs cr

Particulars	FY2019	FY2020	FY2021	FY2022E	FY2023E
Net sales	29065.9	32837.5	33498.1	38034.4	42025.7
Operating profit	6307.6	6989.8	8491.5	10041.1	11557.1
OPM (%)	21.70	21.29	25.35	26.40	27.50
Adj. PAT	3879.8	4025.6	6801.1	7061.5	8214.8
EPS (Rs)	16.2	16.8	28.3	29.4	34.2
PER (x)	47.9	46.1	27.3	26.3	22.6
EV/Ebidta (x)	30.0	26.9	21.7	17.8	14.8
ROCE (%)	10.0	9.6	12.7	14.1	14.8
RONW (%)	9.4	8.9	14.6	13.3	13.6

Source: Company; Sharekhan estimates

Strong quarter: Q1FY22 numbers were strong and ahead of estimates, driven by an impressive performance from the India business coupled with the RoW markets as well as the US business, attributable to strong performance of specialty portfolio. Sales grew by 28% y-o-y to Rs. 9718.7 crore, backed by a 38% growth in the India business while the US and RoW business grew by 31% and 33% y-o-y. The sales are ahead of estimates. The operating margins grew by 494 bps y-o-y to 28.2% and were ahead of estimates. Margin expansion can be attributed to benefits of operating leverage and low operating costs, as part of marketing and promotion activities were restrained. Operating profits at Rs 2741 crore up 55.3% y-o-y. During the quarter the company reported a one-time expense amounting to Rs 631 crore, which includes RS 442 crore towards provision for settlement of legal claims for Taro while Rs 150 crore are towards impairment of intangibles assets acquired and Rs 38 crore towards write-down of assets held for sale. Consequently the adjusted PAT for the quarter stood at Rs 1995 crore as compared to Rs 1898 crore in Q1FY21, which is growth of 5% y-o-y but was ahead of estimates. The PAT for Q1FY21 is adjusted for an exceptional expense of Rs 3633 crore towards provision for settlement of all multi-year investigations at the Department of Justice by subsidiary company.

Expected traction in the specialty segment; growth in the base business to drive the US sales: The US business, which accounts for ~29% of total sales, is on an improvement path and the management sees a strong growth traction going ahead. Revenue from the US have grown by a strong 29% y-o-y and 4% q-o-q. The growth in the US business could be largely attributable to the strong growth in the specialty business backed by strong growth in the specialty portfolio comprising Absorica, Cequa and Ilumya. The sales of all specialty portfolio have been gaining traction and the company continues to gain market share in the respective categories. Going ahead the specialty portfolio is expected to witness further market share gains as doctor OPD's fully open up and patient footfalls increase across markets. Currently the patient footfalls are lower and are below the pre-COVID levels, but are expected to improve, which could lead to higher prescriptions being generated. Also, Sun Pharma is in the process of expanding its specialty portfolio to other geographies, which in turn drive the growth. Pick up in the specialty business in the US augurs well and will be a crucial growth factor. In addition to this, offering in the US consisting of approved ANDAs for 505 products. While it has filed for 86 ANDAs, which are awaiting approvals. Therefore, pick up in the US specialty business coupled with a strong product pipeline, which would unfold going ahead, could be the key growth driver for the US business.

Domestic formulations clocks a strong growth in Q1FY22 backed by chronics and sub chronics: The India formulations business continued its growth trajectory in uncertain times as well. Revenue from India operations was at Rs. 3,308 crore, grew by 38.5% y-o-y, in line with the industry's growth. Growth can be attributed to the strong performance of sub-chronics and chronic segments; while acute therapies segment sales grew at a healthy pace. Going ahead, the management expects the domestic business to gain traction with the chronic including the sub chronics segment being the key growth driver. Moreover, the company has launched 13 new products in Q1FY22 in Indian markets while in FY2021 it has launched 31 new products, which would add to growth momentum, going ahead. Further in Q1FY22, the performance of the acute therapy products in the IPM has been phenomenal given the low base in the previous year due to lower infections. With the opening up of markets, the patient footfalls are expected to improve going ahead. Thus, the acute segment's performance is expected to improve for FY2022 as compared to FY2021. Overall, management sees domestic formulations business to grow strongly going ahead backed by new product launches, improving field-force productivity and expected traction in existing business. Collectively, these factors would drive growth in domestic sales ahead, which are expected to grow in double digit over the next two years.

Q1FY2022 Conference Call Highlights

- Indian branded formulations recorded a revenue of Rs. 3308 crore for Q1FY2022, up 38.5% y-o-y and accounted for ~34% of consolidated sales.
- Sun Pharma's market share in India stood at 8.0% as of Q1FY2022, as per AIOCD AWACS MAT report. The company has launched 13 new products in the Indian markets.

- US business sales stood at Rs. 2,800 crore, registering a strong growth of 30.9% y-o-y. Global specialty products have reported a healthy growth in sales to $148 mn as compared to $ 81 mn backed by improvement in its key products – Ilumya, Cequa and Absorica.
- Revenue of emerging markets stood at Rs. 1605 crore, up 21.9% y-o-y. While revenue from the RoW markets stood at Rs. 1368 crore, up 31.1% y-o-y.
- Revenue from the active pharmaceutical ingredients (API) business stood at Rs. 514.9 crore, falling by 7% y-o-y.
- R&D spends stood at Rs. 592 crore, at 6% of sales. This compares with Rs. 420.6 crore in the corresponding quarter, translating to ~5.5% of sales.
- Sun Pharma during the quarter has repaid debt of ~$185 million. Totally, over the last five quarters, the company has repaid debt of around $765 mn

Results (Consolidated) Rs cr

Particulars	Q1FY2022	Q1FY2021	YoY %	Q4FY2021	QoQ %
Total sales	9,718.7	7,585.3	28.1	8,523.0	14.0
Operating profit	**2,741.2**	**1,764.7**	**55.3**	**2,059.2**	**33.1**
Other Income	152.5	153.8	-0.8	111.0	37.4
EBITDA	**2,893.7**	**1,918.4**	**50.8**	**2,170.2**	**33.3**
Interest	35.1	52.0	-32.5	30.1	16.6
Depreciation	503.2	495.9	1.5	553.5	-9.1
PBT	**2,355.4**	**1,370.6**	**71.9**	**1,586.6**	**48.5**
Taxes	395.6	245.9	60.9	55.0	618.7
Adjusted PAT	**1,995.3**	**1,898.9**	**5.1**	**1,577.7**	**26.5**
EPS	8.3	7.9	5.1	6.6	26.5
Margins			**BPS**		**BPS**
OPM %	28.2	23.3	494	24.2	404
PATM %	14.9	-21.8	3668	10.5	437
Tax rate %	16.8	17.9	-115	3.5	1333

Source: Company; Sharekhan Research

Revenue Mix Rs cr

Particulars	Q1FY2022	Q1FY2021	YoY %	Q4FY2021	QoQ %
Formulations	**9081.6**	**6887.1**	**31.9**	**7958.1**	**14.1**
India	3308.4	2388.4	38.5	2670.8	23.9
US	2800.0	2138.9	30.9	2694.5	3.9
Emerging Market	1605.3	1316.4	21.9	1401.5	14.5
ROW	1368.0	1043.4	31.1	1191.3	14.8
API	514.9	553.7	-7.0	435.6	18.2
Others	72.9	45.0	62.2	37.4	95.0
Total	**9669.4**	**7485.8**	**29.2**	**8431.1**	**14.7**
Other Op Income	49.3	99.4	-50.4	91.6	-46.2
Total Sales	**9718.7**	**7585.3**	**28.1**	**8522.7**	**14.0**

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 and 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 a 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 pharmaceutical companies.

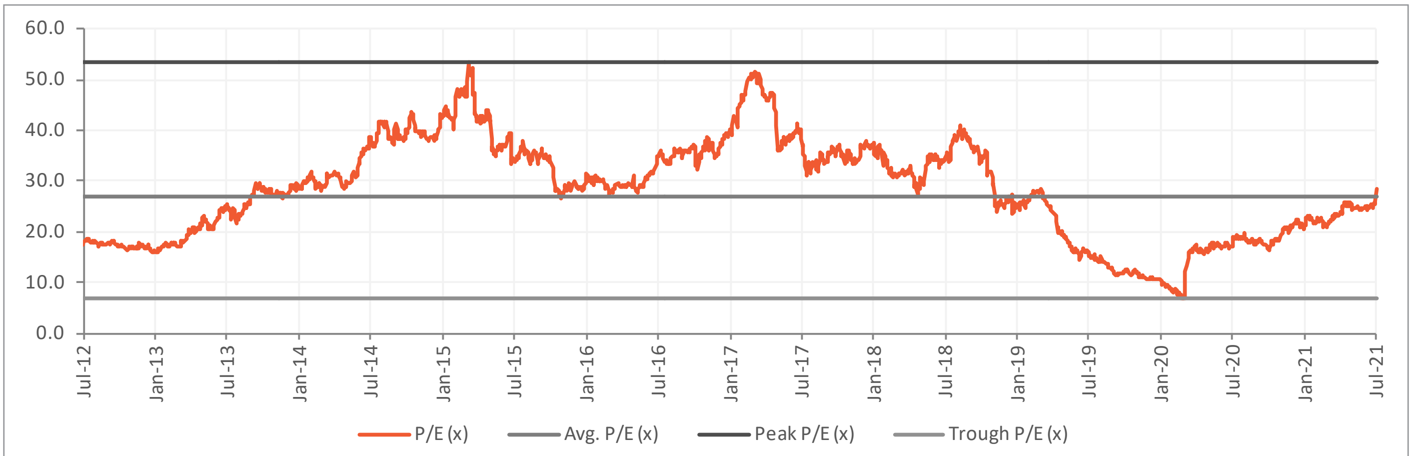
Company Outlook – Better growth prospects

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 the US are key markets for the company and constitute around 60% of the total topline. Sun Pharma's US business is on the path to revival largely backed by a marked improvement in the specialty portfolio due to growth in existing geographies as well as through geographical expansion. 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. Domestic formulations are on a strong footing as the chronic portfolio (50% of India sales) has reported healthy growth. The acute therapies portfolio is also expected to recover and stage a healthy growth. The management expects the domestic formulations business to bounce back on account of new launches, revival in the IPM and improvement in field-force productivity. Therefore, improved outlook across both key geographies India and US and increasing penetration in other geographies would drive growth for Sun Pharma.

Valuation – Retain Buy with a revised PT of Rs. 900

Sun Pharma's key geographies, US and India, are witnessing improved traction. A strong growth in chronic therapies, including the sub chronics along with likely growth in acute therapies and product launches would fuel growth in the domestic formulations business. Growth in the US business would be driven by a pick-up in specialty business coupled with traction from new product launches. Moreover, geographic expansion/increasing penetration for existing products would also add to the growth of the US base business. Q1FY2022 results were ahead of estimates and considering this, we have revised upwards our estimates for FY22E and FY23E. At the CMP, the stock trades at 26.3x/22.6x its FY2022E/FY2023E EPS, which is lower than the long-term historical average multiple. Improved growth prospects, healthy balance sheet position are the key positives, while resolution of all legal matters by subsidiary with Department of Justice antitrust and civil division in the US generic markets is positive and would remove the overhang on the stock. We retain Buy recommendation on the stock with a revised PT of Rs. 900.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBIDTA (x)			RoE (%)		
				FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Sun Pharma	774.0	239.9	1,85,703.0	27.3	26.3	22.6	21.7	17.8	14.8	14.6	13.3	13.6
Aurobindo	917	58.6	53721	21.7	14.0	11.6	9.8	7.8	6.0	12.8	16.2	16.6
Lupin	1107	45.2	50260	41.3	28.1	21.1	21.2	12.2	9.2	8.8	11.7	13.8

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, 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

Dilip S. Shanghvi	Managing Director
Abhay Gandhi	CEO, North America
C. S. Muralidharan	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	ICICI Prudential Asset Management	3.4
2	SBI Funds Management Pvt Ltd	2.0
3	Life Insurance Corp of India	6.6
4	HDFC Asset Management Co Ltd	1.52
5	Vanguard Group Inc/The	1.48
6	Nippon Life India Asset Management	1.43
7	Lakshdeep Investments and Finance	1.18
8	BlackRock Inc	1.15
9	Norges Bank	0.75
10	Mirae Asset Global Investments	0.57

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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