

Sun Pharma

BSE SENSEX
33,317

S&P CNX
10,249

CMP: INR532

TP: INR675(+27%)

Buy

No data integrity issue at Halol; resolution likely over coming months



Stock Info

Bloomberg	SUNP IN
Equity Shares (m)	2,399
52-Week Range (INR)	728 / 433
1, 6, 12 Rel. Per (%)	1/7/-37
M.Cap. (INR b)	1,314.4
M.Cap. (USD b)	20.2
Avg Val, INRm	2823.0
Free float (%)	45.6

Financials Snapshot (INR b)

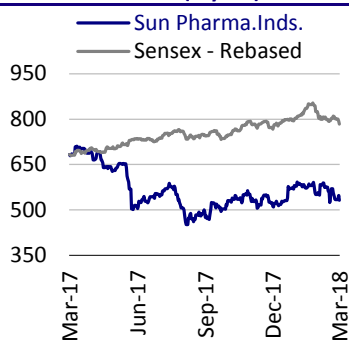
Y/E Mar	2018E	2019E	2020E
Net Sales	265.0	306.3	353.6
EBITDA	53.7	77.0	95.9
PAT	32.6	52.6	67.2
EPS (INR)	13.6	21.9	27.9
Gr. (%)	-48.1	61.4	27.7
BV/Sh (INR)	156.7	171.6	192.5
RoE (%)	8.8	13.3	15.3
RoCE (%)	7.9	13.8	16.3
P/E (x)	39.2	24.3	19.0
P/BV (x)	3.4	3.1	2.8

Shareholding pattern (%)

As On	Dec-17	Sep-17	Dec-16
Promoter	54.4	54.4	54.4
DII	14.9	13.9	12.2
FII	17.2	18.2	21.8
Others	13.5	13.6	11.7

FII Includes depository receipts

Stock Performance (1-year)



The US Food and Drug Administration (US FDA) inspected Sun Pharma's (SUNP) Halol plant from 12-23 February 2018. Notably, the number of observations has come down to three this time from nine in the last inspection that was conducted in December 2016. Given that none of three observations issued in the recent inspection are serious in nature (two are procedural in nature and one is related to aseptic processing of drug products), we expect resolution of the facility over the coming months.

- No data integrity issue – an encouraging sign:** We note that none of the three observations issued in the recent inspection are related to data integrity – which is a positive sign for the company, in our view. The first observation points out the lack of defined area to prevent contamination in operations related to aseptic processing of drugs. The second observation mentions that the written procedures for cleaning and maintenance do not clearly provide details of the methods to disassemble and reassemble equipment. The third observation is related to written procedure giving details of sampling, testing, approval and rejection of drug product containers and closures.
- Key product approvals linked to Halol facility:** SUNP's US business has been under pressure as no products were approved from the Halol facility after the issuance of the warning letter. Halol facility contributes ~10-13% of US sales for SUNP (down from >20% at the time of warning letter). Resolution of the Halol facility is critical for the company as it would provide visibility on key approvals, including Xelpros, Elepsia and Vagifem. Although the company has already initiated a process for site transfer of key products (e.g. Xelpros and Elepsia), we do not expect any approvals over the next 3-6 months. We expect incremental sales of ~USD100-150m from this facility post resolution. We have already built in resolution of the Halol facility from early FY19.
- Earnings recovery expected from FY19:** We expect a pick-up in US sales from FY19, driven by Halol resolution and commercialization of Tildrakuzumab in the US (FY19) and Seciera (2HFY19E). Strategic investments in the specialty business over the last 2-3 years, coupled with stable growth in the domestic market and the enhanced focus on complex generics in the US, will help drive earnings growth over the medium term, in our view.
- Maintain Buy; early resolution at Halol critical:** At current valuations, the stock does not fully value its rich US pipeline and stable cash-generating domestic business. SUNP has historically commanded 20-25% premium to Indian pharma peers, typically at 25-27x one-year forward P/E multiples. The company is trading at ~24x/19x FY19E/20E PER, which is ~15% below 10-year average valuations. We maintain our **Buy** rating on SUNP with a target price of INR675 @ 24x FY20E PER.

Kumar Saurabh – Research Analyst (Kumar.Saurabh@MotilalOswal.com); +91 22 6129 1519

Ankeet Pandya – Research Analyst (Ankeet.Pandya@MotilalOswal.com);

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Exhibit 1: Key specialty products for Sun Pharma

Products	Status	Sales (USDm)
MK-3222 - Tildrakizumab	Post successful result of Phase 3 results, US FDA has accepted SUNP filing. It is expected to be launched in early FY19	100
Seciera (OTX-101)	Dec end US FDA announced acceptance of Seciera filing and is expected to be launched by 2HFY19	60-70
Odomzo	Already launched	40-50
Bromsite	Already launched	50

Source: Industry, Company, MOSL

Exhibit 2: Key products from Halol facility

Generic Products	Products filed from Halol facility	Sales (USD m)
Focalin XR	Market size of ~USD100 with 4 players	15
Ganirelix	Market size of USD60-70m with no generic player	20
Lupron	Market Size of USD100m	20-22
Vagifem	Market size of ~350m with 4 players	35
Protonix IV	Market size of ~USD100 with 4 players	20
Invega	Market size of USD250m with 3 players	20-22
Makena	Market size of USD200m with 3 players	20-22
Specialty Products		
Elepsia	Launch expected in FY19	20-25
Xelpros	Launch expected in FY19	20-25

Source: Industry, Company, MOSL

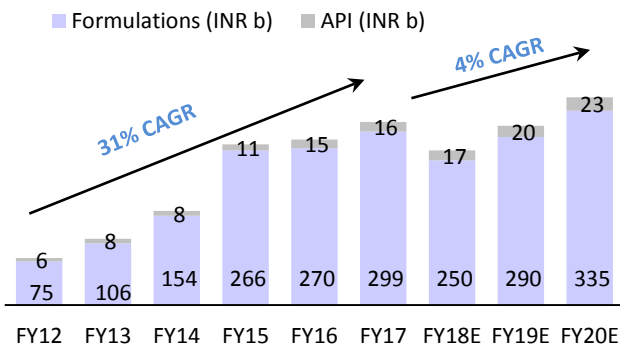
Exhibit 3: Halol facility observation details

Observations	Details
Aseptic processing of drug product	<ol style="list-style-type: none"> Observed rough, crack and uneven surface, which creates difficulty to clean surface in the immediate vicinity of aseptic filling operations. There are HEPA filters above filling equipment, which cannot be accessed during cleaning. The filling operation for injection; operators were observed moving in the aseptic room with their gloved hands.
Lack of written procedure for disassembling and reassembling equipment cleaning and maintenance	<ol style="list-style-type: none"> Bulk product tanks labeled 'cleaned' were found having residue on the gasket, which is dedicated to injectable production. One of the tanks also has a torn and degraded style gasket installed, which was last used for bulk injection. Storage tank that supplies to the production area had degraded and discoloured gasket. Bulk drug formulation equipment also had degraded and discoloured gasket, for which there was no written procedure that specified service of replacement.
Lack of written procedure for sampling, testing, approval and rejection of drug product containers and closures	<ol style="list-style-type: none"> Written procedure for cleaning of Vial/Ampoule machine allows the performance of two sequential failures without initiation of a deviation investigation. The procedure also states repeat rejection from the operation as false rejection.

Source: US FDA, MOSL

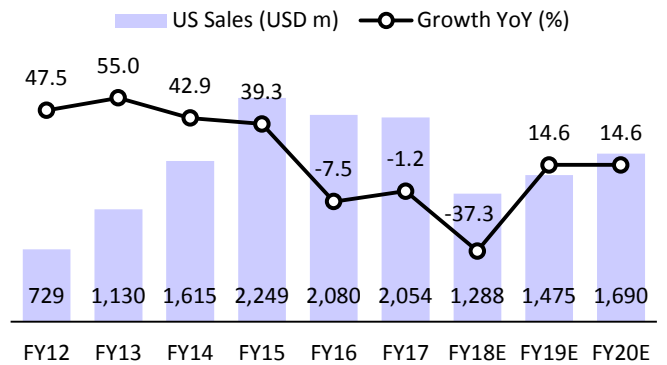
Story in charts

Exhibit 4: Revenues to remain subdued over FY17-20E



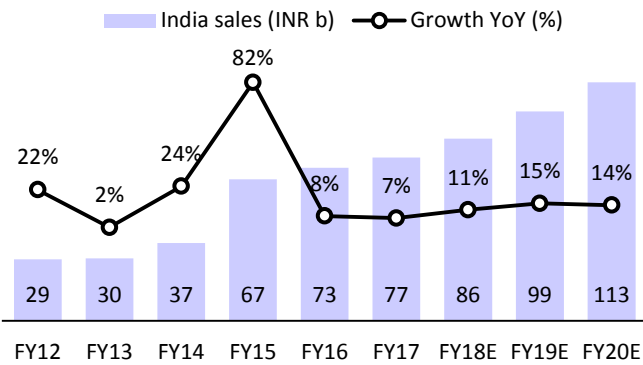
Source: Company, MOSL

Exhibit 5: US generic sales to improve FY19 onward



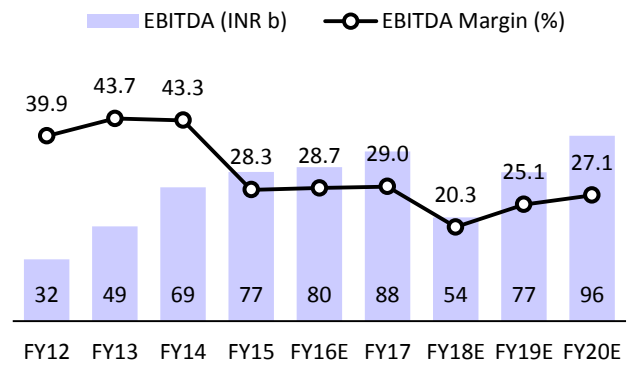
Source: Company, MOSL

Exhibit 6: India biz to grow at 13% CAGR over FY17-20E



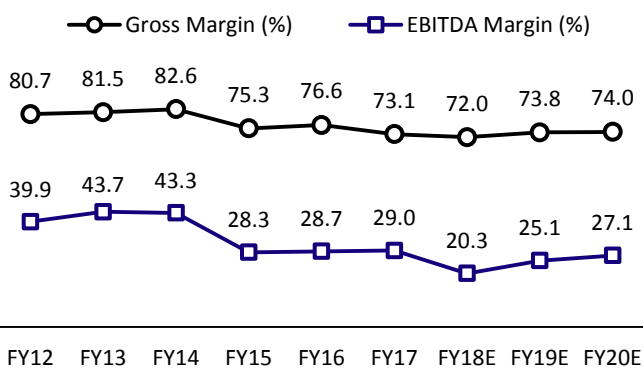
Source: Company, MOSL

Exhibit 7: Margins to pick up FY19 onward



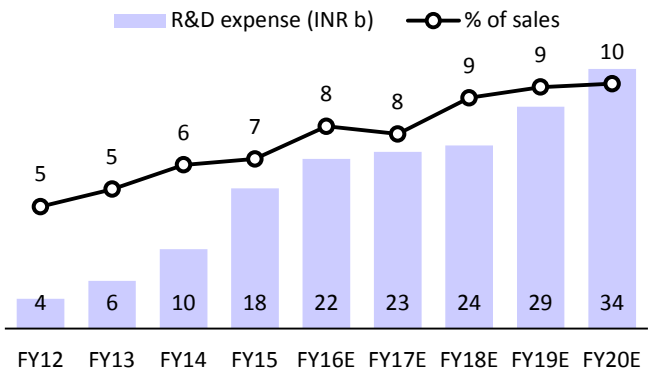
Source: Company, MOSL

Exhibit 8: EBITDA to improve with gross margin expansion



Source: Company, MOSL

Exhibit 9: R&D expense to increase going forward



Source: Company, MOSL

Financials and Valuations

Income Statement						(INR Million)		
Y/E Mar	2013	2014	2015	2016	2017	2018E	2019E	2020E
Net Sales	112,388	160,044	272,865	277,442	302,642	265,029	306,286	353,619
Change (%)	40.3	42.4	70.5	1.7	9.1	-12.4	15.6	15.5
EBITDA	49,063	69,257	77,198	79,561	87,751	53,672	76,963	95,869
EBITDA Margin (%)	43.7	43.3	28.3	28.7	29.0	20.3	25.1	27.1
Depreciation	3,362	4,092	11,947	10,135	12,648	14,100	15,000	15,500
EBIT	45,701	65,165	65,250	69,426	75,103	39,572	61,963	80,369
Interest	443	442	5,790	4,769	3,998	4,500	3,000	2,300
Other Income	3,727	6,282	6,946	9,848	19,374	8,000	10,000	12,500
Extraordinary items	-5,836	-25,174	-2,378	-6,852	0	0	0	0
PBT	43,148	45,831	64,029	67,653	90,479	43,072	68,963	90,569
Tax	8,456	7,022	9,147	9,349	12,116	11,591	10,344	15,397
Tax Rate (%)	19.6	15.3	14.3	13.8	13.4	26.9	15.0	17.0
Min. Int. & Assoc. Share	4,863	7,375	9,488	11,145	8,719	4,000	6,000	8,000
Reported PAT	29,830	31,434	45,394	47,159	69,644	27,481	52,619	67,172
Adjusted PAT	34,791	52,813	47,415	47,069	62,890	32,611	52,619	67,172
Change (%)	34.2	51.8	-10.2	-0.7	33.6	-48.1	61.4	27.7

Balance Sheet						(INR Million)		
Y/E Mar	2013	2014	2015	2016	2017	2018E	2019E	2020E
Share Capital	1,036	2,071	2,406	2,407	2,399	2,399	2,399	2,399
Reserves	148,862	183,178	253,826	327,418	363,997	374,635	410,411	460,740
Net Worth	149,897	185,249	256,232	329,825	366,397	377,034	412,810	463,139
Debt	2,072	24,982	77,827	83,164	80,910	58,073	41,800	30,179
Deferred Tax	-7,122	-9,110	-17,516	-30,462	-21,780	-21,780	-21,780	-21,780
Total Capital Employed	161,197	220,333	345,203	423,379	463,435	455,236	480,738	527,447
Gross Fixed Assets	56,026	63,886	130,369	123,033	133,994	158,994	183,994	213,994
Less: Acc Depreciation	24,421	28,904	60,617	47,201	49,041	63,141	78,141	93,641
Net Fixed Assets	31,604	34,982	69,752	75,831	84,953	95,853	105,853	120,353
Capital WIP	5,626	8,415	20,386	12,035	15,648	17,212	18,934	20,827
Investments	24,116	27,860	27,163	11,161	9,610	9,610	9,610	9,610
Current Assets	113,420	177,393	297,403	332,175	374,799	354,061	381,794	432,751
Inventory	25,778	31,230	56,680	64,225	68,328	61,068	65,665	75,234
Debtors	27,108	22,004	53,123	67,757	72,026	54,766	52,536	60,831
Cash & Bank	40,587	75,902	109,980	131,817	151,408	155,191	180,557	210,891
Loans & Adv, Others	19,948	48,257	77,619	68,377	83,036	83,036	83,036	85,794
Curr Liabs & Provns	38,439	61,509	126,574	100,434	125,739	125,665	139,618	160,259
Curr. Liabilities	15,752	15,887	59,198	51,741	73,469	65,555	70,490	80,763
Provisions	22,687	45,622	67,376	48,693	52,270	60,111	69,127	79,496
Net Current Assets	74,981	115,884	170,828	231,742	249,060	228,395	242,177	272,492
Total Assets	161,198	220,333	345,203	423,379	463,435	455,236	480,738	527,447

Financials and Valuations

Ratios

Y/E Mar	2013	2014	2015	2016	2017	2018E	2019E	2020E
Basic (INR)								
EPS	14.5	22.0	19.7	19.6	26.1	13.6	21.9	27.9
Cash EPS	13.8	14.8	23.8	23.8	34.2	17.3	28.1	34.4
Book Value	62.3	77.0	106.5	137.1	152.3	156.7	171.6	192.5
DPS	2.2	2.6	3.0	1.0	3.5	6.0	6.0	6.0
Payout (incl. Div. Tax.)	17.5	18.7	15.4	4.8	12.5	53.5	28.7	22.4
Valuation(x)								
P/E				29.4	22.0	42.4	26.3	20.6
Price / Book Value				4.2	3.8	3.7	3.3	3.0
EV/Sales				4.8	4.3	4.8	4.0	3.4
EV/EBITDA				16.6	14.8	23.8	16.0	12.4
Dividend Yield (%)				0.2	0.6	1.0	1.0	1.0
Profitability Ratios (%)								
RoE	25.6	31.5	21.5	16.1	18.1	8.8	13.3	15.3
RoCE	28.8	33.4	22.7	18.3	19.0	7.9	13.8	16.3
RoIC	45.2	55.5	37.8	26.2	23.4	10.3	19.3	23.9
Turnover Ratios (%)								
Asset Turnover (x)	0.8	0.8	1.0	0.7	0.7	0.6	0.7	0.7
Debtors (No. of Days)	88	50	71	89	87	75	63	63
Inventory (No. of Days)	84	71	76	84	82	84	78	78
Creditors (No. of Days)	91	64	110	95	125	113	112	114
Leverage Ratios (%)								
Net Debt/Equity (x)	-0.2	-0.2	-0.1	-0.1	-0.2	-0.2	-0.3	-0.3

Cash Flow Statement

(INR Million)

Y/E Mar	2013	2014	2015	2016	2017	2018E	2019E	2020E
Adjusted EBITDA	49,063	69,257	77,198	79,561	87,751	53,672	76,963	95,869
Non cash opr. exp (inc)	-2,109	-18,892	4,569	2,996	19,374	8,000	10,000	12,500
(Inc)/Dec in Wkg. Cap.	-2,336	-5,589	-20,865	-39,077	2,274	24,447	11,585	19
Tax Paid	-10,379	-9,010	-17,553	-22,295	-3,434	-11,591	-10,344	-15,397
Other operating activities	0	0	0	0	0	0	0	0
CF from Op. Activity	34,239	35,767	43,348	21,185	105,964	74,527	88,203	92,991
(Inc)/Dec in FA & CWIP	-22,501	-18,580	-82,570	-43,401	-36,936	-26,565	-26,721	-31,893
Free cash flows	11,737	17,187	-39,223	-22,216	69,028	47,962	61,482	61,098
(Pur)/Sale of Invt	-1,987	-3,745	698	16,002	1,551	0	0	0
Others	0	0	0	0	0	0	0	0
CF from Inv. Activity	-24,488	-22,324	-81,872	-27,399	-35,385	-26,565	-26,721	-31,893
Inc/(Dec) in Net Worth	4,334	6,674	33,994	30,296	-34,910	0	0	0
Inc / (Dec) in Debt	-668	22,910	52,845	5,337	-2,254	-22,837	-16,273	-11,621
Interest Paid	-443	-442	-5,790	-4,769	-3,998	-4,500	-3,000	-2,300
Divd Paid (incl Tax) & Others	-6,058	-7,270	-8,445	-2,816	-9,825	-16,843	-16,843	-16,843
CF from Fin. Activity	-2,835	21,872	72,605	28,049	-50,987	-44,180	-36,116	-30,764
Inc/(Dec) in Cash	6,915	35,315	34,080	21,836	19,592	3,782	25,366	30,334
Add: Opening Balance	33,672	40,587	75,902	109,980	131,817	151,408	155,191	180,557
Closing Balance	40,587	75,902	109,982	131,816	151,408	155,191	180,557	210,891

Explanation of Investment Rating	Expected return (over 12-month)
Investment Rating	
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10% to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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Sun Pharma

Analyst ownership of the stock

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Registered Office Address: Motilal Oswal Tower, Rahimullah Sayani Road, Opposite Parel ST Depot, Prabhadevi, Mumbai-400025. Tel No.: 022-3980 4263; www.motilaloswal.com. Correspondence Address: Palm Spring Centre, 2nd Floor, Palm Court Complex, New Link Road, Malad (West), Mumbai- 400 064. Tel No: 022 3080 1000. Compliance Officer: Neeraj Agarwal, Email Id: na@motilaloswal.com, Contact No.:022-30801085.

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