

Sun Pharma

Performance Highlights

(` cr)	3QFY2019	2QFY2019	% chg (qoq)	3QFY2018	% chg (yoy)
Net sales	7,657	6,846	11.8	6,598	16.0
Other income	277	442	(37.5)	184	50.1
Gross profit	5,491	5,089	7.9	4,498	22.1
Operating profit	2,070	1,440	43.7	1,398	48.0
Adj. Net profit	1,242	947	31.2	322	286.2

Source: Company, Angel Research

For 3QFY2019, Sun Pharma posted robust numbers. For the quarter, the sales came in at `7,657cr v/s. `6,598cr in 3QFY2018, registering a yoy growth of 16.0%. India sales at `2,235cr, were up by 7%, while US finished dosage sales at US\$362mn up 10% yoy V/s 3QFY2018. On the OPM front, the gross margins came in at 71.7% v/s. 68.2% in 3QFY2018, which lead the EBDITA margins to come in at 27.0% v/s. 21.2% in 3QFY2018. This along with a 63.8% yoy dip in tax expenses led the Adj. net profit to come in at `1,242cr v/s. `322cr in 3QFY2018, a yoy growth of 286.2%. **We maintain our Neutral.**

Results better on all fronts: For 3QFY2019, Sun Pharma posted robust numbers. For the quarter, the sales came in at `7,657cr v/s. `6,598cr in 3QFY2018, registering a yoy growth of 16.0%. India sales at `2,235cr, were up by 7%, while US finished dosage sales at US\$362mn up 10% yoy V/s 3QFY2018. On the OPM front, the gross margins came in at 71.7% v/s. 68.2% in 3QFY2018, which lead the EBDITA margins to come in at 27.0% v/s. 21.2% in 3QFY2018. This along with a 63.8% yoy dip in tax expenses led the Adj. net profit to come in at `1,242cr v/s. `322cr in 3QFY2018, a yoy growth of 286.2%. Consolidated R&D expense for 3QFY2019 was `465cr, or 6.1% of sales compared to `473cr or 7.2% of sales for 3QFY2018.

Outlook and valuation: Sun Pharma is expected to post net sales CAGR of 12.1%, while EPS will post a CAGR of ~27% during FY2018–21E. The growth would be mainly driven by improved product mix. However, given the concerns on corporate governance and risk-reward, we remain Neutral. Also, current valuations capture the best-case scenario for the company.

Key financials (Consolidated)

Y/E March (` cr)	FY2018	FY2019E	FY2020E	FY2021E
Net sales	26,489	28,725	32,929	37,340
% chg	(16.1)	8.4	14.6	13.4
Adj. Net profit	2,879	3,737	4,919	5,821
% chg	(58.5)	29.8	31.6	18.3
EPS (`)	12.0	15.6	20.5	24.3
EBITDA margin (%)	17.6	23.0	24.5	24.3
P/E (x)	35.7	27.5	20.9	17.6
RoE (%)	8.8	10.3	12.3	13.5
RoCE (%)	6.6	9.6	11.5	12.0
P/BV (x)	2.7	2.6	2.4	2.1
EV/Sales (x)	3.6	3.3	2.8	2.4
EV/EBITDA (x)	20.7	14.6	11.5	9.8

Source: Company, Angel Research; Note: CMP as of February 11, 2019

NEUTRAL

CMP `428

Target Price -

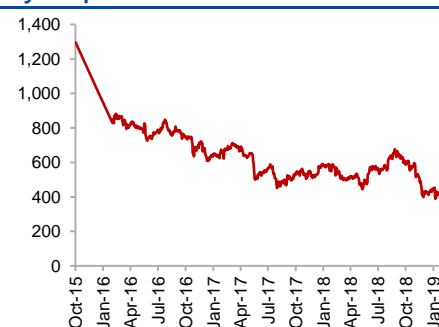
Investment Period 12 months

Sector	Pharmaceutical
Market Cap (` cr)	102,739
Net Debt (` cr)	(6,687)
Beta	0.8
52 Week High / Low	679/375
Avg. Daily Volume	186,302
Face Value (`)	1
BSE Sensex	36,395
Nifty	10,889
Reuters Code	SUN.BO
Bloomberg Code	SUNP@IN

Shareholding Pattern (%)	
Promoters	54.4
MF / Banks / Indian Fls	15.2
FII / NRIs / OCBs	21.6
Indian Public / Others	8.8

Abs. (%)	3m	1yr	3yr
Sensex	0.4	28.4	58.6
Sun Pharma	(6.0)	(34.6)	(48.5)

3-year price chart



Source: Company, Angel Research

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Exhibit 1: 3QFY2019 performance (Consolidated)

Y/E March (` cr)	3QFY2019	2QFY2019	% chg QoQ	3QFY2018	% chg yoy	9MFY2019	9MFY2018	% chg
Net sales	7,657	6,846	11.8	6,598	16.0	21,642	19,355	11.8
Other income	276.5	442.3	(37.5)	184.2	50.1	1,004	693	44.8
Total income	7,933	7,289	8.8	6,782	17.0	22,646	20,048	13.0
Gross profit	5,491	5,089	7.9	4,498	22.1	15,612	13,700	14.0
Gross margin (%)	71.7	74.3		68.2		72.1	70.8	
Operating profit	2,070	1,440	43.7	1,398	48.0	5,031	3,767	33.5
Operating margin (%)	27.0	21.0		21.2		23.2	19.5	
Interest	145	130	11.8	95	51.9	405	362	11.9
Depreciation	471	427	10.4	339	38.8	1,299	1,045	24.4
Extraordinary item loss/ (gain)	0	1,214		0		1,214	951	
PBT	1,730	1,326	30.5	1,148	50.7	4,330	3,054	41.8
Provision for taxation	270.9	269.7	0.5	748.7	(63.8)	630	1,121	(43.8)
PAT before extra-ordinary item	1,459	1,057	38.1	356	309.5	3,701	1,933	91.5
Minority interest(MI)	219	110	99.3	35		(459)	(229)	
Adj. PAT	1,242	947	31.2	322	286.2	3,242	1,704	90.3
Reported PAT	1,242	(270)	-	322	286.2	2,028	753	169.2
Adj. EPS (`)	5.2	3.9		1.3		13.5	7.1	

Source: Company, Angel Research

Sales improve sequentially: For 3QFY2019, the company posted robust numbers. . For the quarter, the sales came in at `7,657cr v/s. `6,598cr in 3QFY2018, registering a yoy growth of 16.0%. India sales at `2,235cr, were up by 7%, while US finished dosage sales at US\$362mn up 10% yoy V/s 3QFY2018.

Sales in the US were US\$362mn for the quarter, a growth of 10% over same period last year and accounted for 34% of total sales. For nine-month period, sales were US\$1,083mn recording a growth of 10% over same period last year. At the same time, Taro posted 3QFY2019 sales of US\$176mn, up 13% over 3QFY2018. For the nine month, sales were US\$490mn, marginally up over nine-month last year. Taro's net profit for 3QFY2019 was US\$93mn while for the nine-month period; it reported a net profit of US\$223mn. The company had 441 ANDAs filed with the USFDA. Currently, ANDAs for 123 products await USFDA approval, including 15 tentative approvals.

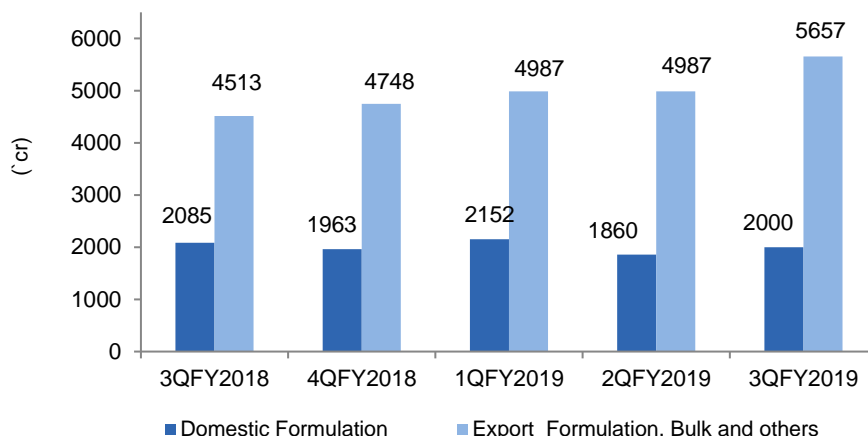
Sale of branded formulations in India for 3QFY2019 was `2,235cr, up by 7% and accounting for 29% of total sales. For the nine month, sales were at `6,247cr, up by 3% over same period last year. Sun Pharma is ranked No. 1 and holds approximately 8.2% market share in the over `129,000cr Indian pharmaceutical market as per AIOCD AWACS December-2018 report. For 3QFY2019, the company launched 20 new products in the Indian market.

Sales in emerging markets were at US\$203mn for 3QFY2019; up 7% over same quarter last year and accounted for 19% of total sales. For the nine month, sales were at US\$594mn, up by 8% yoy over the nine-month period last year. Formulation sales in Rest of World (ROW) markets excluding US & Emerging Markets were US\$125mn in 3QFY2019, a growth of 4% over 3QFY2018 &

accounting for approximately 12% of revenues. For the nine month, sales were US\$340mn, down 2% over nine-month last year.

API business imparts benefits of vertical integration for our formulations business. We continue to increase the API supply for captive consumption for key products. For Q3FY19, external sales of API were at `426cr, up by 15% over 3QFY2018. For the nine month, API sales were at `1,247cr, up by 17% over nine-month in FY2018.

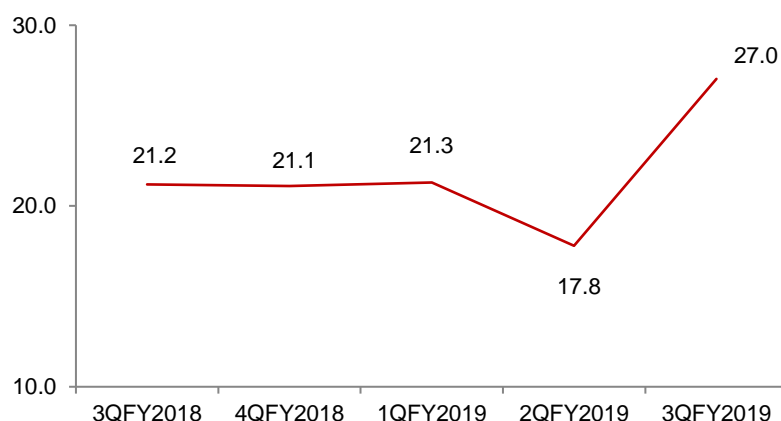
Exhibit 2: Sales trend



Source: Company, Angel Research

OPM at 27.0%, qoq higher than 17.8% in 2QFY2018: On the OPM front, the gross margins came in at 71.7% v/s. 68.2% in 3QFY2018, which lead the EBDITA margins to come in at 27.0% v/s. 21.2% in 3QFY2018. This mainly came in on back of gross margin expansion (which improved on back of improved product mix) along with a 2.1% yoy dip in the SG&A expenses. Consolidated R&D expense for 3QFY2019 was ` 465cr, or 6.1% of sales compared to `473cr or 7.2% of sales for 3QFY2018. For the nine month, R&D expense was `1,417cr' or 6.5% of sales.

Exhibit 3: OPM trend (percentage)

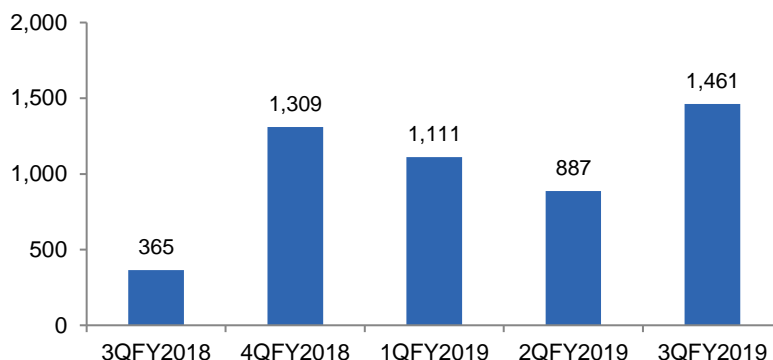


Source: Company, Angel Research,

Net profit slightly better on back of low taxes: OPM expansion aided along with a 63.8% yoy dip in tax expenses led the Adj. net profit to come in at `1,461cr

v/s. ₹364cr in 3QFY2018, a yoy growth of 300.9%. In addition, there was a 50.1% yoy rise in other income.

Exhibit 4: Adjusted Net profit trend (₹ cr)



Source: Company, Angel Research

Concall Takeaways

- Sun pharma is in the process of transitioning distribution from Aditya Medisales to wholly owned subsidiary.
- On the Atlas transaction, the company has provided loan of US\$300mn to Sun Pharmaceuticals in FY2018 as per supply contract terms and conditions, since the company was unable to fulfill the supply obligation due to GMP issues at Halol. On the loan of US\$300mn, Sun Pharmaceuticals, guided that it will unwind the transaction, which will result in assignment of supply contract to one of wholly owned subsidiary and Atlas moving out of the transaction. Hence, on a consolidated basis in FY2019, US\$300mn loan will be squared off against unfulfilled supply obligation.
- In the domestic business, covered market of Sun Pharmaceuticals is growing at ~11% yoy.

Investment arguments

Strong ANDA pipeline; with specialty products to gain strength: Sun Pharma, in terms of ANDAs, cumulatively has 441 products, out of which 123 products now await USFDA approval, including 15 tentative approvals. With the merger of Ranbaxy Laboratories, the company is now the fifth-largest specialty generics company in the world (behind Teva, Sandoz, Actavis and Mylan). Apart from the generic product portfolio, the company is also developing specialty product portfolio. During FY2018, the specialty product business grossed sales of ~US\$300mn constituting around 24-25% of US sales. Currently only Absorica drives the sales and DUSA acquired products.

Going forward, the sales will be driven by products acquired or in-licensed by the company; namely- Ilumya, Cequa, Yonsa, & Xelpros. These products will drive growth of the US sales of the company mainly from FY2020-21E. Overall, we expect the region to post a CAGR of 14.0% in sales over FY2018-21E, accounting for almost ~35% of the overall sales in FY2021E.

Domestic business: Sun Pharma's domestic formulation business is among the fastest growing in the Indian pharmaceutical industry. It contributed 23% to the company's total turnover in FY2014. Sun Pharma, with Ranbaxy Laboratories' merger, is now the segment leader with a market share of 8.3% in the domestic formulation market, followed by Abbott India, which has a market share of 6.3%. This is a significant gap considering that the segment is highly fragmented.

In addition, the company is market leader in the chronic segments and has a well-diversified product basket. Top 10 Brands contribute ~17% of India revenues. Thus, growth is driven by a basket of brands, a very low product concentration. In addition, the company has the highest field productivity of around `0.86cr/MR V/s 0.52cr/ MR – which is the industry average. Overall, we expect the domestic formulation business to post a CAGR of 12.3% over FY2018-21E, contributing ~30% to the overall formulation sales of the company in FY2021.

Healthy balance sheet: Sun Pharma has one of the strongest balance sheets in the sector with cash of ~`10,000cr. The same can continue to support the Management in inorganic growth and in scouting for acquisitions, especially in the US and in emerging markets.

Corporate governance issues weighing on the company: During 3QFY2019, various issues related to corporate governances, which mainly were financial in nature like third party loans, increasing contingent liabilities related to taxes on balance sheet amongst others. Over, this quarter the company has committed to clean up the issues two of which prominent are its arrangement with Aditya Medisales, which was used to distribute the products of the company and with effect from 1QFY2020, will become its wholly owned subsidiary). The other one is unwinding the US\$345mn loan given to Atlas Global Trading by Sun Pharmaceuticals against the supply obligation that Sun has on its balance sheet as liability. The loan was given to Atlas in lieu of Sun Pharma's inability to supply certain products due to Halol warning letter. This unwinding will be concluded in FY2019 itself. While company has clarified these two issues, we still are not convinced, as there are other issues, which will weigh on its corporate governance; some of which are still unanswered.

Outlook and valuation: Sun Pharma is expected to post net sales CAGR of 12.1%, while EPS will post a CAGR of ~27% during FY2018–21E. The growth would be mainly driven by improved product mix. **However, given the concerns on corporate governance and risk-reward, we remain Neutral. Also, current valuations capture the best-case scenario for the company.**

Company background

Sun Pharma is an international specialty pharma company, with a large presence in the US and India, and a footprint across other markets. In India and rest of the world markets, the key chronic therapy areas for the company are cardiology, psychiatry, neurology, gastroenterology, diabetology, etc. The company is a market leader in specialty therapy areas in India. In India, the company has emerged as a leading pharma company, where it is the first leading player. In addition, in the US, a key geography, the company has expanded significantly through both in-organic and organic routes.

Profit & Loss statement (Consolidated)

Y/E March (` cr)	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Gross sales	31,850	26,746	29,010	33,251	37,707
Less: Excise duty	272	257	285	322	367
Net sales	31,578	26,489	28,725	32,929	37,340
Other operating income	160	132	132	132	132
Total operating income	31,739	26,622	28,857	33,061	37,472
% chg	10.6	(16.1)	8.4	14.6	13.3
Total expenditure	21,489	21,832	22,132	24,859	28,275
Net raw materials	8,131	7,425	7,756	8,232	8,588
Other mfg costs	1,380	1,157	1,255	1,439	1,631
Personnel	4,902	5,367	5,796	6,956	8,347
Other	7,076	7,883	7,287	8,517	9,654
EBITDA	10,089	4,658	6,593	8,070	9,065
(% of Net Sales)	31.9	17.6	23.0	24.5	24.3
Depreciation & amort.	1,265	1,500	1,764	1,880	1,996
EBIT	8,985	3,290	4,961	6,322	7,202
% chg	(19.9)	(63.4)	50.8	27.4	13.9
(% of Net Sales)	28.5	12.4	17.3	19.2	19.3
Interest & other charges	400	518	612	600	600
Other income	463	707	1,201	1,306	1,554
(% of PBT)	5.1	20.3	21.6	18.6	19.1
Share in profit of Asso.	-	-	-	-	-
Recurring PBT	9,048	3,479	5,551	7,028	8,156
% chg	-18.0	0.0	0.0	0.0	0.0
Extraordinary expense/(inc.)	-	(720)	1,214	-	1.0
PBT (reported)	9,048	3,479	4,337	7,028	8,155
Tax	1,211.6	845.2	867.3	1,405.7	1,630.9
(% of PBT)	13.4	24.3	20.0	20.0	20.0
PAT (reported)	7,836	2,634	3,469	5,623	6,524
Add: Share of earnings of asso.	10	(25)	(25)	(25)	(24)
Less: Minority interest (MI)	882	447	678	678	678
Prior period items	-	-	-	-	-
PAT after MI (reported)	6,964	2,162	2,766	4,919	5,821
ADJ. PAT	6,932	2,879	3,737	4,919	5,821
% chg	46.2	(69.0)	27.9	77.9	18.3
(% of Net Sales)	1.0	2.0	3.0	4.0	5.0
Basic EPS (`)	28.9	12.0	15.6	20.5	24.3
Fully Diluted EPS (`)	28.9	12.0	15.6	20.5	24.3
% chg	26.2	(58.5)	29.8	31.6	18.3

Balance Sheet (Consolidated)

Y/E March (` cr)	FY2017	FY2018	FY2019E	FY2020E	FY2021E
SOURCES OF FUNDS					
Equity share capital	240	240	240	240	240
Preference capital					
Reserves & surplus	36,400	37,861	39,504	43,300	47,998
Shareholders' funds	36,640	38,101	39,744	43,540	48,238
Minority interest	3,791	3,884	4,562	5,240	5,918
Total loans	9,832	10,385	10,000	10,000	10,000
Deferred tax liability	(2,178)	(1,975)	(1,975)	(1,975)	(1,975)
Other Long Term Liabilities	-	-	-	-	-
Long Term Provisions	1,342	463	443	497	565
Total liabilities	49,426	50,858	52,774	57,303	62,747
APPLICATION OF FUNDS					
Gross block	13,399	14,876	16,876	18,876	20,876
Less: Acc. depreciation	6,791	8,096	9,860	11,740	13,736
Net block	6,608	6,780	7,016	7,136	7,140
Capital work-in-progress	2,801	2,465	2,465	2,465	2,465
Goodwill	5,537	5,607	5,607	5,607	5,607
Investments	5,531	6,466	6,466	6,466	6,466
Long term long & adv.	1,192	7,143	7,507	7,417	7,713
Current assets	4,526	6,103	6,375	6,767	7,059
Cash	32,723	27,545	28,743	34,256	40,869
Loans & advances	15,141	9,929	9,731	12,662	16,610
Other	2,480	2,265	2,366	2,511	2,620
Current liabilities	15,102	15,351	16,647	19,083	21,639
Net current assets	9,491	11,251	11,406	12,811	14,572
Others	23,231	16,294	17,338	21,445	26,297
Total assets	49,426	50,858	52,774	57,303	62,747

Cash Flow Statement (Consolidated)

Y/E March (` cr)	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Profit before tax	9,048	3,479	5,551	7,028	8,156
Depreciation	1,265	1,500	1,764	1,880	1,996
(Inc.)/Dec in working capital	(1,600)	(12,467)	(2,417)	(2,933)	(4,279)
Direct taxes paid	1,212	845	867	1,406	1,631
Cash Flow from Operations	7,502	(8,333)	4,030	4,570	4,242
(Inc.)/Dec.in Fixed Assets	(80)	(1,141)	(2,000)	(2,000)	(2,000)
(Inc.)/Dec. in Investments	1,524	(5,951)	(364)	90	(296)
Other income	-	-	-	-	-
Cash Flow from Investing	1,444	(7,092)	(2,364)	(1,910)	(2,296)
Issue of Equity	-	-	-	-	-
Inc./(Dec.) in loans	(2,214)	(1,433)	365	55	68
Dividend Paid (Incl. Tax)	(1,123)	(1,123)	(1,123)	(1,123)	(1,123)
Others	(3,650)	12,770	(1,106)	1,339	3,057
Cash Flow from Financing	(6,986)	10,215	(1,864)	271	2,002
Inc./(Dec.) in Cash	1,959	(5,211)	(198)	2,931	3,948
Opening Cash balances	13,182	15,141	9,929	9,731	12,662
Closing Cash balances	15,141	9,929	9,731	12,662	16,610

Key Ratios

Y/E March	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Valuation Ratio (x)					
P/E (on FDEPS)	14.8	35.7	27.5	20.9	17.6
P/CEPS	12.5	28.1	22.7	15.1	13.1
P/BV	2.8	2.7	2.6	2.4	2.1
Dividend yield (%)	0.8	0.5	0.5	0.5	0.5
EV/Sales	3.1	3.6	3.3	2.8	2.4
EV/EBITDA	9.7	20.7	14.6	11.5	9.8
EV / Total Assets	2.0	1.9	1.8	1.6	1.4
Per Share Data (₹)					
EPS (Basic)	28.9	12.0	15.6	20.5	24.3
EPS (fully diluted)	28.9	12.0	15.6	20.5	24.3
Cash EPS	34.3	15.3	18.9	28.3	32.6
DPS	3.5	2.0	2.0	2.0	2.0
Book Value	152.3	158.4	165.2	181.0	200.5
DuPont Analysis					
EBIT margin	28.5	12.4	17.3	19.2	19.3
Tax retention ratio	86.6	75.7	80.0	80.0	80.0
Asset turnover (x)	1.0	0.7	0.7	0.8	0.8
ROIC (Post-tax)	25.7	6.7	9.5	11.6	12.7
Cost of Debt (Post Tax)	3.7	7.5	5.3	4.8	4.7
Leverage (x)	0.0	0.0	0.0	0.0	0.0
Operating ROE	25.7	7.9	9.5	11.6	12.7
Returns (%)					
ROCE (Pre-tax)	18.6	6.6	9.6	11.5	12.0
Angel ROIC (Pre-tax)	40.1	11.2	14.6	17.7	19.3
ROE	22.4	8.8	10.3	12.3	13.5
Turnover ratios (x)					
Asset Turnover (Gross Block)	2.3	1.9	1.8	1.8	1.9
Inventory / Sales (days)	76	94	91	95	100
Receivables (days)	68	96	91	95	100
Payables (days)	74	95	94	94	94
WC cycle (ex-cash) (days)	96	44	101	93	78
Solvency ratios (x)					
Net debt to equity	(0.1)	0.0	0.0	(0.1)	(0.1)
Net debt to EBITDA	(0.5)	0.1	0.0	(0.3)	(0.7)
Interest Coverage (EBIT/Int.)	-	-	-	-	-

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2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

*Accumulate (5% to 15%)
Reduce (-5% to -15%)*

*Neutral (-5 to 5%)
Sell (< -15)*