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Q3FY21 result review  
and earnings revision

## Pharmaceuticals

Target price: Rs692

### Earnings revision

(%)	FY21E	FY22E	FY23E
Sales	(0.5)	(1.1)	(0.7)
EPS	13.4	3.8	2.9

### Target price revision

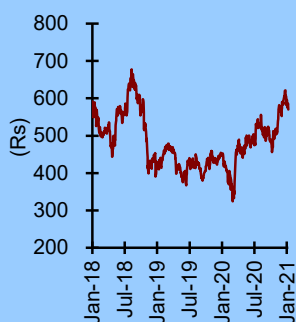
Rs692 from Rs652

### Shareholding pattern

	Jun '20	Sep '20	Dec '20
Promoters	54.7	54.7	54.5
Institutional investors			
MFs and others	32.8	32.8	33.0
FIs/Bank/Ins	10.5	10.9	11.0
FII	9.4	9.5	9.7
FII	12.9	12.4	12.3
Others	12.5	12.5	12.5

Source: BSE India

### Price chart



# Sun Pharmaceutical Industries

**BUY**

**Maintained**

**Strong beat on margin; specialty picks-up**

**Rs586**

Sun Pharmaceutical (Sun) has reported strong operational performance in Q3FY21; beat our estimate on gross and EBITDA margins by 160bps and 520bps, respectively. Consolidated revenue grew 8.4% YoY to Rs88.4bn (I-Sec: Rs88.6bn) and adj. PAT was up 102.8% to Rs18.5bn. Global specialty sales has seen a strong recovery with 37% QoQ rise in revenue, largely driven by higher *Ilumya* sales. *Ilumya* sales in 9MFY21 crossed the FY20 mark of US\$94mn. Generic entry in *Absorica* is a near term risk, although its already factored in estimates. We remain positive on long-term outlook considering strong India business, scale-up in specialty sales and focus on margin expansion through superior revenue mix and operational efficiency. Reiterate **BUY** on Sun Pharma.

- **Growth across the business segments:** US revenues continued to ramp-up driven by the specialty portfolio and improved 11.6% sequentially to US\$374mn despite 5.1% decline in Taro's performance. Specialty revenue stood at US\$148mn, a growth of 37.0% QoQ and we expect further ramp-up in *Ilumya* and *Cequa* sales. We expect overall US revenues to remain flattish over FY20-23E as *Absorica* sales would decline with entry of generic competitor causing price erosion. India business grew strong 9.4% YoY vs an industry growth of 6.4%. Chronic and sub-chronic growth remained strong. We expect the company to outperform industry growth supported by its strong chronic portfolio. ROW grew 15.6% and EMs revenue increased 8.4%. API business declined 9.4% YoY.
- **Margin beat continues:** EBITDA margin at 27.2% was 520bps higher than our estimate led by better gross margin and controlled S,G&A and personnel cost. Gross margin has been strong for past three quarters driven by superior revenue mix with improving sales of specialty products and better operational efficiency in manufacturing. We believe that the current margin expansion caused by operational efficiency, revenue mix and cost control is partially sustainable. Hence, we estimate 370bps EBITDA margin expansion over FY20-FY23E despite decline in *Absorica* sales.
- **Outlook:** We expect India business to continue to outperform and gradual ramp-up in specialty sales to continue. Overall, we expect 6.5% revenue and 20.6% adj. PAT CAGRs over FY20-FY23E with EBITDA margin expansion of 370bps. Focus on cost control and free cash flow generation has augured well and net debt (ex-Taro) now stands at US\$250mn.
- **Valuations and risks:** We raise FY21 earning estimate by 13.4% to factor in strong 9MFY21 and raise FY22-23 EPS by 2-4%, factoring in better margins. Reiterate **BUY** on the stock with a revised target price of Rs692/share based on 24x FY23E EPS (earlier: Rs652/share). Key downside risks: Higher than expected pricing pressures in the US, and regulatory hurdles.

Market Cap	Rs1406bn/US\$19.3bn
Reuters/Bloomberg	SUN.BO / SUNP IN
Shares Outstanding (mn)	2,399.3
52-week Range (Rs)	621/325
Free Float (%)	45.5
FII (%)	12.3
Daily Volume (USD/'000)	75,708
Absolute Return 3m (%)	25.9
Absolute Return 12m (%)	36.2
Sensex Return 3m (%)	16.9
Sensex Return 12m (%)	15.0

Year to Mar	FY20	FY21E	FY22E	FY23E
Revenue (Rs mn)	327,875	336,961	365,062	396,374
Net Income (Rs mn)	37,946	19,861	60,412	69,162
EPS (Rs)	16.4	23.3	25.1	28.8
% Chg YoY	6.9	41.8	7.7	14.9
P/E (x)	35.7	25.2	23.4	20.3
CEPS (Rs)	22.9	32.0	33.9	37.8
EV/E (x)	19.8	15.8	14.5	12.4
Dividend Yield (%)	0.4	0.2	0.7	0.8
RoCE (%)	7.4	10.0	10.6	11.2
RoE (%)	9.1	12.1	12.2	12.7

### Research Analysts:

#### Sriraam Rathi

Sriraam.rathi@icicisecurities.com  
+91 22 6637 7574

#### Vinay Bafna

vinay.bafna@icicisecurities.com  
+91 22 6637 7339

## Highlights of Q3FY21 result and earnings call

Net sales grew 8.4% YoY (+3.3% QoQ) in Q3FY21 to Rs88.4bn.

- **Domestic formulation sales** grew 9.4% YoY to Rs27.5bn. Sequentially, revenue grew 8.8%. Sequential improvement highlights the recovery in the industry with the easing of lockdown. Chronic segment has seen good growth while sub-chronic and acute segment are still recovering at lower pace due to reduced footfalls. Patient footfalls are ~70-75% of the normal rate. It launched 27 new products during the quarter. Easing of restrictions has improved doctor-MR interaction.

Company requested EUA for AQCH to CDSCO for treatment of moderate COVID-19 patients. However, the committee has rejected the application and requested additional data, which the company will address in some time.
- **US formulation sales** grew 11.6% QoQ to US\$374mn (+6.9% YoY). Breakdown: Taro (-5.1% YoY, -1.9% QoQ) and non-Taro (+15.6% YoY, +21.7% QoQ). Sequential improvement is attributed to the recovery in generics as well as specialty segment. Price erosion remains stable in generics space.

Sun filed two ANDAs and received three approvals during the quarter. Cumulative approved ANDAs are 497, while 90 are pending approval (including 22 tentative approvals).
- **Company's specialty product** sales were US\$148mn globally, growing 37.0% QoQ. Sun deployed ~27% of its R&D expenditure towards this segment.

The company has witnessed sequential improvement in *Ilumya*, *Absorica LD* and *Cequa*. *Ilumya* revenues have crossed the pre-COVID levels and its 9M sales have crossed FY20 level. *Levulan* is still affected by lower footfalls at clinics but has witnessed good sequential improvement. The company has been able to shift 20% of the market from *Absorica* to *Absorica LD*. Generic to *Absorica* has still not entered the market while that to *Cequa* would have minimal impact since the target markets are different (Kala's generic targeting acute market).

*Ilumya* has been launched in Japan with optimistic early response.

Sun will continue to observe some savings on sales and marketing of specialty products in the coming quarter, but in general it is expected to rise sequentially. Company would also start DTC marketing for *Cequa* in coming quarter.
- **Emerging markets** grew 4.6% YoY (-2.9% QoQ) to US\$204mn. The underlying growth in constant currency stood at 11%.
- **RoW formulation** markets grew 11.6% YoY (-2.8% QoQ) to US\$173mn. Growth was driven by multiple markets like Japan, EU and Taro-ROW.
- **APIs and others** declined 9.4% YoY to Rs4.9bn during the quarter.
- **EBITDA margin** grew 460bps YoY (+160bps QoQ) to 27.2% with 60bps **gross margin** improvement (-70bps QoQ). **R&D** in Q3FY21 stood at Rs5.5bn (6.2% of net sales).
- Company has repaid more than US\$490mn debt in 9MFY21. Current net debt standing is near US\$250mn (ex-Taro).
- **Adjusted PAT** grew 102.8% YoY to Rs18.5bn with strong performance, higher other income, lower interest and tax rate.

**Table 1: Q3FY21 result review***(Rs mn, year ending March 31)*

	Q3FY21	Q3FY20	YoY % Chg	Q2FY21	QoQ % Chg
<b>Net Sales</b>	<b>88,368</b>	<b>81,549</b>	<b>8.4</b>	<b>85,531</b>	<b>3.3</b>
EBITDA	24,061	18,414	30.7	21,933	9.7
Other income	3,150	1,199	162.7	2,558	23.1
<b>PBIDT</b>	<b>27,211</b>	<b>19,613</b>	<b>38.7</b>	<b>24,491</b>	<b>11.1</b>
Depreciation	5,319	5,470	(2.8)	4,986	6.7
Interest	261	630	(58.5)	333	(21.6)
Extra ordinary income/ (exp.)	-	-	-	-	-
<b>PBT</b>	<b>21,631</b>	<b>13,513</b>	<b>60.1</b>	<b>19,172</b>	<b>12.8</b>
Tax	2,449	3,276	(25.2)	2,571	(4.7)
Minority Interest	656	1,102	(40.4)	1,356	(51.6)
<b>Reported PAT</b>	<b>18,525</b>	<b>9,135</b>	<b>102.8</b>	<b>15,245</b>	<b>21.5</b>
<b>Adjusted PAT</b>	<b>18,525</b>	<b>9,135</b>	<b>102.8</b>	<b>15,900</b>	<b>16.5</b>
EBITDA margins (%)	27.2	22.6	460bps	25.6	160bps

Source: Company data, I-Sec research

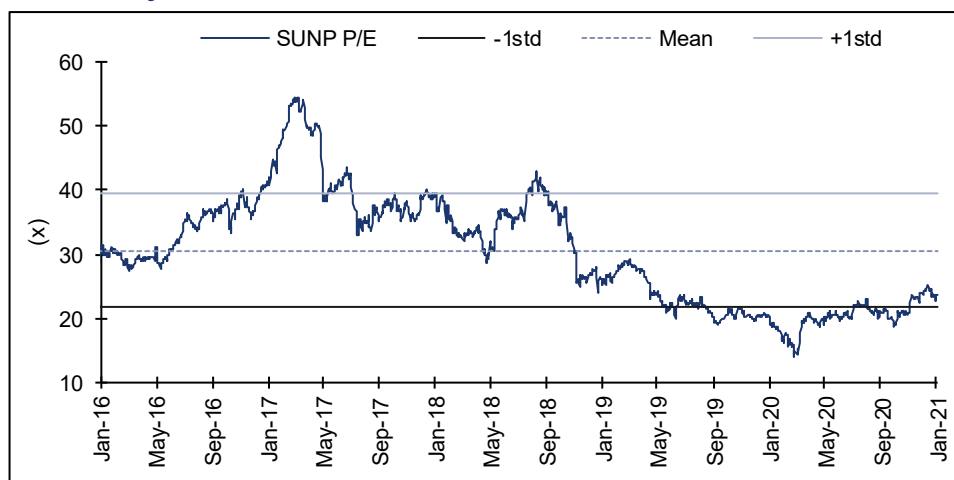
**Table 2: Revenue mix***(Rs mn, year ending March 31)*

	Q3FY21	Q3FY20	YoY % Chg	Q2FY21	QoQ % Chg
<b>Formulations</b>	<b>82,966</b>	<b>75,031</b>	<b>10.6</b>	<b>79,038</b>	<b>5.0</b>
India	27,528	25,170	9.4	25,311	8.8
US	27,609	24,924	10.8	24,920	10.8
Emerging Markets	15,071	13,901	8.4	15,588	(3.3)
ROW	12,758	11,035	15.6	13,220	(3.5)
APIs & Others	4,853	5,356	(9.4)	5,549	(12.6)
Other Op. Income	549	1,162	(52.7)	944	(41.8)
<b>Total Sales</b>	<b>88,368</b>	<b>81,549</b>	<b>8.4</b>	<b>85,531</b>	<b>3.3</b>

Source: Company data, I-Sec research

## Valuations

The stock currently trades at 23.4x FY22E and 20.3x FY23E earnings and EV/EBITDA multiple of 14.5x FY22E and 12.4x FY23E. It has traded at an average P/E of 30.6x 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) likely continued margin recovery leading to 24.3% earnings CAGR over FY20-FY23E. We maintain our **BUY** rating on the stock with a revised target price of Rs692/share based on 24x FY23E EPS (earlier: Rs652/share).

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

Source: Company data, I-Sec research

## Financial summary (consolidated)

Table 3: Profit &amp; loss statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
<b>Formulations</b>	<b>302,780</b>	<b>312,046</b>	<b>339,003</b>	<b>367,907</b>
India	97,102	102,443	114,736	126,209
US	105,425	100,482	103,807	110,764
Emerging Mkts	55,044	59,438	66,571	73,228
ROW & Japan	45,210	49,683	53,890	57,706
APIs & Others	20,471	21,692	23,861	26,160
Other Operating Inc	4,623	3,223	2,198	2,307
<b>Total Gross Sales</b>	<b>327,875</b>	<b>336,961</b>	<b>365,062</b>	<b>396,374</b>
<b>Excise duty</b>	-	-	-	-
<b>Total Net Revenue</b>	<b>327,875</b>	<b>336,961</b>	<b>365,062</b>	<b>396,374</b>
yoy Growth%	12.8	2.8	8.3	8.6
<b>Total Op. Exp.</b>	<b>258,477</b>	<b>252,102</b>	<b>276,277</b>	<b>297,551</b>
<b>EBITDA</b>	<b>69,398</b>	<b>84,859</b>	<b>88,785</b>	<b>98,823</b>
Margins %	21.2	25.2	24.3	24.9
yoy Growth%	10.0	22.3	4.6	11.3
Depreciation	20,528	20,857	21,136	21,552
<b>EBIT</b>	<b>48,870</b>	<b>64,002</b>	<b>67,649</b>	<b>77,271</b>
Other Income	6,360	7,851	8,624	9,507
Interest	3,027	1,475	773	473
EO Items	(2,106)	(36,333)	-	-
<b>PBT</b>	<b>50,096</b>	<b>34,044</b>	<b>75,500</b>	<b>86,305</b>
Tax	8,228	11,964	12,835	14,672
Tax Rate (%)	16.4	35.1	17.0	17.0
Minority Interest	3,922	2,219	2,253	2,471
<b>Reported PAT</b>	<b>37,946</b>	<b>19,861</b>	<b>60,412</b>	<b>69,162</b>
<b>Adj PAT</b>	<b>39,410</b>	<b>55,898</b>	<b>60,183</b>	<b>69,162</b>
Net Margins (%)	12.0	16.6	16.5	17.4

Source: Company data, I-Sec research

Table 4: Balance sheet

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Paid-up Capital	2,399	2,399	2,399	2,399
Reserves & Surplus	450,245	466,278	515,596	572,272
<b>Total Equity</b>	<b>452,645</b>	<b>468,677</b>	<b>517,995</b>	<b>574,671</b>
Minority Interest	38,602	40,969	43,337	45,807
<b>Total Debt</b>	<b>82,222</b>	<b>35,783</b>	<b>15,783</b>	<b>15,783</b>
Deferred Liabilities	(31,172)	(31,172)	(31,172)	(31,172)
<b>Capital Employed</b>	<b>542,297</b>	<b>514,258</b>	<b>545,943</b>	<b>605,090</b>
Current Liabilities	108,475	114,808	124,581	134,385
<b>Total Liabilities</b>	<b>650,772</b>	<b>629,066</b>	<b>670,524</b>	<b>739,475</b>
<b>Net Fixed Assets</b>	<b>240,673</b>	<b>229,815</b>	<b>218,679</b>	<b>209,128</b>
Investments	53,506	53,506	53,506	53,506
Inventory	78,750	76,807	84,173	90,655
Debtors	94,212	96,823	104,898	113,895
Other Current Assets	69,782	70,606	73,154	75,994
Cash and Equivalents	113,849	101,508	136,114	196,297
<b>Total Cur. Assets</b>	<b>356,593</b>	<b>345,744</b>	<b>398,339</b>	<b>476,841</b>
<b>Total Assets</b>	<b>650,772</b>	<b>629,066</b>	<b>670,524</b>	<b>739,475</b>

Source: Company data, I-Sec research

Table 5: Cashflow statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
PBT	49,948	33,896	75,385	86,305
Depreciation	20,528	20,857	21,136	21,552
Net Chg in WC	(2,539)	(2,596)	(11,301)	(11,954)
Taxes	(13,459)	(11,964)	(12,835)	(14,672)
Others	8,043	7,436	3,086	3,439
<b>CFO</b>	<b>62,520</b>	<b>47,630</b>	<b>75,471</b>	<b>84,670</b>
Capex	(14,500)	(10,000)	(10,000)	(12,000)
Net Investments made	(13,834)	-	-	-
Others	2,445	-	-	-
<b>CFI</b>	<b>(25,888)</b>	<b>(10,000)</b>	<b>(10,000)</b>	<b>(12,000)</b>
Change in Share capital	(6,375)	-	-	-
Change in Debts	(31,230)	(46,439)	(20,000)	-
Div. & Div Tax	(6,797)	(3,532)	(10,865)	(12,486)
Others	(111)	-	-	-
<b>CFF</b>	<b>(44,513)</b>	<b>(49,971)</b>	<b>(30,865)</b>	<b>(12,486)</b>
<b>Total Cash Generated</b>	<b>(7,881)</b>	<b>(12,341)</b>	<b>34,606</b>	<b>60,183</b>
<b>Cash Opening Balance</b>	<b>72,756</b>	<b>64,876</b>	<b>52,535</b>	<b>87,140</b>
<b>Cash Closing Balance</b>	<b>64,876</b>	<b>52,535</b>	<b>87,140</b>	<b>147,323</b>

Source: Company data, I-Sec research

Table 6: Key ratios

(Year ending March 31)

	FY20	FY21E	FY22E	FY23E
Adj EPS	16.4	23.3	25.1	28.8
YoY Growth%	6.9	41.8	7.7	14.9
Cash EPS	22.9	32.0	33.9	37.8
EBITDA - Core (%)	21.2	25.2	24.3	24.9
NPM (%)	12.0	16.6	16.5	17.4
Net Debt to Equity (x)	(0.1)	(0.1)	(0.2)	(0.3)
P/E (x)	35.7	25.2	23.4	20.3
EV/EBITDA Core (x)	19.8	15.8	14.5	12.4
P/BV (x)	3.1	3.0	2.7	2.4
EV/Sales (x)	4.2	4.0	3.5	3.1
RoCE (%)	7.4	10.0	10.6	11.2
RoE (%)	9.1	12.1	12.2	12.7
RoIC (%)	8.5	11.5	12.1	13.9
Book Value (Rs)	188.7	195.3	215.9	239.5
DPS (Rs)	2.4	1.2	3.8	4.3
Dividend Payout (%)	15.0	15.0	15.0	15.0
Div Yield (%)	0.4	0.2	0.7	0.8
Asset Turnover Ratio	0.6	0.7	0.7	0.7
Avg. Collection days	103	104	101	101
Avg. Inventory days	111	113	106	107

Source: Company data, I-Sec research

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