

# SUN PHARMA

MARCH 2016

Sun Pharma	
<b>Rating</b>	Accumulate
Target Price	Rs 971
Potential upside	15.00%
<b>Shareholders</b>	
<b>Market data</b>	
Shares outs	2406
Equity cap	2406
Mkt Cap	2041695
52 Wk H/L	1200/706
Volume avg	4395
Face value	1
<b>Market info</b>	
SENSEX	23532
NIFTY	7155

## Result highlights

Sun Pharma's result was above our estimates. Total revenues stood at INR 70.5bn registering a growth of 2.4% YoY on account of slowdown in the US business due to temporary supply constraints at its Halol plant & competitive pressure on some of the products. Taro posted sales of USD 258mn, showed growth of 9% YoY and 22% QoQ with marginal increase in volumes. Elevated other income at INR 2.2bn and lower interest cost coupled with superior operating efficiency and cost curtailment led to enhanced EBITDA at INR 21.7bn which was flattish YoY and up 12% QoQ with EBITDA margins at 30.6% down 61bps YoY and up 235 QoQ. R&D expenses during the quarter stood at INR 5.8bn, at 8.2% of sales growing by 23% YoY and 21% QoQ on account of expenses related to clinical development of Tildrakizumab. PAT stood at INR 14.2bn up 258% YoY and up 28% QoQ on account of higher tax outgo of INR 10.3bn in the corresponding quarter of the last year as compared to a tax outgo of INR 2bn (tax rate of 10% as a % of PBT). EPS for the quarter stood at INR 5.9

**Strong Q3; gGleevec ramp-up to drive growth** SUNP's operating performance for Q3FY16 was in line with estimates while PAT at Rs 14bn (+258% YoY) was propped up by a lower tax rate (10% vs. 19%QoQ). Ex-Taro, we believe base business margins declined by ~150bps QoQ, but are likely to rebound in the ensuing quarters as gGleevec ramps up. This in turn should drive medium term growth for the company. We resume coverage on SUNP with HOLD and a Mar'17 TP of Rs 940, valuing the stock at 25x FY18E EPS.

## Strengthening market leadership in domestic business

Domestic formulation business showed growth of 8% YoY. As per the latest AWACS report Sun Pharma holds 8.8% market share in India and continues to be ranked no.1 in prescription market share with 12 classes of specialists. Sun has divested Ranbaxy's CNS division to Strides Shasun during the quarter as it plans to concentrate on its core competency segments.

## Temporary supply constraints at Halol & competitive pressures impacted US business

US formulations posted sales of USD 486mn down by 11% YoY impacted mainly on account of lower sales of Sun (ex-Taro) which declined by 24% YoY to USD 253mn due to supply constraints arising from remediation efforts at Halol plant, competitive pressure in some of the products like anti depressant duloxetine, antiinfective doxycycline & cancer drug liposomal doxorubicin and revenues from gDiovan exclusivity in Q3FY15. Taro posted sales of USD 258mn, growing 9% YoY and 22% QoQ on account of marginal volume increase.

### US business declines QoQ:

SUNP's Q3 revenues at Rs 70.7bn were 4% higher than our estimate but 3% lower than consensus. US business declined by ~US\$25mn QoQ (ex Taro) and one off sales of US\$40mn in Q2FY16, we believe (lower halol sales + market share loss in Sumatriptan), despite very strong sales from Taro (US\$258mn, up \$46mnQoQ). Domestic business growth continued to be impacted by cessation of bonus/discount (+8.6% YoY). EM and ROW businesses were flat YoY, impacted by currency devaluation and exit from non-remunerative geos

### Taro supports operating performance:

**Margins** expanded 230bps QoQ to 30.6% supported by a strong operating performance at Taro (margins up 820bps QoQ led by price hikes). Ex-Taro, we believe base business margins declined ~150bps QoQ, largely led by higher R&D spends (+110bps QoQ). However, benefits of operating leverage were visible (other operating expenses: -Rs 2.3bn QoQ).

### Earnings call update:

(a) Set to invite USFDA for a re-inspection at Halol in Q1FY17. (b) Sumatriptan sales suspended temporarily due to Halol facility upgrade (IMS shows zero sales in Oct-Dec'15 quarter). (c) gGleevec market share ramp-up to be gradual, given Novartis' special pricing schemes and patient resistance. (d) India sales to normalise ahead. (e) Consolidation of GSK's opiates business lead to higher API sales. (f) SUNP has 156 ANDAs pending approval. (g) SUNP received target action dates for products filed from Halol, (h) Tax rate to increase gradually.

### Valuation:

We have increased the multiple on account of enhanced gGleevec opportunity, expectation of robust revenue from Taro's orphan drug Keveyis (we have modeled USD 90mn as FY18E sales of the drug) coupled with Sun's ability to turn around stressed assets and synergy benefits from erstwhile Ranbaxy in tune of USD 300mn enhancing the companies margins to 34% in FY18E. We believe, majority of remedial expenses at Halol have been undertaken by Sun and anticipate regulatory clearance by earliest at the end of FY17E. At CMP of Rs 842, the stock is trading at 24x FY18E. We revise our rating to 'BUY' from 'ACCUMULATE' on the stock with the target price of INR 971 based on 28x FY18E EPS of INR 34.7

Financial Highlights				
Y/E 31 Mar	FY14A	FY15A	FY16E	FY17E
Revenue	160804	274334	281848	341845
EBITDA	69798	75952	85963	117936
Adjusted net profit	56588	47771	54011	77642
Adjusted EPS	27.3	19.9	22.4	32.3
Adjusted EPS Growth%	-20.7	-27.3	13.1	43.8
DPS	1.5	3	1.6	1.7
ROIC	39.4	25.2	22.8	30.2
Adjusted Roee	33.8	21.6	19.6	23.8
Adjusted P/E	31	42.7	37.7	26.3
EV/EBITDA	29	26.6	23.9	17.1
P/BV	9.5	8	6.9	5.7

Quarterly performance					
Rs mn	Q3FY15	Q2FY16	Q3FY16	Yoyo%	QOQ%
Net revenues	69295	68376	70821	2.2	3.6
Milestone income	0	0	0	0	0
total income	69295	68376	70821	2.2	3.6
total material costs	17127	15583	17554	2.5	12.7
% of revenue	24.7	22.8	24.8		
staff costs	10909	12088	11483	5.3	-5
% of revenue	15.7	17.7	16.2		
R&D expenses	4698	4769	5760	22.6	20.8
% of revenue	6.8	7	8.1		
Other expenses	14915	16600	14334	-3.9	-13.6
% of revenue	21.5	24.3	20.2	-128	-404
EBITDA	21645	19337	21690	0.2	12.2
EBITDA Margin%	31.2	28.3	30.6	-61	235
other income	-733	1913	2192	-399.1	14.6
interest	1529	1484	1170	-23.5	-21.1
deperciation	2284	2711	2508	9.8	-7.5
PBT	17099	17055	20205	18.2	18.5
Tax	10290	3355	2020	-80.4	-39.8
tax rate	60.2	19.7	10		
minority interest	2856	2633	4019	40.7	52.6
Report PAT	3953	11067	14166	258.3	28
Adjusted PAT	3953	11067	14166	258.3	28

Revenue summary					
Rs mn	Q3FY15	Q2FY16	Q3FY16	Yoyo%	QOQ%
<b>Total formulations</b>	66950	65402	66415	-0.8	1.5
<b>india</b>	17454	18187	18903	8.3	3.9
<b>US</b>	33858	33158	32003	-5.5	-3.5
<b>ROW</b>	10042	9089	9941	-1	9.4
<b>EM</b>	5596	4967	5570	-0.5	12.1
<b>BULK</b>	2477	3146	4405	77.9	40
<b>Others</b>	122	142	207	69.5	46.3
<b>total sales</b>	69549	68689	71028	2.1	3.4

Taros quarterly performance					
In US\$ Min	Q3FY16	Q2FY16	Q3FY16	Yoyo%	QOQ%
<b>Net revenues</b>	238	212	258	8.7	21.8
<b>total material costs</b>	44	43	44	-0.1	2
<b>As % of sales</b>	18.6	20.4	17.1		
<b>Gross profit</b>	193	169	214	10.7	26.9
<b>As % of sales</b>	81.4	79.6	82.9		
<b>SG&amp;A</b>	21	25	23	7	-8.8
<b>As % of sales</b>	9	11.8	8.8		
<b>R&amp;D Expenses</b>	13	19	18	39.9	-4.2
<b>As % of sales</b>	5.4	8.8	6.9		
<b>PBIDT</b>	159	125	173	8.8	38.7
<b>As % of sales</b>	67	58.9	67.1	9	818
<b>other income</b>	0	1	1	96.1	-6.3
<b>interest exps</b>	-11	-38	-27	139.7	-29.6
<b>PBT Before extraordinary items</b>	171	164	201	17.6	22.6
<b>tax</b>	28	30	12	-58	-61.1
<b>NPAT From continuing operatios</b>	143	134	189	32.5	41.7
<b>Net loss from discontinued operations</b>	0	0	0		
<b>Net income attributable to non controlling interests</b>	0	0	0	-25.8	-29.5
<b>net income attributable to taro</b>	142	133	189	32.7	41.7

## Expect 23% EPS CAGR over FY15-FY18 gGleevec:

### A limited competition opportunity for an extended period

- In Feb'16, SUNP launched gGleevec, a US\$ 2bn drug, indicated for multiple myeloma under six-month exclusivity. While there are multiple DMF filers for Imatinib Mesylate (gGleevec), currently only a few players, viz. DRRD, Breckenridge, Shilpa Medicare, Amneal, Roxane (part of BI) and Apotex, are known to have filed for the product.
- Apotex is not sued and has tentative approval, and is thus likely to enter the market ♣ on 181-day post SUNP's exclusivity. Barring Apotex, others are sued on the #051 patent which expires in 2019.
- DRRD's filing is linked to the Srikakulam plant (under warning letter) and it is looking ♣ to transfer the product to another site. It has indicated a launch a few quarters post SUNP.
- Breckenridge is unlikely to enter the market before Feb'17 (until mandatory ♣ 30-month stay expiry). Shilpa Medicare and Amneal are recent filers. ♣ Our estimates factor in US\$ 100mn/US\$ 410mn revenues in FY16/FY17 from the gGleevec launch and we expect staggered competition in the product.

### Ranbaxy deal: US\$ 280mn-300mn of synergies by FY18

Revenue synergies: We believe most of revenue synergies are likely to be realised in the domestic and EM businesses (South Africa + Russia + Romania sales > US\$ 100mn) over the near term with a wider and largely non-overlapping product portfolio (higher prescription share, strengthening leadership position in key therapies) and a broader

distribution reach (in rural areas where SUNP has negligible presence). We however think there is limited scope for revenue synergies in the US business, though with a larger scale there could be better negotiations in the backdrop of recent channel consolidation.

### Productivity gains:

RBXY's field-force productivity is one of the lowest in the industry and SUNP has significant scope to improve this. Cost rationalisation: With EBITDA margins of 8-9% when acquired, RBXY's cost base is significantly inflated even as its gross margins were largely in line with peers. We believe SUNP is taking a more balanced approach towards cost reduction by rationalising redundant portfolios/geographies. SUNP has already closed a few non-strategic geographies, divested its Ireland and Ohio facilities and its CNS portfolio to Strides.

Resolution of regulatory issues: SUNP's focus is to resolve the outstanding regulatory issues at important plants (four RBXY plants + one own plant at Karkhadi under import alert + one plant at Halol under warning letter). We believe that amongst these, SUNP's Halol plant and RBXY's Mohali plant can see faster resolution. In its earnings call, SUNP mentioned that it expects to invite USFDA for a re-inspection in Q1FY17.

### Halol issues priced in; resume coverage with HOLD

SUNP stock has fallen by 30% from its peak in April 2015 on USFDA concerns relating to the Halol facility. Our reading of the warning letter suggests that the resolution can take around a year's time but chances of an import alert are slim, given no data integrity issues or system-side compliance demanded. The warning letter is unlikely to hit the current business significantly (7-8% of FY16 revenues, 10-11% of profits), but should impact future approvals – all of SUNP's injectable filings are filed from this site and approvals may thus get delayed. We build in a warning letter resolution in Q4FY17.

We resume coverage on SUNP and value the stock at 25x FY18 EPS of Rs 37.5 to arrive at a Mar'17 TP of Rs 940. Our exit multiple is in-line with the historical average.

<b>Valuation Ratios</b>					
Y/E 31 Mar	FY14A	FY15A	FY16E	FY17E	FY18E
EV/Sales	12.6	7.4	7.3	5.9	5.5
EV/EBITDA	29	26.6	23.9	17.1	14.8
Adjusted P/E	31	42.7	37.7	26.3	22.6
P/BV	9.5	8	6.9	5.7	4.7
<b>Financial ratios</b>					
Y/E 31 Mar	FY14A	FY15A	FY16E	FY17E	FY18E
<b>Profitability and return ratios</b>					
EBITDA Margin	43.4	27.7	30.5	34.5	37
EBIT Margin	40.9	23.3	26.9	30.5	32.9
Adjusted profit margin	35.2	17.4	19.2	22.7	25
Adjusted Roee	33.8	21.6	19.6	23.8	23
ROCE	27.9	18.1	16.5	20.6	20.7
<b>Yoyo Growth%</b>					
Revenue	42.3	70.6	2.7	21.3	5.9
EBITDA	42.7	8.8	13.2	37.2	13.5
Adjusted EPS	-20.7	-27.3	13.1	43.8	16.4
Invested Capital	27.9	74.5	1.3	6.9	3
<b>Working capital and liquidity ratios</b>					
Receivables	56	50	70	64	69
Inventroy	65	58	74	66	71
Payables	54	41	60	58	65
current ratio	2.1	1.6	1.8	2.2	2.7
quick ratio	0.9	0.6	0.7	0.9	1.3
<b>Turnover and leverage ratios</b>					
Gross asset turnover	2	2.2	1.6	1.8	1.8
total asset turnover	0.6	0.7	0.6	0.6	0.6
Net interest coverage ratio	0	0	0	0	0
Adjusted Debt/equity	-0.3	-0.1	-0.2	-0.3	-0.4
<b>Dupont anaysis</b>					
Y/E 31 Mar	FY14A	FY15A	FY16E	FY17E	FY18E
Tax burden net income PBT	123.5	74.6	76	72.2	73.1
Interest burden PBT/EBIT	69.8	100	93.8	103.2	103.9
EBIT Margin EBIT/Revenue	40.9	23.3	26.9	30.5	32.9
Asset turnover Revenue/avg TA	64.6	70.3	56.1	62.5	58.9
Leverage Avg TA/AVG Equities	148.5	176.7	182.3	168	156
Adjusted Roee	33.8	21.6	19.6	23.8	23

<b>Income statement</b>					
<b>Y/E 31 Mar</b>	<b>FY14A</b>	<b>FY15A</b>	<b>FY16E</b>	<b>FY17E</b>	<b>FY18E</b>
<b>total revenue</b>	160804	274334	281848	341845	361859
<b>EBITDA</b>	69798	75952	85963	117936	133888
<b>EBIT</b>	65706	64005	75768	104142	119044
<b>Net interest income/expenses</b>	5299	2402	2149	3335	4625
<b>other income/expenses</b>	0	0	0	0	0
<b>exceptional items</b>	-25174	-2378	-6852	0	0
<b>EBT</b>	71004	66407	77917	107477	123669
<b>Income taxes</b>	-7022	-9147	-11370	-17196	-19787
<b>extraordinary items</b>	0	0	0	0	0
<b>min int/inc from associates</b>	-7395	-9488	-12536	-12639	-13505
<b>Reported net profit</b>	31414	45394	47159	77642	90377
<b>adjustments</b>	25174	2378	6852	0	0
<b>adjusted net profit</b>	56588	47771	54011	77642	90377

<b>Balance sheet</b>					
<b>Y/E 31 Mar</b>	<b>FY14A</b>	<b>FY15A</b>	<b>FY16E</b>	<b>FY17E</b>	<b>FY18E</b>
<b>Accounts payables</b>	13283	31538	32402	39299	41600
<b>other current liabilities</b>	1977	13624	13624	13624	13624
<b>provisions</b>	45622	67376	67772	73644	76097
<b>debt funds</b>	25609	89939	75963	65963	55963
<b>other liabilities</b>	0	1923	1923	1923	1923
<b>Equity capital</b>	2071	2071	2406	2406	2406
<b>Reserves and surplus</b>	183178	254310	292049	354734	427701
<b>Shareholders funds</b>	185249	256381	294455	357140	430107
<b>Total liabilities and equities</b>	290951	489294	514652	580106	647827
<b>cash and cash eq</b>	75902	109980	130416	163865	217728
<b>accounts receivables</b>	22004	53123	54578	66196	70072
<b>inventories</b>	31230	56680	58232	65559	74763
<b>other current assets</b>	48257	77067	79177	96032	101654
<b>investments</b>	27860	27163	27163	27163	27163
<b>net fixed assets</b>	49827	89815	94620	95826	95981
<b>CWIP</b>	8415	20386	15386	10386	5386
<b>Intangible assets</b>	18346	37010	37010	37010	37010
<b>Deferred tax assets net</b>	9110	17516	17516	17516	17516
<b>other assets</b>	0	554	554	554	554
<b>total assets</b>	290952	489294	514652	647827	647827

<b>Cash flow statement</b>					
<b>Y/E 31 Mar</b>	<b>FY14A</b>	<b>FY15A</b>	<b>FY16E</b>	<b>FY17E</b>	<b>FY18E</b>
<b>Net income+Depreciation</b>	35506	57341	57354	91436	105221
<b>Interest expenses</b>	-5299	-2402	-2149	-3335	-4625
<b>Non cash adjustments</b>	0	0	0	0	0
<b>Changes in working capital</b>	-25791	-47502	-4254	-28902	-16401
<b>other operating cash flows</b>	35172	45778	0	0	0
<b>cash flow from operations</b>	39589	53215	50951	59198	84195
<b>capital expenditure</b>	-20548	-111188	-10000	-10000	-10000
<b>changes in investments</b>	-3745	697	0	0	0
<b>other investing cash flows</b>	622	83782	7159	8546	9046
<b>cash flow from investing</b>	-23671	-26710	-2841	-1454	-954
<b>equities issued</b>	-881	4337	0	0	0
<b>debt raised/repaid</b>	23012	64331	-13976	-10000	-10000
<b>Interest expenses</b>	1840	-507	-5010	-5211	-4421
<b>dividend paid</b>	-6058	-3635	-8689	-9085	-14957
<b>other financing cash flows</b>	-12847	-75401	0	0	0
<b>cash flow from financing</b>	5066	-10875	-27675	-24296	-29378
<b>changes in cash and cash eq</b>	20984	15631	20435	33449	53863
<b>closing cash and cash eq</b>	43587	60337	80772	114221	168084

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