Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Sun Pharmaceutical Industries Limited

Strong Q4; Long term levers intact

Pharmaceuticals	Sharekhan code: SUNPHARMA	Result Update

Stock 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. 700**	
Price Target: **Rs. 810**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

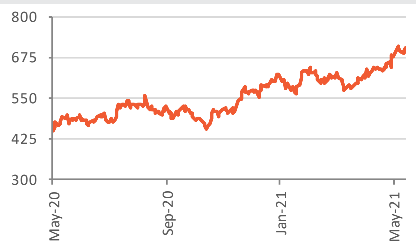
Company details

Market cap:	Rs. 1,67,889 cr
52-week high/low:	Rs. 721 / 443
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	9.5	17.6	36.8	55.4
Relative to Sensex	5.0	13.5	21.1	-6.4

Sharekhan Research, Bloomberg

Summary

- Q4FY21 numbers were strong with Sun Pharma reporting higher-than-expected earnings.
- India business growth is expected to backed by new product launches, improving the field force's productivity and expected traction in existing business. In FY21 Sun Pharma has launched 31 products, which would gather pace going ahead.
- The outlook for the US business has improved, following a pick-up in the lucrative specialty business with the management eyeing market share gains.
- The management sees uncertainties to stay due to Covid, however it stays focused on growing the performance across segments as the long term growth levers are intact. We retain Buy recommendation on the stock with a revised PT of Rs. 810.

Q4FY21 numbers were strong with Sun Pharma reporting higher-than-expected earnings. Sales rose 4% y-o-y to Rs. 8,523 crore. The US business declined marginally by 0.7% y-o-y, while the India business grew by 12.9% y-o-y. OPM stood at 24.2%, translating to a 577 bps y-o-y expansion on the back of a rise in gross margins as well as lower operating costs. The company reported an exceptional expense amounting to Rs 673 crore and adjusting for this, PAT stood at Rs. 1,577 crore as compared to Rs. 802 crore and was ahead of estimates. India and the US are the company's key markets and constitute ~60% of the total topline. India sales for the quarter rose by 12.9% y-o-y comfortably outpacing the Indian Pharmaceutical Market's (IPM's) growth. Going ahead, the management expects the growth momentum to sustain backed by new product launches, improving the field force's productivity and expected traction in existing business. Sun Pharma has launched 31 products in India in FY2021 and the management is looking to sustain the launch momentum going ahead. The acute therapy segment is expected to pick up on the back of a low base while chronics segment is expected to sustain growth traction. The US business's topline however declined slightly by 0.7% y-o-y largely led by weak performance of the US arm Taro. The specialty business however continued its growth trajectory. 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 improving and the company expects further market share gains to accrue. Also Sun has launched around 18 new products in the US generics market and is also expecting the base business to grow backed by these products and opportunities from the shortage of drugs in the US. Further on account of the ongoing second wave of COVID-19, the management expects uncertainties to stay around, though it is focusing on growth across segments. Therefore, healthy growth outlook across both key geographies and increasing penetration in other regions would drive growth for Sun Pharma.

Key positives

- Revenues from the domestic market grew by strong 12.9% y-o-y, outperforming the IPM growth.
- Revenue from RoW markets grew by 6% y-o-y.
- OPM expanded by a sturdy 577 bps to 24.2% due to low expenses.

Key negatives

- Delay in USFDA resolution for Halol plant.
- Management expects COVID-led uncertainties to stay.

Our Call

Valuation – Retain Buy with a revised PT of Rs 810: 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 pipeline of new products further provides visibility on India business' revenue growth. Improvement in the US specialty business coupled with traction from new product launches would drive up US revenue. Moreover, geographic expansion/increasing penetration for existing products would grow the base business. Q4FY2021 was a strong quarter for Sun Pharma, however the management expects COVID-led uncertainties to stay and hence has refrained from giving growth guidance. However it stays focused on growing the performance across segments as the long term growth levers are intact. We have marginally tweaked our estimates for FY22E / FY23E basis the Q4FY2021 results. At the CMP, the stock trades at 25x/22.5x its FY2022E/FY2023E EPS, which is below the long-term historical average multiple. Improved growth prospects over the longer term, healthy balance sheet position would be key positives. Therefore, we retain Buy recommendation on the stock with a revised PT of Rs. 810.

Key Risks

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	37575.0	40895.6
Operating profit	6307.6	6989.8	8491.5	9393.8	10223.9
OPM(%)	21.70	21.29	25.35	25.00	25.00
Adj. PAT	3879.8	4025.6	6801.1	6716.1	7477.3
EPS (Rs)	16.2	16.8	28.3	28.0	31.2
PER (x)	43.3	41.7	24.7	25.0	22.5
EV/Ebidta (x)	27.2	24.4	19.6	17.1	15.1
D:E	0.26	0.20	0.16	0.13	0.11
ROCE (%)	10.0	9.6	12.7	12.9	12.9
RONW (%)	9.4	8.9	14.6	12.8	12.6

Source: Company; Sharekhan estimates

Strong quarter: Sun Pharma reported strong numbers in Q4FY21 with adjusted PAT beating estimates. Sales for the quarter stood at Rs. 8523 crore, up 4% y-o-y. The US business for the quarter declined marginally by 0.7% y-o-y largely due to weak performance of the subsidiary Taro. The sales of the specialty segment continued to grow. The Domestic formulations were up strongly by 12.9% y-o-y while that from the RoW markets were up 6% y-o-y. Overall revenue was largely in line with estimates. OPM for the quarter stood at 24.2%, translating to a 577 bps y-o-y expansion. This was because of a 190 bps y-o-y expansion in gross margin, while lower other expenses and employee cost also added to the margin expansion. Operating profit for the quarter at Rs. 2,059.2 crore grew by 36.8% y-o-y and was largely in line with the estimates. Interest expenses declined by 42% y-o-y to Rs 30 crore due to reduction in the debt levels. During the quarter the company reported an exceptional expenses amounting to Rs. 673 crore and off this Rs 583 crore is towards higher provisioning done by Taro towards settlement of litigations in the US and the balance Rs 89 cr is towards settlement of disputed in the European region. In addition, the tax for the quarter reflected a reversal of Rs 121.23 crore due to recognition of deferred tax assets arising out of settlements. Adjusting for one off expenses, PAT for the quarter stood at Rs. 1,577 crore as compared to Rs. 802 crore in Q4FY2021, ahead of estimates. Reported PAT stood at Rs 894 crore.

Expected traction in the specialty segment; growth in the base business to drive the US sales: The US business, which accounts for ~30% of total sales, is on an improvement path and the management sees a strong growth traction going ahead. Revenue from the US have marginally declined by 0.7% y-o-y and by 2.4% q-o-q. The decline is attributable to the weak performance of the Subsidiary Taro, while the other business of the specialty products grew and the generics remained competitive. Growth in US revenue can be attributed to improvement in the specialty business. For FY2021, 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. 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 key reasons for growth in the US business. 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 501 products. While it has filed for 94 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, new launches and field force productivity improvement: The India formulations business continued its growth trajectory in uncertain times as well. Revenue from India operations was at Rs. 2,670 crore, grew by 12.9% 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 a 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. Also the acute therapy products are expected to pick up going ahead. Moreover, the company has launched 31 new products in the Indian markets during FY2021, which would add to growth momentum, going ahead. Further, the acute therapy segment's performance has been muted during the quarter, attributable to lower infections and low patient footfalls. However, with the opening up of markets, doctors have commenced OPD consultations, and the patient footfalls are expected to improve going ahead. Thus, the acute segment's performance is expected to improve, though gradually. Over the past one year, the company has added around 1000 field force to the existing one and going ahead expects the productivity from the field force to improve leading to expansion in reach and deepening of the product portfolio. Overall, management sees the 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 the domestic sales ahead, which are expected to grow in double digit over the next two years.

Q4FY2021 Conference Call Highlights

- Sun Pharma's branded formulations business in India recorded revenue of Rs. 2,670 crore for Q4FY2021, up 12.9% y-o-y and accounted for ~30% of consolidated sales.

- Sun Pharma's market share in India stood at 8.3% as of Q4FY2021, as per AIOCD AWACS MAT report. The company has launched 31 new products in the Indian market during the year.
- US business sales stood at Rs. 2,694 crore, registering a slight decline of 0.7% y-o-y. Excluding the Taro performance the sales of the other business have grown. The specialty products have reported a healthy growth backed by improvement in the three products – Ilumya, Cequa and Absorica.
- Revenue of emerging markets stood at Rs. 1401 crore, up 3.5% y-o-y and accounted for around 17% of the overall quarterly sales. While revenue from the RoW markets stood at Rs. 1191 crore, up 6.3% y-o-y.
- Revenue from the active pharmaceutical ingredients (API) business stood at Rs. 435.6 crore, falling by 10% y-o-y.
- R&D spends stood at Rs. 557 crore, 6.6% of sales. This compares with Rs. 536 crore in the corresponding quarter, translating to around 6.6% of sales.
- 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.

Results Rs cr

Particulars	Q4FY2021	Q4FY2020	Y-o-Y %	Q3FY2021	Q-o-Q %
Total sales	8,523.0	8,184.9	4.1	8,836.8	-3.6
Operating profit	2,059.2	1,505.1	36.8	2,334.5	-11.8
Other Income	111.0	102.2	8.6	315.0	-64.8
EBITDA	2,170.2	1,607.3	35.0	2,649.5	-18.1
Interest	30.1	51.8	-41.9	26.1	15.3
Depreciation	553.5	575.4	-3.8	531.9	4.1
PBT	1,586.6	980.2	61.9	2,091.4	-24.1
Taxes	55.0	83.1	-33.8	244.9	-77.5
Adjusted PAT	1,577.7	802.6	96.6	1,780.9	-11.4
Reported PAT	894.1	399.9	123.6	1,852.5	-51.7
Margins			**BPS**		**BPS**
OPM %	24.2	18.4	577	26.4	-226

Source: Company; Sharekhan Research

Revenue Mix

Particulars	Q4FY2021	Q4FY2020	Y-o-Y %	Q3FY2021	Q-o-Q %
Formulations	**7958.1**	**7552.7**	**5.4**	**8296.6**	**-4.1**
India	2670.8	2364.8	12.9	2752.8	-3.0
US	2694.5	2712.8	-0.7	2760.9	-2.4
Emerging Market	1401.5	1353.9	3.5	1507.1	-7.0
ROW	1191.3	1121.2	6.3	1275.8	-6.6
API	435.6	483.4	-9.9	450.5	-3.3
Others	37.4	41.7	-10.3	34.8	7.6
Total	**8431.1**	**8077.8**	**4.4**	**8781.8**	**-4.0**
Other Op Inc	91.6	106.9	-14.3	54.9	66.7
Total Sales	**8522.7**	**8184.7**	**4.1**	**8836.8**	**-3.6**

Source: Company; Sharekhan Research

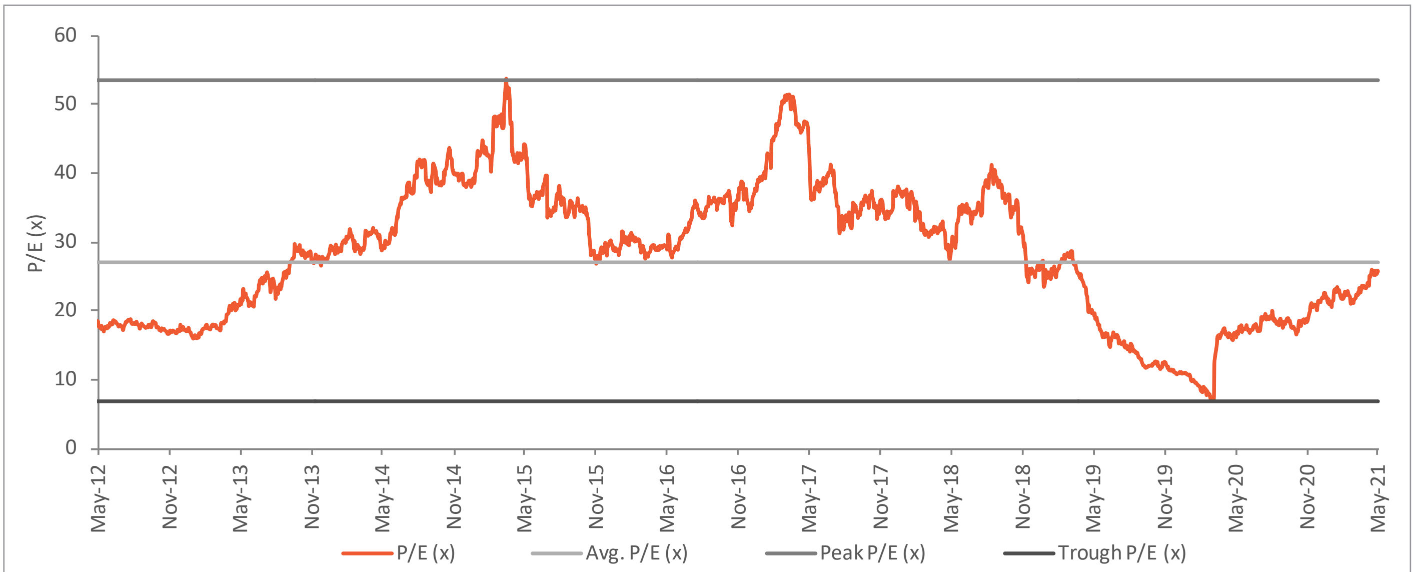
Outlook and Valuation

- **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. 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 business and 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 and increasing penetration in other geographies would drive growth for Sun Pharma.

- **Valuation - Retain Buy with a revised PT of Rs 810:** 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. Q4FY2021 was a strong quarter for Sun Pharma, however the management expects covid led uncertainties to stay and hence has refrained from giving growth guidance, however it stays focused on growing the performance across segments as the long term growth levers are intact. We have marginally tweaked our estimates for Fy22E / FY23E basis the Q4FY2021 results. At the CMP, the stock trades at 25x/22.5x its FY2022E/FY2023E EPS, which is below the long-term historical average multiple. Improved growth prospects over the longer term, healthy balance sheet position would be key positives. Therefore, we retain Buy recommendation on the stock with a revised PT of Rs. 810.

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	700.0	239.9	167,889.0	24.7	25.0	22.5	19.6	17.1	15.1	14.6	12.8	12.6
Aurobindo*	1032	58.6	60489	18.5	15.9	13.3	10.6	8.6	6.8	16.3	15.1	15.6
Lupin	1203	45.2	54590	44.9	30.5	22.9	22.9	13.5	10.2	8.8	11.7	13.8

*Source: Company, Sharekhan estimates; * FY21 Nos are 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	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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by BNP PARIBAS

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