Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Sun Pharmaceuticals Industries Ltd

Mixed bag Q1; specialty biz ramp-up to drive growth

Pharmaceuticals	Sharekhan code: SUNPHARMA
Reco/View: Buy ↔	CMP: Rs. 944
	Price Target: Rs. 1,130 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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

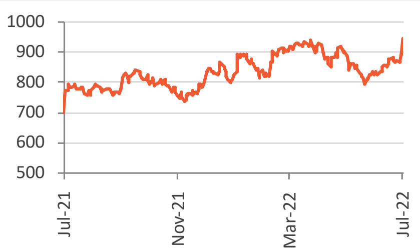
Company details

Market cap:	Rs. 226,383 cr
52-week high/low:	Rs. 966 / 681
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	12.6	1.6	13.1	34.2
Relative to Sensex	4.0	0.7	13.9	24.8

Sharekhan Research, Bloomberg

Summary

- Sun Pharmaceutical Industries Limited (Sun Pharma) reported strong growth on the sequential basis while on a y-o-y basis, growth moderated due to a high base on account of covid in Q1FY22. The results are ahead of estimate
- Robust growth outlook across key geographies of India and US aided by expanding product portfolio, increasing reach and penetration, growth in base business coupled with traction in global specialty business would be key growth drivers for Sun Pharma.
- Sun Pharma has a strong product pipeline for the US with 89 ANDAs and 13 NDAs awaiting USFDA approval. Strong product pipeline could enable Sun to offset competitive pressures.
- Improved growth prospects across businesses and healthy balance sheet position would be key positives. We retain a Buy with an upwardly revised PT of Rs 1130.

Sun Pharmaceutical Industries Limited (Sun Pharma) Sun Pharma reported a strong growth on a sequential basis for Q1FY23, while on a y-o-y basis, growth moderated due to a high base on account of COVID-19. Yet, results are ahead of estimates. Overall revenues grew by 10.7% y-o-y while ex-COVID product sales, revenues grew 14% y-o-y, which is strong growth. Robust growth outlook across key geographies of India and US aided by expanding product portfolio, increasing reach and penetration, growth in base business coupled with traction in global specialty business would be key growth drivers for Sun Pharma. However, as costs across markets are normalising, selling and promotion expenses are likely to be higher and hence could moderate the OPM expansion.

Key positives

- Domestic revenue, ex-COVID sales grew strongly by 13% y-o-y due to new launches and thus outpaced industry growth.
- Global specialty sales reported strong growth of 29% y-o-y to $191 million.
- Sales in emerging markets grew in double digits – 18% y-o-y.

Key negatives

- OPM declined by 280 bps y-o-y due to higher employee cost and other expenses.

Management Commentary

- Global specialty segment's sales for the quarter at $191 million were up 29% y-o-y. The specialty portfolio consisting Illumya, Cequa, Odomzo and Winlevi are expected to gain traction in the US and Canada markets. Management sees a robust outlook for its specialty portfolio.
- Based on strong uptick across segments in domestic markets, Sun Pharma looks to outpace the domestic industry's growth backed by strong New launch momentum and expansion of field force would be key growth drivers.
- Sun Pharma has a strong product pipeline for the US with 89 ANDAs and 13 NDAs awaiting USFDA approval. Strong product pipeline could enable Sun to offset the competitive pressures.

Revision in estimates – Sun Pharma reported a strong growth for Q1FY23 on the sequential basis while on a y-o-y basis, growth moderated due to a high base on account of COVID-19. Results are ahead of estimates. Given the string 29% y-o-y growth in the specialty sales and an encouraging commentary we have revised upwards our estimates by 4% and 8% for FY23E and FY24E.

Our Call

Valuation – Retain Buy with revised PT of Rs. 1130: Sun Pharma's key geographies, US and India, are witnessing improved traction. Growth in the US business would be driven by a 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. Likely cost pressures due to normalisation of costs, could moderate OPM expansion. At the CMP, the stock trades at 26.2x/22.1x its FY2023E/FY2024E EPS, respectively, which is below the historical long-term average multiple. Improved growth prospects across businesses and healthy balance sheet position would be key positives. Therefore, we retain our Buy recommendation on the stock with an upwardly revised PT of Rs. 1130.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Net sales	33498.1	38654.5	42740.7	47927.9
Operating profit	8491.5	10397.7	11753.7	13659.5
OPM(%)	25.35	26.90	27.50	28.50
Adj. PAT	6801.1	7839.5	8628.8	10248.6
EPS (Rs)	28.3	32.7	36.0	42.7
PER (x)	33.3	28.9	26.2	22.1
EV/EBIDTA (x)	26.4	21.4	17.1	13.9
ROCE (%)	12.7	17.3	16.6	17.1
RONW (%)	14.6	16.3	15.4	15.6

Source: Company; Sharekhan estimates

Strong sequential performance; results ahead of estimates: Sun pharma reported a strong growth on the sequential basis, while y-o-y basis, growth moderated due to a high base on account of COVID-19. Yet, overall, results are ahead of estimates. Revenues at Rs 10,762 crore, were up 10.7% y-o-y backed by a 15.8% y-o-y growth in US sales while emerging markets grew by 17.8% y-o-y. The India business depicted a slow growth of 2.4% on account of a high base of COVID products in Q1FY22. Adjusting for the Covid products, the topline grew by 14% y-o-y while the India sales were up by 13% y-o-y. The operating margins contracted by 280 bps y-o-y to 25.4% on the back of a 190 bps and 120 bps y-o-y increase in other expenses / sales and employee cost / sales. The gross margins on the other had expanded slightly by 30 bps y-o-y. The operating profit at Rs. 2,739 crore was almost flat y-o-y, but was ahead of estimates. The other income for the quarter was sharply lower at RS 2 cr as compared to a run rate of Rs. 100 crore. This resulted in the adjusted PAT declining by 4% y-o-y at Rs 1915 crore, but staying ahead of estimates.

Q1FY2023 Conference Call Highlights:

- **Specialty segment to drive US revenue growth:** Revenue from the US grew strongly by 15.5% y-o-y despite price erosion seen across the industry. Growth can be largely attributed to double-digit growth in the specialty business backed by strong growth in the specialty portfolio comprising Cequa, Ilumya, Odomzo, while Absorica sales were under stress due to increased competition. The global specialty portfolio reported 29% y-o-y growth in Q1FY2023. Going ahead, the specialty portfolio is expected to witness further market share gains as doctor OPDs gain traction and patient footfalls increase across markets. Currently, patient footfalls are lower and are below pre-COVID levels. However, they are expected to improve, which could lead to higher prescriptions being generated. 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 10,000 doctors, which have prescribed medicine and traction points at a ramp up. In the subsequent quarters, these launches are expected to gain traction. On the generic portfolio, the company has launched two new products in Q1 and in the past quarter has launched a strong five new products which would gain traction going ahead. 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 89 ANDAs and 13 NDAs awaiting USFDA approvals. Therefore, a pick-up in the US specialty business coupled with a strong product pipeline, which would unfold going ahead and a healthy growth in generics, could be key drivers for the US business.

- **Set to outpace industry growth in India business:** The India formulations business continued its growth trajectory in uncertain times as well. Revenue from India operations was at Rs. 3387 crore, grew by 2.4% y-o-y, however, adjusting for COVID-19-led high base, growth was 13% thus comfortably beating the industry's growth. Double-digit growth can be attributed to strong performance of chronic and acute therapies. The company gained market share in the Indian markets and holds a market share of 8.5% in the IPM. Going ahead, management expects the domestic business to gain traction with all-around growth across therapy areas. Moreover, the company has launched 22 new products in India markets in Q1 and has launched in excess of 70 products in FY22, which points at a strong growth momentum and would add to growth going ahead. Moreover, the company has added substantial field force in India business a with an objective to increase the penetration. Collectively, these factors would drive growth in domestic sales and management looks to outpace the industry's growth.

- **Other highlights**
  - Sun Pharma's market share in India stood at 8.5% as of June 2022, as per AIOCD AWACS MAT report. The company has launched 22 products in India, which would help it outpace the industry's growth.
  - Revenue from emerging markets stood at Rs. 1,891 crore, up 17.8% y-o-y. While revenue from RoW markets stood at Rs. 1467.8 crore, up 7% y-o-y.
  - Research and development (R&D) spends stood at Rs. 460.8 crore in Q1FY2023, as compared to Rs. 592 crore in Q1FY2022.
  - In the US, the company has 515 products and filings for 89 ANDAs await USFDA approval, including 28 tentative approvals. During Q1FY23, the company received three approvals. Also Sun pharma has 13 NDA's awaiting USFDA approvals.

Results (Consolidated) Rs cr

Particulars	Q1FY23	Q1FY22	YoY %	Q4FY2022	QoQ %
Total sales	10,761.8	9,718.7	10.7	9,446.8	13.9
Operating profit	2,738.7	2,741.2	-0.1	2,179.4	25.7
Other Income	2.1	152.5	-98.6	113.6	-98.1
EBITDA	2,740.9	2,893.7	-5.3	2,292.9	19.5
Interest	13.7	35.1	-61.0	37.3	-63.3
Depreciation	588.0	503.2	16.8	556.5	5.7
PBT	2,139.2	2,355.4	-9.2	1,699.1	25.9
Taxes	189.0	395.6	-52.2	146.8	28.8
Adjusted PAT	1,915.2	1,995.3	-4.0	1,497.5	27.9
Margins			**BPS**		**BPS**
OPM %	25.4	28.2	-276	23.1	238
PATM %	19.2	14.9	429	-24.1	4326
Tax rate %	8.8	16.8	-796	8.6	20

Source: Company, Sharekhan Research

Revenue Mix Rs cr

Particulars	Q1FY23	Q1FY22	YoY %	Q4FY22	QoQ %
Formulations	9989.6	9081.6	10.0	8908.3	12.1
India	3387.1	3308.4	2.4	3095.6	9.4
US	3243.7	2800.0	15.8	2924.6	10.9
Emerging Market	1891.0	1605.2	17.8	1547.4	22.2
ROW	1467.8	1368.0	7.3	1340.7	9.5
API	598.7	514.8	16.3	413.7	44.7
Others	55.5	72.9	-23.9	64.0	-13.3
Total	**10643.8**	**9669.3**	**10.1**	**9386.0**	**13.4**
Other Op Inc	117.8	49.3	138.9	60.6	94.4
Total Sales	**10761.6**	**9718.6**	**10.7**	**9446.6**	**13.9**

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.

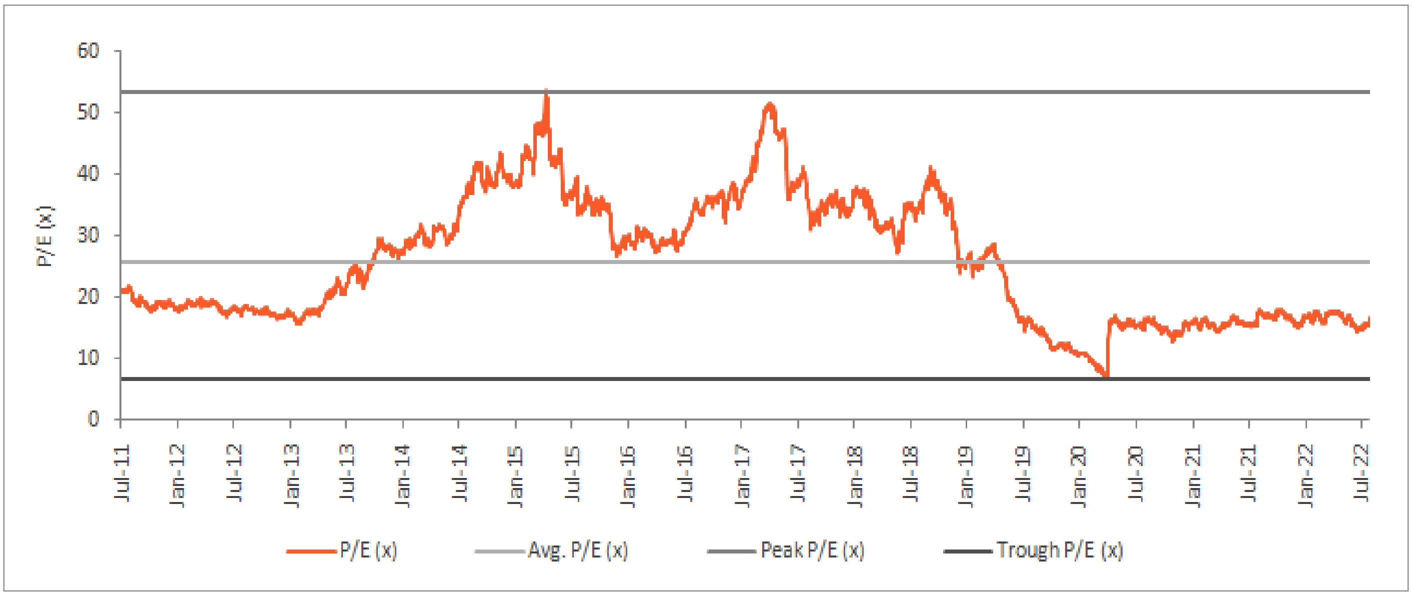
■ Company outlook - Healthy prospects

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 - Retain Buy with a revised PT of Rs 1130

Sun Pharma's key geographies, US and India, are witnessing improved growth traction. Strong growth across therapies and a significant increase in new launch momentum coupled with field force expansion would fuel growth in the domestic formulations business. Growth in the US business would be driven by pick-up in specialty business coupled with traction from new product launches and steady growth in generics. Overall, Q1FY23 results were ahead of estimates. Given the string 29% y-o-y growth in the specialty sales and a encouraging commentary we have revised upwards our estimates by 4% and 8% for FY23E and FY24E. At CMP, the stock trades at 26.2x/22.1x its FY2023E/FY2024E EPS, respectively, which is below the historical long-term average multiple. Improved growth prospects across businesses and healthy balance sheet position would be key positives. Therefore, we retain our Buy recommendation on the stock with an upwardly revised PT of Rs. 1,130.

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	944.0	239.9	226,383	28.9	26.2	22.1	21.4	17.1	13.9	16.3	15.4	15.6
Torrent Pharma	1529.0	17.0	51739	41.2	33.2	27.1	22.9	19.4	15.8	21.1	24.0	25.0
Cipla	978.0	80.6	78,935	28.8	25.4	20.0	17.1	15.4	12.4	14.6	13.9	15.4

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 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, 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 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

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