

October 11, 2013

BSE Code: 524715 NSE Code: SUNPHARMA Reuters Code: SUN.BO Bloomberg Code: SUNP:IN

Sun Pharmaceutical Industries Ltd (Sun Pharma) is an international, integrated, specialty pharmaceutical company with 70% of its revenues generated from US branded generics market and rest of the world. Sun Pharma is ranked 2nd and holds 5.1% market share in the ₹720 billion Indian pharmaceutical market. It is having 18 manufacturing sites worldwide with six in India, six in US, and also in Canada, Brazil, Mexico, Hungary, Israel, and Bangladesh

Investor's Rationale

Sun Pharma has witnessed robust growth of 31% YoY in terms of net sales on consolidated basis at ₹34.82 bn in Q1FY'14 on the account of strong domestic branded generic sales (accounting for 24% of total sales) up by 44% YoY at ₹8.49 bn. US finished dosages sale (accounting for 58% of total sales) in dollar terms rose 28% YoY to \$364 mn in Q1FY'14, while the international formulation sales grew 19% to \$81 mn. On the back of good growth in its US business coupled with incremental revenue from its acquisitions in FY'13, the company is expecting 18-20% YoY growth for FY'14E.

Recently, Sun Pharma launched the generic version of anti-diabetic brand Prandin. The company is well poised to benefit from this launch as the company is having six months of marketing exclusivity in the US that will help the company to sustain healthy growth in revenues and profits over the next two quarters. While in Q1FY14, the company has launched 10 products. With the expectation of 25 ANDAs filling in FY'14E, we believe healthy market share in existing products, recent products launched and pending ANDAs approval to augment revenue growth over FY13-F15E.

Sun Pharma has created strong international presence through strategic acquisitions overseas over the last few years. The recent US acquisitions — DUSA (get access to branded dermatology product in US) and URL Pharma (added 107 products to its US portfolio) helped revenue growth in the US. With an aim to grow business faster than its competitors, the company is looking to acquire makers of injectable and oral liquid medicines. We expect these acquisitions will further strengthen its presence in international market and profitability in the coming quarters.

With strong foothold in the domestic market, Sun Pharma has maintained the leadership position in the chronic segment and remains as the top 3 player in over 50% of more than 500 brands. Its top 10 brands contribute 20% of India sales. In order to gain further market share, the company continuously embark on increasing its sales force, currently having 4,000+ sales representatives covering 140,000 specialist doctors. We expect the domestic business to continue on its strong trajectory led by its strong operations in the chronic segment.

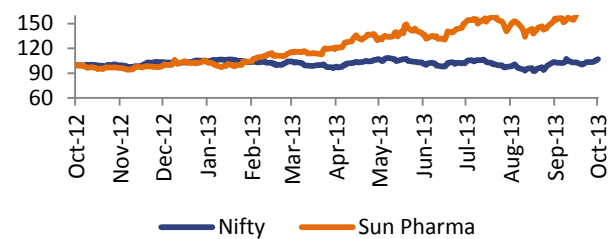
Market Data

Rating	BUY
CMP (₹)	625.7
Target (₹)	713
Potential Upside	~14%
Duration	Long Term
Face Value (₹)	1
52 week H/L (₹)	650/328
Adj. all time High (₹)	650
Decline from 52WH (%)	3.7
Rise from 52WL (%)	90.8
Beta	1.1
Mkt. Cap (₹bn)	1,295.8
Enterprise Value (bn)	1,272.2

Fiscal Year Ended

Y/E	FY12A	FY13A	FY14E	FY15E
Net Sales (₹bn)	80.2	113.0	142.4	163.7
Net Profit (₹bn)	26.6	29.8	24.7	48.9
Sh. Capital (₹bn)	1.0	1.0	2.0	2.0
EPS (₹)	25.7	28.8	11.9	23.6
PE (x)	24.3	21.7	52.6	26.5
P/BV (x)	5.3	4.3	7.7	6.5
ROE (%)	21.7	19.9	14.7	24.4
ROCE (%)	19.3	20.6	15.5	25.3

One year Price Chart



Shareholding Pattern	Aug'13	Jun'13	Diff.
Promoters	63.65	63.68	(0.03)
FII	22.89	22.76	0.13
DII	3.07	3.24	(0.17)
Others	63.65	63.68	(0.03)

Sun Pharma operates in four segments, namely, Indian Branded Generics, US Generics, International Branded Generics (ROW) and Active Pharmaceutical Ingredients (API).

Over 57% of Sun Pharma sales are from markets outside India, primarily in the US.

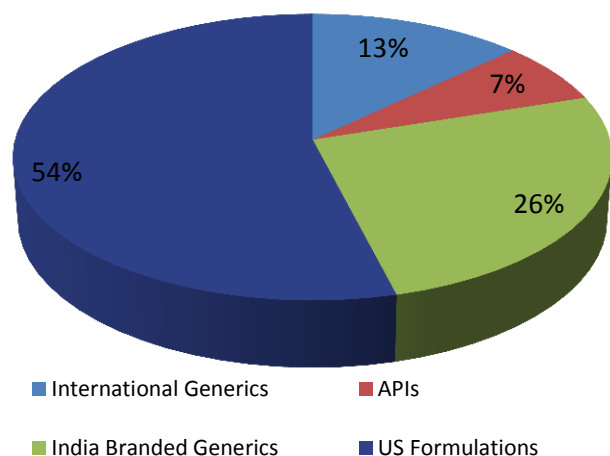
Sun Pharma - an international, integrated, specialty pharmaceutical company

Sun Pharma Industries Ltd, an Indian global pharmaceutical company engaged in manufacturing and marketing of pharmaceutical formulations such as branded generics, as well as generics in India, the United States and several other markets across the world. It operates primarily in four segments, namely, Indian Branded Generics, US Generics, International Branded Generics (ROW) and Active Pharmaceutical Ingredients (API). In India, the company is a leader in niche therapy areas of psychiatry, neurology, cardiology, nephrology, gastroenterology, orthopedics and ophthalmology. Some of the top brands of the company include pantocid, susten, aztor, gemer, repace, glucored, strocit, clopilet and cardivas. The company has strong skills in product development, process chemistry, and manufacturing of complex API, as well as dosage forms.

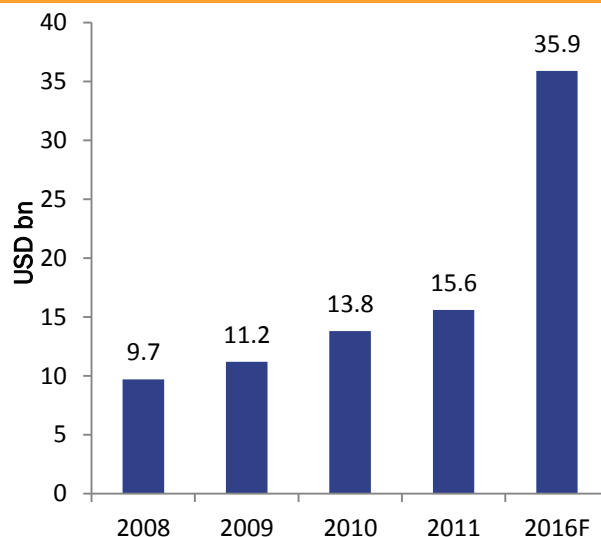
Sun Pharma's Indian formulation business has a strong foothold in the domestic market and has grown at a 23% CAGR, i.e, above the industry's average over FY'05-12. The company maintained the leadership position in the chronic segment and remains as the top 3 player in over 50% of more than 500 brands. Its top 10 brands contribute 20% of India sales. In order to gain further market share, the company continuously embark on increasing its sales force, currently having 4,000+ sales representatives covering 140,000 specialist doctors. Moving ahead, over 57% of Sun Pharma sales are from markets outside India, primarily in the US. The company has its manufacturing centres located across 23 locations, including the US, Canada, Brazil, Mexico and Israel. In the US, the company markets over 200 generics, with another 150 awaiting approval from the US Food and Drug Administration (USFDA).

During Q1FY'14, the company witnessed a robust performance as net sales of the drug maker grew 31% to ₹34.82 bn on the back of rise in branded generics sales in India, dosages sales and international formulation sales. All the businesses of the company continue to perform in line with its expectations. The company remained focused on strengthening its existing businesses and developing a differentiated and specialty driven product basket.

Revenue Composition in FY'13



Revenue of Indian pharmaceuticals industry is expected to reach USD 35.9 bn by 2016

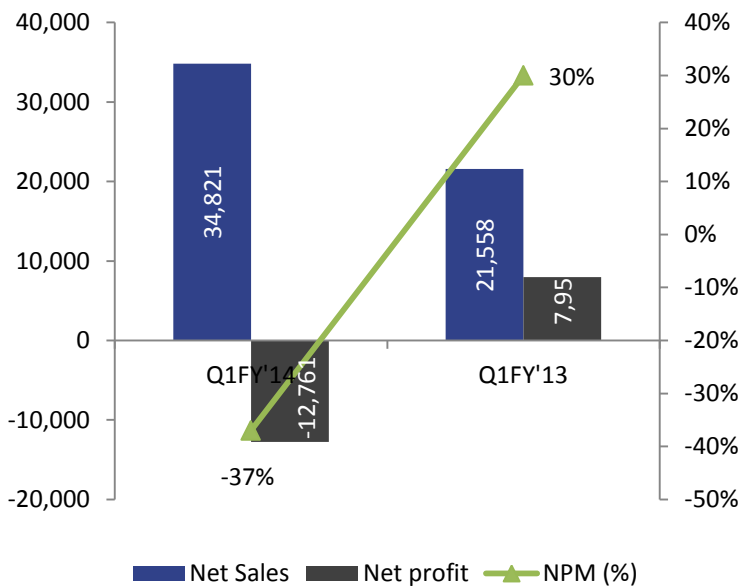


Net sales increased by 31% in Q1FY'14, on the back of strong growth across all the verticals.

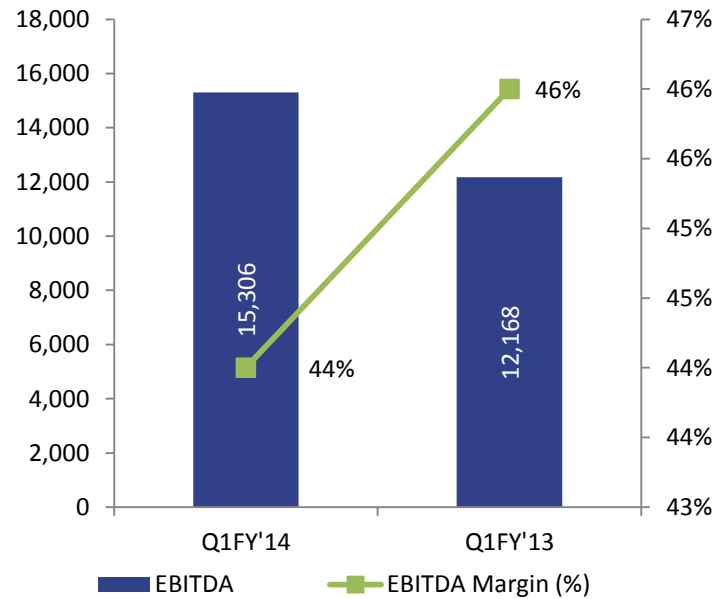
Posted mixed performance in Q1FY'14

Sun Pharma registered mixed performance in Q1FY'14 with 31% YoY growth in net sales/Income from operations at ₹34,821 mn driven by better performance of all its business verticals. Sales of branded prescription formulations in India rose 44% at ₹8.49 bn, accounting for 24% of total sales. Adjusted sales growth for the quarter was 11%. The sales in the US rose 28% at US\$ 364 mn for the quarter, accounting for 58% of total sales. Formulation sales in rest of the world (ROW) markets outside of India and US grew 19% to US\$ 81 mn in Q1FY'14. Excluding ex-US Taro sales, underlying sales growth in US\$ terms for Sun Pharma's

Robust sales to improve performance (in ₹mn)



Witnessed good traction in EBITDA (₹mn)



EBITDA during the quarter rose 26% YoY at ₹15,306 mn while EBITDA margins stood at 44%, compared to 46% in Q1 last year.

The company has guided for 18-20% YoY growth for FY'14 on the back of good growth in its US business coupled with incremental revenue from its acquisitions in FY'13.

business in these markets was 23% for Q1FY'14. EBITDA during the quarter rose 26% YoY at ₹15,306 mn while EBITDA margins stood at 44%, compared to 46% in Q1 last year. The company's consolidated R&D expenditure stood at ₹2.05 bn during which worked out 6% of sales. However, the company posted a consolidated net loss of ₹12,761 mn in Q1FY'14 on account of provision of ₹25.17 bn for settlement agreement with Pfizer Inc., Wyeth LLC and Nycomed GmbH with respect to patent infringement litigation related to generic versions of 'Protonix'.

The material cost as a percentage of the net sales during Q1FY'14 stood at 15%, lower than Q1 last year, mainly due to better product-mix, which the company expect to normalize during the year. Further, the staff costs as a percentage of the net sales rose to 15% from Q1 last year, primarily on account of consolidation of the DUSA and URL acquisitions. The other expenditure as a percentage of net sales also rose to 27%, mainly due to bunching of certain expenses in the quarter and is likely to normalize over the coming quarters. The tax rate during the quarter has been on the lower side compared to its initial assessment and the company expect the overall tax rate for FY'14 to be around 15%.

Besides, the company has launched 10 products during the quarter. Meanwhile, the company has guided for 18-20% YoY growth for FY'14, on the back of good growth in its US business coupled with incremental revenue from its acquisitions in FY'13.

Formulation sales in ROW markets outside of India and US rose 19% to US\$ 81 million in Q1FY14.

Indian formulation sales surged 44% YoY to ₹8.49 bn, during the quarter.

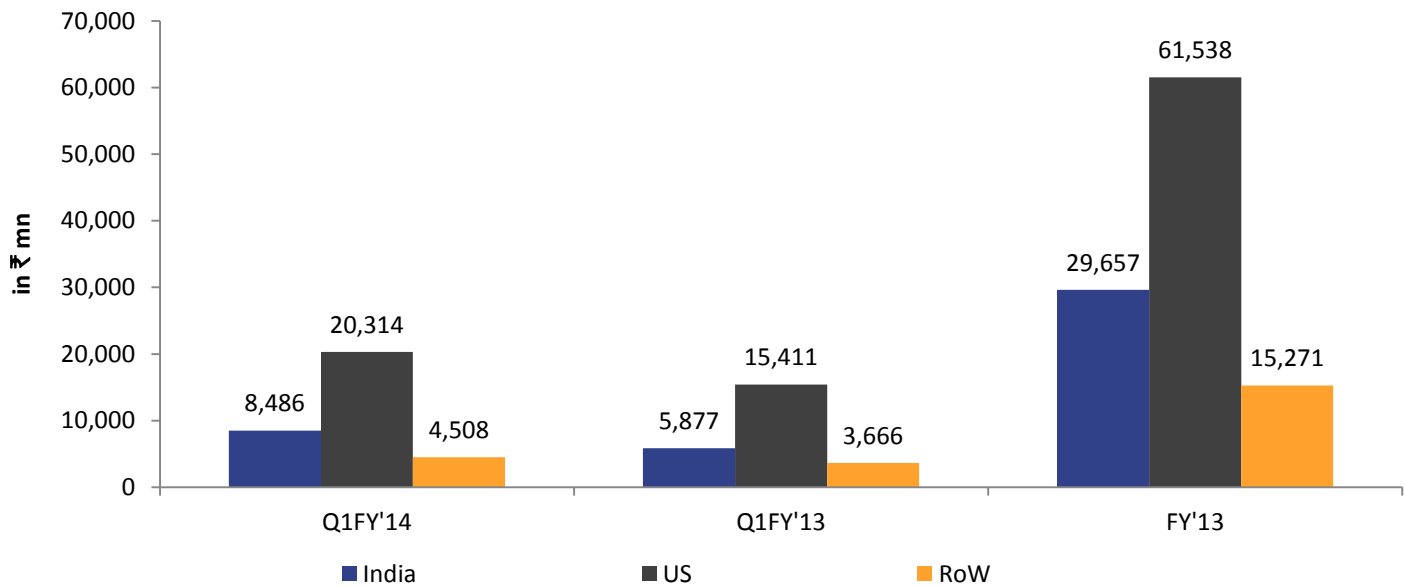
Vertical and Geography wise performance

US formulation business: US Formulations segment posted strong performance in Q1FY'14 led by Sun portfolio with the sales in the US, accounting for 58% of total sales, rose 28% at US\$ 364 mn and this includes revenue contribution from DUSA and URL which were not part of the company in Q1 last year. Taro registered a decline of 4% in overall sales at US\$ 153 million for Q1FY'14 as compared to the corresponding quarter last year and the decline is mainly due to charges taken to meet contractual obligations associated with price adjustments made in the quarter. However, the sales would have been higher by 10% if one-time charge related to price adjustments on contractual obligations is excluded. The net profit for Q1 was US\$ 59 mn.

Indian formulation business: India Formulations business posted strong performance with the sales for Q1FY14 surging 44% YoY to ₹8.49 bn on a low base despite the trade strike in the state of Maharashtra during the quarter and the suspension on sale of Pioglitazone formulations which has subsequently been withdrawn. The company launched 10 products during the quarter.

Rest of World: Sun Pharma witnessed remarkable performance from rest of the world (ROW) with the Formulation sales in ROW markets outside of India and US rose 19% to US\$ 81 mn in Q1FY'14. However, the sales growth would have been 23% for Q1FY'14 if ex-US Taro sales, underlying sales growth in US\$ terms for Sun Pharma's business in these markets is excluded.

Revenue from US continued to contribute the highest



Acquisitions in US to boost earnings visibility and strengthen company's presence in the region

Sun Pharma derives around 75% of revenue from international markets that reflects its strong international presence mainly created through strategic acquisitions overseas over the last few years. The recent US acquisitions — DUSA (get access to branded dermatology

Sun Pharma has recently acquired DUSA Pharmaceuticals and this acquisition marks Sun Pharma's entry into the specialty dermatology segment.

The URL acquisition adds ANDAs corresponding to 107 products to the Company's US generics portfolio.

Sun Pharma has received 9 ANDAs approval during Q1FY'14 taking the total number of approvals to 320 (as on June 30, 2013).

The company believes healthy market share in existing products, recent products launched and pending ANDAs approval to augment growth over FY'13-F'15E.

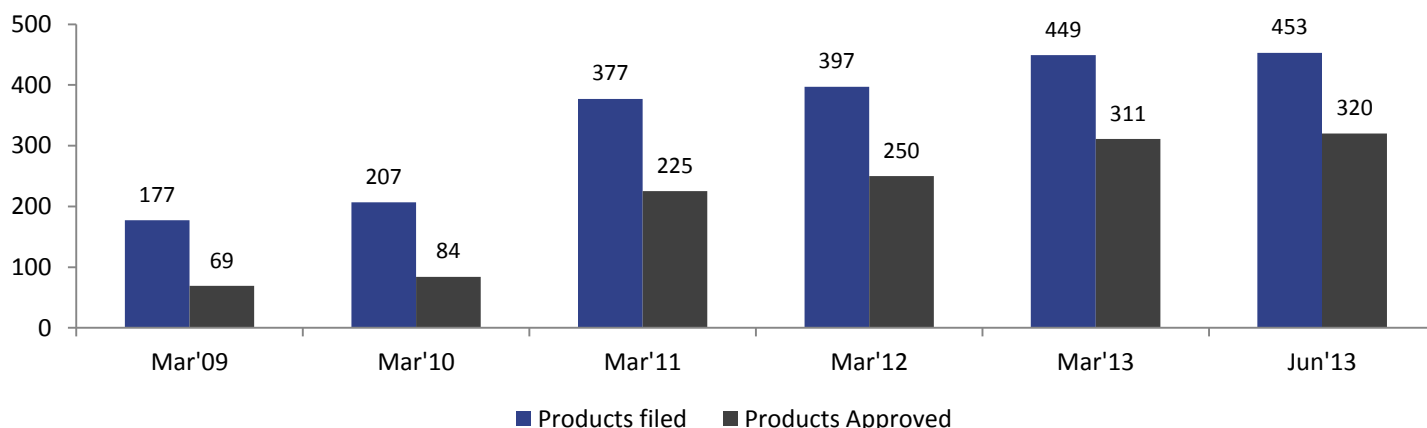
product in US) and URL Pharma helped revenue growth in the US, compensating for the marginal decline in Taro's revenues in Q1FY'14. The company acquired DUSA Pharmaceuticals, with all cash deal of approximately US\$ 230 mn and this acquisition marks Sun Pharma's entry into the specialty dermatology segment through a differentiated product. Further, the URL acquisition adds ANDAs corresponding to 107 products to the Company's US generics portfolio. The acquisition will lead to addition of large portfolio of products, two US FDA compliant manufacturing facilities and three delivery system technologies to Sun Pharma's US presence. Further, Caraco (a wholly-owned subsidiary of Sun Pharma) entered into a definitive agreement with Takeda pharmaceuticals Inc to buy URL Pharma's non-coldcrys business. This acquisition expands Sun Pharma's product basket in the US generics market and will support revenue growth in the US and will yield high ROI. We expect these acquisitions will further strengthen its presence in US and profitability in the coming quarters. The company continues to review opportunities to expand and strengthen its global footprint and is eyeing to enter into the European market. The company is mulling for acquisition opportunity in an attempt to reduce its dependence on the US market for foreign revenue.

Research- Investing for future

Continued investment on research and development boosts revenue outlook of the company. The company has incurred ₹2.05 bn in Q1FY'14 as R&D expense. The company having four R&D centers spends more than 6% of its revenues annually on R&D.

Sun Pharma is sharpening its focus on building brands and it continues to strengthen its product portfolio and increase more in licensing products. The ANDAs filling remains strong with the cumulative ANDAs fillings stood at 453 with the USFDA as on June 30, 2013. However, the company has received 9 ANDAs approval during Q1FY'14 taking the total number of approvals to 320 (as on June 30, 2013). The product pipeline remains strong with 133 products now await USFDA approval, including 19 tentative approvals. The above ANDA statistics exclude the discontinued/withdrawn products of URL. The total number of patent applications submitted stood at 791, with 503 patents granted so far. Meanwhile, the company has guided for ANDAs filling of 25 products for FY'14. We believe healthy market share in existing products, recent products launched and pending ANDAs approval to augment growth over FY13-F15E. Going ahead, the Company will continue to concentrate on the chronic segments, which offer stable returns and ensure competitive long-term stability.

Strong ANDA pipeline augurs well for the company

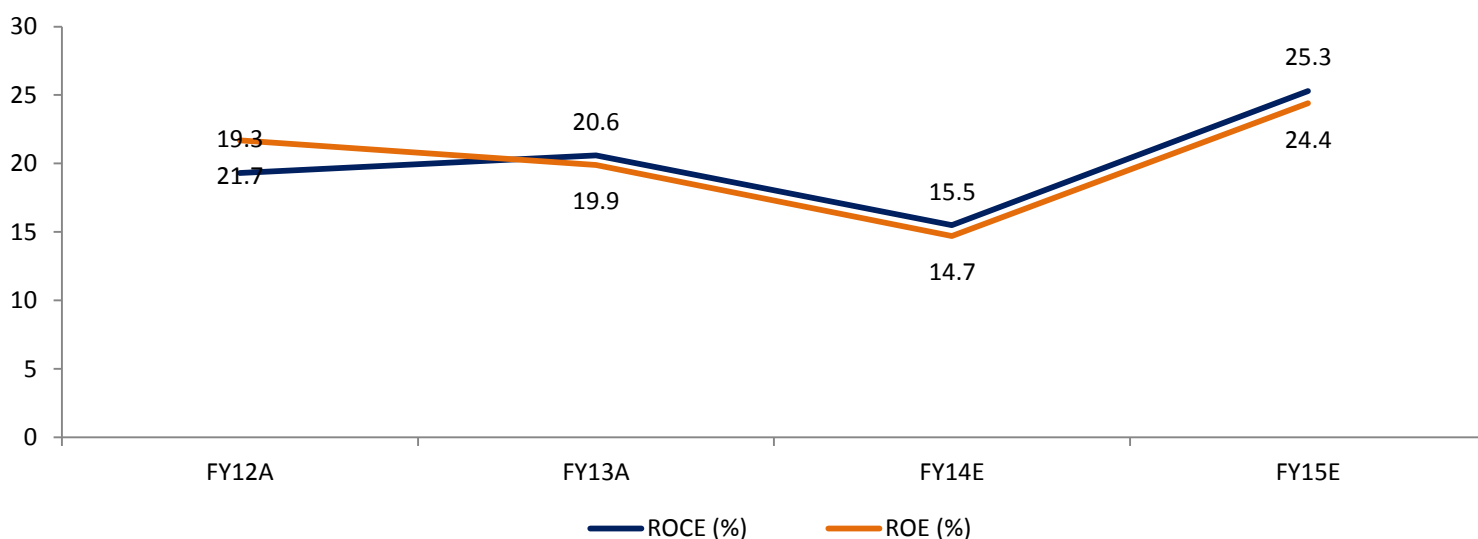


The Ministry of Commerce has targeted Indian pharma sector exports at ~US\$ 25 billion by 2016.

Domestic business to continue to grow led by its strong operations in the chronic segment

Sun Pharma's domestic formulation business has a strong foothold in the domestic market and has grown at a 23% CAGR, i.e, above the industry's average over FY'05–12. The company maintained the leadership position in the chronic segment and remains as the top 3 player in over 50% of more than 500 brands. Its top 10 brands contribute 20% of India sales. In order to gain further market share, the company continuously embark on increasing its sales force, currently having 4,000+ sales representatives covering 140,000 specialist doctors. The company has completed the process of transferring its domestic formulations business to Sun Pharma Laboratories Ltd., a wholly owned subsidiary. We expect the domestic business to continue on its strong trajectory led by its strong operations in the chronic segment.

Key return trend



Key Concerns

- High competition remains a major concern for the Indian pharmaceutical market due to the entry of new players. With this some brands and therapy segments are facing stiff competition from new innovative products of the competitors.
- Developing new medicines is becoming an increasingly expensive business. Recently, USFDA has raised the fees for generic drug makers up to 48% which in turn will compel Indian pharma companies to face high cost of sales.
- Some other concerns such as delay in regulatory approvals, weak seasonal demand, adverse impact of inflationary pressures on disposable incomes coupled with uncertainties surrounding the implementation of the new pricing policy is further going to pull the industry's growth momentum.

Balance Sheet (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Share Capital	1,035.60	1,035.60	2071.2	2071.2
Reserve and surplus	121,322.2	148,861.7	166,340.5	198,640.9
Net Worth	122,357.8	149,897.3	168,411.7	200,712.1
Minority Interest	11,614.5	16,350.8	16,350.8	16,350.8
Total debt	2,649.9	1,982.1	1,684.8	1,432.1
Total Provisions	12,912.7	22,687.2	24,955.9	27,451.5
Current liabilities	13,563.8	15,751.8	18,115	20,832
Deferred Tax Liabilities	1,552.0	2,053.5	2,053.5	2,053.5
Other liabilities	89.3	89.4	89.4	89.4
Total liabilities	164,740.0	208,812.1	231,660.7	268,921.2
Fixed Assets	32,741.9	50,771.3	55,848.4	61,433.3
Goodwill	10,218.1	11,329.5	11,329.5	11,329.5
Investment	22,128.7	24,115.7	24,115.7	24,115.7
Loans & Advances	16374.2	19,173.6	22,049.6	26,459.6
Other Assets	174.10	78.6	78.6	78.6
Current Assets	76,267.9	94,167.5	109,062.9	136,328.6
Deferred Tax Assets	6,835.1	9,175.9	9,175.9	9,175.9
Total assets	164,740.0	208,812.1	231,660.7	268,921.2

Profit & Loss Account (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Net Sales	80,194.90	112,998.60	142,378.2	163,735.0
Expenses	48,152	64,036	80,045.3	96,054.3
EBITDA	32,043.2	48,962.4	62,333.0	67,680.7
Other Income	4,715.10	3,880.90	4,269.0	4,695.9
Depreciation	2,911.60	3,361.70	4,034.0	4,840.8
Extra ordinary item	0.0	5,835.80	25,174.1	0.0
EBIT	33,846.7	55,317.4	87,742.0	67,535.7
Interest	282	431.6	323.7	259.0
Profit Before Tax	33,564.7	43,214.2	37,070.1	67,276.8
Tax	3,131.90	8,455.50	7,414.0	13,455.4
Profit After Tax before MI	30,432.8	34,758.7	29,656.1	53,821.4
Minority Interest	3,865.9	4,928.1	4,928.1	4,928.1
Net Profit	26,566.9	29,830.6	24,728.0	48,893.3

Key Ratios (Consolidated)

Y/E	FY12A	FY13A	FY14E	FY15E
EBITDA Margin (%)	40.0	43.3	43.8	41.3
EBIT Margin (%)	36.3	35.2	23.3	38.4
NPM (%)	33.1	26.4	17.4	29.9
ROCE (%)	19.3	20.6	15.5	25.3
ROE (%)	21.7	19.9	14.7	24.4
Adj EPS (₹)	25.7	28.8	11.9	23.6
P/E (x)	24.3	21.7	52.6	26.5
BVPS (₹)	118.2	144.7	81.3	96.9
P/BVPS (x)	5.3	4.3	7.7	6.5
EV/Operating Income (x)	7.8	5.5	9.0	7.7
EV/EBITDA (x)	19.6	12.8	20.5	18.7
EV/EBIT (x)	21.6	15.7	38.6	20.1

Valuation and view

On the back of strong foothold in domestic market and robust growth in the international business along with its low-cost generic will result in sustainable long-term profitability for the firm. We believe with strong product portfolio, and the capability to manufacture complex products, Sun Pharma will continue to maintain its growth trajectory. We expect US generics to be the key growth driver led by the integration of DUSA Pharma and URL generics (URL Pharma recently acquired) and approval for Lipodox. With the company having focus on niche generic drug segments (including topicals and injectables) will keep Sun Pharma ahead of the competition.

We rate the stock as 'BUY' at the current market price of ₹625.7, given the strong fundamentals, apt management and long term growth visibility. The current market price of ₹625.7, implies a P/E of ~26.5x FY'15E, EPS of ₹23.6 and P/BV of 6.5x on FY'15E BVPS of ₹96.9 respectively.



Indbank Merchant Banking Services Ltd.
I Floor, Khiviraj Complex I,
No.480, Anna Salai, Nandanam, Chennai 600035
Telephone No: 044 – 24313094 - 97
Fax No: 044 – 24313093
www.indbankonline.com

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