

Sun Pharmaceuticals Industries Ltd. - Investor's Delight

13th June, 2013

Temporary aberrations may have some effect but premium deserved owing to strong parentage, product profile, R&D capabilities and market leadership...Expect bounce back!

Industry	Pharmaceuticals
BSE Code	524715
NSE Code	SUNPHARMA
Bloomberg Code	SUNP:IN
Beta of stock	0.66
FV	Re. 1
Equity Capital (Rs in mn)	1035.6
Networth	Rs. 141 bn
Market Capitalization	Rs. 983 bn
FY13 EPS (Consolidated)	Rs. 29
52 Week High/Low	Rs. 575.5 (12 th June, 2012) /Rs. 1084.8 (30 th May, 2013)
Book Value as on Mar 2013	Rs. 136
CMP	Rs. 949
Target Price	Rs. 1,150
Upside	21%
Annexure attached	Shareholding Pattern

Background

Sun Pharma is an international, integrated, speciality pharmaceutical company with brands and branded generics in US, India and over forty markets across the world. A comprehensive product offering with technology-based differentiation are a highlight of the portfolio. Sun Pharma is the largest specialty pharmaceutical company in India with established brands across niche therapies such as psychiatry, neurology, cardiology, nephrology, gastroenterology, orthopedics and ophthalmology. In the United States of America, Sun Pharma is an integrated generic drugs company with several complex products approved for sale. Sun Pharma's API (Active Pharmaceutical Ingredients) program began in 1995 to facilitate the manufacture of complex formulations and products for which complete vertical integration would help the business. APIs are currently manufactured at nine plants, including locations in Hungary, US and Israel. Technical capabilities and dedicated sites to make complex API such as anticancers, peptides, sex hormones and controlled substances are an important feature of our API business. Starting with 2 actives in 1995, the API list has since expanded to over 200, and this includes a number of APIs with regulated market approvals such as US and European drug master files (DMFs). Every year it scales up about 25 APIs, and make a large number of filings based on the technology it develops at its research centre. A range of APIs including complex actives like anticancer, steroids, peptides and hormones are manufactured in dedicated areas that follow international norms for systems and processes. It's API products include Acamprosate Calcium, Alendronate Sodium, Amifostine trihydrate, Budenonide and Carvedilol. In September 2010, it acquired Taro Pharmaceutical Industries Ltd.

The company's research commitment usually is between 7-8% of revenue and more than Rs. 20 billion has been spent for generic research since 1993. Every year, Sun typically brings about 30 new products to the Indian market, scales up 25 API including drug master files for US and Europe and develops and files for more than 30 ANDAs for the US. As of June 2012, 266 products have been approved by the USFDA for sale in the United States and 135 filings await approval. Sun Pharma, along with its subsidiaries, has four state-of-the-art R&D centers across the world with more than 800 scientists employed. The company continues to be ranked no. 1 based on share of prescriptions with 7 classes of specialists: psychiatrists, neurologists, cardiologists, ophthalmologists, orthopedicians, nephrologists and gastroenterologists.

Temporary Aberration: Key development on 13th June, 2013

Sun Pharma shares closed 3 percent lower at Rs 949.45, but way above their intra-day low of Rs 916, after the company had to settle its patent case with Pfizer related to the acid-reflux drug Protonix (pantoprazole), for USD 550 million, which is much higher than the amount it had earlier set aside for a sum higher than what it had provided. **Sun Pharma had set aside USD 107 million, last financial year towards potential damages to Pfizer. Now it is suddenly saying it will pay about USD 450 million more to settle the case.** 60 percent of Sun Pharma's USD 1.3 billion in cash is with its subsidiaries Taro and Caraco, which can't be used. Consequently, Sun would be forced to pay the settlement amount through its own pockets and that will leave little or no cash for acquisitions in the near future.

In 2005, Wyeth (now a division of Pfizer) and Altana Pharma (now Takeda GmbH) had filed a patent infringement suit against Sun Pharma after it filed its ANDA (abbreviated new drug application) for pantoprazole. Sun Pharma launched the drug in 2008, but in 2010, a jury held Altana's patent as valid. Under the terms of the settlement, the parties have dismissed all the claims and Sun Pharma will pay a lump-sum USD 550 million as a part of the agreement. The settlement amount is even higher than the USD 300 million. Sun Pharma's payout is about 42 percent of Sun Pharma's consolidated cash balance and the incremental liability of USD 440 million is 17 percent of the company's net worth as of March 2013. The outflow would happen in FY14 and will be a significant dent to Sun Pharma's cash balance (66 percent of consolidated and 40 percent of standalone cash). The cash outflow will be from the high yielding standalone cash, thus impacting Sun of robust other income which will reduce by Rs 300 crore.

Highlights of Q4 FY13 consolidated financials

- 1) Net sales / Income from operations at Rs. 3,071 crores, a growth of 32% over same quarter last year.
- 2) Branded generic sales in India were at Rs. 780 crores. Adjusted for the extra sales recorded in the Q4FY12 as well as the change in treatment of expected sales returns and treatment of discounts, the underlying sales growth of the domestic formulation business is 16%.
- 3) US finished dosage sales at US\$ 330 million grew by 63% (in US\$ terms) over Q4 last year.
- 4) International formulation sales at US\$ 73 million grew by 13% (in US\$ terms) over same quarter last year
- 5) EBITDA at Rs. 1,260 crores grew by 32% YoY while sustaining EBITDA margin at 41%.
- 6) Net profit at Rs 1,011 crores witnessed a growth of 23% over Q4 last year; resulting margin of 33%

Highlights of FY13 consolidated financials

- 1) Net sales / income from operations at Rs 11,239 crores, a growth of 40% over previous year.
- 2) India branded generic sales were at Rs 2,966 crores. Adjusted for the extra sales recorded in the Q4FY12 as well as the change in treatment of expected sales returns and treatment of discounts, the underlying sales growth of the domestic formulation business is 19%.
- 3) US finished dosage sales at US\$ 1,132 million grew by 56% (in US\$ terms) over previous year.
- 4) International formulation sales at US\$ 281 million grew by 21% (in US\$ terms) over the same period last year.
- 5) EBITDA at Rs. 4,906 crores grew by 51% YoY; resulting EBITDA margin of 44%, compared to 41% for previous year.
- 6) Recurring Net profit at Rs 3,591 crores witnessed a growth of 39% over previous year; resulting margin of 32%.
- 7) In Q2FY13, the company had made a provision of Rs.584 crores towards potential damages in respect of patent infringement litigation related to generic Protonix. After considering this provision, net profit for FY13 was at Rs 3,008 crores, registering a growth of 16% over corresponding period last year.

India Branded Generics –Chronic Therapy Leadership

Sale of branded prescription formulations in India was Rs. 780 crores for the fourth quarter, accounting for 25% of total sales. For FY13, sales were at Rs 2,966 crores accounting for 26% of total sales. **Sun Pharma is ranked 3rd and holds 4.9% market share in the Rs.70,000 crores pharmaceutical market, as per March-2013 AIOCD-AWACS report. Based on SMSRC data for Feb-2013, the company continues to be ranked no. 1 based on share of prescriptions with 7 classes of specialists: psychiatrists, neurologists, cardiologists, ophthalmologists, orthopedicians, nephrologists and gastroenterologists. 3 products were launched during the quarter taking the total to 25 for FY13.**

US Formulations: Strong performance, DUSA & URL Acquisitions to further strengthen US presence

Sales in the US were US\$ 330 million for Q4FY13, up by 63%, accounting for 57% of total sales. This quarter is the first quarter of full consolidation of the DUSA acquisition, while the URL acquisition was consolidated for part of the quarter. For FY13, US sales were US\$ 1,132 million recording a growth of 56%.

Taro recently posted Q4 FY13 sales of US\$ 165 million, up 14% from the corresponding quarter last year. For FY13, Taro's sales were US\$ 671 million up 24%. Taro's Net profit for Q4 was US\$ 49 million and US\$ 266 million for FY13, post provision of US\$ 22

million and US\$ 33 million, respectively for settlements and loss contingencies. Both for the fourth quarter and FY13 volumes declined marginally.

During the quarter, the URL acquisition achieved financial closure. The non-Colcrys (Colchicine, USP) generic assets of URL Pharma are now owned and managed by the Company. With a portfolio of 107 products represented by over 230 ANDAs, it expands its US portfolio. In February-2013, the US FDA granted it the final approval for Doxorubicin HCl Liposomal injection. The development and successful commercialization of this product again reflects Sun Pharma's technological strengths.

Rest of World

Formulation sales in rest of the world (ROW) markets outside of India and US accounted for US\$ 73 million in Q4FY13 registering a growth of 13% (in US\$ terms). ROW sales for FY13 were US\$ 281 million, growing at 21% (in US\$ terms). Excluding ex-US Taro sales, underlying sales growth in US\$ terms for Sun Pharma business in these markets was 32% for FY13.

The company's management has guided 18 percent-20 percent topline growth at constant currency basis for FY14 which is achievable if Sun Pharma & Taro continues to launch niche products. Management has also guided for 25 ANDA filings in FY14.

Total capex, for FY14, is expected to be ~ Rs 800 crore. R&D expenditure for fourth quarter was Rs 203 crore at 6.6 percent of the sales, while for the full year it was Rs 676 crore or 6 percent of sales. For next year R&D expenses are expected to be around 6 percent to 8 percent of sales with expected tax rate ~ 18 percent to 20 percent.

The Company has recommended payment of dividend of Rs. 5 per equity share of Rs. 1/- each of the Company for the year ended March 31, 2013. In addition, it has recommended issue of bonus shares to existing shareholders in the ratio of 1:1 to the equity shareholders. The bonus issue is proposed on completion of 30 years and crossing the US\$ 2 billion revenue milestone.

Outlook and Valuation

We expect growth of 18 percent to 20 percent in FY14 on account of higher base and expect that some of the growth drivers in FY13 are not sustainable. At CMP of Rs. 949 stock is quoting at 23x and 21x FY14E and FY15E earnings which is a 15 percent premium to peers. Reduction in the cash balance could lead to some correction in PE multiples. However, we feel these are temporary aberrations may not dent its dominance in Pharma space. Based on historic median PE and due consideration to factors like **strong parentage, product profile, R&D capabilities, good FY13 results and market leadership**; we assign a **PE of 25x on FY15 estimated EPS to arrive at a target price of Rs. 1,150 for investors with a horizon of 9-12 months.**



Annexure

Shareholding Pattern

Category of Shareholder	Total No. of Shares	Total No. of Shares held in Dematerialized Form	Total Shareholding as a % of Total No. of Shares	
			As a % of (A+B)	As a % of (A+B+C)
(A) Shareholding of Promoter and Promoter Group				
(1) Indian				
Individuals / Hindu Undivided Family	152326100	152326100	14.71	14.71
Bodies Corporate	506512000	506512000	48.91	48.91
Any Others (Specify)	640100	640100	0.06	0.06
Trusts	640100	640100	0.06	0.06
Sub Total	659478200	659478200	63.68	63.68
(2) Foreign				
Total shareholding of Promoter and Promoter Group (A)	659478200	659478200	63.68	63.68
(B) Public Shareholding				
(1) Institutions				
Mutual Funds / UTI	13632085	12383985	1.32	1.32
Financial Institutions / Banks	21323553	21322133	2.06	2.06
Central Government / State Government(s)	203909	203909	0.02	0.02
Foreign Institutional Investors	234100940	234094940	22.61	22.61
Qualified Foreign Investor	18107	18107	0.00	0.00
Sub Total	269278594	268023074	26.00	26.00
(2) Non-Institutions				
Bodies Corporate	50697515	50594570	4.90	4.90
Individuals				
Individual shareholders holding nominal share capital up to Rs. 1 lakh	37121156	31232615	3.58	3.58
Individual shareholders holding nominal share capital in excess of Rs. 1 lakh	16529780	16529780	1.60	1.60

MEMBER : NSE → BSE → MCX-SX → OTCEI → MPSE → CDSL → MCX*

*Through Subsidiary Company

Any Others (Specify)	2476710	2402100	0.24	0.24
Non Resident Indians	773184	698574	0.07	0.07
Clearing Members	322777	322777	0.03	0.03
Trusts	734299	734299	0.07	0.07
Foreign Corporate Bodies	646450	646450	0.06	0.06
Sub Total	106825161	100759065	10.32	10.32
Total Public shareholding (B)	376103755	368782139	36.32	36.32
Total (A)+(B)	1035581955	1028260339	100.00	100.00
(C) Shares held by Custodians and against which Depository Receipts have been issued	0	0	0.00	0.00
(1) Promoter and Promoter Group	0	0	0.00	0.00
(2) Public	0	0	0.00	0.00
Sub Total	0	0	0.00	0.00
Total (A)+(B)+(C)	1035581955	1028260339	0.00	100.00

Shareholding of securities (including shares, warrants, convertible securities) of persons belonging to the category Public and holding more than 1% of the total number of shares

Sl. No.	Name of the Shareholder	No. of Shares held	Details of warrants			Details of convertible securities		Total shares (including underlying shares assuming full conversion of warrants and convertible securities) as a % of diluted share capital
			Shares as % of Total No. of Shares	Number of warrants held	As a % total number of warrants of the same class	Number of convertible securities held	% w.r.t total number of convertible securities of the same class	
1	Genesis Indian	26771113	2.59	0	0.00	0	0.00	2.59
2	Lakshdeep	11113000	1.07	0	0.00	0	0.00	1.07
	Total	37884113	3.66	0	0.00	0	0.00	3.66

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