



# Sun Pharmaceuticals

BSE SENSEX	S&P CNX	CMP: INR692	TP: INR730	Neutral
18,670	5,684			
Bloomberg	SUNP IN			
Equity Shares (m)	1,035.6			
52-Week Range (INR)	729/487			
1,6,12 Rel. Perf. (%)	-3/5/29			
M.Cap. (INR b)	718.7			
M.Cap. (USD b)	13.1			

\* Including Para-IV/one-off upsides

## Sun Pharma's 2QFY13 performance significantly above estimates. Key highlights:

- Sun Pharma reported 40% revenue growth to INR26.57b (v/s est of INR26.47b), a 49% EBITDA growth to INR11.68b (v/s est of INR10.6b) and 47% PAT decline to INR3.19b (v/s est of INR7.77b). It made a one-time provision of INR5.83b for the generic Protonix litigation in the US. Adjusted for one-off supplies to the US, we estimate core revenues at INR24.59b (in line with est), core EBITDA at INR10.68b (v/s est of INR9.6b) and core PAT at INR8.32b (v/s est of INR7.06b). Core performance was above estimates and led mainly by the strong performance at Taro and favorable currency.
- Guidance raised - management increased FY13E revenue growth guidance from 18-20% to 30-32% based on the strong performance in the first half.
- Announces DUSA acquisition - Sun also announced the acquisition of DUSA Pharmaceuticals (USA) for a cash consideration of USD230m, implying a valuation of 5x DUSA's CY11 sales and 20x EBITDA (refer details below).

**Outlook and view:** An expanding generic portfolio coupled with sustained double-digit growth in high-margin lifestyle segments in India could bring long term benefits for Sun. Its ability to sustain superior margins even on a high base is a clear positive. Key drivers for the future include: 1) ramp-up in the US business, 2) monetization of the Para-IV/low competition pipeline in the US, 3) launch of controlled substances in the US, 4) sustaining Taro's high profitability and 5) ability to leverage on DUSA's technology franchise. The stock is valued at 25.1x FY13E and 23.8x FY14E core earnings. Though we are positive on the company's business outlook, rich valuations have tempered down our bullishness. We maintain **Neutral** with a target price of INR730 (25x FY14E EPS). Inorganic initiatives (Sun has cash of over USD1b) are a key risk to our rating.

Y/E March	Quarterly Performance (Consolidated)										(INR Million)	
	FY12				FY13				FY12	FY13E	Estimates	
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			2QE	% chg.
Net Revenues	16,357	18,946	21,451	23,299	26,581	26,572	24,757	25,405	80,057	103,316	26,477	0.4
YoY Change (%)	16.9	38.3	34.0	59.2	62.5	40.3	15.4	9.0	39.9	29.1	39.8	
Total Expenditure	10,883	11,106	11,814	13,728	14,413	14,888	15,597	16,204	47,530	61,101	15,878	
EBITDA	5,474	7,840	9,638	9,571	12,169	11,685	9,161	9,201	32,527	42,215	10,599	10.2
Margins (%)	33.5	41.4	44.9	41.1	45.8	44.0	37.0	36.2	40.6	40.9	40.0	
Depreciation	647	668	774	823	801	829	834	871	2,912	3,335		
Net Other Income	969	1,183	-272	2,242	-231	1,476	1,313	1,444	3,941	4,003		
PBT before EO Exp	5,796	8,355	8,591	10,991	11,136	12,332	9,640	9,774	33,556	42,883		
EO Exp/(Inc)	0	0	0	0	0	5,836	0	0	0	5,836		
PBT	5,796	8,355	8,591	10,991	11,136	6,496	9,640	9,774	33,556	37,047		
Tax	143	1,281	634	2,604	1,925	2,139	1,735	1,920	3,826	7,719		
Rate (%)	2.5	15.3	7.4	23.7	17.3	32.9	18.0	19.6	11.4	20.8		
Profit after Tax	5,653	7,074	7,957	8,388	9,211	4,357	7,905	7,854	29,730	29,328		
Share of Minority Partner	643	1,097	1,274	841	1,256	1,161	1,100	1,109	3,855	4,626		
Reported PAT	5,010	5,977	6,683	7,547	7,956	3,196	7,940	7,168	25,875	26,260	7,771	-58.9
One-off upsides	624	523	573	923	1,240	712	1,135	423	2,644	3,510	712	
Adj Net Profit	4,386	5,454	6,110	6,624	6,716	8,320	6,805	6,745	23,231	28,586	7,060	17.9
YoY Change (%)	30.4	32.8	99.2	26.9	53.1	52.6	11.4	1.8	65.4	23.1	29.4	
Margins (%)	26.8	28.8	28.5	28.4	25.3	31.3	27.5	26.6	29.0	27.7	28.8	

E: MOSL Estimates; \* Quarterly no. don't match with annual no. because of reinstatement of financials

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Investors are advised to refer through disclosures made at the end of the Research Report.

## 2Q performance was significantly above est - led by Taro, one-off supplies to US & currency

Revenues grew 40% to INR26.57b, driven by a strong 66% jump in US revenues to INR13.3b (growth was 38% in USD-terms). Price increases for key Taro products, favorable currency and one-off revenues for Doxorubicin were key drivers of US sales. One-off revenues in US mainly include supply of Doxorubicin under one-time supply arrangement allowed by the US FDA to bridge shortages.

**Core Performance:** Adjusted for one-off supplies to US, we estimate core topline at INR24.59b (in-line with est), core EBITDA at INR10.68b (vs est of INR9.6b) and core PAT at INR8.32b (vs est of INR7.06b). Core EBITDA margins at 43.4% (up 330bps YoY) were above our est of 39.1%.

Domestic formulations business recorded 15% growth YoY to INR8.1b (lower than our est of INR8.5b). Growth was partly impacted on account of the one-time sales booked by the company in 4QFY12. Management indicated that adjusted for this one-time impact, underlying sales growth was 19%.

Sales in RoW markets grew by 45% while constant currency growth was 21%.

### Revenue Mix (INR M)

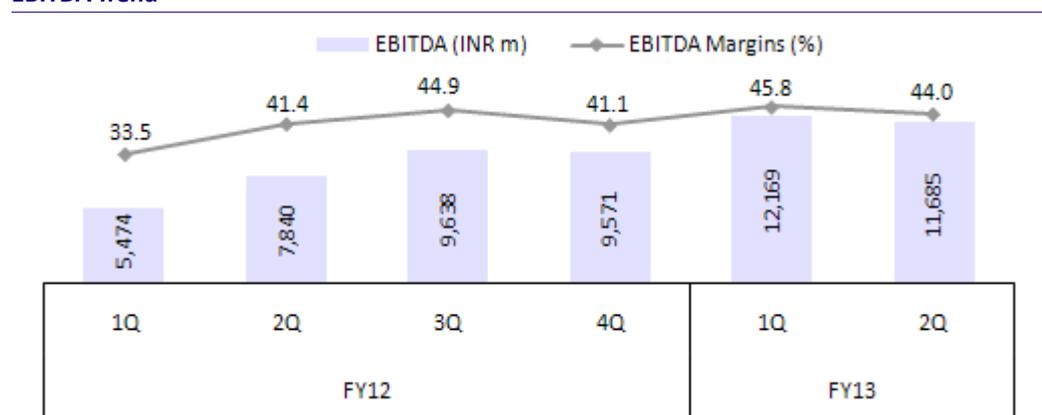
	2QFY13	2QFY12	YoY (%)	1QFY13	QoQ (%)
Formulations	25,125	17,604	42.7	24,954	0.7
India	8,099	7,046	14.9	5,877	37.8
US	13,301	7,991	66.5	15,411	-13.7
RoW	3,726	2,567	45.1	3,666	1.6
API	1,758	1,603	9.6	2,002	-12.2
Others	125	4	2953.7	18	591.7
<b>Gross Revenues</b>	<b>27,008</b>	<b>19,211</b>	<b>40.6</b>	<b>26,974</b>	<b>0.1</b>

Source: Company, MOSL

### Core EBITDA was above estimates

Reported EBITDA margins at 44% were above estimates of 40% mainly led by Taro, favourable currency and one-off supplies of Doxorubicin. The company has made some changes in computing the cost of materials consumed and changes in inventory. Due to this change the translation gain on consolidation has been reflected in the forex currency translation reserve. If the company had not made this change, the PAT for 2Q would have been lower by INR369m.

### EBITDA Trend



Source: Company, MOSL

## 2QFY13 Concall highlights

- FY13 Guidance Upgraded - Management has upgraded its topline growth guidance for FY13 to 30-32% from the previous 18-20% (consensus estimates were already much higher). 1HFY13 topline growth was ~51% implying that 2HFY13 growth will be lower. This is in-line with our expectations led by likely decline in Doxil supplies and high base of 2HFY12.
- US business - Management has reiterated that the price increase undertaken by Taro for some of its dermatology products may not be sustainable in the long-term. It also expects increased R&D investments to strengthen Taro's generic pipeline. Overall, ANDAs for 136 products are pending approval and the company expects to file another 25 in FY13. SUNP's future focus will be on filing more complex, difficult-to-manufacture products. We expect that temporary supplies of Doxorubicin to continue in 3QFY13 as well but may not sustain from 4Q onwards.
- India business - Underlying growth in this business remains strong. However, based on lower than expected 2QFY13 performance for domestic business, we have reduced our revenue estimates for FY13E and FY14E.

## Taro performance - Profitability continues to be strong

Taro (Sun Pharma's subsidiary) recently reported 2QFY13 results with 16% topline growth, 33% EBITDA growth and 11% PAT growth (tempered down by absence of forex gains). The strong profitability is primarily led by lower competitive intensity in some of Taro's key dermatology products in the US, which has enabled the company to gain market share as well as take price increases. This has been the trend for the past 3 quarters. Management remains cautious of the increasing competition and consequential erosion of volume on some of these major products and the challenge in maintaining current performance. It has cautioned investors in the past that the current high profitability may not sustain once competition comes back to the market.

### Taro financials (USD M)

	2QFY13	2QFY12	% YoY	1QFY13	% QoQ
Sales	161.0	138.3	16.4	148.1	8.7
Cost of sales (incl Depn)	39.6	44.9	-11.8	42.1	-5.7
Gross profit	121.3	93.3	30.0	106.0	14.4
GP Margin (%)	75.4	67.5		71.6	
<b>Operating expenses</b>					
R&D	10.9	6.9	57.8	8.9	23.4
R&D as a % of sales	6.8	5.0		6.0	
SG&A	28.0	24.4	14.5	22.7	23.2
SG&A as a % of sales	17.4	17.7		15.3	
<b>EBITDA</b>	<b>82.4</b>	<b>61.9</b>	<b>33.1</b>	<b>74.5</b>	<b>10.7</b>
EBITDA Margin (%)	51.2	44.8		50.3	
Financial expenses	-0.2	1.5		0.3	
Extraordinary items incl forex	1.0	-16.4		6.7	
Other income	0.2	0.2		-0.6	
<b>PBT</b>	<b>81.9</b>	<b>77.0</b>	<b>6.4</b>	<b>66.9</b>	<b>22.4</b>
Taxes	16.4	18.3		4.6	
Effective tax rate (%)	20.1	23.8		6.8	
<b>Net income</b>	<b>65.5</b>	<b>58.7</b>	<b>11.6</b>	<b>62.3</b>	<b>5.0</b>
Minority interest	0.1	-0.3		-0.1	
<b>Net income</b>	<b>65.4</b>	<b>58.9</b>	<b>10.9</b>	<b>62.4</b>	<b>4.7</b>

Source: Company, MOSL

### Proposes to acquire DUSA in US for USD230m - No immediate financial upside, long-term +ve

Sun Pharma has proposed the acquisition of DUSA Pharmaceuticals (USA) for a cash consideration of USD230m, implying a valuation of 5x DUSA's CY11 sales and 20x EBITDA. The company had reported a revenues of USD 45m for CY11 with PAT of USD7.3m. A significant portion of the proposed consideration will reflect as goodwill on Sun's books if the acquisition goes through.

Importantly, DUSA has USFDA's NDA approval to market its dermatology product, Aminolevulinic Acid HCL, for the treatment of moderate inflammatory acne vulgaris and general dermatological conditions. DUSA seems to be technologically driven company with access to certain proprietary technologies.

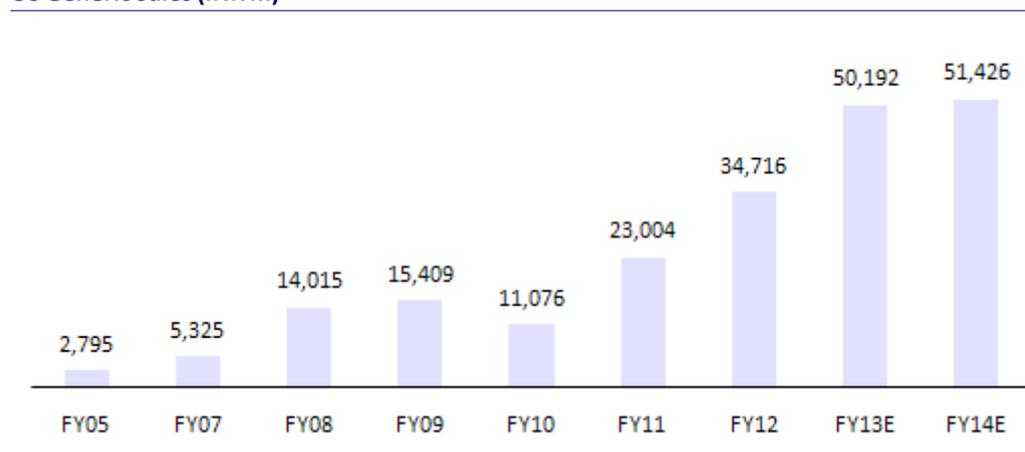
We do not expect any major financial upside for Sun Pharma from this acqn in the near-term, given the small size. While the valuation offered by Sun Pharma to DUSA shareholders seems to be rich, it intends to strengthen its presence in dermatology segment (both US and emerging markets) by unlocking the latent value in this proprietary franchise. We also note that Sun Pharma has a very good track record as far as inorganic initiatives are concerned.

#### DUSA - Financial Snapshot (USD M)

	1HCY12	CY11	CY10	CY09
<b>Sales</b>	<b>25.1</b>	<b>45.3</b>	<b>36.4</b>	<b>28.3</b>
Growth (%)	-44%	24%	29%	
<b>EBITDA</b>	<b>2.8</b>	<b>8.2</b>	<b>3.1</b>	<b>-2.4</b>
EBITDA (%)	11%	18%	9%	-8%
<b>Net Income/(Loss)</b>	<b>1.9</b>	<b>7.3</b>	<b>2.7</b>	<b>-2.5</b>

Source: Company, MOSL

#### US Generic Sales (INR m)



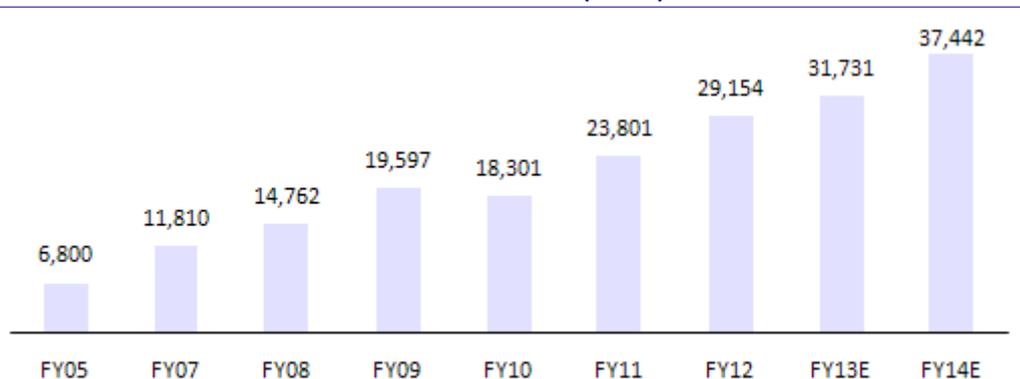
Source: Company, MOSL

### Domestic formulations to report muted growth in FY13; Emerging markets portfolio to grow at ~35% CAGR

Given its strong positioning in the lifestyle segment, we expect Sun to sustain its underlying growth momentum in the domestic formulations business in the long-term. It is among the top players in the CNS, CVS, Gastro, Ophthalmology and Orthopedics segments.

This business has grown at 25% CAGR for FY08-12 partly aided by the one-time supplies of INR1.8b made in 4QFY12. This one-time sales is likely to have increased the inventory in the trade channels and hence will partly temper down domestic formulations growth for FY13.

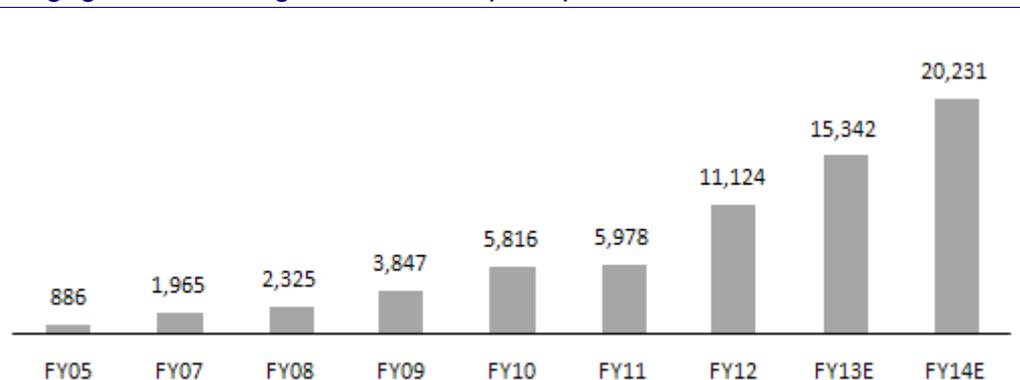
#### Domestic Formulations Sales - Sustained momentum (INR m)



Source: Company, MOSL

We also believe that SUNP's emerging markets revenues are likely to grow at ~35% CAGR over next two years given its plans to increase its penetration in key markets. Management has indicated that its emerging markets business has good growth potential going forward.

#### Emerging market sales to grow at 35% CAGR (INR m)



Source: Company, MOSL

#### Valuation and view

An expanding generic portfolio coupled with sustained double-digit growth in high-margin life-style segments in India is likely to bring in long-term benefits for SUNP. Its ability to sustain superior margins even on a high base is a clear positive. Key drivers for future include: 1) Ramp-up in US business, 2) Monetization of the Para-IV/low-competition pipeline in the US, 3) Launch of controlled substances in the US, 4) Sustaining Taro's high profitability & 5) Ability to leverage on DUSA's technology franchise. Post the 2QFY13 results; we have upgraded our core EBITDA est for FY13E and FY14E by 6% and 3%. However, our EPS estimates remain largely unchanged due to lower other income.

The stock is currently valued at 25.1x FY13E and 23.8x FY14E core earnings. While we are positive on SUNP's business outlook, rich valuations have tempered down our bullishness. Price increases for certain products by Taro (due to absence of competition), positive impact of a favourable currency and temporary Doxil supplies to US were the key reasons for the significant increase in growth and profitability for SUNP in 1HFY13. Of these, the significant jump in profitability at Taro is not sustainable in the long-term and is likely to reverse post the re-entry of some of the competitors. Doxil supplies are likely to taper off as J&J has re-entered the US market. Tax rate for FY13 will be ~18% compared to 11.4% for FY12. We maintain Neutral with target price of INR730 (25x FY14 EPS). Inorganic initiatives (SUNP has cash of over USD1b) is a key risk to our rating.

## Sun Pharmaceuticals: an investment profile

### Company description

Sun Pharma is among the largest players in the domestic formulations market and the most profitable one. It makes and markets specialty medicines and APIs for chronic therapy areas such as cardiology, psychiatry, neurology, etc. Sun has forayed into regulated markets by acquiring majority stake in Caraco Pharma and has strengthened its presence in US by recent acquisition of Taro.

### Key investment arguments

- Ability to identify niches in long term therapy areas with high entry barriers and build strong franchise to ensure sustainable growth and high margins.
- Sustaining superior profitability on higher base is a strong positive.
- One of the strongest ANDA pipelines from India with 135 ANDAs pending approval. The pipeline includes a combination of low-competition, patent challenge and normal product opportunities.

### Key investment risks

- Unresolved USFDA issues related to Caraco's manufacturing facilities will continue to impact sales in the US and pending ANDA approvals from that facility.

- Capability to scale up exports, particularly to unregulated markets, is yet to be fully demonstrated.

### Recent developments

- Announced the acquisition of DUSA Pharmaceuticals (USA) for a cash consideration of USD230m.

### Valuation and view

- While we are positive on SUNP's business outlook, rich valuations have tempered down our bullishness.
- The stock is currently valued at 25.1x FY13E and 23.8x FY14E core earnings. Maintain Neutral with TP of INR730 (25x FY14E EPS)

### Sector view

- Emerging markets and USA would remain the key sales and profit drivers in the medium term. Japan is expected to emerge as the next growth driver for generics in the long-term.
- We are overweight on companies that are towards the end of the investment phase, with benefits expected to start coming in from the next fiscal.

### Comparative valuations

		Sun Pharma	Ranbaxy	DRL
P/E (x)	FY13E	25.1	13.8	19.9
	FY14E	23.8	20.1	17.1
P/BV (x)	FY13E	5.1	3.5	4.5
	FY14E	4.4	3.0	4.0
EV/Sales (x)	FY13E	6.3	2.0	2.9
	FY14E	5.5	2.1	2.7
EV/EBITDA (x)	FY13E	15.3	12.3	13.8
	FY14E	15.6	15.7	13.3

### Shareholding pattern (%)

	Sep-12	Jun-12	Sep-11
Promoter	63.7	63.7	63.7
Domestic Inst	5.2	5.3	6.5
Foreign	20.6	20.6	19.1
Others	10.6	10.4	10.7

### EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY13	27.6	29.7	-7.1
FY14	29.2	31.8	-8.0

### Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
692	730	5.5	Neutral

### Stock performance (1 year)



## Financials and Valuation

Consolidated Income Statement		(INR Million)			
Y/E March	2011	2012	2013E	2014E	
<b>Net Sales</b>	57,214	80,054	103,316	115,610	
Change (%)	39.5	39.9	29.1	11.9	
Total Expenditure	37,514	47,530	61,101	74,898	
% of Sales	65.6	59.4	59.1	64.8	
<b>EBITDA</b>	19,700	32,524	42,215	40,712	
Margin (%)	34.4	40.6	40.9	35.2	
Depreciation	2,041	2,912	3,335	3,658	
<b>EBIT</b>	17,659	29,613	38,880	37,055	
Int. and Finance Charges	577	282	164	164	
Other Income - Rec.	3,276	4,223	4,167	5,086	
Extra-ordinary Exp			5,836		
PBT	20,358	33,554	37,047	41,977	
Tax	1,284	3,826	7,719	7,556	
Tax Rate (%)	6.3	11.4	20.8	18.0	
<b>Profit after Tax</b>	19,074	29,727	29,328	34,421	
Change (%)	41.6	55.9	-1.3	17.4	
Margin (%)	33	37	28	30	
Less: Mionrity Interest	913	3855	4626	4163	
<b>Net Profit</b>	18,161	25,873	24,702	30,258	
<b>Adj. PAT</b>	14,041	23,228	28,586	30,258	

Consolidated Balance Sheet		(INR Million)			
Y/E March	2011	2012	2013E	2014E	
Equity Share Capital	1,036	1,036	1,036	1,036	
Total Reserves	93,798	120,628	139,155	161,243	
<b>Net Worth</b>	94,833	121,664	140,190	162,278	
Minority Interest	8,472	11,615	16,240	20,403	
Deferred Liabilities	-3652	-5199	-5199	-5199	
Secured Loan	1,804	1,319	1,319	1,319	
Unsecured Loan	2,452	1,420	1,420	1,420	
Total Loans	4,256	2,739	2,739	2,739	
<b>Capital Employed</b>	103,908	130,818	153,971	180,222	
Gross Block	45,520	46,542	51,542	56,042	
Less: Accum. Deprn.	20,286	20,407	23,742	27,400	
<b>Net Fixed Assets</b>	25,234	26,135	27,800	28,642	
Capital WIP	2,706	3,447	3,447	3,447	
Goodwill	7,720	13,378	13,378	23,978	
Investments	22,310	22,303	22,303	22,303	
<b>Curr. Assets</b>	60,172	90,506	117,765	140,383	
Inventory	14,794	20,870	22,166	29,039	
Account Receivables	11,716	19,261	22,645	25,339	
Cash and Bank Balance	21,936	33,672	51,725	62,249	
L & A and Others	11,726	16,703	21,229	23,756	
<b>Curr. Liability &amp; Prov.</b>	14,234	24,950	30,722	38,531	
Account Payables	9,203	14,410	16,828	22,805	
Provisions	5,030	10,541	13,894	15,725	
<b>Net Current Assets</b>	45,939	65,556	87,043	101,852	
<b>Appl. of Funds</b>	103,908	130,818	153,971	180,222	

E: MOSL Estimates

Ratios		(INR Million)			
Y/E March	2011	2012	2013E	2014E	
<b>Basic (INR)</b>					
EPS	13.6	22.4	27.6	29.2	
<b>Fully Diluted EPS</b>	13.6	22.4	27.6	29.2	
Cash EPS	19.5	27.8	27.1	32.7	
BV/Share	91.6	117.5	135.4	156.7	
DPS	3.5	4.2	5.1	6.7	
Payout (%)	22.1	17.2	21.1	23.7	
<b>Valuation (x)</b>					
P/E		30.9	25.1	23.8	
Cash P/E		25.0	25.6	21.2	
P/BV		5.9	5.1	4.4	
EV/Sales		8.3	6.3	5.5	
EV/EBITDA		20.5	15.3	15.6	
Dividend Yield (%)		0.6	0.7	1.0	
<b>Return Ratios (%)</b>					
RoE	16.2	21.5	21.8	20.0	
RoCE	23.4	30.3	27.8	27.4	
<b>Working Capital Ratios</b>					
Fixed Asset Turnover (x)	2.8	3.1	3.8	4.1	
Debtor (Days)	75	88	80	80	
Inventory (Days)	94	95	78	92	
Working Capital T/O (Days)	293	299	308	322	
<b>Leverage Ratio</b>					
Debt/Equity (x)	0.0	0.0	0.0	0.0	

Cash Flow Statement		(INR Million)			
Y/E March	2011	2012	2013E	2014E	
OP/(Loss) bef. Tax	19,700	32,524	42,215	40,712	
Int./Dividends Recd.	3,276	4,223	4,167	5,086	
Direct Taxes Paid	-4,046	-5,373	-7,719	-7,556	
(Inc)/Dec in WC	-533	-7,882	-3,434	-4,285	
<b>CF from Operations</b>	18,397	23,493	35,229	33,958	
(inc)/dec in FA	-16,864	-10,212	-5,000	-15,100	
(Pur)/Sale of Invest.	8,354	7	0	0	
<b>CF from investments</b>	-8,510	-10,205	-5,000	-15,100	
Change in networth	8,223	5,361	0	0	
(Inc)/Dec in Debt	2,545	-1,517	0	0	
Interest Paid	-577	-282	-164	-164	
Dividend Paid	-4,213	-5,115	-6,176	-8,170	
<b>CF from Fin. Activity</b>	5,977	-1,553	-6,340	-8,334	
<b>Inc/Dec of Cash</b>	15,864	11,736	23,889	10,524	
Add: Beginning Balance	6,072	21,936	33,672	51,725	
<b>Closing Balance</b>	21,936	33,672	57,561	62,249	

Note: Cashflows do not tally due to acquisition

**N O T E S**

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