Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Sun Pharmaceutical Industries Ltd

Decent Q1; Global specialty revenue growth continues to be key

Pharmaceuticals	Sharekhan code: SUNPHARMA

Reco/View: Buy	↔	CMP: **Rs. 1,130**	Price Target: **Rs. 1,300**	↑

↑ 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 31.6

Updated Apr 13, 2023

High Risk

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

Source: Morningstar

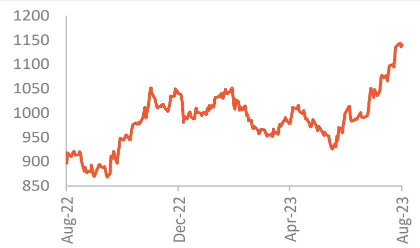
Company details

Market cap:	Rs. 2,73,764 cr
52-week high/low:	Rs. 1,070 / 790
NSE volume: (No of shares)	84.6 lakh
BSE code:	524715
NSE code:	SUNPHARMA
Free float: (No of shares)	130.7 cr

Shareholding (%)

Promoters	45.5
FII	16.5
DII	19.8
Others	18.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	10.5	18.4	10.5	27.2
Relative to Sensex	10.4	11.8	3.2	15.4

Sharekhan Research, Bloomberg

Summary

- Sun Pharmaceutical's (Sun Pharma) gross margins improved for the fifth consecutive quarter y-o-y in Q1FY2024 due to a favourable product mix with stronger-than-anticipated growth in the U.S., as well as decent growth in the specialty segment's sales.
- R&D spending stood at ~5.7% of sales, which increased at ~47% y-o-y in Q1FY2024, indicative of its efforts towards realising the potential of its specialty and other pipeline of products over the medium-long term.
- The company posted strong ~385 bps and ~244 bps y-o-y expansion in gross margin and OPM to ~76.9% and ~27.9%, respectively, beating our estimates by 335 bps and 140 bps, respectively. Hence, we revise our sales and earnings CAGR estimates upwards to ~10.6% and ~8.9% over FY2023-FY2025E from ~9.4% and ~8.1% CAGR, estimated before.
- The stock trades at ~28.5x/~26.1x its FY2024E/FY2025E EPS. We believe superior profitability enables it to trade at a premium to peers. We maintain Buy with a revised PT of Rs. 1,300.

Sun Pharmaceutical Industries Limited (Sun Pharma) posted a beat on its adjusted net income in Q1. Net income on an adjusted basis stood at Rs. 2,345.4 crore, up ~13.8% y-o-y (vs. our estimate of Rs. 2,140 crore and consensus estimate of Rs. 2,146 crore). Reported PAT declined by ~1.9% y-o-y to Rs. 2,022.5 crore for Q1FY2024. Growth in adjusted PAT was driven by a ~9,453.3% y-o-y increase in other income to Rs. 204.4 crore, partially offset by a ~490.8% y-o-y increase in finance costs to Rs. 80.9 crore, while adjusted operating profit rose by ~21.6% y-o-y to Rs. 3,329.7 crore (vs. our estimate of Rs. 2,881 crore and consensus estimate of Rs. 2,876 crore), as OPM improved by ~244 bps y-o-y to ~27.9% (vs. consensus and our estimate of ~24.6%, each). The company reported healthy ~385 bps y-o-y rise in gross profits margin (GPM) to ~76.9% in Q1, even though employee and other operating expenses, including R&D costs, increased. R&D cost stood at Rs. 680 crore, up ~47% y-o-y (or ~5.7% of revenue). Sun Pharma posted an ~11% y-o-y rise in operating revenue to Rs. 11,940.8 crore (vs. our estimate of Rs. 11,733 crore and consensus estimate of Rs. 11,696 crore). Growth was driven by strong growth in the U.S., emerging markets, and rest of the world's (RoW) segments. Operating revenue growth was also driven by a strong ~21.5% y-o-y rise in global specialty revenue to ~USD232 million or Rs. 1,909 crore (~16.2% of revenue).

Key positives

- Global specialty sales grew by ~21.5% y-o-y to USD232 million in Q1FY2024.
- U.S. and emerging markets grew at a strong pace of ~19.3% y-o-y to Rs. 3,871 crore and ~13.4% y-o-y to Rs. 2,145 crore in Q1FY2024.
- As of Q1FY2024, net cash stood at USD1.7 billion at consolidated levels and USD436 million at ex. Taro level.
- Gross debt reduced from USD754 million as of Q4FY2023 to USD472 million as of Q1FY2024 as it repaid part of the debt (USD275 million) during the quarter.

Key negatives

- Regulatory actions at its Halol, Pithampur, and Mohali plants continue.

Management Commentary

- The company continues to remain focused on the Rx segment in India. The company has launched its specialty product, Cequa, in India for which the initial response has been good.
- Sun Pharma ranks no. 1 in India and holds an 8.3% market share as of June 2023 vs. 8.5% in June 2022 (AIOCD report).
- Consolidated gross sales increased q-o-q due to higher sales of gRevlimid (as it was launched in Q4FY2023); however, the company expects its sales to remain episodic, going forward.

Revision in estimates: As the company clocks in operating profitability, which exceeded the estimates, we revise our sales and earnings CAGR estimates to 10.6% and 8.9% from 9.4% and 8.1%, respectively, over FY2023-FY2025E.

Our Call

View: Maintain Buy with a revised PT of Rs. 1,300: The company continues to report decent earnings growth on account of strong growth in the U.S., emerging markets, and RoW. This is also led by strong growth in global specialty revenue, which is inching higher at a robust pace. However, its cGMP compliance concerns surrounding Halol, Pithampur and Mohali plants can act as headwinds to its optimum sales growth potential. Nevertheless, as the company clocks in operating profitability, which is far exceeding estimates, we revise our sales and earnings CAGR estimates to 10.6% and 8.9% from 9.4% and 8.1%, respectively, over FY2023-FY2025E. The stock trades at ~28.5x/~26.1x its FY2024E/FY2025E EPS. We believe superior profitability enables it to trade at a premium to peers. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 1,300.

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.

Source: Company Data; Sharekhan estimates Rs cr

Particulars	FY2021	FY2022	FY2023	FY2024E	FY2025E
Net sales	33498.1	38654.5	43885.7	48663.9	53655.7
Operating profit	8467.7	10243.8	11772.9	13612.7	15009.1
EBITDA Margin (%)	25.3	26.5	26.8	28.0	28.0
Adj. PAT	7210.0	7685.6	8771.1	9516.9	10402.9
EPS (Rs)	30.1	32.0	36.6	39.6	43.3
PER (x)	37.6	35.3	30.9	28.5	26.1
EV/EBIDTA (x)	32.5	26.9	23.4	20.2	18.4
ROCE (%)	13.7	17.3	14.9	16.3	16.1
RONW (%)	14.6	15.1	14.8	14.5	14.2

Source: Company Data; Sharekhan estimates

Strong Q1 outperformed on an adjusted net income basis.

Sun Pharma posted a strong beat on the adjusted net income front in Q1FY2024. Net income on an adjusted basis (adjusted for exceptional items such as Rs. 149 crore towards impairment of an acquired intangible asset under development, forex loss of Rs. 123 crore pertaining to Ranbaxy Nigeria, and Rs. 50 crore towards the impact of planned relocation of Alchemee operations from California to New York) stood at Rs. 2,345.4 crore, up ~13.8% y-o-y (vs. our estimate of Rs. 2,140 crore and consensus estimate of Rs. 2,146 crore). Reported PAT declined by 1.9% y-o-y to Rs. 2,022.5 crore though. Growth in adjusted net profit was driven by a ~9,453.3% y-o-y rise in other income to Rs. 204.4 crore, partially offset by a ~490.8% y-o-y rise in finance costs to Rs. 80.9 crore in Q1FY2024, while adjusted operating profit rose by ~21.6% y-o-y to Rs. 3,329.7 crore (vs. our estimate of Rs. 2,881 crore and consensus estimate of Rs. 2,876 crore), as OPM improved by ~244 bps y-o-y to ~27.9% in Q1 (vs. consensus and our estimate of ~24.6%, each). This was with a healthy ~385 bps y-o-y rise in GPM to ~76.9% in Q1 even though employee costs and other operating expenses, including R&D cost, increased at ~14.3% y-o-y for Q1FY2024. R&D cost stood at Rs. 680 crore, up ~47% y-o-y (or ~5.7% of revenue) for Q1FY2024.

Sun Pharma posted an ~11.0% y-o-y rise in its operating revenue to Rs. 11,940.8 crore (vs. our estimate of Rs. 11,733 crore and consensus estimate of Rs. 11,696 crore) in Q1. Growth was driven by a ~19.3% y-o-y rise in the U.S. revenue to Rs. 3,871 crore (~33.0% of operating revenue), ~5.1% y-o-y increase in India revenue to Rs. 3,560 crore (~30.0% of revenue), ~13.4% y-o-y rise in the emerging market revenue to Rs. 2,145 crore (~18% of revenue), and a ~9.3% y-o-y increase in RoW revenue to Rs. 1,604 crore (~14% of revenue). This was offset by a ~9.9% y-o-y decline in API revenue to Rs. 540 crore (~5% of revenue). Operating revenue growth was also driven by strong ~21.5% y-o-y rise in global specialty revenue to USD232 million or Rs. 1,909 crore (~16.2% of revenue).

Q1FY2024 Conference Call Highlights

- **Gross profitability improved on account of improved products mix:** Improved largely on account of strong sales growth in the specialty segment and improved product mix. Operating expenses increased due to annual increments to staff, consolidation of Concert Pharma, and increased selling and distribution expenses.
- **Balance sheet pose to be strong:** As of Q1FY2024, net cash was at USD 1.7 billion at consolidated levels and USD 436 million at ex. Taro level. Gross debt reduced from USD 754 million as of Q4FY2023 to USD 472 million as of Q1FY2024 as it repaid part of the debt (USD 275 million) during the quarter.
- **gRevlimid led to consolidated gross sales growth q-o-q:** Consolidated gross sales increased by q-o-q due to higher sales of gRevlimid (as it was launched in Q4FY2023), which the company expects its sales to remain episodic going forward.
- **India business growth subdued due to genericization in diabetes products and NLEM-led price reductions:** In Q1FY2023, Sitagliptin product patent expired. Similarly, NLEM-related price reductions were announced in Q3FY2023. That led to subdued growth in India business. However, the company expects to grow in line with the market and intends to surpass the market growth eventually. The company continues to remain focused on the Rx segment in India. The company has launched Cequa in India for which the initial response has been good. Sun Pharma ranks no. 1 in India and holds an 8.3% market share as of June 2023 vs. 8.5% in June 2022 (AIOCD report). It launched 10 new products in India in Q1FY2024.
- **U.S. business continues to grow backed by strong growth in specialty sales:** The U.S. specialty business continues to do well. There was seasonality in Levulan' sales leading to a q-o-q decline in specialty sales in Q1FY24; however, the underlying prescription trend for specialty products continues to remain strong. The company launched two generic products on an ex-Taro basis in Q1FY2024. Information Technology attack has led to moderation in ANDA filings in the U.S.
- **Global specialty continues to grow at a strong pace:** It clocked in USD232 million, 21.0% y-o-y, revenue in Q1FY2024. Specialty R&D stood at 35.8% of total R&D in Q1FY2024. In June 2023, Sun Pharma announced the results for Phase I study of its novel drug GL0034, which is being researched for the treatment of type 2 diabetes. The drug reduced body weight after a single dose in obese individuals without diabetes. Phase II study is to commence shortly in 2023, which will be carried out on patients with obesity and type

2 diabetes. Illumya phase III study for Psoriatic Arthritis is being accelerated by increasing enrollment and activation of new and more sites. In May 23, it entered into an exclusive agreement with Philogen for commercialising Philogen's specialty product Nidlegy (phase III candidate for skin cancer) in Europe, Australia, and New Zealand. In June 23, Winlevi bagged the approval for marketing in Canada. For new indications also, the patents will be in place – leading to exclusivity of that product. The company continues to improve access to the products, which can ensure volume momentum to sustain for the products.

- **Taro's acquisition:** The dermatology business is the primary focus for Taro and the company is seeing increased competition in the segment and that business was not expected to run independently. Hence, the company has acquired it to enable its growth.
- **Compliance:** Supply has not started from Mohali yet, but there is some inventory leading to sales; however, it will be materially lower y-o-y and q-o-q. For clearing USFDA concerns, re-inspection will be needed. For Halol and Pithampur, once the company is ready with remediation measures, it will be intimated to the USFDA. De-risking the products through multiple inter-changeable sites is not feasible.
- **U.S. drug shortages:** Not leading to any opportunities as it is not present in injectables largely, where drug shortage is the highest.

Results (Consolidated) Rs cr

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Total sales	11,940.8	10,761.8	11.0	10,930.7	9.2
Expenditure	8,611.1	8,023.0	7.3	8,101.4	6.3
EBITDA	3,329.7	2,738.7	21.6	2,829.3	17.7
Depreciation	651.3	588.0	10.8	671.5	-3.0
EBIT	2,678.4	2,150.7	24.5	2,157.8	24.1
Interest	80.9	13.7	490.8	92.7	-12.8
Other Income	204.4	2.1	9453.3	373.3	-45.2
PBT	2,802.0	2,139.2	31.0	2,438.3	14.9
Taxes	468.1	189.0	147.7	222.9	110.0
PAT Before MI and JV from associates	2,333.9	1,950.2	19.7	2,215.4	5.3
MI and JV Income or losses	-9.5	35.0	NM	32.3	-129.4
Forex Losses	-2.0	-145.7	NM	27.2	-107.5
Adjusted PAT	2,345.4	2,060.9	13.8	2,155.9	8.8
Exceptional Items	322.9	0.0	NM	171.5	NM
Reported PAT	2,022.5	2,060.9	-1.9	1,984.5	1.9
EPS (Rs.)	8.4	8.6	-1.9	8.3	1.9
Margins			**BPS**		**BPS**
GPM (%)	76.9	73.1	385	79.4	-251
EBIDTA (%)	27.9	25.4	244	25.9	200
Adj. NPM (%)	19.5	18.1	142	20.3	-72
Tax rate (%)	16.7	8.8	787	9.1	756

Source: Company, Sharekhan Research

Revenue Mix Rs cr

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Formulations	**11,181**	**9,990**	**11.9**	**10,293**	**8.6**
India	3,560	3,387	5.1	3,364	5.8
US	3,871	3,244	19.3	3,534	9.5
Emerging Market	2,145	1,891	13.4	1,820	17.8
ROW	1,604	1,468	9.3	1,574	1.9
API	540	599	-9.9	385	40.1
Others	65	56	17.1	47	38.0
Total	**11,785**	**10,644**	**10.7**	**10,726**	**9.9**
Other Operating Income	156	118	32.2	205	-24.1
Total Sales	**11,941**	**10,762**	**11.0**	**10,931**	**9.2**

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Regulatory concerns and pricing erosion prove a hurdle over the short-medium term

Over the years, Indian pharmaceutical companies have established themselves as a dependable source for global pharma companies. The confluence of other factors, including focus on specialty/complex products in addition to emerging opportunities in the API space, would be key growth drivers over the long term. However, ongoing USFDA plant inspections and a few companies being issued Form 483 with observations point to apparent regulatory concerns. We believe in the near term, based on the headwinds that may drag the performance, especially in the API and CDMO space and for large pharma players seeing USFDA OAI or WL status on their facilities, we have a Neutral view on the sector.

■ Company Outlook – Strong growth 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 U.S. are key markets for the company and constitute around 60% of the total topline. Sun Pharma's U.S. business is on the path to improvement, largely backed by a 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 U.S. 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 strong growth traction. Management expects the domestic formulations business to continue its strong growth on account of new launches, growth in the existing business, and field force productivity improvement, and aims to outpace the industry's growth. Therefore, improved outlook across both key geographies, India and U.S., and increasing penetration in other geographies, would drive growth for Sun Pharma

■ Valuation – Maintain Buy with a revised PT of Rs. 1,300

The company continues to report decent earnings growth on account of strong growth in the U.S., emerging markets, and RoW. This is also led by strong growth in global specialty revenue, which is inching higher at a robust pace. However, its cGMP compliance concerns surrounding Halol, Pithampur and Mohali plants can act as headwinds to its optimum sales growth potential. Nevertheless, as the company clocks in operating profitability, which is far exceeding estimates, we revise our sales and earnings CAGR estimates to 10.6% and 8.9% from 9.4% and 8.1%, respectively, over FY2023-FY2025E. The stock trades at ~28.5x/~26.1x its FY2024E/FY2025E EPS. We believe superior profitability enables it to trade at a premium to peers. We maintain our Buy rating on the stock with a revised PT of Rs. 1,300.

Peer Comparison

Companies	CMP (Rs / Share)	O/S Shares (Crs)	Mcap (Rs Cr)	P/E (x)			EV / EBITDA (x)			RoE (%)		
				FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
Sun Pharma	1,130.3	239.9	2,71,184.8	30.9	28.5	26.1	23.4	20.2	18.4	14.8	14.5	14.2
Torrent Pharma	1995.8	33.8	67,546.9	54.5	37.0	31.8	25.6	18.8	16.2	20.3	26.9	26.0
Cipla	1,165.9	80.7	94,084.3	31.5	24.5	21.0	18.5	15.9	13.9	12.6	14.2	14.5

Source: Company; Sharekhan Research

About the 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 U.S. 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 U.S. are the key markets for the company and constitute around 60% of the total topline. Outlook for the U.S. business has improved on account of a likely revival in the U.S. specialty business coupled with a strong product pipeline, which would unfold going ahead and would be the key growth driver for the U.S. business. Moreover, price erosion is largely stable in the U.S. 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 it 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 U.S. 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 U.S. with regards to price collusion.

Additional Data

Key management personnel

Dilip S. Shanghvi	Managing Director and Founder
Abhay Gandhi	CEO, North America
Kirti Ganorkar	EVP
C. S. Muralidharan	Chief Financial Officer
Anoop Deshpande	Company Secretary and Compliance Officer

Source: BSE; Company Website

Top shareholders

Sr. No.	Holder Name	Holding (%)
1	ICICI Prudential Asset Management Co.	3.3
2	Life Insurance Corporation of India	3.1
3	SBI Funds Management Ltd.	2.5
4	Aditya Medisales Ltd.	1.7
5	Vanguard Group Inc.	1.5
6	BlackRock Inc.	1.4
7	Norges Bank	1.1
8	NPS Trust UTI Retirement Solutions	1.1
9	HDFC Asset Management Co. Ltd.	0.9

Source: BSE

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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