

Sun Pharmaceutical Industries

9 November 2012

Reuters: SUN.BO; Bloomberg: SUNP IN

Strong Performance, But Stretched Valuation

Sun Pharmaceutical Industries (SPL) reported better-than-expected earnings for 2QFY13, which coupled with the management's guidance of 30%-32% revenue growth for FY13 (from 18-20% earlier) and Dusa buyout led us to revise our FY13E/14E EPS up by 9%/3%, respectively. We have revised our TP up marginally, from Rs638 to Rs651, but retained our Sell rating on SPL due to stretched valuation (24x FY14E EPS) as we feel maintaining organic growth in FY14 will be a challenge in the wake of a high FY13 base and commoditised product pipeline.

2QFY13 results above expectations: SPL made a one-time provision of ~US\$110mn (~10% of Wyeth's claim of US\$960mn) for Protonix, owing to which reported PAT of Rs3.2bn was significantly below our estimate. We have noted that the provision is much below our expectation of ~US\$. Adjusted for this, PAT stood at Rs9.0bn, 22%/18% above our/consensus estimates, respectively. Revenue stood at Rs26.7bn, in line with our estimate and 8% above consensus estimate. Domestic growth moderated to 15%YoY - partly on account of pre-booked sales in 4QFY12 - while US revenue declined by ~US\$40mn QoQ, which we believe is largely on account of moderation in Lipodox sales (our estimate is ~US\$20mn). Rest-of-the-world (ROW) markets grew 21%YoY in constant currency terms (34% excluding Taro). EBITDA margin stood at 44.1%, in line with our estimate of 43.7% and 265bps above consensus estimate. Excluding Taro, we believe margins are at ~41% for SPL.

Dusa Pharmaceuticals acquisition is strategic fit at premium valuation: SPL's tender offer of US\$8/share, or US\$230mn, to acquire 28.8mn outstanding shares of Dusa Pharmaceuticals values the latter at 4.4x CY12E revenue and 33x PAT. Dusa is a vertically integrated dermatology company developing and marketing Levulan PDT (photodynamic therapy platform) technology. We feel the deal is at a premium, considering other recent buyouts - Valeant-Medicis and Sandoz-Fougera acquisitions took place at 3.6x revenue. While Dusa has no direct synergy with Taro's business, we believe the acquisition fits well into SPL's strategy to consolidate its presence in the high-growth US dermatology segment, where it already is a leading player. We expect this acquisition to add 3.0%/2.4% to SPL's FY14E revenue/PAT, respectively.

Raise earnings estimates: We have revised our FY13E/FY14E EPS upwards by 9%/3%, respectively, factoring in strong 1HFY13 performance and Dusa acquisition. Consequently, we have revised our TP marginally upwards by 2% to Rs651, valuing the stock at 22x FY14E revised EPS of Rs29.6 and retained our Sell rating on it.

SELL

Sector: Pharmaceuticals

CMP: Rs694

Target Price: Rs651

Downside: 6%

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Key Data

| | |
|--------------------------|------------|
| Current Shares O/S (mn) | 1,034.0 |
| Mkt Cap (Rsbn/US\$bn) | 717.8/13.1 |
| 52 Wk H / L (Rs) | 729/486 |
| Daily Vol. (3M NSE Avg.) | 979,436 |

Price Performance (%)

| | 1 M | 6 M | 1 Yr |
|-------------|-------|------|------|
| Sun Pharma | (4.0) | 15.7 | 41.5 |
| Nifty Index | (0.3) | 14.3 | 8.9 |

Source: Bloomberg

| Y/E March (Rsmn) | 2QFY12 | 1QFY13 | 2QFY13 | YoY (%) | QoQ (%) | 1HFY12 | 1HFY13 | YoY (%) |
|------------------------------------|--------|--------|---------|---------|---------|--------|---------|---------|
| Net revenue | 18,946 | 26,835 | 26,639 | 40.6 | (0.7) | 35,303 | 53,473 | 51.5 |
| Total raw material costs | 3,639 | 5,023 | 4,886 | 34.3 | (2.7) | 7,709 | 9,909 | 28.5 |
| Raw material costs/net revenue (%) | 19.2 | 18.7 | 18.3 | - | - | 21.8 | 18.5 | - |
| Personnel costs | 2,727 | 3,512 | 3,568 | 30.8 | 1.6 | 5,513 | 7,080 | 28.4 |
| Personnel costs/ net revenue (%) | 14.4 | 13.1 | 13.4 | - | - | 15.6 | 13.2 | - |
| Other expenses | 4,740 | 5,878 | 6,434 | 35.7 | 9.5 | 8,766 | 12,312 | 40.5 |
| Other expenses/net revenue (%) | 25.0 | 21.9 | 24.2 | - | - | 24.8 | 23.0 | - |
| PBIDT | 7,840 | 12,422 | 11,751 | 49.9 | (5.4) | 13,315 | 24,173 | 81.5 |
| PBIDT/net revenue (%) | 41.4 | 46.3 | 44.1 | - | - | 37.7 | 45.2 | - |
| Other income | 765 | (272) | 1,693 | 121.2 | (721.9) | 1,419 | 1,421 | 0.1 |
| Interest costs | (417) | 212 | 283 | (167.7) | 33.2 | (733) | 495 | (167.5) |
| Depreciation | 668 | 801 | 829 | 24.2 | 3.4 | 1,315 | 1,630 | 24.0 |
| Exceptional item | - | - | (5,836) | - | - | - | (5,836) | - |
| PBT | 8,355 | 11,136 | 6,496 | (22.2) | (41.7) | 14,151 | 17,633 | 24.6 |
| Tax | 1,281 | 1,925 | 2,139 | 67.0 | 11.1 | 1,424 | 4,064 | 185.4 |
| Tax/PBT (%) | 15.3 | 17.3 | 32.9 | - | - | 10.1 | 23.0 | - |
| PAT | 7,074 | 9,211 | 4,358 | (38.4) | (52.7) | 12,728 | 13,569 | 6.6 |
| Share of minority partner | 1,097 | 1,256 | 1,161 | 5.8 | (7.5) | 1,740 | 2,417 | 38.9 |
| Reported PAT | 5,977 | 7,956 | 3,196 | (46.5) | (59.8) | 10,987 | 11,152 | 1.5 |

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Financial summary

| Y/E March (Rsmn) | FY10 | FY11 | FY12 | FY13E | FY14E |
|------------------|--------|--------|--------|---------|---------|
| Revenue | 41,028 | 58,341 | 80,064 | 104,269 | 114,241 |
| YoY (%) | (4.0) | 42.2 | 37.2 | 30.2 | 9.6 |
| EBITDA | 13,633 | 19,672 | 32,521 | 45,253 | 44,211 |
| EBITDA (%) | 33.2 | 33.7 | 40.6 | 43.4 | 38.7 |
| Adj.PAT | 13,512 | 18,609 | 25,810 | 31,974 | 30,263 |
| YoY (%) | (25.7) | 37.7 | 38.7 | 23.9 | (5.4) |
| Fully DEPS | 13.0 | 18.0 | 24.9 | 30.9 | 29.2 |
| RoE (%) | 18.2 | 21.5 | 24.7 | 25.2 | 20.1 |
| RoCE (%) | 15.3 | 18.4 | 24.9 | 29.6 | 24.0 |
| P/E (x) | 53.2 | 38.6 | 27.8 | 22.5 | 23.7 |
| EV/EBITDA (x) | 52.4 | 35.6 | 21.3 | 15.1 | 15.1 |

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Segmental break-up

| Y/E March (Rsmn) | 2QFY12 | 1QFY13 | 2QFY13 | YoY (%) | QoQ (%) | 1HFY12 | 1HFY13 | YoY (%) |
|---------------------------|---------------|---------------|---------------|-------------|------------|---------------|---------------|-------------|
| India formulations | 7,046 | 5,877 | 8,099 | 14.9 | 37.8 | 13,431 | 13,975 | 4.1 |
| US formulations | 7,991 | 15,411 | 13,301 | 66.5 | (13.7) | 14,211 | 28,712 | 102.0 |
| ROW formulations | 2,567 | 3,666 | 3,726 | 45.1 | 1.6 | 5,089 | 7,392 | 45.3 |
| Total formulations | 17,604 | 24,955 | 25,125 | 42.7 | 0.7 | 32,730 | 50,079 | 53.0 |
| Bulk | 1,603 | 2,002 | 1,758 | 9.6 | (12.2) | 3,079 | 3,760 | 22.1 |
| Others | 4 | 18 | 125 | 2,953.7 | 591.7 | 6 | 143 | 2,414.0 |
| Total sales | 19,211 | 26,974 | 27,008 | 40.6 | 0.1 | 35,815 | 53,982 | 50.7 |

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Taro financials

| Y/E December (US\$mn) | 3QCY11 | 2QCY11 | 3QCY12 | YoY (%) | QoQ (%) |
|--------------------------------|--------|--------|--------|---------|---------|
| Net revenue | 138 | 159 | 161 | 16.4 | 1.1 |
| Total raw material costs (a+b) | 45 | 45 | 40 | (11.8) | (12.0) |
| TMC/net revenue (%) | 32.5 | 28.3 | 24.6 | - | - |
| SG&A | 24 | 24 | 28 | 14.5 | 18.6 |
| SG&A/net revenue (%) | 17.7 | 14.8 | 17.4 | - | - |
| R&D expenses | 7 | 12 | 11 | 57.8 | (5.0) |
| R&D expenses/net revenue (%) | 5.0 | 7.2 | 6.8 | - | - |
| PBIDT | 62 | 79 | 82 | 33.1 | 4.3 |
| PBIDT/gross sales (%) | 44.8 | 49.6 | 51.2 | - | - |
| Other income | 16 | 0 | (1) | - | - |
| Interest costs | 2 | (0) | (0) | (116.5) | (21.7) |
| PBT | 77 | 80 | 82 | 6.8 | 2.8 |
| Tax expenses | 18 | 17 | 16 | (10.3) | (0.5) |
| PAT | 58 | 63 | 65 | 12.2 | 3.7 |

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Actuals versus our estimates, Bloomberg consensus estimates

| | Actuals | NBIE estimates | Variation (%) | BBG cons. est. | Variation (%) |
|-------------------|---------|----------------|---------------|----------------|---------------|
| Revenue | 26,639 | 25,730 | 3.5 | 26,025 | 2.4 |
| EBITDA | 11,751 | 11,237 | 4.6 | 10,791 | 8.9 |
| EBITDA margin (%) | 44.1 | 43.7 | - | 41.5 | - |
| PAT | 3,196 | 7,426 | (57.0) | 7,632 | (58.1) |

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Change in our earnings estimates

| (Rsmn) | FY13E | | | FY14E | | |
|-------------------|--------|---------|------------|---------|---------|------------|
| | Old | New | Change (%) | Old | New | Change (%) |
| Revenue | 99,869 | 104,269 | 4.4 | 106,190 | 114,241 | 7.6 |
| EBITDA | 40,447 | 45,253 | 11.9 | 40,352 | 44,211 | 9.6 |
| EBITDA margin (%) | 40.5 | 43.4 | - | 38.0 | 38.7 | - |
| Adjusted PAT | 29,349 | 31,974 | 8.9 | 29,486 | 30,263 | 2.6 |

Rating history

| Date | Rating | Market price (Rs) | Target price (Rs) |
|------------------|--------|-------------------|-------------------|
| 1 November 2011 | Hold | 503 | 513 |
| 15 November 2011 | Hold | 510 | 532 |
| 12 January 2012 | Buy | 519 | 592 |
| 14 February 2012 | Buy | 552 | 635 |
| 19 March 2012 | Hold | 545 | 596 |
| 16 April 2012 | Hold | 579 | 596 |
| 31 May 2012 | Hold | 566 | 596 |
| 13 August 2012 | Sell | 675 | 638 |
| 4 October 2012 | Sell | 698 | 638 |
| 19 October 2012 | Sell | 700 | 638 |

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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