

# Investment Ideas

Aug 12, 2010

## SUN PHARMACEUTICAL INDUSTRIES LIMITED

**HOLD**

**Sun Pharmaceutical Industries Limited (SPIL)** is one of India's leading pharma companies manufacturing and supplying formulation and bulk drugs both in the domestic and international markets. SPIL has a 3.7% market share in Indian Branded Generics with strong presence in key therapy areas like cardiology, psychiatry, neurology, gastroenterology, diabetology and respiratory.

- Pantocid, a proton pump inhibitor crossed Rs1000mn mark within the company. This is the first product to have crossed the mark for the company. Company has 4 to 5 products with revenues in the Rs500mn mark which are expected to cross the Rs 1000mn mark in the coming years.
- The company has discontinued the sales of Protonix (Heart Burn drug) during the 4QFY10 and has discontinued the sales of Eloxatin (cancer drug) from June 2010.
- US revenues continue to remain under pressure, however Caraco Pharmaceutical, a US generic subsidiary, has submitted work plan for remedial measures and is working on the transferring some of its owned products to alternative facilities so that revenues can be regained on those products. No timeline for USFDA approval is specified.
- For 1QFY11, SPIL posted net profit of Rs 5.64bn, up 244% Y-o-Y, on account of one time sales of generic drug of Eloxatin and lower base in the Indian formulation business. The net sales increased to Rs13.99bn from Rs7.87bn up 77.72% Y-o-Y.
- We expect SPIL's revenues to grow at a CAGR of 15.2% over FY2010-12 to Rs 54.44bn by FY2012. We further estimate that the PAT would grow at a CAGR of 17.6% over FY2010-12 to Rs 18.58bn in FY2012 from Rs 13.44bn in FY2010.

**Based on a consolidated FY12 P/E multiple of 22, the fair value for SPIL works out to 1974.**

### Financial Snapshot

| Projections (Rs Mn) | FY08A  | FY09A  | FY10A  | FY11E  | FY12E  |
|---------------------|--------|--------|--------|--------|--------|
| Revenue             | 33,603 | 42,795 | 41,028 | 48,277 | 54,447 |
| Y-o-Y Growth %      | 57.6%  | 27.4%  | -4.1%  | 17.7%  | 12.8%  |
| EBIDTA              | 17,051 | 20,784 | 15,682 | 18,546 | 21,236 |
| Y-o-Y Growth %      | 83.8%  | 21.9%  | -24.5% | 18.3%  | 14.5%  |
| PAT After MI        | 14,869 | 18,177 | 13,447 | 16,161 | 18,587 |
| Y-o-Y Growth %      | 89.6%  | 22.2%  | -26.0% | 20.2%  | 15.0%  |
| EPS Rs              | 70.0   | 85.4   | 64.9   | 78.0   | 89.7   |
| BVPS Rs             | 241.0  | 340.1  | 391.3  | 455.4  | 529.3  |
| EBIDTA %            | 50.7%  | 48.6%  | 38.2%  | 38.4%  | 39.0%  |
| NPM %               | 44.2%  | 42.5%  | 32.8%  | 33.5%  | 34.1%  |
| ROE %               | 29.0%  | 25.1%  | 16.6%  | 17.1%  | 17.0%  |
| PER x               |        |        |        | 22.4   | 19.5   |
| P/B Ratio           |        |        |        | 3.8    | 3.3    |

| Recommendations | <= 1 year | 1 - 2 yrs | 2 - 5 yrs |
|-----------------|-----------|-----------|-----------|
| Strong Buy      |           |           |           |
| Buy             |           |           |           |
| Hold            |           |           |           |
| Reduce          |           |           |           |
| Sell            |           |           |           |

**Strong Buy** – Expected Returns > 20% p.a.  
**Buy** – Expected Returns from 10 to 20% p.a.  
**Hold** – Expected Returns from 0% to 10% p.a.  
**Reduce** – Expected Returns from 0% to 10% p.a. with possible downside risk  
**Sell** – Returns < 0%



### STOCK DATA

|                    |                   |
|--------------------|-------------------|
| BSE / NSE Code     | 524715/ SUNPHARMA |
| Bloomberg Code     | SUNP IN EQUITY    |
| No. of Shares (Mn) | 207               |
| Sensex / Nifty     | 18,070/5,420.6    |

### PRICE DATA

|                       |              |
|-----------------------|--------------|
| CMP Rs (11th Aug' 10) | 1,746.4      |
| Beta                  | 0.36         |
| Market Cap (Rs mn)    | 361,704      |
| 52 Week High-low      | 1846/1122.25 |
| Average Daily Volume  | 25,663       |

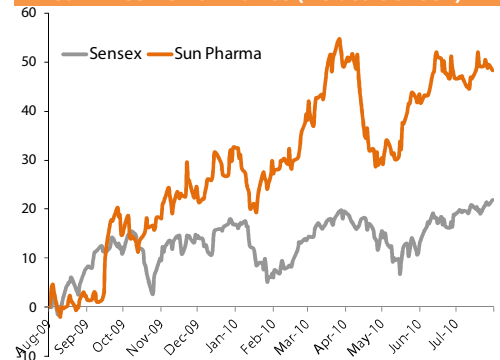
### STOCK RETURN (%)

|                     | 30D | 3M  | 6M  | 1Y  |
|---------------------|-----|-----|-----|-----|
| Sun Pharmaceuticals | 0%  | 13% | 15% | 45% |
| Sensex              | 1%  | 5%  | 12% | 20% |
| Nifty               | 1%  | 6%  | 12% | 21% |

### SHARE HOLDING PATTERN (%)

|                 |              |
|-----------------|--------------|
| Promoter        | 63.7         |
| Institution     | 25.5         |
| Non Institution | 10.8         |
| <b>Total</b>    | <b>100.0</b> |

### 1 Year Price Performance (Rel. to Sensex)



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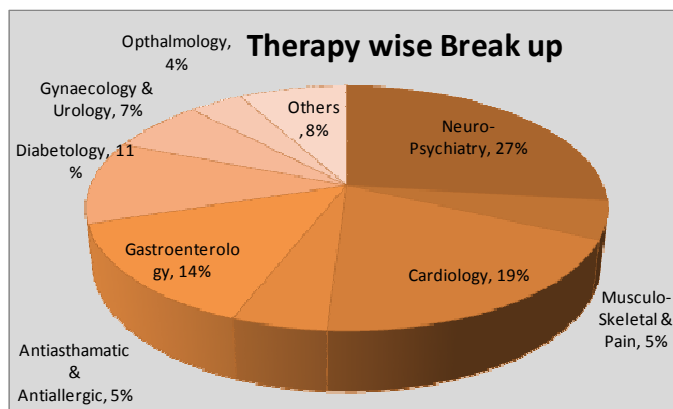
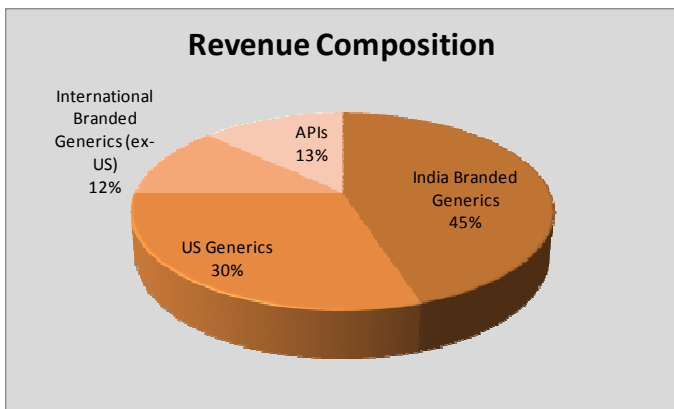


# Investment Ideas

## BUSINESS PROFILE

Sun Pharmaceutical Industries started its operations in 1983 selling products for psychiatric ailments. Post listing in 1994, the company set up its first active pharmaceutical ingredient (API) facility in Panoli and went on to become the largest integrated pharmaceutical manufacturers in India. It has 18 manufacturing facilities, five for API's, 10 for formulations and remaining 3 for both. The company is currently engaged in selling both formulations in India, emerging markets and the regulated markets especially in the U.S. through its subsidiary Caraco Pharmaceutical Labs Ltd. It has a strong sales field force of approximately 2500 in India and another 600 outside India. SPIL patent library consist of 245 patents including the 79 approvals. It has a strong product pipeline of 123 ANDA with 12 tentative approvals. SPIL has strong research teams in generic finished dosage development, biological support chemistry with a generic R&D spend of around 8% of net sales. It has two R & D centres in Baroda and Mumbai. It is virtually a zero debt company. With the acquisition of Chattem, the company is also foraying into controlled substances and has already received approval for two such products. The company has been successful in tapping the benefit of Para IV opportunities. SPIL has a very small exposure to the European countries and is not likely to face problems due to economic trouble in the Euro zone. In the Euro zone the company is mainly focused on complex generics and injectibles.

**The domestic business grew at a 24% CAGR. The US business grew at a CAGR of 33%.**



### Overhang on acquisition of Taro Pharmaceuticals

For Taro Pharmaceuticals, Sun Pharma is awaiting verdict from the Supreme Court of Israel, after getting a favorable verdict from the lower court of Israel and US court. The lower court has rejected Taro's request for discovery remarking that Taro had not explained any purpose that discovery could serve. Completion of Taro acquisition would be a positive for the company, as it would enhance its product portfolio and distribution network in the largest pharmaceutical market globally, the US. SPIL has received USFDA approval for generic version of Gemzar, Flomax, Optivar, Xanax, Keppra Injection, Namenda, Wellbutrin SR. For Namenda it was the first to file and has a 180 day's market exclusivity. These drugs present a market opportunity of USD 1480mn. SPIL can market the drugs Stalevo and Comtan from FY13. Sun Pharma has limited competition opportunity for the generic version of Stalevo, Gabitril, Exelon, Strattera and Gleevec.

**If Taro acquisition happens company would have to pay USD 40mn**

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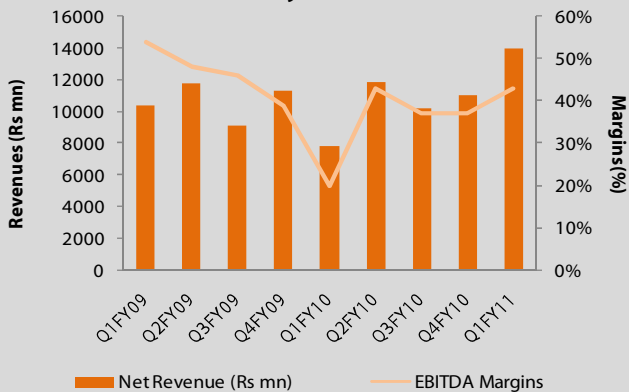
## BUSINESS PERFORMANCE

### Strong performance.....

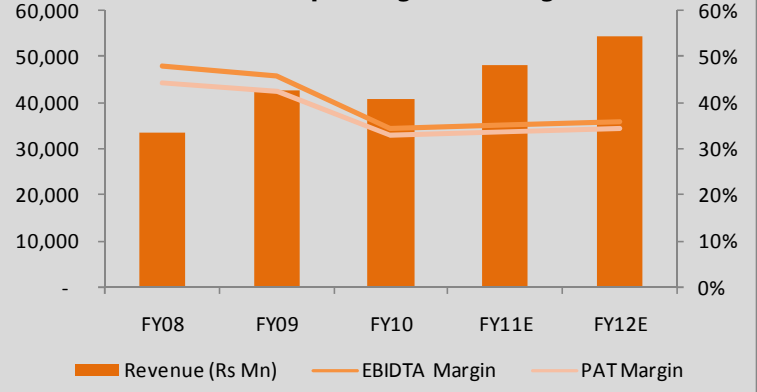
For the quarter ended June 2010, the net sales increased by whopping 78% to Rs 13.99bn on the back of one time sales from launch of Oxaliplatin in US market and lower base in the Indian formulation business. The operating profit margins increased by whopping 2770 bps to 44.0% during the quarter compared to 16.3% in the corresponding previous quarter. The interest income fell by 39% to Rs 203.2 mn and increase in the depreciation by 7% to Rs 402 mn restricted growth in PBT to 288% to Rs 5.87bn. Minority interest of Rs 133.1 mn further restricted growth in net profit to 244% to Rs 5.64bn. For the year ended March 2010 declined by 4% to Rs 41.03bn due to higher base on time sales in Q4 FY'09 and due to change in distribution system and no revenues from Caraco manufactured products. The net profit declined by 26% to Rs 13.51bn.

**The company has one of the strongest balance sheets in the sector with cash of 40bn.**

### Quarterly Performance



### Revenue, Operating & PAT Margin



### Peer Group Comparison

| Companies           | Revenue (Rs. mn) | EBIDTA Margin (%) | PAT Margin (%) | ROE (%) | P/E (x) | P/B (x) | CMP (Rs.) | FV (Rs.) |
|---------------------|------------------|-------------------|----------------|---------|---------|---------|-----------|----------|
| Sun Pharmaceuticals | 41028            | 38%               | 33%            | 17%     | 26.8    | 4.5     | 1746      | 5.0      |
| Cipla               | 53595            | 29%               | 20%            | 19%     | 22.9    | 4.3     | 314       | 2.0      |
| Dr. Reddy Labs      | 70312            | 15%               | 5%             | 9%      | 63.1    | 5.9     | 1315      | 5.0      |
| Lupin               | 47405            | 21%               | 14%            | 35%     | 23.2    | 8.2     | 1834      | 10.0     |

\* FY10 consolidated figures

### Peer Comparison

SPII operates at robust PAT and EBITDA margins compared to its peers. Going forward we expect the company to maintain its margins. The company will report better revenues on the completion of Taro acquisition and clearing the FDA issues with its US subsidiary.

**SPII is expected to perform better on the back of a strong ANDA pipeline.**

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# Investment Ideas

## VALUATION

We expect SPIL's revenues to grow at a CAGR of 15.2% over FY2010-12 to Rs 54.44bn by FY2012. We further estimate that the PAT would grow at a CAGR of 17.6% over FY2010-12 to Rs 18.58bn in FY2012 from Rs 13.44bn in FY2010.

**Based on a consolidated FY12 P/E multiple of 22, the fair value for SPIL works out to 1974**

**Based on a consolidated FY12 P/E multiple of 22, the fair value for SPIL works out to 1974.**

We recommend the stock as a **'BUY'**.

| Financial Analysis and Projections |        |        |        |              |              |
|------------------------------------|--------|--------|--------|--------------|--------------|
| Particulars (Rs Mn)                | FY08A  | FY09A  | FY10A  | FY11E        | FY12E        |
| Net Revenue                        | 33,603 | 42,795 | 41,028 | 48,277       | 54,447       |
| Other Income                       | 1,539  | 2,144  | 2,053  | 2,421        | 2,730        |
| Total Income                       | 35,143 | 44,940 | 43,081 | 50,698       | 57,177       |
| Operating Expenditure              | 18,092 | 24,156 | 27,400 | 32,153       | 35,941       |
| Depreciation                       | 969    | 1,233  | 1,533  | 1,548        | 1,626        |
| EBIT                               | 16,082 | 19,551 | 14,148 | 16,997       | 19,610       |
| EBIT Margin (%)                    | 47.9%  | 45.7%  | 34.5%  | 35.2%        | 36.0%        |
| Interest                           | 88     | 59     | 64     | 74           | 85           |
| Profit Before Tax                  | 15,994 | 19,492 | 14,084 | 16,923       | 19,525       |
| Less: Tax                          | 485    | 712    | 679    | 717          | 884          |
| Profit After Tax                   | 15,509 | 18,780 | 13,406 | 16,207       | 18,641       |
| Minority Interest                  | 640    | 603    | -41    | 46           | 54           |
| PAT After MI                       | 14,869 | 18,177 | 13,447 | 16,161       | 18,587       |
| PAT Margin (%)                     | 44.2%  | 42.5%  | 32.8%  | 33.5%        | 34.1%        |
| ROE (%)                            | 29.0%  | 25.1%  | 16.6%  | 17.1%        | 17.0%        |
| EPS (Rs)                           | 70.0   | 85.4   | 64.9   | 78.0         | 89.7         |
| BVPS (Rs)                          | 241.0  | 340.1  | 391.3  | 455.4        | 529.3        |
| <b>Valuation Ratios (x)</b>        |        |        |        | <b>FY11E</b> | <b>FY12E</b> |
| P/E                                |        |        |        | 22.4         | 19.5         |
| P/B                                |        |        |        | 3.8          | 3.3          |

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# Investment Ideas

## Board of Directors

| Director Name        | Current Position                   | Description   |
|----------------------|------------------------------------|---|
| Dilip S. Shanghvi    | Chairman and Managing Director     | Dilip S. Shanghvi is currently the Chairman and Managing Director of Sun Pharmaceutical. He is a graduate in commerce from Kolkata University. He founded the company in 1982 and has extensive industrial experience in the pharmaceutical industry. Mr. Shanghvi is actively involved in international pharmaceutical markets and research and development functions of the company and is also the Chairman of its primary subsidiary, Caraco, in Detroit, U.S.A.  |
| Sudhir V. Valia      | Executive Director                 | Sudhir V. Valia is currently serving as the Executive Director of the company. He is a fellow Member of Institute of Chartered Accountants of India and carries more than two decades of taxation and finance experience. He joined the company in 1994, prior to which he was in private taxation practice. In addition to being on the Board of Directors of a number of companies of the group, he is also on the Board of Directors of Caraco.  |
| Sailesh T. Desai     | Executive Director                 | Sailesh T. Desai is currently serving as the Executive Director of the company. He is a science graduate from Kolkata University, with more than 28 years of industrial experience, 18 of which have been in the pharmaceutical industry. Mr. Desai has had comprehensive corporate affairs experience, being involved in the turnaround at Milmet prior to the acquisition of it, as well as in the early stages of the company's growth.  |
| S. Kalyanasundaram   | Additional Director                | S. Kalyanasundaram is an additional director of the company. He is a BSc, ACA and carries almost three decades of regional/ global experience much of which has been in pharmaceuticals, largely with Glaxosmithkline, where he has held both Country, Regional and global responsibilities. As the Managing Director, GSK India, he led the GSK India turnaround; and in the regional role, he spearheaded the company's differentiated and region-specific emerging markets strategy. He also led the commencement of operations in certain emerging markets such as Vietnam, IndoChina, as well as the Wellcome New Zealand reorganization.  |
| Hasmukh S. Shah      | Non-Executive Independent Director | Hasmukh S. Shah is currently serving as an Independent Director. He has four decades of experience in senior management, and was formerly the Chairman and Managing Director of Indian Petrochemical Corporation Ltd, as well as the Vice Chairman of GE Capital and advisor to GE in India. He has had wide experience in various government departments, including as Joint Secretary to the Prime Minister, as Secretary, Post & Telegraph and as Chairman, National Institute of Design, as well as the Institute of Rural Management, Anand and the Gujarat Council of Science & Technology.   |
| Keki M. Mistry       | Non-Executive Independent Director | Keki M. Mistry is currently serving as an Independent Director. He is a Fellow Member of the Institute of Chartered Accountants of India and a Member of the Michigan Association of Certified Public Accountants, USA. He is the Managing Director of the Housing Development Finance Corporation Limited, widely considered to be India's leading housing finance company. He has worked as a consultant to the Commonwealth Development Corporation in various emerging markets as well as to the Asian Development Bank. He holds a number of directorships and is a member of the management committee of the Bombay Chamber of Commerce & Industry.   |
| Ashwin Dani          | Non-Executive Independent Director | Ashwin Dani is currently serving as an Independent Director. He is a science graduate from the Institute of Science, University of Mumbai and U.D.C.T., University of Mumbai. He also holds a Masters Degree in polymer science from University of Akron, Ohio, USA and Diploma in colour science from Rensselaer Polytechnic, Troy, New York. He is Vice Chairman and Managing Director of Asian Paints (India) Limited, one of India's leading paint companies. He also holds a number of directorships and has been nominated by the government as a Trustee on the Central Board of Trustees of the Employees Provident Fund. He is also a member of the executive committee of the Federation of Indian Chambers of Commerce and industry. |
| S. Mohandchand Dadha | Non-Executive Independent Director | S. Mohandchand Dadha is currently serving as an Independent Director. He has approximately four decades of experience in the pharmaceutical industry. Mr. Dadha was Managing Director and Promoter of Tamilnadu Dadha Pharmaceuticals Ltd, which merged with Sun Pharma in April 1997.  |

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