

Sun Pharma

Refer to important disclosures at the end of this report

Good quarter; near-term headwinds limit upside potential

- We maintain Hold rating on the stock as we believe the current valuations limit the upside potential in view of near-term headwinds such as 1) potential increase in R&D expense, 2) reversal of Covid and seasonal product sales in India and 3) increase in S&M costs.
- Q1 revenue/EBITDA/PAT beat our expectations by 3%/11%/33%. The revenue beat was driven by higher revenue in India, EM and the RoW businesses. The EBITDA beat was driven by slightly better gross margins and lower-than-expected other and R&D expenses.
- Global specialty sales of US\$157mn included a milestone payment of US\$10mn related to two specialty products. Excluding that, specialty sales were flat qoq. QoQ growth in Ilumya and Cequa was offset by Abosrica genericization and supply issues in Levulan.
- The stock is trading at a 1-year forward P/E of ~25x, which is largely in line with the historical average. We value SUNP at a 21x P/E on our Dec'23E EPS to arrive at a core business value of Rs750/share and add NPV/share of Rs25 for SCD-044 and gRevlimid.
- **All businesses, except API, see yoy growth:** India revenue growth of 26% yoy was driven by good growth in its chronic and sub-chronic therapies due to the longer monsoon season and ~Rs600mn contribution from Covid-related sales. Global specialty sales of US\$157mn included a milestone payment of US\$10mn related to two specialty products. Excluding that, specialty sales were largely flat qoq. Taro revenue was down 11% qoq. RoW and emerging markets saw a healthy uptick in sales (+10% yoy). API sales saw a decline, mainly due to lower opioid sales.
- **One-offs and lower R&D aid profitability:** The quarter included a US\$10mn milestone payment and Covid sales of ~Rs600mn in the domestic business. Adjusting for these, EBITDA margin would come down to ~27% from the reported EBITDA margin of 28.1%. In addition to topline one-offs, R&D expenses were exceptionally lower at 5.1% of sales (ex-Taro) due to slow patient enrollment in the PsA and SCD-004 trials.
- **Mixed guidance:** Management sounded confident in ramping up specialty sales. However, the FY23/24 specialty breakeven guidance given in Q1FY22 was withdrawn. On the cost front, management expects R&D expenses to inch up. Moreover, other expenses are expected to inch up due to the launch costs related to Winlevi and the return of medical conferences and international travel. ETR was also guided higher for the ensuing quarters.
- **Softness in Specialty and near-term headwinds keep us on sidelines:** We raise our FY22E earnings estimates by 8% to reflect the Q2 beat but largely maintain our FY23/24E estimates. Specialty sales growth paused in Q2, a trend we believe could likely continue in Q3 as well, as more Absorica competition has emerged. Despite baking in ample upside for key specialty molecules, such as Ilumya and Cequa, the stock is still trading at a 1-year forward P/E of 25x, in line with its historical average. **Upside risks:** Higher-than-expected growth in businesses and Halol plant resolution. **Downside risks:** Lower-than-expected growth in specialty, adverse regulatory actions, and higher price erosion in the US.

Please see our sector model portfolio (Emkay Alpha Portfolio): [Pharmaceuticals \(Page 9\)](#)

Financial Snapshot (Consolidated)

(Rs mn)	FY20	FY21	FY22E	FY23E	FY24E
Net Sales	328,375	334,981	379,123	410,667	445,374
EBITDA	70,559	84,677	99,511	108,606	121,669
EBITDA Margin (%)	21.5	25.3	26.2	26.4	27.3
APAT	42,438	59,318	68,536	74,374	86,706
EPS (Rs)	17.7	24.7	28.6	31.0	36.2
EPS (% chg)	9.4	39.8	15.5	8.5	16.6
ROE (%)	9.8	12.9	13.9	13.5	13.9
P/E (x)	46.1	33.0	28.5	26.3	22.6
EV/EBITDA (x)	27.8	22.7	19.0	16.8	14.4
P/BV (x)	4.3	4.2	3.8	3.3	3.0

Source: Company, Emkay Research

CMP	Target Price
Rs 815 as of (November 2, 2021)	Rs 775 (▲) 12 months
Rating	Upside
HOLD (■)	(5.0) %

Change in Estimates

EPS Chg FY22E/FY23E (%)	-/
Target Price change (%)	3.3
Target Period (Months)	12
Previous Reco	HOLD

Emkay vs Consensus

EPS Estimates		
	FY22E	FY23E
Emkay	28.6	31.0
Consensus	29.0	33.0
Mean Consensus TP (12M)	Rs 881	

Stock Details

Bloomberg Code	SUNP IN
Face Value (Rs)	1
Shares outstanding (mn)	2,399
52 Week H/L	851 / 459
M Cap (Rs bn/USD bn)	1,956 / 26.19
Daily Avg Volume (nos.)	4,124,513
Daily Avg Turnover (US\$ mn)	43.9

Shareholding Pattern Sep '21

Promoters	54.5%
FIIIs	12.1%
DIIIs	21.7%
Public and Others	11.7%

Price Performance

(%)	1M	3M	6M	12M
Absolute	(1)	5	25	74
Rel. to Nifty	(3)	(5)	2	15

Relative price chart



Source: Bloomberg

This report is solely produced by Emkay Global. The following person(s) are responsible for the production of the recommendation:

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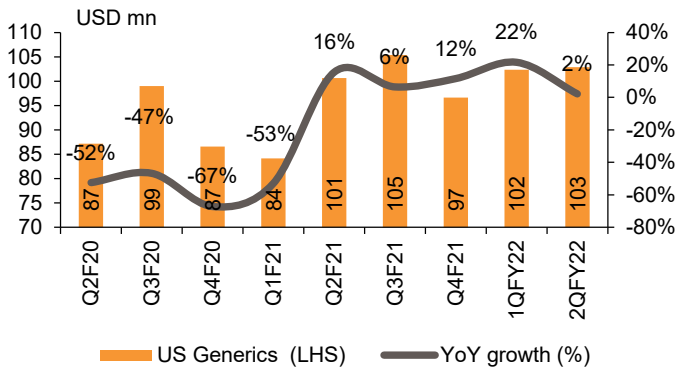
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Story in Charts

Exhibit 1: US generics revenue (ex-Taro) grew modestly yoy



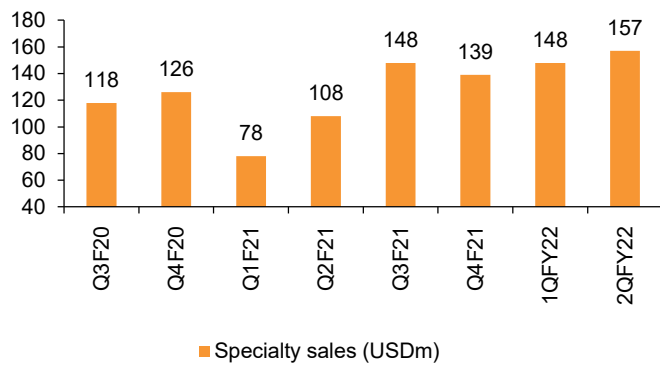
Source: Company, Emkay Research

Exhibit 2: Taro sales declined drastically



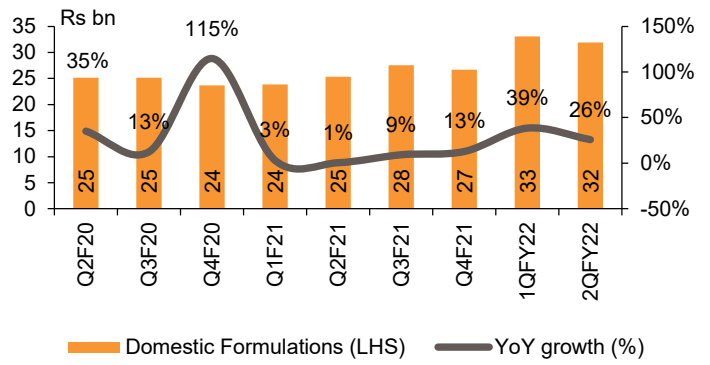
Source: Company, Emkay Research

Exhibit 3: Specialty sales grew by US\$9mn sequentially



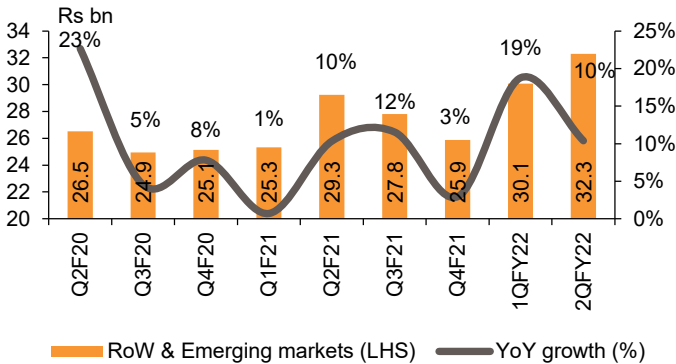
Source: Company, Emkay Research

Exhibit 4: India business continued its strong momentum



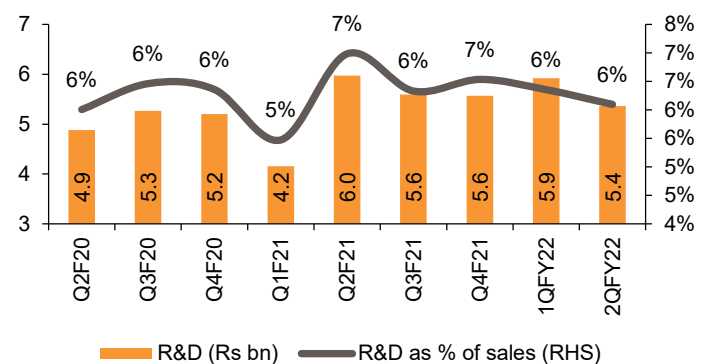
Source: Company, Emkay Research

Exhibit 5: RoW and EM revenues also posted healthy growth



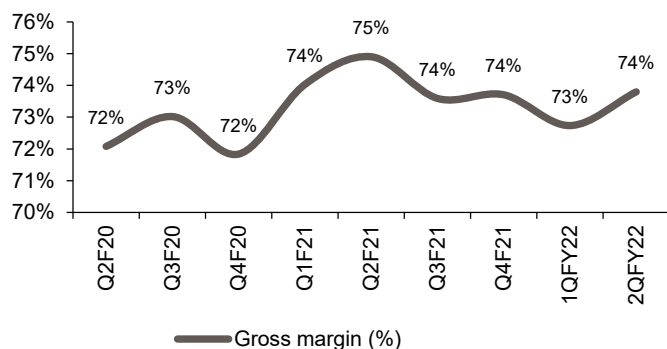
Source: Company, Emkay Research

Exhibit 6: R&D expenses have come off sequentially



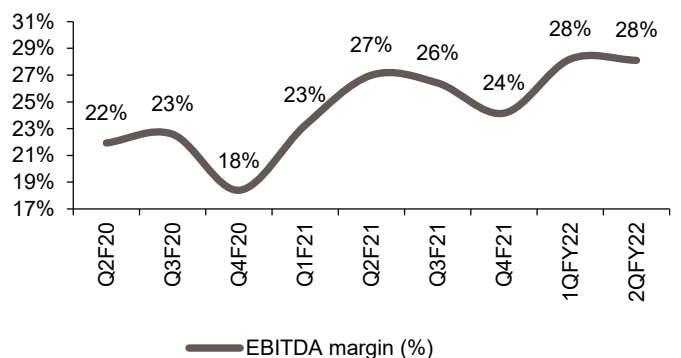
Source: Company, Emkay Research

Exhibit 7: Sequentially, gross margin improved a bit



Source: Company, Emkay Research

Exhibit 8: EBITDA margin remained flat qoq



Source: Company, Emkay Research

Exhibit 9: Quarterly Snapshot

Particulars (Rs mn)	2QFY22	2QFY21	YoY (%)	1QFY21	QoQ (%)	Emkay 2QFY22E	Var (%)
Total revenue	96,259	85,531	13	97,187	(1)	93,710	3
COGS	25,219	21,463	17	26,494	(5)	24,909	1
% of revenues	26.2	25.1	110	27.3	-106	26.6	-38
Personnel exp & others	43,978	40,972	7	43,281	2	44,493	(1)
% of revenues	46	48	-222	45	115	47	-179
EBITDA	27,063	23,096	17	27,412	(1)	24,308	11
EBITDAM (%)	28.1	27.0	111	28.2	(9)	25.9	217
Depreciation & Amortization	5,304	4,986	6	5,032	5	5,238	1
EBIT	21,759	18,110	20	22,380	(3)	19,070	14
EBITM (%)	22.6	21.2	143	23.0	-42	20.4	225
Other income + FX gain/loss	1,465	1,394	5	2,324	(37)	514	185
Interest cost	360	333	8	351	2	217	65
PBT	22,865	19,172	19	24,353	(6)	19,367	18
Tax	1,978	1,911	4	3,956	(50)	3,292	(40)
% Tax rate	9	10	-132	16	-759	17	-835
Minorities / Associates	(418)	(1,356)	-	355	-	(716)	(42)
Adjusted Net profit	20,470	15,905	29	20,752	(1)	15,359	33
Exceptional items	-	2,223	-	(6,311)	-	0	na
Reported Net profit	20,470	18,128	13	14,442	42	15,359	33

Source: Company, Emkay Research

Exhibit 10: Segmental Breakdown

Particulars (Rs mn)	2QFY22	2QFY21	YoY (%)	1QFY21	QoQ (%)	Emkay 2QFY22E	Var (%)
North America	16,967	14,380	18	17,388	(2)	17,789	(5)
RoW	31,933	29,252	9	30,089	42	29,721	7
India	31,878	25,311	26	33,084	(4)	29,108	10
API	4,358	5,104	(15)	5,149	(15)	5,104	(15)
Other operating income	692	944	(27)	493	40	991	(30)
Total ex-Taro revenue	85,827	74,991	14	86,203	9	82,713	4
Taro revenue	10,891	10,540	3	10,984	(41)	10,997	(1)
Total Revenue	96,259	85,531	13	97,187	(1)	93,710	3

Source: Company, Emkay Research

Exhibit 11: Actual vs. Estimates (Q2FY22)

(Rs mn)	Actual	Estimates		Variation		Comments
		Emkay	Consensus	Emkay	Consensus	
Revenues	97,187	91,425	87,546	6.3%	11.0%	Revenue beat driven by India and RoW
EBITDA	27,412	22,926	21,007	19.6%	30.5%	Lower employee costs and R&D drove EBITDA beat
EBITDA margin	28%	25%	24.0%	313bps	421bps	
Adj. PAT	20,752	14,704	14,128	41.1%	46.9%	PAT beat driven by EBITDA beat & lower tax

Source: Company, Emkay Research

Change in estimates

Exhibit 12: Revision in earnings estimates

Y/E, Mar (Rs mn)	FY22E			FY23E			FY24E		
	Earlier	Revised	% Change	Earlier	Revised	% Change	Earlier	Revised	% Change
Revenues	375,483	379,123	1%	410,748	410,667	0%	444,856	445,374	0%
EBITDA	96,317	99,511	3%	107,862	108,606	1%	122,348	121,669	-1%
EBITDAM (%)	25.7%	26.2%	55bps	26.3%	26.4%	15bps	27.5%	27.3%	-18bps
APAT	63,535	68,536	8%	73,114	74,374	2%	86,955	86,706	0%
EPS (Rs)	26.5	28.6	8%	30.5	31.0	2%	36.3	36.2	0%

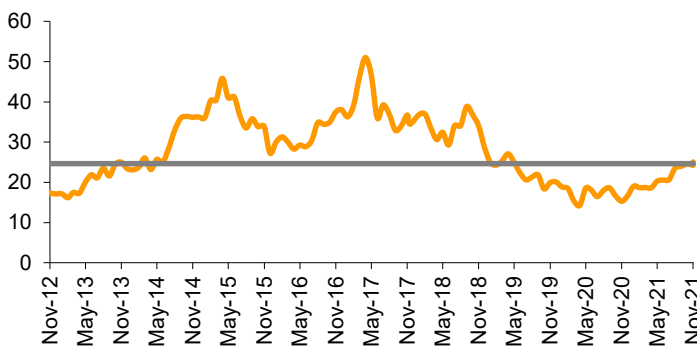
Source: Emkay Research

Exhibit 13: Emkay vs. Consensus

Y/E, Mar (Rs mn)	FY22E			FY23E			FY24E		
	Emkay	Consensus	% Variation	Emkay	Consensus	% Variation	Emkay	Consensus	% Variation
Revenues	379,123	379,273	0%	410,667	415,345	-1%	445,374	461,270	-3%
EBITDA	99,511	99,905	0%	108,606	112,048	-3%	121,669	128,824	-6%
EBITDAM (%)	26.2%	26.3%	-9bps	26.4%	27.0%	-53bps	27.3%	27.9%	-61bps
APAT	68,536	68,822	0%	74,374	77,306	-4%	86,706	91,135	-5%
EPS (Rs)	28.6	28.7	0%	31.0	32.2	-4%	36.2	38.0	-5%

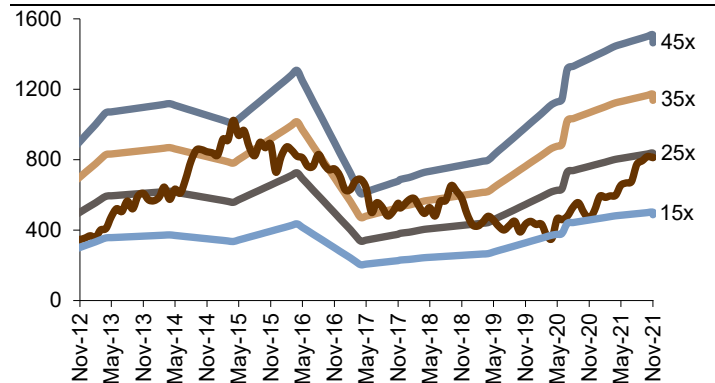
Source: Emkay Research

Exhibit 14: 1-year forward PE



Source: Emkay Research, Bloomberg

Exhibit 15: P/E Band



Source: Emkay Research, Bloomberg

Con-call takeaways

Specialty

- The global specialty business clocked revenues of US\$157mn in this quarter vs. US\$108mn in Q2FY21. Specialty sales of US\$157mn also include US\$10mn of sales milestone for two of its products. While Ilumya and Cequa continued to grow yoy and qoq, Levulan sales were down qoq due to supply issues, which are getting normalized.
- Ilumya saw growth both year-over-year and sequentially, and continued to gain traction in the US and global markets. On an annualized basis, Ilumya and Cequa grew 70% and 100% yoy, respectively.
- DTC in Ilumya has come down significantly in the US, and the current DTC expenses should be considered as the normal base.
- In the Isotretinoin market, Sun Pharma had a market share of 7% before Absorica genericization. The company holds a similar market share now as well, despite Absorica genericization, although realization has declined.
- The company recently launched Winlevi in the US. It will initially focus on communicating the message to the doctors, as companies are not allowed to undertake DTC in the first six months of a launch. Formulary coverage for any product is an ongoing process and takes time to ramp up. Management highlighted it is comfortable with the access it has at the time of launch. The company has increased its size of the field force for the commercialization of Winlevi although it ruled out any significant increase in field force subsequently.
- Q2 is a weak quarter for Derma. Patient flows to doctor clinics are still lower than pre-Covid levels.

US Generics

- US generics (ex-Taro) recorded yoy growth on new launches and better supply-chain management.
- Filings of 88 ANDAs and 13 NDAs await US FDA approval, including (20 tentative approvals). All 13 NDAs are filed through the 505(b)(2) route. Sun Pharma received 3 approvals and launched 6 products in the quarter.
- Management highlighted that it continues to face pricing pressure in the generics business.
- The product chosen for biosimilars would fall under the 3rd wave of biosimilars with patent expiry in 2027/28.

India Business

- India business growth was driven by improving growth in the chronic segment, sub-chronic segment and anti-infective therapies (primarily cough and cold). Improved patient flows to clinics aided growth as well. Sun Pharma's underlying base business also saw strong growth in Q2.
- Sun Pharma had expanded its field force by ~10%. This helped the company grow faster than IPM. The field force has now stabilized, and travel costs have returned to near normal levels.
- The company launched 28 new products in India in the quarter.
- Patient footfall is 85-90% of the pre-Covid level.

Business commentary

- Covid-related contribution in the quarter was minimal at ~Rs600-700mn.
- Material costs in the current quarter were higher than in Q2 last year due to product mix and geography mix. Higher selling & distribution expenses drove other expenses up.
- The decline in R&D expenses yoy was due to the spill-over of certain clinical studies into subsequent quarters. The cost of clinical trials is linked to the ability to enroll new subjects for clinical trials, and since the enrollment was slow due to Covid, R&D expenses were subdued. Specialty R&D accounted for 28% of total R&D.
- Going forward, margins should be under pressure from a cost point of view. However, Sun Pharma has been able to pass the cost increases to customers in many businesses. While normalization of operations should increase other expenses, the company may not reach 100% of pre-Covid other expenses due to cost-saving measures.
- ETR should inch up gradually, going forward.

Others

- The company strongly denied all allegations mentioned in the news regarding the whistleblower complaint. In addition, the US SEC has not reached out to the company.
- Sun Pharma has not received any intimation from the US FDA regarding the audit of the Halol facility.

Key Financials (Consolidated)**Income Statement**

Y/E Mar (Rs mn)	FY20	FY21	FY22E	FY23E	FY24E
Net Sales	328,375	334,981	379,123	410,667	445,374
Expenditure	257,816	250,304	279,613	302,062	323,705
EBITDA	70,559	84,677	99,511	108,606	121,669
Depreciation	20,528	20,800	20,747	21,275	21,542
EBIT	50,031	63,878	78,764	87,330	100,126
Other Income	5,662	8,592	3,867	5,096	8,214
Interest expenses	3,028	1,414	1,003	1,156	1,113
PBT	52,666	71,055	81,628	91,270	107,228
Tax	6,009	8,582	11,783	14,603	18,229
Extraordinary Items	(2,606)	(30,280)	(6,311)	0	0
Minority Int./Income from Assoc.	(4,219)	(3,155)	(1,308)	(2,293)	(2,293)
Reported Net Income	39,832	29,038	62,226	74,374	86,706
Adjusted PAT	42,438	59,318	68,536	74,374	86,706

Balance Sheet

Y/E Mar (Rs mn)	FY20	FY21	FY22E	FY23E	FY24E
Equity share capital	2,399	2,399	2,399	2,399	2,399
Reserves & surplus	450,245	462,229	516,551	582,037	659,256
Net worth	452,645	464,628	518,950	584,437	661,656
Minority Interest	38,602	30,171	31,479	33,772	36,065
Loan Funds	75,783	33,430	38,530	37,093	34,886
Other Liabilities	13,924	11,431	11,431	11,431	11,431
Total Liabilities	580,954	539,660	600,391	666,732	744,038
Net block	112,263	111,715	162,575	159,299	155,757
Investment	125,311	141,048	141,048	141,048	141,048
Current Assets	316,542	304,421	359,717	439,436	530,024
Cash & bank balance	64,876	64,455	101,913	164,289	231,623
Other Current Assets	78,704	59,382	60,660	65,707	71,260
Current liabilities & Provision	101,571	137,007	125,826	135,928	145,667
Net current assets	214,971	167,414	233,891	303,508	384,356
Misc. exp	0	0	0	0	0
Total Assets	580,954	539,660	600,391	666,732	744,038

Cash Flow

Y/E Mar (Rs mn)	FY20	FY21	FY22E	FY23E	FY24E
PBT (Ex-Other income)	47,004	62,463	77,761	86,174	99,014
Depreciation & Amortisation	20,528	20,800	20,747	21,275	21,542
Chg in working cap	8,986	25,641	(29,020)	(7,241)	(13,514)
Operating Cashflow	45,816	54,424	11,598	39,006	42,171
Capital expenditure	14,500	10,730	15,000	18,000	18,000
Free Cash Flow	60,315	65,154	26,598	57,006	60,171
Investments	(21,541)	(15,738)	0	0	0
Other Investing Cash Flow	0	0	0	0	0
Investing Cashflow	(1,379)	3,584	18,867	23,096	26,214
Equity Capital Raised	0	0	0	0	0
Loans Taken / (Repaid)	(33,419)	(44,896)	5,100	(1,438)	(2,206)
Dividend paid (incl tax)	10,957	(15,862)	(6,595)	(6,595)	(7,194)
Other Financing Cash Flow	(28,336)	18,488	(2,443)	5,096	8,214
Financing Cashflow	(53,516)	(43,712)	(4,941)	(4,092)	(2,299)
Net chg in cash	(9,080)	14,296	25,524	58,009	66,087
Opening cash position	149,648	0	0	0	0
Closing cash position	64,876	64,455	101,913	164,289	231,623

Source: Company, Emkay Research

Key Ratios

Profitability (%)	FY20	FY21	FY22E	FY23E	FY24E
EBITDA Margin	21.5	25.3	26.2	26.4	27.3
EBIT Margin	15.2	19.1	20.8	21.3	22.5
Effective Tax Rate	11.4	12.1	14.4	16.0	17.0
Net Margin	14.2	18.6	18.4	18.7	20.0
ROCE	9.0	11.7	14.1	14.0	14.4
ROE	9.8	12.9	13.9	13.5	13.9
RoIC	19.2	26.8	30.9	29.5	33.0

Per Share Data (Rs)	FY20	FY21	FY22E	FY23E	FY24E
EPS	17.7	24.7	28.6	31.0	36.2
CEPS	26.3	33.4	37.2	39.9	45.1
BVPS	188.8	193.8	216.4	243.7	275.9
DPS	1.6	1.6	1.6	1.6	1.6

Valuations (x)	FY20	FY21	FY22E	FY23E	FY24E
PER	46.1	33.0	28.5	26.3	22.6
P/CEPS	31.1	24.4	21.9	20.4	18.1
P/BV	4.3	4.2	3.8	3.3	3.0
EV / Sales	6.0	5.7	5.0	4.4	3.9
EV / EBITDA	27.8	22.7	19.0	16.8	14.4
Dividend Yield (%)	0.2	0.2	0.2	0.2	0.2

Gearing Ratio (x)	FY20	FY21	FY22E	FY23E	FY24E
Net Debt/ Equity	0.0	(0.1)	(0.1)	(0.2)	(0.3)
Net Debt/EBIDTA	0.1	(0.4)	(0.7)	(1.2)	(1.6)
Working Cap Cycle (days)	166.8	112.2	127.1	123.7	125.2

Growth (%)	FY20	FY21	FY22E	FY23E	FY24E
Revenue	13.0	2.0	13.2	8.3	8.5
EBITDA	11.9	20.0	17.5	9.1	12.0
EBIT	9.9	27.7	23.3	10.9	14.7
PAT	49.4	(27.1)	114.3	19.5	16.6

Quarterly (Rs mn)	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Revenue	85,531	88,368	85,230	97,187	96,259
EBITDA	23,096	23,345	20,592	27,412	27,063
EBITDA Margin (%)	27.0	26.4	24.2	28.2	28.1
PAT	18,128	18,525	8,942	14,442	20,470
EPS (Rs)	7.6	7.7	3.7	6.0	8.5

Source: Company, Emkay Research

Shareholding Pattern (%)	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Promoters	54.7	54.5	54.5	54.5	54.5
FIIIs	12.4	12.2	11.7	11.5	12.1
DIIIs	20.5	20.9	21.6	22.0	21.7
Public and Others	12.5	12.5	12.2	12.1	11.7

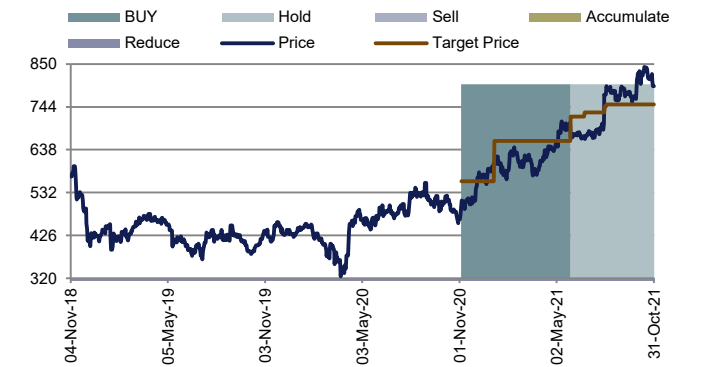
Source: Capitaline

RECOMMENDATION HISTORY TABLE

Date	Closing Price	TP	Period (months)	Rating	Analyst
11-Oct-21	833	750	12m	Hold	Kunal Dhamesha
11-Sep-21	776	750	12m	Hold	Kunal Dhamesha
05-Sep-21	789	750	12m	Hold	Kunal Dhamesha
13-Aug-21	778	750	12m	Hold	Kunal Dhamesha
03-Aug-21	795	750	12m	Hold	Kunal Dhamesha
31-Jul-21	774	745	12m	Hold	Kunal Dhamesha
18-Jul-21	689	730	12m	Hold	Kunal Dhamesha
13-Jul-21	683	730	12m	Hold	Kunal Dhamesha
11-Jul-21	668	730	12m	Hold	Kunal Dhamesha
23-Jun-21	665	730	12m	Hold	Kunal Dhamesha
13-Jun-21	681	720	12m	Hold	Kunal Dhamesha
28-May-21	670	720	12m	Hold	Kunal Dhamesha
13-Apr-21	627	660	12m	Buy	Kunal Dhamesha
12-Mar-21	614	660	12m	Buy	Kunal Dhamesha
14-Feb-21	627	660	12m	Buy	Kunal Dhamesha
31-Jan-21	586	660	12m	Buy	Kunal Dhamesha
12-Jan-21	610	660	12m	Buy	Kunal Dhamesha
05-Jan-21	603	660	12m	Buy	Kunal Dhamesha
16-Dec-20	577	560	12m	Buy	Kunal Dhamesha
04-Nov-20	505	560	12m	Buy	Kunal Dhamesha

Source: Company, Emkay Research

RECOMMENDATION HISTORY CHART



Source: Bloomberg, Company, Emkay Research

Emkay Alpha Portfolio – Pharmaceuticals



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Sector

Pharmaceuticals

Analyst bio

Dr. Kunal Dhamesha is an MBBS and has completed his MBA from IIM Lucknow. As an equity analyst, he has tracked multiple healthcare verticals for 9+ years. His team currently covers 7 stocks.

EAP sector portfolio

Company Name	BSE200 Weight	EAP Weight	OW/UW (%)	OW/UW (bps)	EAP Weight (Normalised)
Pharmaceuticals	2.70	2.70	0%	0	100.00
Aurobindo Pharma	0.19	0.19	-1%	0	6.93
Cadila Healthcare	0.12	-0.79	-739%	-91	-29.29
Cipla	0.45	0.45	1%	1	16.72
Dr. Reddy's Lab	0.56	0.68	21%	12	25.20
Gland Pharma	0.17	0.50	186%	33	18.56
Ipca Lab	0.14	0.21	52%	7	7.78
Lupin	0.22	0.49	122%	27	18.04
Sun Pharma	0.85	0.97	15%	13	36.07
Cash	0.00	0.00	NA	0	0.00

Source: Emkay Research

* Not under coverage: Equal Weight

High Conviction/Strong Over Weight High Conviction/Strong Under Weight

Sector portfolio NAV

	Base					Latest
	1-Apr-19	2-Nov-20	3-May-21	2-Aug-21	30-Sep-21	1-Nov-21
EAP - Pharmaceuticals	100.0	150.6	179.5	184.4	185.8	180.2
BSE200 Neutral Weighted Portfolio (ETF)	100.0	133.7	166.2	170.9	171.9	165.5

*Performance measurement base date 1st April 2019

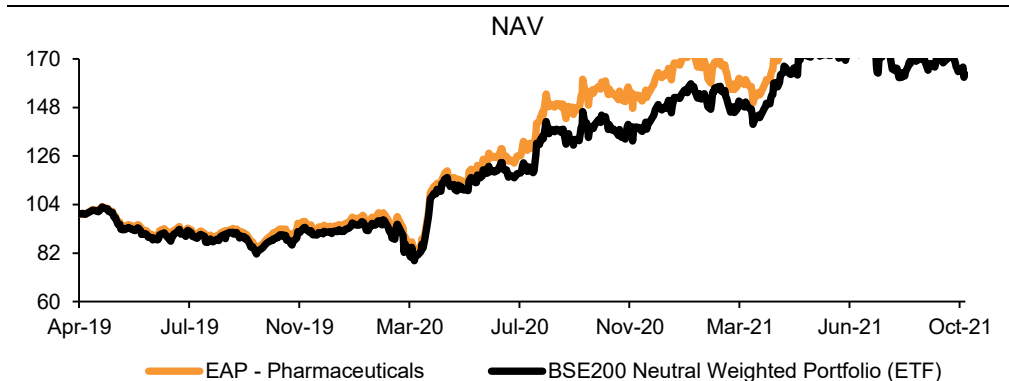
Source: Emkay Research

Price Performance (%)

	1m	3m	6m	12m
EAP - Pharmaceuticals	-3.0%	-2.3%	0.4%	19.6%
BSE200 Neutral Weighted Portfolio (ETF)	-3.7%	-3.1%	-0.4%	23.8%

Source: Emkay Research

NAV chart



Source: Emkay Research

Please see our model portfolio (Emkay Alpha Portfolio): [Nifty](#)

Please see our model portfolio (Emkay Alpha Portfolio): [SMID](#)

“Emkay Alpha Portfolio – SMID and Nifty are a supporting document to the Emkay Alpha Portfolios Report and is updated on regular intervals”

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

Completed Date: 03 Nov 2021 03:30:12 (SGT)

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