Indbank Merchant Banking Services Ltd (A Subsidiary of Indian Bank)

Sun Pharmaceuticals Industries Ltd.

EQUITY REPORT

October 17th, 2014

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

Sun Pharmaceuticals Ltd (Sun Pharma), established in 1983, is an international specialty pharma company. The company is engaged in the manufacturing and marketing of pharmaceutical formulations such as branded generics, as well as generics in India, the US and several other markets across the world. Operating primarily in four segments, namely, Indian Branded Generics, US Generics, International Branded Generics (ROW) and Active Pharmaceutical Ingredients (API), Sun Pharma is a leader in niche therapy areas of psychiatry, neurology, cardiology, nephrology, gastroenterology, orthopedics and ophthalmology. With its 18 manufacturing sites worldwide, the company markets over 200 generics in the US with another 150 awaiting approval from the US Food and Drug Administration (USFDA).

Investor's Rationale

Witnessed healthy numbers in Q1FY15 - Sun Pharma has reported a strong set of numbers in Q1FY15, with sales growing by 13% YoY to ₹39.4 bn, led by 14% growth in US generic sales and 17% growth in Indian formulations. Going forward, we expect Sun Pharma to continue its steady growth momentum in the domestic formulations business driven by better product mix and new launches. Further, with the price hike initiative undertaken in Taro portfolio will also trigger US growth. Meanwhile, the management has maintained its guidance for consolidated FY15 revenue growth of 13-15%.

Acquisition of Ranbaxy will make Sun Pharma India's largest pharma firm by market share - In a move to further fortify its presence in the domestic as well as global markets, Sun Pharma is in the process of acquiring Ranbaxy Laboratories in all share swap deal. So far the company has received approvals from the NSE, BSE and anti-competitive regulatory bodies of various countries, except the US and the India. The management guided for USD 250 mn in synergies benefit at EBITDA level, aided by both growth and operational efficiency in the third year post the deal is concluded.

Strong product pipeline augurs well for Sun Pharma - Sun Pharma is having a strong product pipeline with approved ANDAs for 350 products while filings for 140 products await USFDA approval, including 12 tentative approvals at the end of Q1FY15. Sun Pharma continues to incur R&D expenditure with a view to build strong product portfolio to earn higher return and is planning to incur ~6-8% of revenue towards capex. On a consolidated basis, the company currently has 575 patent fillings with 349 granted patents.

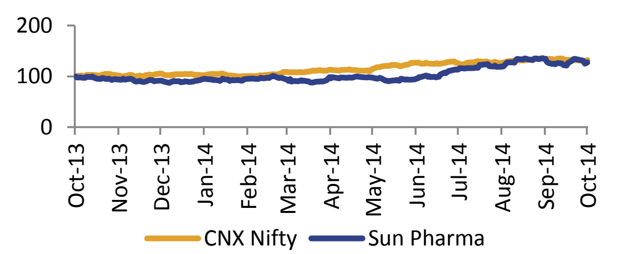
Market Data

Rating	**BUY**
CMP (₹)	797
Target (₹)	**900**
Potential Upside	~12.9%
Duration	Long Term
Face Value (₹)	1.0
52 week H/L (₹)	878.4/552.6
Adj. all time High (₹)	1,159.0
Decline from 52WH (%)	9.3
Rise from 52WL (%)	44.2
Beta	0.7
Mkt. Cap (₹bn)	1,650.4
Enterprise Value (₹bn)	1,618.6

Fiscal Year Ended

Y/E	FY13A	FY14A	FY15E	FY16E
Revenue (₹bn)	113.0	160.8	184.9	218.2
EBITDA (₹bn)	49.0	70.0	85. 1	101.5
Net Profit (₹bn)	29.8	31.4	64.3	76.4
EPS (₹)	28.8	15.2	31.0	36.9
P/E (x)	27.7	52.5	25.7	21.6
P/BV (x)	5.5	8.9	6.9	5.6
EV/EBITDA (x)	33.3	23.1	18.8	15.6
ROCE (%)	27.9	30.6	29.1	28.0
ROE (%)	19.9	17.0	27.1	25.8

One year Price Chart



Shareholding Pattern	Jun'14	Mar'14	Diff.
Promoters	63.6	63.6	-
FII	23.0	22.5	0.5
DII	5.1	5.6	(0.5)
Others	8.3	8.3	-

Sun Pharma is currently the fifth largest specialty pharmaceutical company, manufacturing and marketing a variety of pharmaceutical formulations such as branded generics, as well as generics in the US, India and several other global markets.

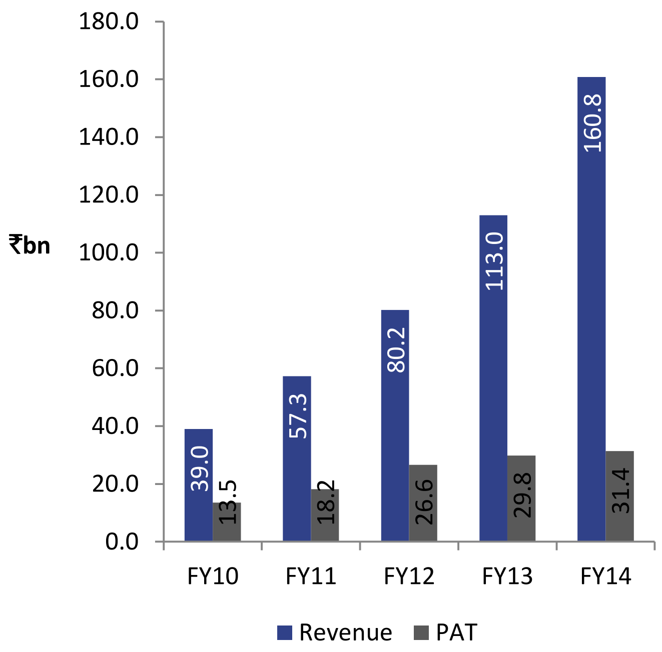
The company is ranked 2nd and holds 5.4% market share in the highly competitive Indian Branded Generics market, as per the latest AIOCD-AWACS report.

Sun Pharma # an international specialty pharma company holding 5.4% market share in the Indian pharmaceutical market

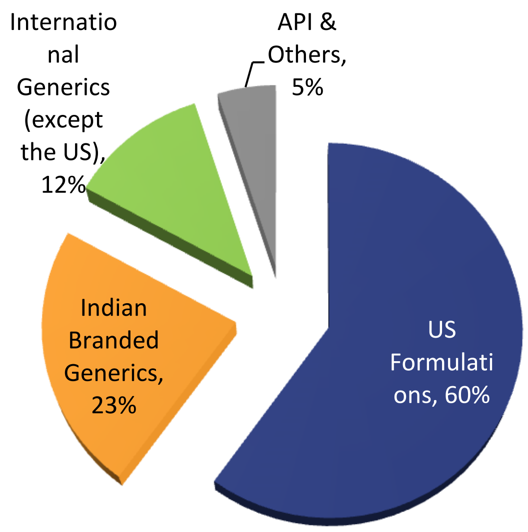
Sun Pharmaceutical Industries Ltd. (Sun Pharma) was established in 1983 with five psychiatry products and a compact manufacturing facility at Vapi, Gujarat. Sun Pharma, a leader in chronic therapies is ranked 2nd and holds 5.4% market share in the ₹770.0 bn Indian pharmaceutical market. Globally, Sun Pharma is currently the fifth largest specialty pharmaceutical company manufacturing and marketing a variety of pharmaceutical formulations such as branded generics, as well as generics in the US, India and several other global markets. In India, Sun Pharma is having established brands across niche therapies such as psychiatry, neurology, cardiology, nephrology, gastroenterology, orthopedics and ophthalmology. The company has strong skills in product development, process chemistry, and manufacturing of complex dosage forms. Sun Pharma has evolved into an international, integrated, specialty pharmaceutical company with 75% of its revenues from US branded generics market and rest of the world. The company is having strong research teams in generics, finished dosage development, biological support and chemistry with over 900 scientists in four R&D centers.

The company has entered into a joint venture with Merck for emerging markets excluding India. With equal representation in the joint venture, the agreement allows each partner to use each other's infrastructure for development, manufacturing and commercialization. Sun Pharma has led its inorganic growth through various acquisitions and joint ventures all over the world. Its recent acquisition has been URL and DUSA in the US. Sun Pharma has 18 manufacturing sites worldwide. There are 6 manufacturing sites each in India and US and one each in Canada, Brazil, Mexico, Hungary, Israel and Bangladesh.

Revenue and PAT trend



Business unit wise sales (FY14)



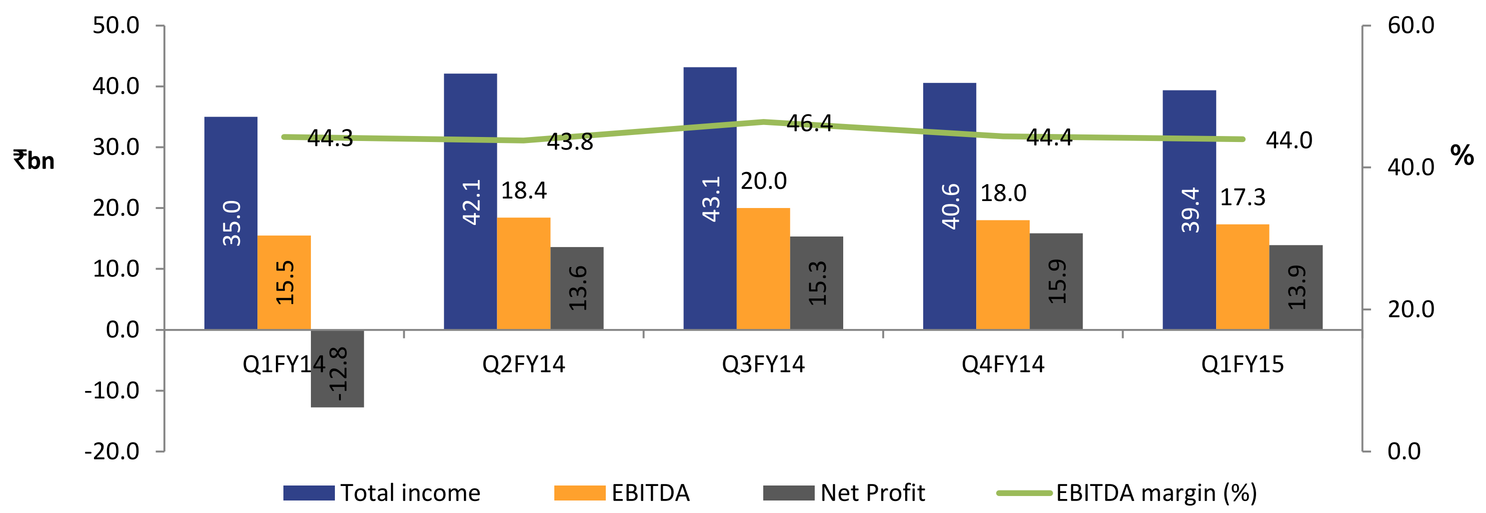
Strong sales performance was primarily led by 14% growth in US generic sales and 17% growth in Indian formulations.

The management expects that the current run rate of other expenses as a % of sales to continue. A 300 bps sequential drop in other expenses was the key driver of margin performance.

Witnessed healthy numbers in Q1FY15 backed by strong growth in India branded generics and US formulations

Sun Pharma's revenue grew by 13% YoY to ₹39.4 bn in Q1FY15 as against ₹35.0 bn in Q1FY14 led by strong growth in US generic sales and Indian formulations growth. The company's branded generic sales in India increased by 17% YoY at ₹9.9 bn, while sales in the US market was up by 14.4% YoY at ₹23.2 bn in Q1FY15. In addition, the international formulation sales outside US grew by 9.0% at ₹4.9 bn. Further, depreciation of domestic currency also assisted the growth as overall international revenues accounted for more than 70% of total revenues in Q1FY15. During Q1FY15, company's EBITDA grew by 13% YoY to ₹17.3 bn, However the EBITDA margin decline marginally by 27.5 bps YoY to 44.0% YoY due to a higher raw material costs and purchases though offset partially by lower other expenses which had an element of onetime costs incurred in Q1 of last year. The company reported a net profit at ₹13.9 bn in Q1FY14, compared to a net loss of ₹12.8 bn in Q1 last year. The loss in Q1FY14 was on account of a provision of ₹25.2 bn towards settlement for patent infringement litigation related to generic versions of 'Protonix'.

Quarterly performance trend



RoW (ex-US formulations) growth was impacted due to certain supply issues (raw material, packaging material, breakdown of facility); but this will normalise soon.

Segment-wise performance

US formulations: US revenues increased by ~14% to ₹23.2 bn, accounting for 58% of revenue sales despite weak performance by Taro, which reported a decline in sales (-15% YoY to USD 130 mn) and PAT (-22% YoY to USD 46 mn) mainly due to a price protection charge taken during the quarter.

India branded generics: India branded formulations increased 17% YoY during the quarter, beating industry run rate which stood at 8% YoY growth. During the quarter, the company launched 7 new products in the domestic market and holds number 2 position with 5.4% market share in the ₹770.0 bn pharma market.

RoW ex-US formulation sales: International formulation sales ex-US grew at ~2% YoY to USD 82 mn. Excluding ex-US Taro sales, underlying sales growth in USD terms for Sun Pharma business in these markets was 4% for Q1FY15.

APIs and R&D: External sales of API reached ₹1.7 bn in Q1FY15, a decline of 10% over Q1 last year. On the other hand, the company increased its API supply for captive consumption significantly for key products which enabled it to enjoy the benefits of strategic vertical integration.

Better product mix and new launches aided healthy growth in the company's US based subsidiary, Taro.

Taro has stepped up its ANDA filings and currently has 31 ANDAs pending approval.

We expect the US business to see some uptick on a higher base during FY14-16E backed by new launches and base business growth.

Taro price hike and upcoming launches to generate incremental revenue for Sun Pharma

The company's US based subsidiary, Taro to continue to deliver healthy growth in domestic formulations business driven by better product mix and new launches. The US topical derma market size is USD 10 bn. Taro's products currently address a market worth only USD 2.6 bn, which is 25% of the market. Of the remaining USD 7.5 bn, USD 3.5 bn is patent-protected and/or limited to only one player. The company continues to have a very strong pipeline of 140 ANDAs with products like gActonel, gNiaspan and gGleevec (FTF) which would be able to offset near term price erosion in niche products like Doxycycline Hyclate and gCymbalta. As Sun pharma owns a ~70% stake in Taro to Sun pharma's profits, thus any incremental benefit arising out of new launches will benefit the Sun Pharma as well. Moreover, we expect that the recent price increases in Taro's portfolio will help margins to remain strong in the balance part of the year and beyond.

Strong product pipeline to aid US business performance

The company's US business grew at a CAGR of 44% during FY09-14 on the back of successful acquisitions such as Caraco and Taro (recently Dusa and URL) and timely product launches. The US product basket remains robust. The company cumulatively filed 490 ANDAs, out of which it received approvals for 350 products. Moreover, the US growth is also being backed by extensive infrastructure- out of the 23 global manufacturing facilities 15 have been approved by the USFDA. The only blot in an otherwise smooth journey is the warning letter to the Gujarat based Karkhadi unit. We expect the US business to see some uptick on a higher base during FY14-16E backed by new launches and base business growth. The lower growth also takes into account possible competition in Lipodox in the US.

Performance highlights

US Generics	478 Cumulative ANDA filed	344 Cumulative ANDAs approved	45%- 5-year revenue CAGR
India Branded Generics	Top 3 In over 50% of more than 500 brands	2nd Largest domestic drug maker by market share	14%-5-year revenue CAGR
International Generics (ex-US)	Market presence in over 48 countries	More than 900 products	38%-5-year revenue CAGR
International Generics (ex-US)	Market presence in over 48 countries	More than 900 products	38%-5-year revenue CAGR

Licensing Agreement with Merck for tildrakizumab; strengthens Sun Pharma's presence in the US

This collaboration is a part of the company's strategy towards building strong pipeline of innovative dermatology products in a market with strong growth potential.

The US-based Merck & Co., Inc. and Sun Pharmaceuticals have entered into an exclusive worldwide licensing agreement for Merck's dermatology molecule - tildrakizumab (MK-3222), which is currently under phase 3 registration trials. Tildrakizumab is developed for the treatment of chronic plaque psoriasis, a skin ailment. Under terms of the agreement, Sun Pharma will acquire worldwide rights to tildrakizumab for use in all human indications from Merck in exchange for an upfront payment of USD 80 mn. This collaboration is a part of company's strategy towards building a pipeline of innovative dermatology products in a market with strong growth potential. Further, the deal will strengthen Sun Pharma's presence in the US's skin market and also boost revenue potential.

Sun Pharma to become the world's fifth largest generics drugs company post Sun-Ranbaxy deal

The merged entity (Ranbaxy & Sun pharma) will generate synergy benefits of about USD 250 mn by the third year post closure of deal. Synergy benefits will be achieved on account of revenue growth & cost rationalization.

During Q1FY15, Sun Pharma announced the acquisition of Ranbaxy Laboratories (India's leading company in sales) in one of India's largest M&A transactions. The deal, an all-stock transaction valued at USD 4.0 bn, is expected to be completed by December 2014. Under the terms of the deal, shareholders of Ranbaxy will receive four shares of Sun Pharma for every five shares they hold. The USD 4.0 bn deal would create the fifth largest specialty generics company in the world and the largest pharmaceutical company in India with over 9% market share, enhancing value share across product offerings and market territories. The scope for synergies and the management's guidance of USD250 mn cumulative synergies at the end of the third year seem realistic. The combined entity would have operations in 65 countries, 47 manufacturing facilities across 5 continents, and a significant platform of specialty and generic products marketed globally. Moreover, Sun Pharma has prepared a three-pronged strategy, which includes integration of supply chain and field force for enhanced efficiency and productivity, resolution of regulatory issues and higher growth through synergy in domestic and emerging markets. It may take three-to-four-year period after the closure of the transaction to achieve full turnaround of Ranbaxy. Sun Pharma expects to close the deal by December 2014.

Acquisition of Pharmalucence Inc. - a move to enter into generic radio pharmaceuticals business

The acquisition of New England-based firm Pharmalucence, enables Sun pharma to enter into generic radio pharmaceuticals business and also augment injectable manufacturing capacity & R&D capabilities.

A subsidiary of Sun Pharma has acquired New England-based firm Pharmalucence, which manufactures human injectable pharmaceuticals. Pharmalucence currently manufactures its own line of diagnostic commercial products (non-radioactive radiopharmaceuticals). In addition to these products, it manufactures a number of products on a contract basis for pre-clinical, clinical and commercial needs and has extensive experience with technology transfers from existing commercial sites. This acquisition enables Sun pharma to enter into generic radio pharmaceuticals business and also augment injectable manufacturing capacity and R&D capabilities.

The management has guided for USD 250 mn synergies at EBITDA level purely due to revenue growth and cost synergies to be realized in the third year post the deal is concluded.

Management Guidance

- The management has maintained its guidance for consolidated FY15E revenue growth of 13-15% with R&D spending stands at 6-8% of revenues. Moreover, the company is targeting to fill 25 ANDA in the US and capex of ₹9,000 mn and tax rate to be ~10-15% in FY15E. This guidance takes into account the higher base of FY14 as well the risks associated with increase in competition for some products. Guidance is at constant exchange rate and excludes the impact of the proposed acquisition of Ranbaxy pending the deal closure.

- Paclitaxel Injection (PICN): The product has approved in Jan'14 and shall be launched in this year (mostly H1FY15). The company plans to set a dedicated sales team for A class cities for the sale of this product.

- The management highlighted that the new price control list of 108 medicines in domestic market will not have any significant impact on the company.

- The management highlighted that it would now concentrate on the integration of Ranbaxy with itself and hope for a robust revenue growth and cost optimization through synergistic benefits. Sun Pharma would also focus on the regulatory resolution in some of Ranbaxy's key facilities at Dewas and Paonta post the acquisition which is expected by December 2014. It has guided for USD 250 mn synergies at EBITDA level purely due to revenue growth and cost synergies to be realized in the third year post the deal is concluded.

Key risks

- Any product approval delays, unfavorable litigation outcomes and potential future adverse inspections from USFDA could be key risks to its growth.

- Sun Pharma is impacted by forex fluctuations, as it exports more than 50% of its sales and has presence abroad through subsidiaries/other infrastructure.

- Government-mandated price controls.

- Delay in clinical trial approvals.

Balance Sheet (Consolidated)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Share Capital	1,035.6	2,071.2	2,071.2	2,071.2
Reserve and surplus	148,861.7	183,178.3	235,432.2	293,813.3
Net Worth	149,897.3	185,249.5	237,503.4	295,884.5
Minority Interest	16,350.8	19,211.8	27,914.7	38,184.0
Loans	1,982.1	24,890.1	26,134.6	27,441.3
Provisions	22,687.2	45,622.0	47,903.1	50,298.3
Deferred tax liability (net)	2,053.5	2,756.7	2,756.7	2,756.7
Other Liabilities	15,841.2	15,978.1	16,788.9	17,642.4
Capital Employed	**208,812.1**	**293,708.2**	**359,001.3**	**432,207.1**
Fixed assets	50,771.3	58,242.0	67,242.0	82,035.2
Goodwill	11,329.5	18,346.2	18,346.2	18,346.2
Investments	24,115.7	27,860.2	33,432.2	40,118.7
Deferred tax Assets (net)	9,175.9	11,866.9	11,866.9	11,866.9
Loans & advances	19,173.6	22,957.3	27,548.8	32,759.8
Cash	40,587.1	75,901.5	108,469.7	137,658.1
Other Current Assets	53,659.0	78,534.1	92,095.6	109,422.1
Capital Deployed	**208,812.1**	**293,708.2**	**359,001.3**	**432,207.1**

Key Ratios (Consolidated)

Y/E	FY13A	FY14A	FY15E	FY16E
EBITDA Margin (%)	43.3	43.5	46.0	46.5
EBIT Margin (%)	43.8	44.4	46.7	47.0
NPM (%)	26.4	19.5	34.8	35.0
ROCE (%)	27.9	30.6	29.1	28.0
ROE (%)	19.9	17.0	27.1	25.8
EPS (₹)	28.8	15.2	31.0	36.9
P/E (x)	27.7	52.5	25.7	21.6
BVPS (₹)	144.7	89.4	114.7	142.9
P/BVPS (x)	5.5	8.9	6.9	5.6
EV/Operating Income (x)	14.4	10.1	8.6	7.2
EV/EBITDA (x)	33.3	23.1	18.8	15.6

Profit & Loss Account (Consolidated)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Total Income	**112,998.6**	**160,803.6**	**184,924.1**	**218,210.5**
Expenses	64,036.2	90,786.7	99,859.0	116,742.6
EBITDA	**48,962.4**	**70,016.9**	**85,065.1**	**101,467.9**
EBITDA margin (%)	*43.3*	*43.5*	*46.0*	*46.5*
Depreciation	3,361.7	4,092.3	4,828.9	5,698.1
EBIT	**49,481.6**	**71,446.9**	**86,310.7**	**102,451.7**
Interest	431.6	441.9	464.0	487.2
Exceptional Item (loss)	5,835.8	25,174.1	0.0	0.0
Profit Before Tax	**43,214.2**	**45,830.9**	**85,846.7**	**101,964.5**
Tax	8,455.5	7,021.7	12,877.0	15,294.7
Minority Interest	65.3	19.2	0.0	0.0
Share of associate profit	(4,862.8)	(7,375.3)	(8,702.9)	(10,269.4)
Net Profit	**29,830.6**	**31,414.7**	**64,266.9**	**76,400.5**
NPM (%)	*26.4*	*19.5*	*34.8*	*35.0*

Valuation and view

We believe Sun Pharma's low-cost advantage, brand recognition in emerging markets, and its capability to manufacture complex products will result in sustainable long-term profitability. The firm has a narrow moat primarily due to its low-cost advantage, which includes low manufacturing and labor costs at its primary manufacturing base in India, as well as a vertically integrated API segment that lowers raw material procurement costs. Moreover, Sun Pharma has been able to build out a strong portfolio of products in the US generic market, including injectable and topical drugs, where fewer participating competitors generally lead to more favorable pricing and profitability.

We initiate BUY rating on Sun Pharma. At a current CMP of ₹797, Sun Pharma is currently trading at P/E of 25.7x FY15E and 21.6x FY16E. Considering the company's strong fundamentals, we recommend 'BUY' with a target price of ₹900, which implies potential upside of ~12.9% to the CMP from 1 year perspective.

Indbank Merchant Banking Services Ltd (A Subsidiary of Indian Bank)

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