Sharekhan
by BNP PARIBAS

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Stock Update

Sun Pharmaceutical Industries Limited

Specialty Business to pave the growth path

Pharmaceuticals | Sharekhan code: SUNPHARMA | 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		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 576**	
Price Target: **Rs. 660**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

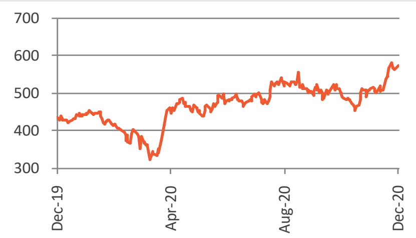
Company details

Market cap:	Rs. 138,210 cr
52-week high/low:	Rs. 592 / 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	12.8
DII	20.5
Others	12.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	12.1	16.2	20.1	31.3
Relative to Sensex	6.1	-3.2	-16.9	18.5

Sharekhan Research, Bloomberg

Summary

- We retain a Buy recommendation on Sun Pharmaceutical Industries with a revised PT of Rs. 660.
- Sun Pharma's specialty business is on a strong footing and traction is expected to improve further backed by rising prescriptions and geographical expansion. This coupled with a strong product pipeline would drive US business.
- Strong growth momentum in chronics, likely traction in recent new launches and a possible improvement in acute therapies is likely to fuel growth in the domestic formulations business.
- Healthy outlook for specialty portfolio, improved growth prospects, healthy balance sheet, and improving return ratios would support P/E multiple expansion.

Sun Pharmaceutical Industries Limited's (Sun Pharma) specialty business is on a path to improvement and is expected to gain traction. Two of its existing specialty products - Ilumya and Cequa are witnessing a rise in the prescription numbers and have almost crossed the pre-COVID levels. Also the company had taken a price hike in the specialty portfolio in recent past, which bodes well. The other products in the specialty basket are also witnessing a gradual pick up and would add to the topline growth. In addition to this the company is working on expanding the geographical presence for the specialty portfolio, which would further drive the growth. This coupled with a strong product pipeline, which is expected to unfold in the near term and comparatively stabilizing price erosion in the US generics markets could support growth. Domestic formulations business is on a strong footing backed by sturdy growth in the chronic's. Given Sun Pharma's leadership position in chronics segment which is likely to sustain and the expected pick up in the recent launches would drive the growth in the domestic business and would enable the company to outperform the broader markets. Collectively, US and India constitute around 60% of the company's overall revenues and a strong growth outlook across both the geographies augurs well from a growth perspective. On the back of a favorable mix, the margins are expected to expand 340 bps over FY2020-FY2023, leading to a strong PAT CAGR of 22% over a similar period. Therefore, healthy growth outlook across both the key geographies and increasing penetration in other geographies would drive growth for Sun Pharma.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 660: Sun Pharma's Specialty business is witnessing improved traction. Pick up in the US specialty business coupled with likely traction from sturdy new product launch pipeline, would fuel the growth of the US business. Moreover, geographic expansion/increasing penetration for specialty portfolio, in markets other than the US, would also aid the growth of specialty portfolio. Healthy growth in chronic therapies along with new launches gaining traction and a possible improvement in acute therapies is likely to fuel growth in the domestic formulations business. Moreover, a favorable mix is expected to lead to margins expansion, which in turn would result in a strong 22% PAT CAGR over FY2020-FY2023. At CMP, the stock trades at an attractive valuation of 21.3x/19x its FY2022E/FY2023E EPS. Healthy outlook for specialty portfolio, Improved growth prospects, healthy balance sheet, and improving return ratios would support P/E multiple expansion. We retain our Buy recommendation on the stock with a revised PT of Rs. 660.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
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	5462.0	6486.1	7259.2
EPS (Rs)	16.2	16.8	22.8	27.0	30.3
PER (x)	35.6	34.3	25.3	21.3	19.0
EV/EBITDA (x)	22.5	20.1	15.8	13.7	11.8
ROCE (%)	10.0	9.6	12.7	12.7	12.9
RONW (%)	9.4	8.9	11.7	12.4	12.3

Source: Company; Sharekhan estimates

Specialty business to pick up backed by improving traction:

Sun has been focusing in the recent past to grow the specialty portfolio across geographies. The company has invested substantial resources towards building a strong specialty portfolio. Sun Pharma has invested around $1Bn towards specialty portfolio in addition to the investments towards building a field force for the same. Currently the company is in the concluding stages of development and is now gradually moving its focus towards generating material returns. The products already launched are slowly gaining tractions and are likely to aid the revival. Sun has a healthy portfolio of Specialty products which is expected to gain traction.

Specialty Product Portfolio

Product	Indication	Geographies Present
Ilumya	Plaque Psoriasis	US, Australia, Japan & China (out licensed to CMS)
Cequa	Dry Eye disease	US, China (through CMS)
Absorica	Severe recalcitrant nodular acne	US
Levulan	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
Infusmart	Chemotherapy	Europe, US

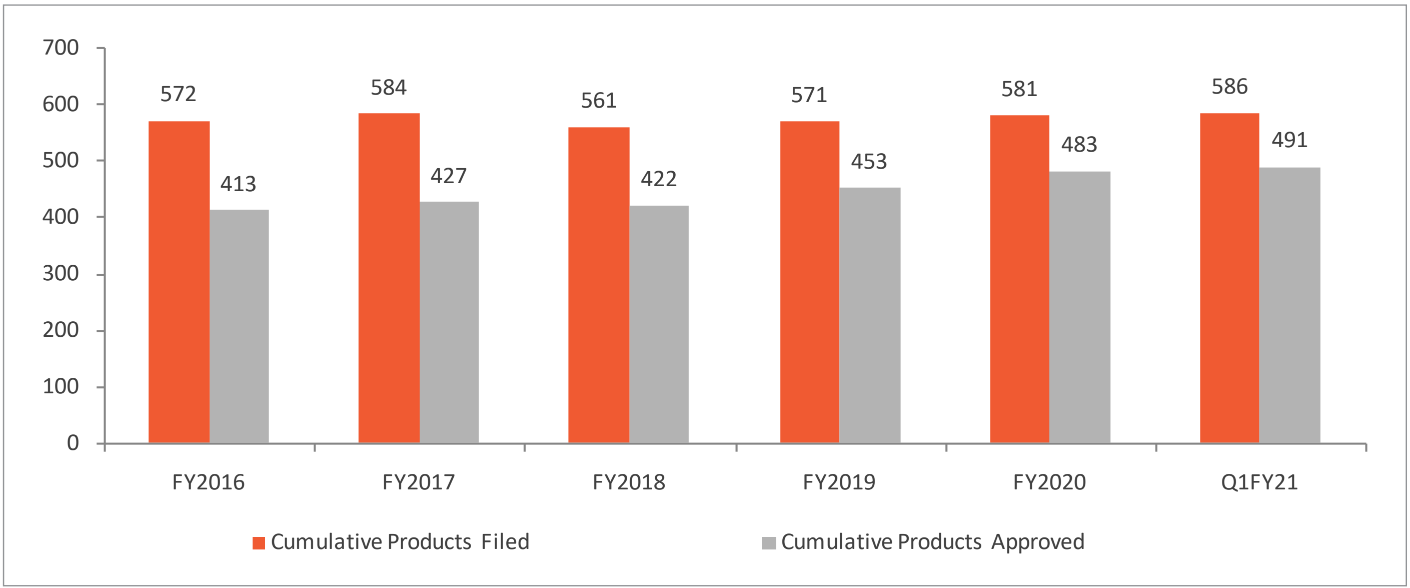
Source: Company, Sharekhan

The company expects the traction in the specialty business to improve hereon as the pandemic led disruptions had impacted the sales of the specialty products in 1HFY2021. With the medical practioners resuming OPD consultations the patient footfall is expected to improve, thus translating in to higher prescriptions generated. Existing products such as Ilumya and Cequa have witnessed remarkable improvement in prescription levels, which have almost crossed pre-COVID levels. Secondly, Sun Pharma is also looking to expand the geographic presence / increase the penetration for its specialty portfolio, which also would be one of the key factors to fuel the growth of the segment. We expect the specialty segment sales to regain its normalized growth trajectory and result in a strong performance of specialty segment in 2HFY2021.

US business gaining traction driven by a pickup in the specialty business and a strong product pipeline

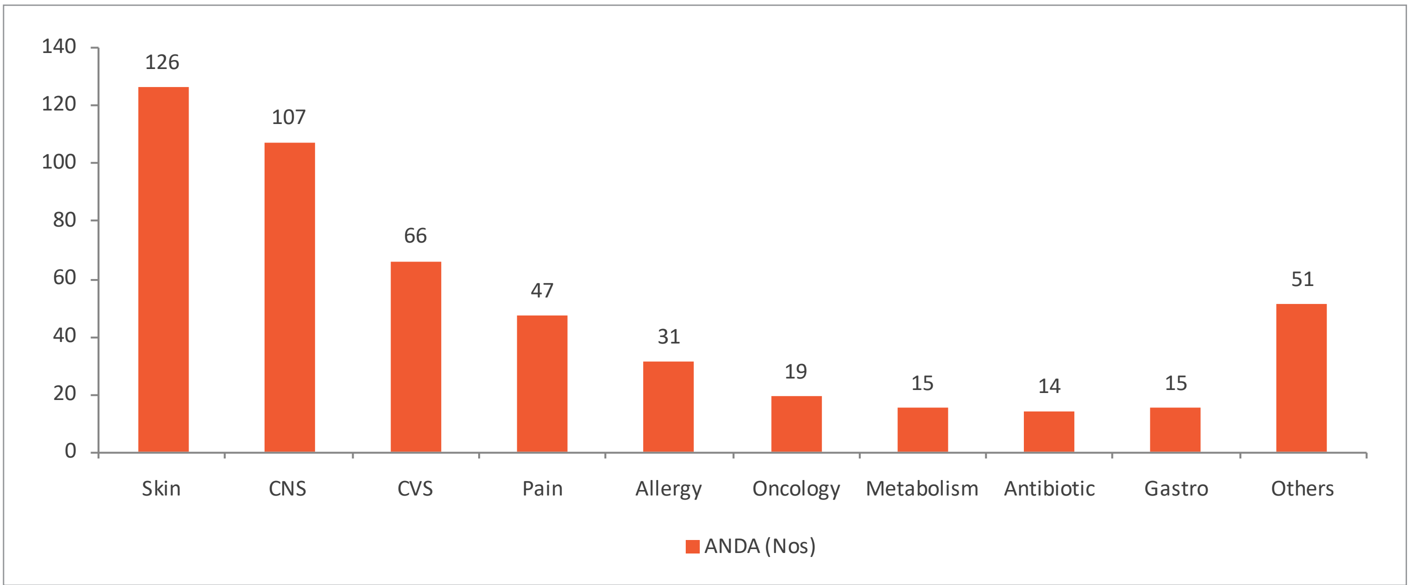
Sun Pharma's US business accounts for around 30% of the overall sales for the company as of 1HFY2021. Recently, the US business has shown signs of a pick up largely attributable to the expected revival in the Specialty business, attributable to an expected rise in the prescriptions as patient footfalls increase. In addition to this, 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). For the quarter ending September, the company has filed one ANDA and received approvals for four ANDAs. It also has 55 approved NDAs and six NDAs that are awaiting USFDA approval. 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.

ANDA Filed and Approved



Source: Company, Sharekhan Research

Therapy wise ANDA approvals



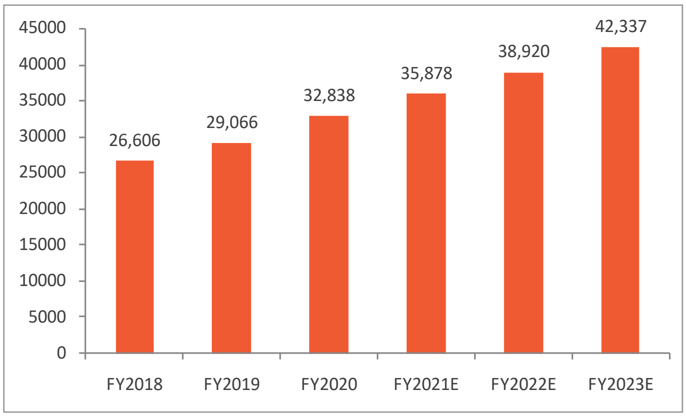
Source: Company, Sharekhan Research

Domestic formulations business to grow at a healthy pace:

Sun Pharma's India formulations business, which constitutes around 31% of its 1HFY2021 revenues, is expected to stage a healthy growth going ahead. The performance for the quarter ending September points at a sequential pick up. Further, industry reports indicate that the IPM (Indian Pharmaceutical Market) growth is expected to be better in 2HFY2021 as compared to that in 1HFY2021. Sun Pharma's domestic growth in Q1FY2021 had outperformed the IPM aided by double-digit growth across the chronic therapies, while in Q2FY2021, the growth was in line with that of the IPM growth. Further, 22 new products launches done by the company in Indian markets in the previous quarters, provide ample visibility on the growth going ahead. This coupled with the leadership position in the chronics space would also enable the company to outperform the broader market. Further the acute segment performance is also expected to pick up going ahead. Collectively, these factors would drive growth in the domestic business.

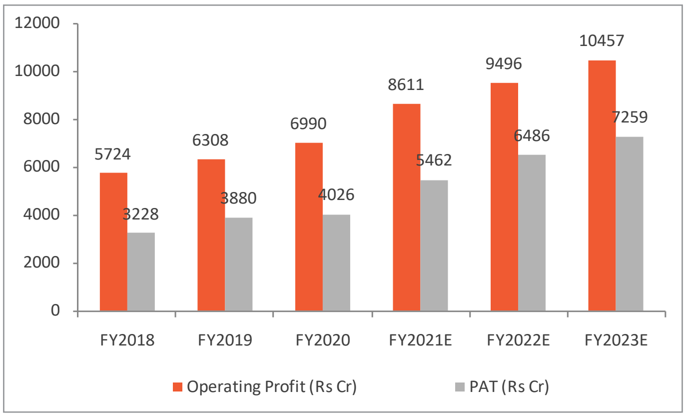
Financials in charts

Sales Trends Rs Cr



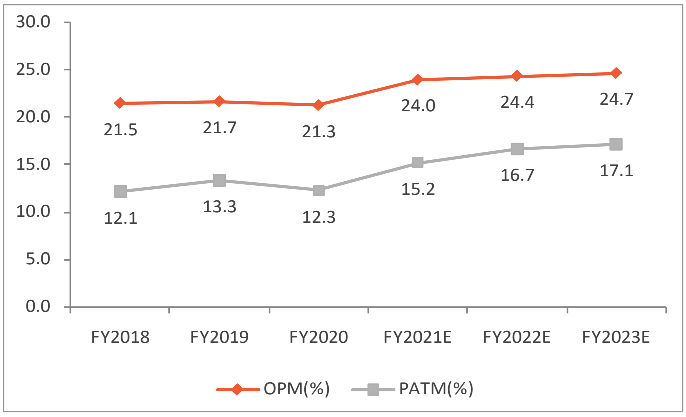
Source: Company, Sharekhan Research

Operating Profit - PAT Trends



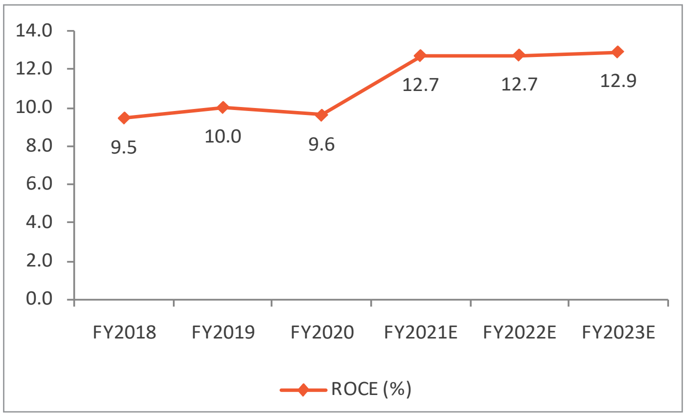
Source: Company, Sharekhan Research

Margins on an improving trend



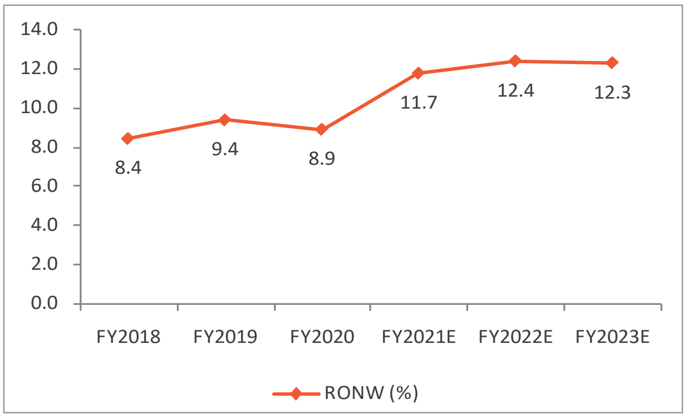
Source: Company, Sharekhan Research

ROCE (%)



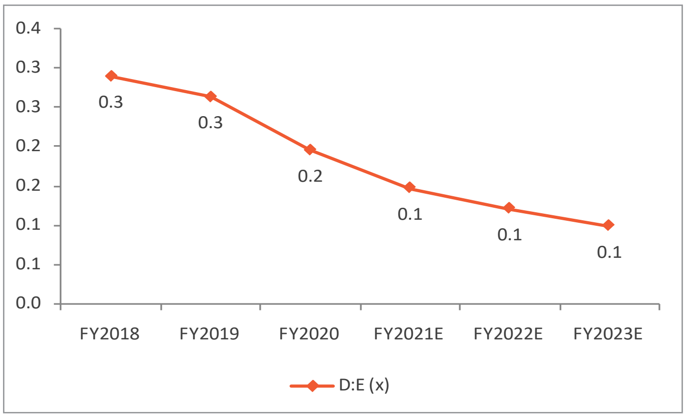
Source: Company, Sharekhan Research

Return ratios improving (RoE %)



Source: Company, Sharekhan Research

Debt : Equity (x)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - 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.

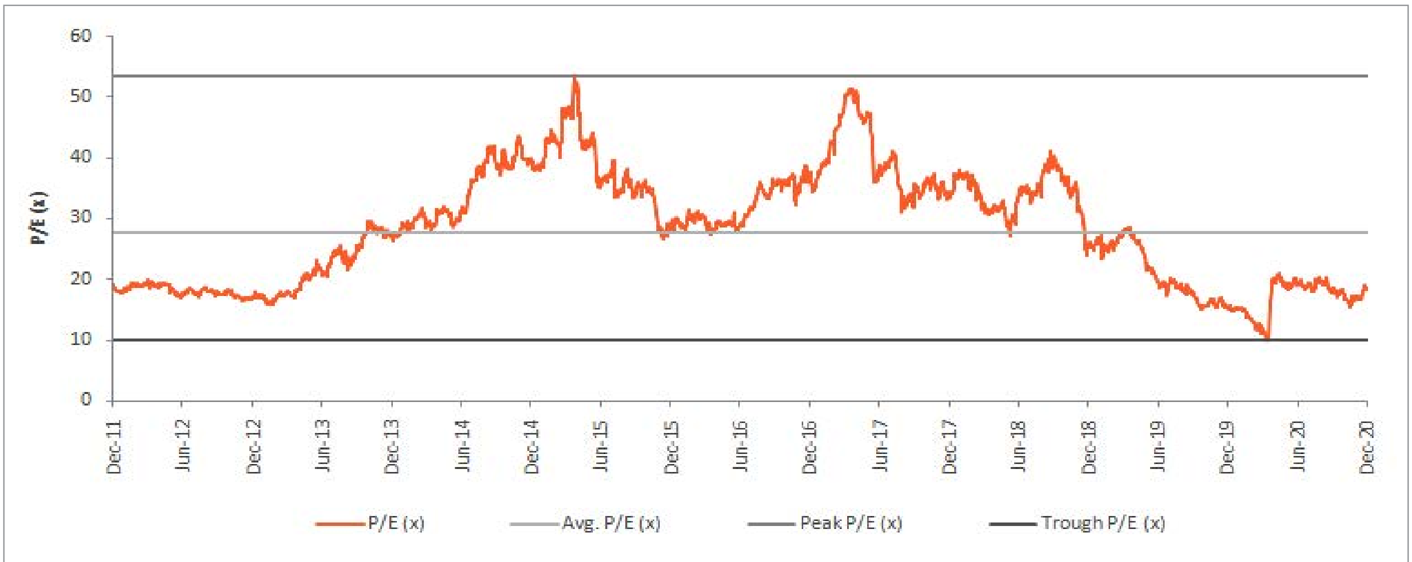
■ Company outlook - Improving growth prospects

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 a 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. The management expects the domestic formulations business to bounce back on account of new launches and gradual improvement in the economy. Therefore, improved outlook across both the key geographies and increasing penetration in other geographies would drive growth for Sun Pharma.

■ Valuation - Retain Buy with a revised PT of Rs. 660

Sun Pharma's Specialty business is witnessing improved traction. Pick up in the US specialty business coupled with likely traction from sturdy new product launch pipeline, would fuel the growth of the US business. Moreover, geographic expansion/increasing penetration for specialty portfolio, in markets other than the US, would also aid the growth of specialty portfolio. Healthy growth in chronic therapies along with new launches gaining traction and a possible improvement in acute therapies is likely to fuel growth in the domestic formulations business. Moreover, a favorable mix is expected to lead to margins expansion, which in turn would result in a strong 22% PAT CAGR over FY2020-FY2023. At CMP, the stock trades at an attractive valuation of 21.3x/19x its FY2022E/FY2023E EPS. Healthy outlook for specialty portfolio, Improved growth prospects, healthy balance sheet, and improving return ratios would support P/E multiple expansion. We retain our Buy recommendation on the stock with a revised PT of Rs. 660

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/EBITDA (x)			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Sun Pharma	576.0	239.9	138,210.0	34.3	25.3	21.3	20.1	15.8	13.7	8.9	11.7	12.4
AurobindoPharma	889.0	58.6	52,093.0	17.9	15.8	14.5	11.2	9.7	8.2	19.0	17.9	16.7

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 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

Additional Data

Key management personnel

Israel Makov	Chairman
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	Life Insurance Corp of India	6.56
2	ICICI Prudential Asset Management	3.29
3	SBI Funds Management Pvt Ltd	1.81
4	Vanguard Group Inc/The	1.53
5	Nippon Life India Asset Management	1.48
6	Lakshdeep Investments and Finance	1.37
7	BlackRock Inc	1.02
8	HDFC Asset Management Co Ltd	0.92
9	Norges Bank	0.91
10	Aditya Birla Sunlife Asset Management Co	0.58

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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