Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Sun Pharmaceutical Industries Ltd

Specialty ramp up to drive growth

Pharmaceuticals	Sharekhan code: SUNPHARMA
Reco/View: Buy ↔	CMP: Rs. 828	Price Target: Rs. 1000 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Stock Update

Company 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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 36.25

Updated Feb 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

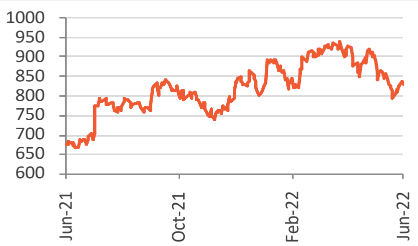
Company details

Market cap:	Rs. 198,648 cr
52-week high/low:	Rs. 966 / 664
NSE volume: (No of shares)	40.3 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	-8.4	-8.5	1.6	22.4
Relative to Sensex	-5.3	-0.8	9.7	21.6

Sharekhan Research, Bloomberg

Summary

- We re-iterate our Buy recommendation on the stock of Sun Pharma with an unchanged price target of Rs. 1,000. The stock price has corrected by ~ 12% over the past two months and the valuations are now attractive.
- Growth in the specialty business with strong product pipeline and portfolio, new product launches and steady growth in US generics are drivers for US business.
- Strong growth across therapies and traction from new launches and field force expansion would be the key drivers for India business and basis this Sun Pharma looks to outpace the industry growth.
- Improved growth prospects across businesses and a healthy balance sheet position are the key positives.

Sun Pharmaceutical Industries Limited's (Sun Pharma) Specialty business is poised for a strong growth ahead with Illumya, Cequa and Winlevi to be the key contributors. Also the robust growth outlook for the India business backed by field force addition and new product launches gaining traction, would also add to the overall growth. The management has guided for a high single digit to low double-digit growth in revenue for FY2023 and basis the expected strong traction in specialty segment and India business, this seems achievable comfortably. While on the cost front the elevated cost pressures are expected to normalize gradually and thus could aid OPM expansion.

- **Expected traction across specialty Business to aid US sales growth:** Revenue from the US business grew strongly by 12% y-o-y despite price erosion seen across the industry in the US, aided by strong growth in the specialty segment sales which grew by 42% y-o-y in FY22. The strong performance of Illumya has been the key growth driver for speciality segment, well supported by other products. Going ahead growth in existing products, a strong product pipeline, expanding geographic presence and a pick-up in new launches are likely to offset the impact of reduced Absorica sales, thus making the speciality segment a key growth driver.
- **India business to outpace the industry growth:** The India business continued its strong growth trajectory in FY22 with the revenues growing by 23% y-o-y supported by a strong performance of Chronics as well as acute therapies. The management expects the strong growth traction to sustain backed by a sturdy new product pipeline with the company launching 77 new products in FY22 which would ramp up going ahead. Overall, management sees domestic formulations business to grow strongly going ahead, backed by new product launches, improving field force productivity and expansion, and expected traction in the existing business. Collectively, basis the above the company expects to outpace the industry growth.
- **Outlook Improving:** The management had guided for a high single-digit or low double-digit growth in revenue for FY2023 backed by growth across segments, with specialty segment and India business likely to be a key growth driver. Considering the expected traction in the specialty segment and strong outlook for the India business the guidance seems achievable. While on the cost front the elevated cost pressures are expected to normalize gradually and thus could aid OPM expansion with the margins expected to expand 110 bps over FY22 to FY24E.

Our Call

Valuation – Specialty Segment to fuel the growth; Re-iterate Buy: Sun Pharma's key geographies, US and India, are witnessing improved traction. Growth in the US business would be driven by likely pick up in the specialty business coupled with traction from new product launches and steady growth in US generics, while strong growth across therapies and field force expansion would drive India sales. At the CMP, the stock trades at 23.9x/21.1x its FY2023E/FY2024E EPS, respectively, which is below the historical long-term average multiple. Further, the stock price has corrected by ~ 12% in the past two months and the valuations are now attractive. Improved growth prospects across businesses and a healthy balance sheet position would be key positives. We re-iterate the Buy recommendation on the stock with an unchanged price target of Rs. 1,000.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Net sales	33498.1	38654.5	42437.6	47560.6
Operating profit	8491.5	10397.7	11670.3	13317.0
OPM(%)	25.35	26.90	27.50	28.00
Adj. PAT	6801.1	7839.5	8310.3	9414.4
EPS (Rs)	28.3	32.7	34.6	39.2
PER (x)	29.2	25.3	23.9	21.1
EV/Ebidta (x)	23.1	18.7	14.8	12.2
ROCE (%)	12.7	17.3	16.9	17.2
RONW (%)	14.6	16.3	14.9	14.6

Source: Company; Sharekhan estimates

Speciality segment to witness strong traction despite of weak Absorica sales; to aid US revenue growth: For FY22, Revenue from the US business grew strongly by 12% y-o-y despite price erosion seen across the industry in the US, aided by strong growth in the speciality segment sales which grew by 42% y-o-y in FY22, attributable to strong growth in Cequa, Ilumya, Odomzo, while Absorica sales were under stress due to increased competition. Primarily the strong performance of Illumya has been a key driver of the speciality segment sales. Going ahead, the speciality portfolio is expected to witness further market share gains as doctor OPDs fully open up and patient footfalls increase across markets, leading to higher prescriptions being generated. In addition to the expected traction from Illumya, the other products like Cequa, Levulan, Odomzo and the recently launched Winlevi have enabled Sun to offset the decline in sales for Absorica (due to higher competition pressures) and the same trend is expected to sustain over the medium term as well. In addition to the traction in existing products, Sun pharma also has a strong product pipeline for the speciality segment, which could unfold and provides ample growth visibility.

Specialty Segment Product portfolio:

Product	Indication	Geographies Present
Ilumya	Plaque Psoriasis	US, Australia, Europe, Japan & China (out licensed to CMS)
Cequa	Dry Eye disease	US, China (through CMS), Canada
Winlevi	Treatment of Acne vulgaris	US
Absorica LD	Severe recalcitrant nodular acne	US
Levulan Kerastick	Minimal to moderately thick actinic keratoses of the face, scalp, or upper extremities.	US
Odomzo	LABCC (locally advanced basal cell carcinoma)	US, Germany, France, Denmark, Switzerland, Australia, Isreal
Yonsa	Prostate Cancer	US
Bromsite	prevention of ocular pain & treatment of inflammation following cataract surgery	US
Xelpros	For elevated IOP in Patients with Glucoma	US
Sprinkle Portfolio	Sprinkle versions of Metoprolol and Rosuvastatin (cardiology), Duloxetine (Neuro Psychiatry)	US

Source: Company; Sharekhan Research

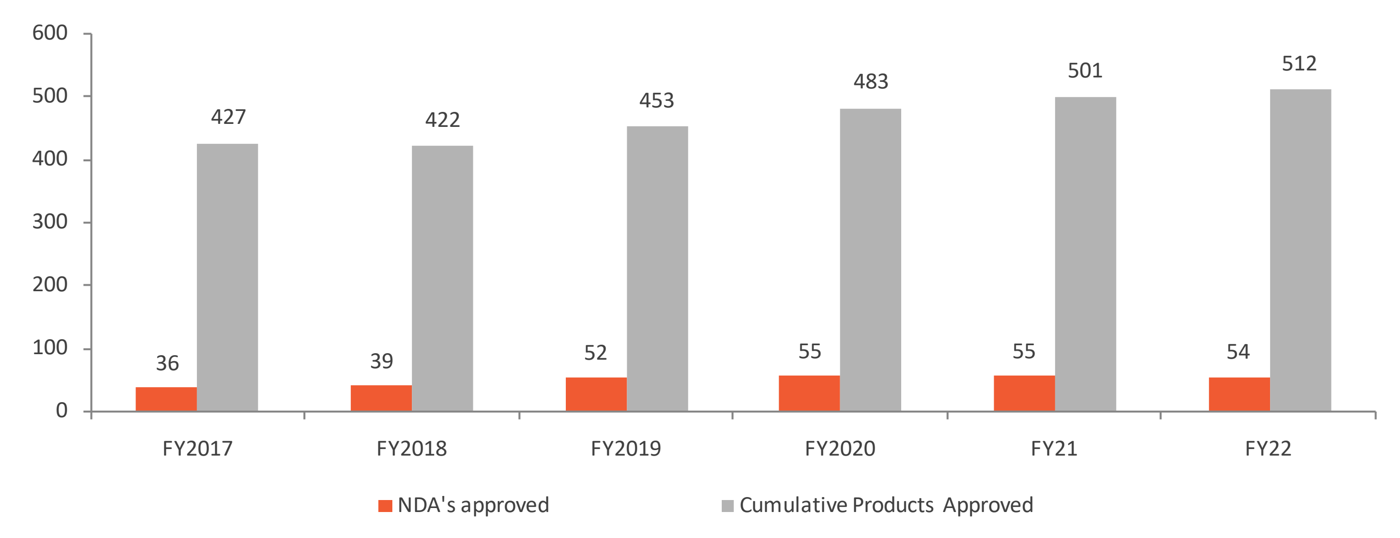
Specialty segment product pipeline:

Molecule/Asset	Indication	Route of Administration	Mechanism of Action	Pre-clinical	Phase-1	Phase-2	Phase-3	Registration	Approved
Ilumya (tildrakizumab)	Psoriatic Arthritis	Injection	IL-23 Antagonist						
SCD-044	Psoriasis, Atopic Dermatitis	Oral	Selective SIPR1 Agonist						
MM-II	Treatment of pain in osteoarthritis	Injection	Liposomal intra -articular lubrication						
GL0034	Type 2 Diabetes	Injection	GLP-1R Agonist						

Source: Company, Sharekhan Research

Moreover, Sun Pharma is in the process of expanding its specialty portfolio to other geographies and has launched Illumya and Cequa in Canada and Winlevi in the US. With Winlevi, the company has managed to reach a higher number of doctors, which have prescribed medicines and traction points at a likely ramp up. In the subsequent quarters, these launches are expected to gain traction. On the generic portfolio, Sun Pharma has launched five new products in Q4 and had launched 15-17 new products in 9MFY2022, taking the total no of product launches in FY22 to around 20+ for Fy22 and aims to sustain the launch momentum in the subsequent quarters. Sun Pharma has a strong product launch line up in the US and has developed supply chain efficiencies in US generics; and collectively, these could help it tide over pricing pressures in the US generics segment. Improvement in the specialty business in the US augurs well and will be a crucial growth factor. In addition to this, Sun Pharma has 93 ANDAs and 134 NDAs awaiting USFDA approvals. Therefore, a pick-up in the US speciality business coupled with a strong product pipeline, which would unfold going ahead and healthy growth in generics, could be key drivers for the US business.

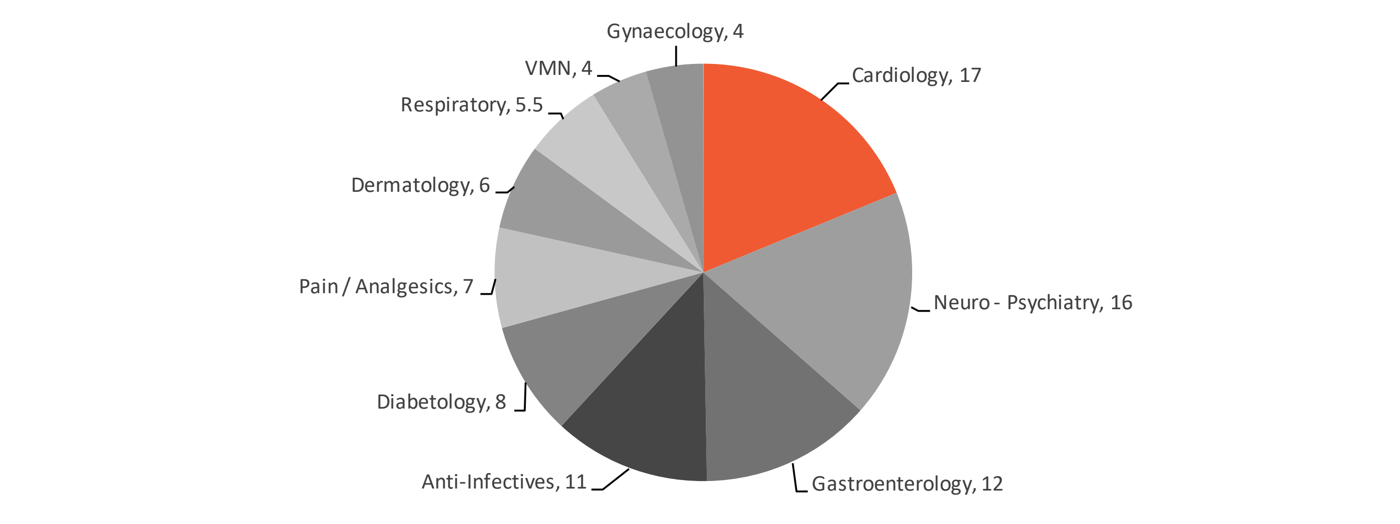
ANDA & NDA approval trends



Source: Company, Sharekhan Research

India business to outpace the industry growth: The India formulations business continued its strong growth trajectory in FY22 which was one of the years with uncertain times. Revenue from India operations grew strongly by 23% for Fy2022 to Rs 12759 crore thus comfortably beating the industry's growth. Double-digit growth can be attributed to the strong performance of chronic therapies in which the company has a leadership position while in the acute it has a relatively strong position. and acute therapies.

India Business - therapy-wise Sales mix (%)



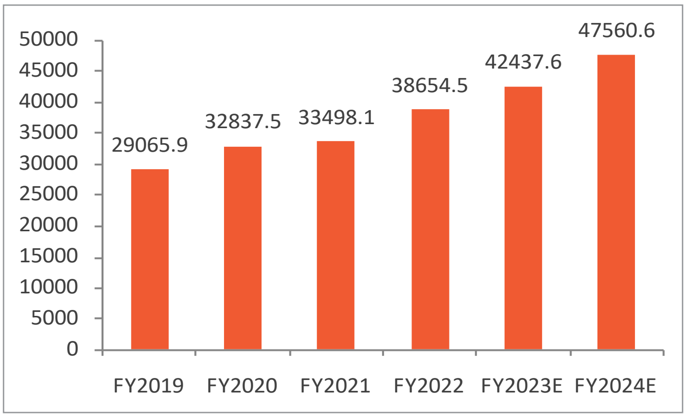
Source: Company, Sharekhan Research

Going ahead, management expects the domestic business to gain traction with all-around growth across therapy areas. Moreover, the company has launched 77 new products in Indian markets in FY2022, while in FY2021, it launched 31 new products, which points to a strong growth momentum and with the expected ramp up in the recently launched products. Moreover, the company has planned to add around 10% of the field force for India business so as to increase the geographic penetration as well as to de-clutter the business and accelerate growth and gain market share. Field force operations are fully normal and the company plans to increase the field force so as to expand its geographic reach. Overall, management sees domestic formulations business to grow strongly going ahead, backed by new product launches, improving field force productivity and expansion, and expected traction in the existing business. Collectively, basis the above the company expects to outpace the industry growth.

Margins to improve gradually aided by cost normalisation: Sun Pharma's margins for 2HFy2022 have contracted by 330 bps y-o-y to ~24.8% this could be attributable to elevated cost pressures especially higher raw material costs and freight costs. Also, the company has guided for high R&D costs (~7-8% of sales) for FY23. But given the expected cooling off of the raw material costs and likely easing of freight costs along with the mix turning favourable with likely higher share of specialty segment, the margins are expected to improve by 110 bps over FY22-FY24E.

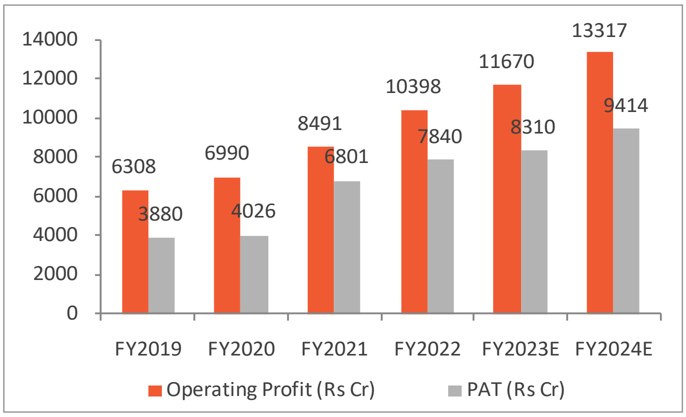
Financials in charts

Sales Trends Rs Cr



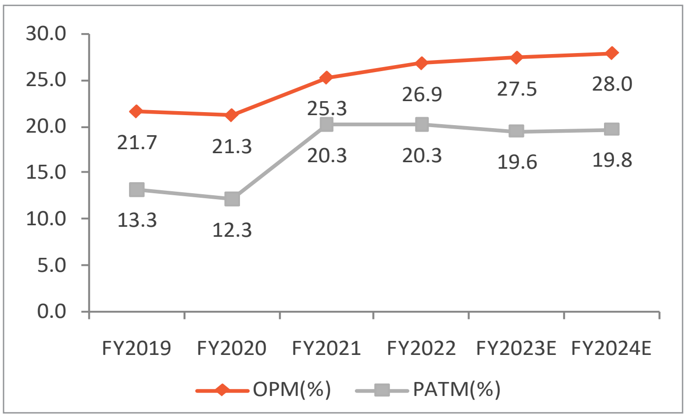
Source: Company, Sharekhan Research

Operating Profit - PAT Trends



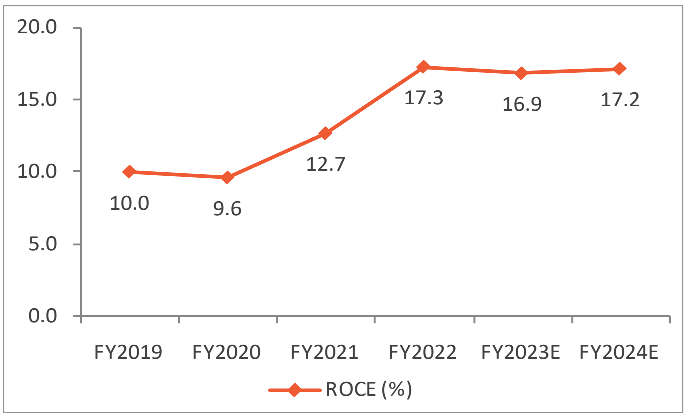
Source: Company, Sharekhan Research

Margins on an improving trend



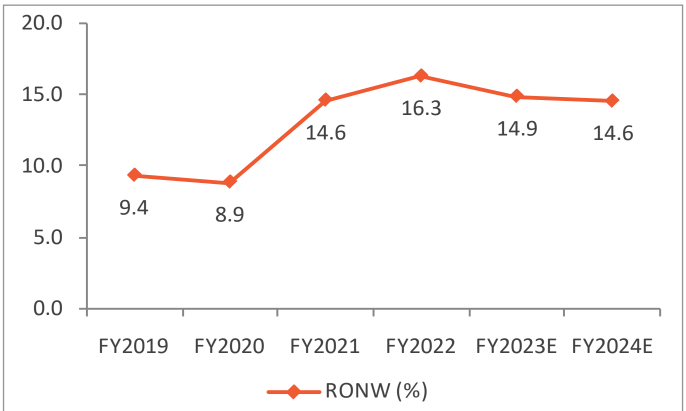
Source: Company, Sharekhan Research

ROCE (%)



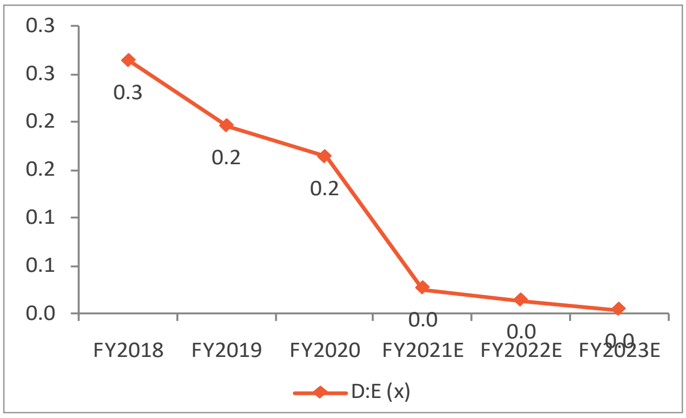
Source: Company, Sharekhan Research

Return ratios improving (RoE %)



Source: Company, Sharekhan Research

Debt : Equity (x)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Healthy growth momentum to sustain

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, plant resolutions by the USFDA, strong growth prospects in domestic markets, and emerging opportunities in the API space would be key growth drivers. This would be complemented by 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.

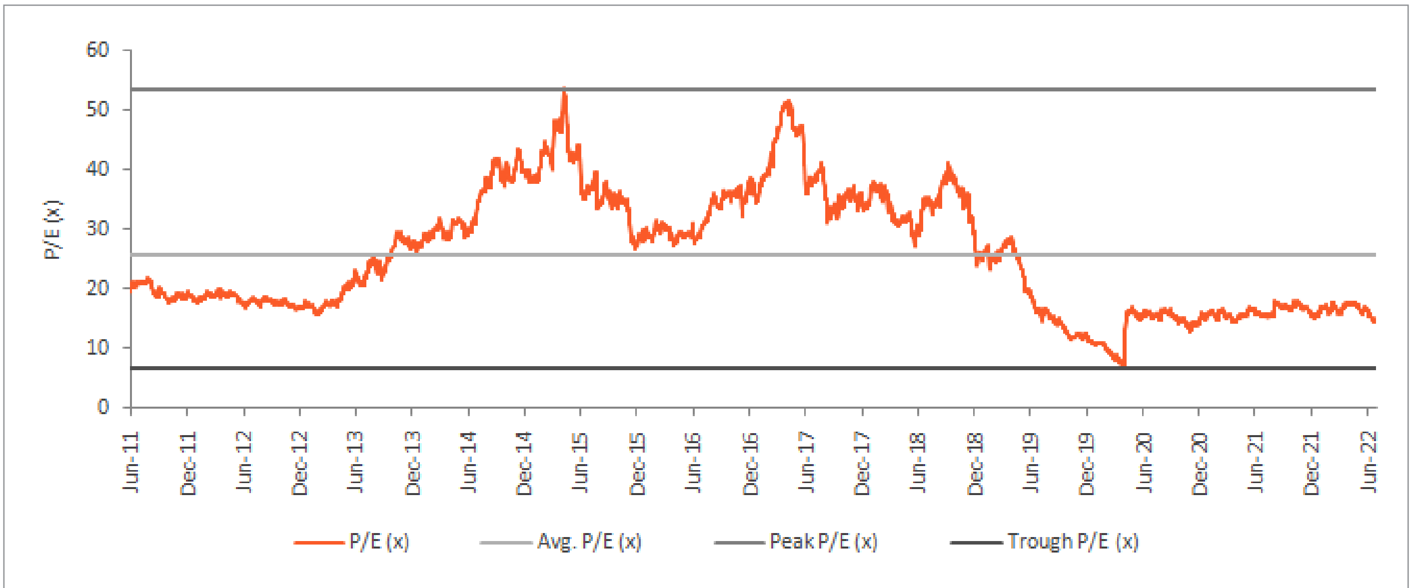
■ Company outlook - Healthy prospects

Sun Pharma, a global pharmaceutical company, is 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 improvement, largely backed by marked improvement in the specialty portfolio due to growth in existing geographies as well as tapping new geographies and product portfolio expansion/launches. This coupled with a strong product pipeline, which would unfold going ahead, would be the key growth driver for the US business. Domestic formulations are on a strong footing as the chronic portfolio has reported healthy growth. The acute therapies portfolio has also gathered traction and is expected to sustain the strong growth traction. Management expects the domestic formulations business to continue its strong growth on account of new launches, growth in existing business, and field force productivity improvement, and aims to outpace the industry's growth. Therefore, improved outlook across both key geographies, India and US, and increasing penetration in other geographies would drive growth for Sun Pharma.

■ Valuation - Valuation – Specialty Segment to fuel the growth; Re-iterate Buy

Sun Pharma's key geographies, US and India, are witnessing improved traction. Growth in the US business would be driven by likely pick up in the specialty business coupled with traction from new product launches and steady growth in US generics, while strong growth across therapies and field force expansion would drive India sales. At the CMP, the stock trades at 23.9x/21.1x its FY2023E/FY2024E EPS, respectively, which is below the historical long-term average multiple. Further the stock price has corrected by ~ 12% in the past two months and the valuations are now attractive. Improved growth prospects across businesses and healthy balance sheet position would be key positives. We re-iterate our Buy recommendation on the stock with unchanged price target of Rs. 1,000.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV / EBITDA (x)			RoE (%)		
				FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Sun Pharma	828	239.9	198,648	25.3	23.9	21.1	18.7	14.8	12.2	16.3	14.9	14.6
Cipla	945	80.6	76228	27.8	24.8	19.5	16.5	14.9	12.0	14.6	13.8	15.3
Dr Reddy's	4,375	16.6	72,801	33.3	21.3	18.7	13.7	11.2	9.4	11.4	16.4	16.4

Source: Company, Sharekhan Research

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 a 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. 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 was impacted, but now has been revived. Management sees the domestic formulations business to sustain the strong growth momentum and outpace the industry's growth. While driven by the specialty segment's sales, the US business also has healthy growth prospects.

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

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

Sharekhan

by BNP PARIBAS

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