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Q1FY21 result review  
and earnings revision

## Pharmaceuticals

Target price Rs612

### Earnings revision

(%)	FY21E	FY22E
Sales	(2.5)	(0.8)
EPS	3.0	4.6

### Target price revision

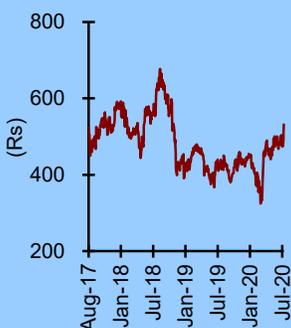
Rs612 from Rs585

### Shareholding pattern

	Dec '19	Mar '20	Jun '20
Promoters	54.6	54.7	54.7
Institutional investors	33.0	32.4	32.8
MFs and others	10.6	10.8	10.5
FIs/Bank/Ins	8.2	8.5	9.4
FII	14.1	13.1	12.9
Others	12.4	12.9	12.5

Source: BSE India

### Price chart



# Sun Pharmaceutical Industries

**BUY**

**Maintained**

## Operationally strong performance

**Rs531**

Sun Pharmaceutical Industries' (Sun) reported strong operational performance in Q1FY21 beat our estimate of gross and EBITDA margin by 250bps and 450bps respectively. However, revenue growth was below estimate largely due to weak performance in Taro. Consol. revenue declined 9.4% YoY to Rs75.9bn (I-Sec: Rs81.2bn) and adj. PAT dropped 17.4% to Rs11.5bn. Gross margin improvement of 330bps was driven by better revenue mix and focus on operational efficiency in manufacturing, partially sustainable in our view. Drop in global specialty sales is temporary due to lockdown and would recover in coming quarters. We remain positive on long-term outlook considering strong India business, scale-up of specialty sales and focus on margin expansion through superior revenue mix and operational efficiency. Reiterate Sun Pharma as top pick.

- ▶ **India growth surprises positively, US impacted by COVID-19:** India business growth stood at 3.2% YoY vs estimated flat sales and industry decline of ~5%. The outperformance was led by strong chronic portfolio which grew ~10% and we expect trend of higher than industry growth to continue. US revenues declined 24.8% QoQ to US\$282mn due to weak sales in Taro and specialty products on account of COVID-19 related lockdown. However, we believe this is temporary and sales would improve in coming quarters. Specialty revenue stood at US\$78mn, a drop of 38.1% QoQ. We expect US revenues to remain flattish over FY20-22E with decline in *Absorica* sales in H2FY21 and generic price erosion. API sales grew strong by 20.1% driven by strong demand for API products.
- ▶ **Margin beat partially sustainable:** EBITDA margin at 24.3% was 450bps higher than our estimate led by improved gross margin, lower S,G&A amid lockdowns and reduced R&D spend. Gross margin improvement was driven by superior product mix (higher chronic sales in India) and better operational efficiency in manufacturing. We believe margin expansion caused by operational efficiency, revenue mix and cost control is sustainable. We raise our EBITDA margin estimates by ~100bps to 23.1% in FY21E and 24.4% in FY22E.
- ▶ **Outlook:** We expect India business growth to remain strong and other markets growth to revert to positive trajectory in coming quarters. Overall, we expect 7.9% revenue and 24.6% adjusted PAT CAGRs over FY20-FY22E with EBITDA margin expansion of 320bps. Recent settlement by Taro for DoJ investigations for US\$419mn removes the key overhang from the stock.
- ▶ **Valuations and risks:** We raise EPS estimates by 3-5% to factor in better margins and remain positive on long term outlook. Reiterate **BUY** with a revised target price of Rs612/share based on 24x FY22E EPS (earlier: Rs585/share). Key downside risks are: higher than expected pricing pressures in the US, and regulatory hurdles.

Market Cap	Rs1276bn/US\$17.1bn
Reuters/Bloomberg	SUN.BO / SUNP IN
Shares Outstanding (mn)	2,399.3
52-week Range (Rs)	532/325
Free Float (%)	45.3
FII (%)	12.9
Daily Volume (USD/'000)	70,011
Absolute Return 3m (%)	14.5
Absolute Return 12m (%)	26.3
Sensex Return 3m (%)	12.2
Sensex Return 12m (%)	1.5

Year to Mar	FY19	FY20	FY21E	FY22E
Revenue (Rs mn)	290,659	327,875	350,067	381,976
Net Income (Rs mn)	26,683	37,946	13,955	61,433
EPS (Rs)	15.4	16.4	20.8	25.5
% Chg YoY	21.1	6.9	26.9	22.3
P/E (x)	34.5	32.3	25.5	20.8
CEPS (Rs)	21.8	25.0	29.5	34.3
EV/E (x)	20.1	17.8	15.0	12.4
Dividend Yield (%)	0.5	0.4	0.2	0.7
RoCE (%)	7.7	7.4	8.8	10.4
RoE (%)	9.3	9.1	10.9	12.5

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## Highlights of Q1FY21 result and earnings call

Net sales declined 9.4% YoY (-7.3% QoQ) in Q1FY21 to Rs75.9bn.

- Domestic formulation sales** grew 3.2% YoY to Rs23.9bn. Sequentially revenue grew 1.0%. The low growth is attributed to the nationwide lockdown implemented due to COVID-19. While acute and sub-chronic business segment witnessed a decline its chronic segment (~50% of sales) grew 10% lifting overall growth. Low patient-doctor consultations resulted in low new prescriptions affecting acute sales. Company has largely completed its planned addition of field force. Company launched 10 new products (27 SKUs) during the quarter. Company is engaging with the HCPs digitally to maintain connect and market newer products. However, easing of restrictions has enabled physical interaction of MRs with doctors that has reached ~50% in Jul'20.
- US formulation sales** declined 24.8% QoQ to US\$282mn (-33.5% YoY). Breakdown: Taro (-27.1% YoY, -32.8% QoQ) and non-Taro (-37.4% YoY, -17.8% QoQ). The significant decline YoY was on a high base last year that included one-time opportunity. Sequential decline is attributed to the demand and supply disruption created by the pandemic. On the bright side, the company has managed to improve its digital connect with doctors. Although there is improvement in the market in US every week, its gradual and complete recovery will take time.

Sun filed seven ANDAs and received eight approvals during the quarter. Cumulative approved ANDAs are 491 while 95 are pending approval (including 20 tentative approvals).
- Company's specialty product** sales were US\$78mn globally declining 38.1% QoQ. Company deployed ~39% of its R&D expenditure towards this segment. The sharp decline in the quarter was due fall in revenue from *Ilumya* and *Levulan* as they are administered in clinics which were impacted due to lockdown.

*Ilumya* has been approved in Japan and company would be launching the product shortly. Company has also partnered with Hikma to market specialty products in MENA region.

Company is promoting both forms of *Absorica* but due to the lockdown marketing has been limited and so the conversion remains low.

Company has also received DCGI approval to initiate trials for two of its drugs that were repurposed for COVID-19. Enrolment has been speedy and trial outcome is expected in few months.
- Emerging markets** declined 10.8% YoY (-7.5% QoQ) to US\$173mn. The decline was in the tender business in S.Africa. Ex-tender performance was stable.
- RoW formulation** markets declined 18.6% YoY (-12.3% QoQ) to US\$136mn. This was partly due to lower sales in Japan and Taro-ROW markets.
- APIs and others** grew 21.6% YoY to Rs6.0bn during the quarter with strong demand for API products.
- EBITDA margin** grew 50bps YoY (+760bps QoQ) to 24.3% with 330bps **gross margin** improvement (+220bps QoQ). Sequential growth of EBITDA is due to lower R&D and S,G&A expenses. **R&D** in Q1FY21 stood at Rs4.2bn (5.5% of net sales). S,G&A expenses was down 31.6% due to reduced marketing, selling and travelling expenses across markets.
- Adjusted PAT** declined 17.4% YoY to Rs11.5bn. Company has reported an exceptional expense of Rs36.3bn (US\$419mn) paid by Taro to US DOJ.

**Table 1: Q1FY21 result review***(Rs mn, year ending March 31)*

	Q1FY21	Q1FY20	YoY % Chg	Q4FY20	QoQ % Chg
<b>Net Sales</b>	<b>75,853</b>	<b>83,744</b>	<b>(9.4)</b>	<b>81,849</b>	<b>(7.3)</b>
EBITDA	18,435	19,956	(7.6)	13,630	35.3
Other income	1,538	2,130	(27.8)	1,022	50.4
<b>PBIDT</b>	<b>19,973</b>	<b>22,086</b>	<b>(9.6)</b>	<b>14,652</b>	<b>36.3</b>
Depreciation	4,959	4,571	8.5	5,754	(13.8)
Interest	520	1,041	(50.1)	518	0.3
<b>PBT</b>	<b>(21,839)</b>	<b>16,474</b>	<b>(232.6)</b>	<b>5,774</b>	<b>(478.2)</b>
Tax	2,459	1,461	68.4	831	196.0
Minority Interest	(7,742)	1,139	(779.7)	945	(919.2)
<b>Adjusted PAT</b>	<b>11,460</b>	<b>13,875</b>	<b>(17.4)</b>	<b>6,605</b>	<b>73.5</b>
Extra ordinary income/ (exp.)	(36,333)	-		(2,606)	
<b>Reported PAT</b>	<b>(16,556)</b>	<b>13,875</b>	<b>(219.3)</b>	<b>3,998</b>	<b>(514.1)</b>
EBITDA margins (%)	24.3	23.8	50bps	16.7	760bps

Source: Company data, I-Sec research

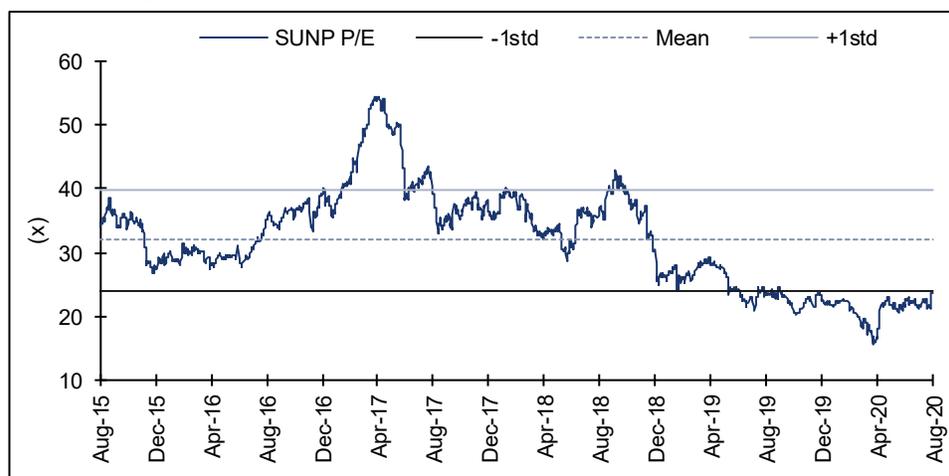
**Table 2: Revenue mix***(Rs mn, year ending March 31)*

	Q1FY21	Q1FY20	YoY % Chg	Q4FY20	QoQ % Chg
Formulations	<b>68,709</b>	<b>77,688</b>	<b>(11.6)</b>	<b>75,529</b>	<b>(9.0)</b>
India	23,884	23,137	3.2	23,648	1.0
US	21,364	29,474	(27.5)	27,129	(21.2)
Emerging Markets	13,161	13,486	(2.4)	13,540	(2.8)
ROW	10,300	11,591	(11.1)	11,212	(8.1)
APIs & Others	5,963	4,905	21.6	5,252	13.6
Other Op. Income	1,181	1,151	2.6	1,069	10.4
<b>Total Sales</b>	<b>75,853</b>	<b>83,744</b>	<b>(9.4)</b>	<b>81,849</b>	<b>(7.3)</b>

Source: Company data, I-Sec research

## Valuations

The stock currently trades at 25.5x FY21E and 20.8x FY22E earnings and EV/EBITDA multiple of 15.0x FY21E and 12.4x FY22E. It has traded at an average P/E of 32.0x 1-year forward earnings over the past five years and below mean over the past one year. We remain positive on the stock considering: i) ramp-up in revenues from branded/specialty business in the US, ii) recovery in India business growth, iii) potential to buy inorganic growth based on strong balance sheet, and iv) expected continued margin recovery leading to 24.6% earnings CAGR over FY20-FY22E. We maintain our **BUY** rating with a revised target price of Rs612 based on 24x FY22E EPS (earlier: Rs585/share).

**Chart 1: 1-year forward P/E**

Source: Company data, I-Sec research

## Summary financials (consolidated)

Table 3: Profit &amp; Loss statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
<b>Formulations</b>	<b>268,375</b>	<b>302,780</b>	<b>322,542</b>	<b>351,930</b>
India	73,483	97,102	105,841	118,542
US	106,713	105,425	105,908	112,633
Emerging Mkts	53,625	55,044	61,110	67,221
ROW & Japan	34,554	45,210	49,683	53,534
APIs & Others	18,488	20,471	22,902	25,192
Other Operating Inc	3,796	4,623	4,623	4,854
<b>Total Gross Sales</b>	<b>290,659</b>	<b>327,875</b>	<b>350,067</b>	<b>381,976</b>
<b>Excise duty</b>	-	-	-	-
<b>Total Net Revenue</b>	<b>290,659</b>	<b>327,875</b>	<b>350,067</b>	<b>381,976</b>
yoy Growth%	10.3	12.8	6.8	9.1
<b>Total Op. Exp.</b>	<b>227,583</b>	<b>258,477</b>	<b>269,263</b>	<b>288,881</b>
<b>EBITDA</b>	<b>63,076</b>	<b>69,398</b>	<b>80,804</b>	<b>93,095</b>
Margins %	21.7	21.2	23.1	24.4
yoy Growth%	15.1	10.0	16.4	15.2
Depreciation	17,533	20,528	20,857	21,136
<b>EBIT</b>	<b>45,543</b>	<b>48,870</b>	<b>59,947</b>	<b>71,959</b>
Other Income	10,255	6,360	7,377	8,348
Interest	5,553	3,027	2,424	1,803
EO Items	(12,144)	(2,106)	(36,333)	-
<b>PBT</b>	<b>38,102</b>	<b>50,096</b>	<b>28,568</b>	<b>78,504</b>
Tax	6,009	8,228	11,033	13,346
Tax Rate (%)	15.8	16.4	38.6	17.0
Minority Interest	5,410	3,922	3,579	3,725
<b>Reported PAT</b>	<b>26,683</b>	<b>37,946</b>	<b>13,955</b>	<b>61,433</b>
<b>Adj PAT</b>	<b>36,883</b>	<b>39,410</b>	<b>49,992</b>	<b>61,136</b>
Net Margins (%)	12.7	12.0	14.3	16.0

Source: Company data, I-Sec research

Table 4: Balance sheet

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
Paid-up Capital	2,399	2,399	2,399	2,399
Reserves & Surplus	411,691	450,245	461,438	511,537
<b>Total Equity</b>	<b>414,091</b>	<b>452,645</b>	<b>463,837</b>	<b>513,936</b>
Minority Interest	33,135	38,602	42,330	46,203
<b>Total Debt</b>	<b>104,795</b>	<b>75,783</b>	<b>68,783</b>	<b>38,783</b>
Deferred Liabilities	(24,506)	(31,172)	(31,172)	(31,172)
<b>Capital Employed</b>	<b>527,515</b>	<b>535,858</b>	<b>543,779</b>	<b>567,751</b>
Current Liabilities	93,875	114,913	121,559	131,370
<b>Total Liabilities</b>	<b>621,389</b>	<b>650,772</b>	<b>665,337</b>	<b>699,121</b>
<b>Net Fixed Assets</b>	<b>232,477</b>	<b>240,673</b>	<b>229,815</b>	<b>218,679</b>
Investments	40,306	53,506	53,506	53,506
Inventory	78,860	78,750	82,036	88,013
Debtors	88,842	94,212	100,589	109,758
Other Current Assets	68,642	69,782	71,794	74,688
Cash and Equivalents	112,263	113,849	127,597	154,476
<b>Total Cur. Assets</b>	<b>348,607</b>	<b>356,593</b>	<b>382,016</b>	<b>426,936</b>
<b>Total Assets</b>	<b>621,389</b>	<b>650,772</b>	<b>665,337</b>	<b>699,121</b>

Source: Company data, I-Sec research

Table 5: Cashflow statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
PBT	38,087	49,948	28,419	78,355
Depreciation	17,533	20,528	20,857	21,136
Net Chg in WC	(24,213)	(2,539)	(7,467)	(11,733)
Taxes	(8,864)	(13,459)	(11,033)	(13,346)
Others	(6,131)	8,043	2,437	3,504
<b>CFO</b>	<b>16,412</b>	<b>62,520</b>	<b>33,214</b>	<b>77,917</b>
Capex	(31,852)	(14,500)	(10,000)	(10,000)
Net Investments made	(1,887)	(13,834)	-	-
Others	26,926	2,445	-	-
<b>CFI</b>	<b>(6,813)</b>	<b>(25,888)</b>	<b>(10,000)</b>	<b>(10,000)</b>
Change in Share capital	(6,084)	(6,375)	-	-
Change in Debts	8,902	(31,230)	(7,000)	(30,000)
Div. & Div Tax	(5,787)	(6,797)	(2,466)	(11,037)
Others	(33,168)	(111)	-	-
<b>CFF</b>	<b>(36,137)</b>	<b>(44,513)</b>	<b>(9,466)</b>	<b>(41,037)</b>
<b>Total Cash Generated</b>	<b>(26,538)</b>	<b>(7,881)</b>	<b>13,748</b>	<b>26,880</b>
<b>Cash Opening Balance</b>	<b>99,294</b>	<b>72,756</b>	<b>64,876</b>	<b>78,623</b>
<b>Cash Closing Balance</b>	<b>72,756</b>	<b>64,876</b>	<b>78,623</b>	<b>105,503</b>

Source: Company data, I-Sec research

Table 6: Key ratios

(Year ending March 31)

	FY19	FY20	FY21E	FY22E
Adj EPS	15.4	16.4	20.8	25.5
YoY Growth%	21.1	6.9	26.9	22.3
Cash EPS	21.8	25.0	29.5	34.3
EBITDA - Core (%)	21.7	21.2	23.1	24.4
NPM (%)	12.7	12.0	14.3	16.0
Net Debt to Equity (x)	(0.0)	(0.1)	(0.1)	(0.2)
P/E (x)	34.5	32.3	25.5	20.8
EV/EBITDA Core (x)	20.1	17.8	15.0	12.4
P/BV (x)	3.1	2.8	2.7	2.5
EV/Sales (x)	4.4	3.8	3.5	3.0
RoCE (%)	7.7	7.4	8.8	10.4
RoE (%)	9.3	9.1	10.9	12.5
RoIC (%)	8.6	8.3	10.4	12.5
Book Value (Rs)	172.6	188.7	193.3	214.2
DPS (Rs)	2.8	2.4	0.9	3.8
Dividend Payout (%)	24.8	15.0	15.0	15.0
Div Yield (%)	0.5	0.4	0.2	0.7
Asset Turnover Ratio	0.6	0.6	0.6	0.7
Avg. Collection days	107	103	103	102
Avg. Inventory days	118	111	109	107

Source: Company data, I-Sec research

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