Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Sun Pharmaceutical Industries Limited

Shining strong

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. 586**	
Price Target: **Rs. 700**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

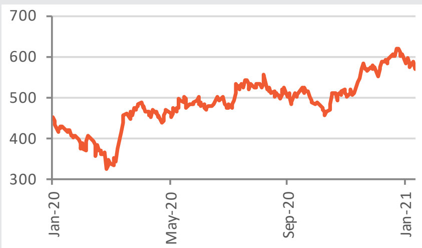
Company details

Market cap:	Rs. 1,40,706 cr
52-week high/low:	Rs. 628 / 315
NSE volume: (No of shares)	102 lakh
BSE code:	524715
NSE code:	SUNPHARMA
Free float: (No of shares)	109.2 cr

Shareholding (%)

Promoters	54.5
FII	12.8
DII	20.5
Others	12.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.7	28.4	19.0	30.3
Relative to Sensex	2.1	12.0	-2.6	18.0

Sharekhan Research, Bloomberg

Summary

- We retain Buy recommendation on Sun Pharmaceutical Industries (Sun Pharma) with a revised PT of Rs 700.
- Sun Pharma reported strong performance for Q3FY2021 with higher-than-expected earnings performance.
- Sun Pharma's key geographies, US and India, are witnessing improved traction. Strong growth in chronic therapies, likely improvement in acute therapies & healthy product pipeline to drive India business. Pick up specialty business, new product launch pipeline to fuel US business growth.
- Improved growth prospects, healthy balance sheet, and improving return ratios would be key positives.

Sun Pharma reported strong performance for Q3FY2021 with the company reporting higher-than-expected earnings. Sales for the quarter stood at Rs. 8,836 crore, up 8.4% y-o-y, because of 11% growth in the US business, while domestic revenues grew by 9% y-o-y. Overall revenue was largely in line with estimates. OPM for the quarter stood at 26.4%, translating to a 480 bps y-o-y expansion, largely driven by cost savings/low operating expenses. Operating profit stood at Rs. 2,334 crore, up 32.7% y-o-y. Reported PAT for the quarter at Rs. 1,852 crore was up 103% y-o-y because of higher other income and low tax. India and US are the key markets for the company and constitute around 60% of the total topline. US revenue grew by 11% y-o-y, the second consecutive quarter of growth after four consecutive quarters of decline. Growth can be largely attributed to improvement in the specialty business and growth in new product launches and base business. The outlook for the US business has improved, following a pick-up in the lucrative specialty business with sales of three specialty products Illumya, Cequa and Absorica now at pre covid levels and the company expects further market share gains to accrue. Also strong product pipeline, which would unfold going ahead provides ample visibility for growth. Domestic formulations business is also on a strong footing, backed by sturdy growth in the chronic segment. Performance of the acute segment has been weak. Management expects the same to improve going ahead, as around 95% of the doctors return to OPDs and patient footfalls are expected to increase, which current stand at 75% of pre covid levels. Management sees the domestic formulations business to bounce back on account of new launches and gradual improvement in prescriptions. Therefore, healthy growth outlook across both the key geographies and increasing penetration in other geographies would drive growth for Sun Pharma. Sales and PAT are expected to stage a 9% and 23% CAGR, respectively, over FY2020-FY2023.

Key positives

- After four consecutive quarters of decline, US revenue grew for the second consecutive quarter, up 11% y-o-y, driven by improvement in the specialty business.
- Revenue from emerging markets grew by 16% y-o-y.
- OPM expanded by sturdy 480 bps to 26.4% due to low operating expenses.

Key negatives

- Delay in USFDA resolution for Halol plant.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 700: 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. A sturdy new product pipeline 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. Q3FY2021 was a strong quarter for Sun Pharma with revenue and earnings coming ahead of estimates. Favourable mix has resulted in OPM expanding by ~480 bps y-o-y. Factoring this, we have revised upwards our earnings estimates for FY2022/FY2023 by 2% each. At the CMP, the stock trades at 21.2x/18.9x its FY2022E/FY2023E EPS, which is below the long-term historical average multiple. Improved growth prospects, healthy balance sheet, and improving return ratios would be key positives. Therefore, we retain our Buy recommendation on the stock with a revised PT of Rs. 700.

Key Risks

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

Valuations (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	8790.1	9574.2	10584.3
OPM(%)	21.70	21.29	24.50	24.60	25.00
Adj. PAT	3879.8	4025.6	5755.9	6629.7	7453.4
EPS (Rs.)	16.2	16.8	24.0	27.6	31.1
PER (x)	36.2	34.9	24.4	21.2	18.9
EV/EBIDTA (x)	22.9	20.5	15.8	13.8	11.9
ROCE (%)	10.0	9.6	13.0	12.8	13.0
RONW (%)	9.4	8.9	12.3	12.5	12.5

Source: Company; Sharekhan estimates

Strong quarter: Sun Pharma reported a strong performance for the quarter with earnings coming ahead of estimates. Sales for the quarter stood at Rs. 8,836 crore, up 8.4% y-o-y. The US business grew by 11% y-o-y, while revenue from the Rest of the World (RoW) formulations segment grew by 16% y-o-y. India revenue were up 9.4% y-o-y. Overall revenue was largely in line with estimates. OPM for the quarter stood at 26.4%, translating to a 480 bps y-o-y expansion. This was because of a 60 bps y-o-y expansion in gross margin, while other expenses/sales declined by 470 bps y-o-y due to lower operating costs. Operating profit for the quarter at Rs. 2,234.5 crore grew by 32.7% y-o-y and was slightly ahead of estimates. Other income for the quarter was up at Rs. 315 crore versus Rs. 120 crore in Q3FY2020. Tax rate was also lower at 11.7% as compared to 25.8% in the corresponding quarter of the previous year. Consequently, PAT for the quarter stood at Rs. 1,852 crore as compared to Rs. 913.5 crore in Q3FY2021, ahead of estimates. Adjusted PAT for the quarter stood at Rs. 1,781 crore, up 114% y-o-y.

Expected traction in the specialty segment to drive the US business: Sun Pharma's US business, which accounts for ~30% of total sales, is on an improvement path. Revenue from US has grown for the second consecutive quartet after a decline for four consecutive quarters. Sequentially as well, revenues grew by 11%. 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 and have resulted in market share gains in their respective segments. The three key specialty products – Illumya, Absorica – LD and Cequa – have crossed their pre-COVID level in sales. Going ahead, the company expects these products to gain further market share. Moreover, with most doctors re-opening their clinics, patient footfalls are expected to increase going ahead, which are currently below the pre-COVID levels. Higher prescription due to doctors returning to OPDs and improving patient footfalls are the key reasons for growth in the US business. 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 497 products. While it has filed for 90 ANDAs, which are awaiting approvals. Therefore, revival 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 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 was at Rs. 2,753 crore, grew by 9.4% y-o-y, comfortably outpacing the industry's growth. Growth can be attributed to the strong performance of the chronics segments; while the sub-chronic segment has also shown signs of pick up. Going ahead, management expects the domestic business to gain traction with the chronic segment being the key growth driver, followed by traction in the sub-chronic space. Moreover, the company has launched 27 new products in the Indian markets during Q3FY2021, which would add to growth momentum. Further, the acute segment's performance has been muted during the quarter, attributable to lower infections and low patient footfalls. However, with the opening up of markets, around 95% of the doctors have commenced OPD consultations, though patient footfalls are still lower at 75% of normal levels, which is expected to improve going ahead. 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 activities with an objective to expand its reach and deepen its penetration. Collectively, these factors would drive growth in the domestic business.

Q3FY2021 Conference Call Highlights

- Sun Pharma's branded formulations business in India recorded revenue of Rs. 2,793 crore for Q3FY2021, up 9% y-o-y and accounted for ~31% of consolidated sales.
- Sun Pharma's market share in India stood at 8.03% as of Q3FY2021, as per AIOCD AWACS MAT report. The company has launched 27 new products in the Indian market during the quarter.
- US business sales stood at Rs. 2,761 crore, registering 11% growth y-o-y for Q3FY2020. Growth comes because of four consecutive quarters of decline in revenue. Improvement in the US specialty business, market share gains therein, and improving trend in doctor OPDs led to growth.
- Revenue of emerging markets stood at Rs. 1,507 crore, up 8.4% y-o-y. While revenue from ROW markets stood at Rs. 1,276 crore, up 16% y-o-y.

- Revenue from the active pharmaceutical ingredients (API) business stood at Rs. 450 crore, decline of 10.5% y-o-y.
- R&D spends during the quarter stood at Rs. 560 crore, 6.4% of sales. This compares with Rs. 527 crore in the corresponding quarter, translating to around 6.6% of sales.
- Sun Pharma has a strong product pipeline in US markets in the generic space with 90 ANDAs awaiting approval from USFDA (including 22 ANDAs with tentative approvals). In Q3FY2021, the company filed two ANDAs and received approvals for three ANDAs. In addition to this, the company has 55 approved NDAs and eight 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 9MFY2021, the company has repaid debt of around $490 million.

Results Rs cr

Particulars	Q3FY2021	Q3FY2020	YoY %	Q2FY2021	QoQ %
Total sales	8,836.8	8,154.9	8.4	8,553.1	3.3
Expenditure	6,502.3	6,395.3	1.7	6,243.5	4.1
Operating profit	**2,334.5**	**1,759.6**	**32.7**	**2,309.6**	**1.1**
Other Income	315.0	119.9	162.7	255.8	23.1
EBITDA	**2,649.5**	**1,879.5**	**41.0**	**2,565.4**	**3.3**
Interest	26.1	63.0	-58.5	33.3	-21.6
Depreciation	531.9	547.0	-2.8	498.6	6.7
PBT	**2,091.4**	**1,269.5**	**64.7**	**2,033.5**	**2.8**
Taxes	244.9	327.6	-25.2	-31.2	-885.1
Adjusted PAT	**1,780.9**	**831.7**	**114.1**	**1,929.2**	**-7.7**
Reported PAT	**1,852.5**	**913.5**	**102.8**	**1,812.8**	**2.2**
Margins			**BPS**		**BPS**
OPM %	26.4	21.6	484	27.0	-59

Source: Company; Sharekhan Research

Revenue Mix Rs cr

Particulars	Q3FY2021	Q3FY2020	YoY %	Q2FY2021	QoQ %
Formulations	**8296.6**	**7502.9**	**10.6**	**7903.8**	**5.0**
India	2752.8	2516.8	9.4	2531.1	8.8
US	2760.9	2492.4	10.8	2492.0	10.8
Emerging Market	1507.1	1390.1	8.4	1558.8	-3.3
ROW	1275.8	1103.5	15.6	1322.0	-3.5
API	450.5	503.2	-10.5	510.4	-11.7
Others	34.8	32.4	7.3	44.5	-21.8
Total	**8781.8**	**8038.4**	**9.2**	**8458.8**	**3.8**
Other Op Inc	54.9	116.2	-52.7	94.4	-41.8
Total Sales	**8836.8**	**8154.6**	**8.4**	**8553.1**	**3.3**

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 Q3FY2021, 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 - Retain Buy with a revised PT of Rs 700:** 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. 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. Q3FY2021 was a strong quarter for Sun Pharma, with revenue and earnings coming ahead of estimates. Favourable mix has resulted in OPM expanding by ~480 bps y-o-y. Factoring in this, we have revised upwards our earnings estimates for FY2022/FY2023 by 2% each. At the CMP, the stock trades at 21.2x/18.9x its FY2022E/FY2023E EPS, which is below the long-term historical average multiple. Improved growth prospects, healthy balance sheet, and improving return ratios would be key positives. Therefore, we retain Buy recommendation on the stock with a revised PT of Rs. 700..

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 (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Sun Pharma	586.0	239.9	140,706.0	34.9	24.4	21.2	20.5	15.8	13.8	8.9	12.3	12.5
Aurobindo	998	58.6	58476	18.2	16.9	14.7	11.4	10.2	8.4	19.0	17.2	16.8

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

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	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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by BNP PARIBAS

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