

Sun Pharma - SELL

Long road to recovery

Aditya Medisales impact offsets one-off US growth

Sun Pharma reported a weaker than estimated quarter as Aditya Medisales (AML) restructuring shaved off Rs11bn from India sales. Excluding this impact, Q4 revenues up 6.5% qoq coupled with 25.5% margin vs reported 14.2%. US business ex-Taro jumped 41% qoq driven by a significant 6-month supply contract for generics starting from Q4; notably company indicated no improvement in underlying US generics business. Ilumya sales now covers 1,200 doctors out of potential pool of 8k prescribers but sales ramp has been slow driven by competitive focus on early access program as Sun negotiates with payors; consequently, since the product is free for patients and funded by company, revenue recognition is delayed till patient plans cover the product. Sun aired DTC ads for Ilumya which coupled with higher other expenses on specialty basket led to ~40% qoq surge in other expenses dampening EBIDTA margin; albeit strong US sales had a salutary effect on gross margin, which rose 230bps qoq.

Ilumya is key to US growth; Sell stays

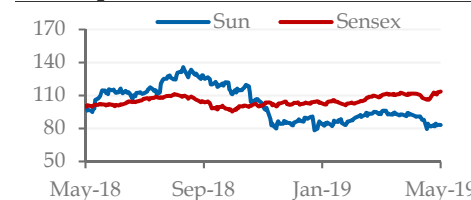
Sun management guided to a mid-teens growth on reported base combined with capex of US\$200mn in current fiscal. It spent a large part of the call fielding queries on Ilumya which is understandably the largest driver of specialty sales over next 2-3 years as it climbs towards peak revenues. However, we see difficulties in margin moving beyond 24-25% in 2 years as high investments combined with sluggish US generics environment imply EBIDTA cagr of just 20%. Assign SELL with 1-year PT of Rs350, as US revenues carried one-off benefits in Q4 with persistently high dependence on Ilumya in the medium term.

CMP (Rs) 413 12-mts Target (Rs) 350 Downside 15.3%
Stock data (As on May 28, 2019)

Sector: Pharmaceuticals

Sensex:	39,750
52 Week h/l (Rs)	679/350
Market cap (Rs mn)	987,813
Enterprise value (Rs mn)	830,738
6m Avg t/o (Rs mn):	5,474
FV (Re):	1
Div yield (%):	0.7
Bloomberg code:	SUNP IN
BSE code:	524715
NSE code:	SUNPHARMA

Stock performance



Shareholding pattern (As of Dec'18 end)

Promoter	54.4%
FII+DII	32.9%
Others	12.7%

Exhibit 1: Result table

(Rs mn)	Q4 FY19	Q3 FY19	% qoq	Q4 FY18	% yoy
Revenues	71,639	77,402	(7.4)	69,771	2.7
RM + inventory	(16,412)	(14,442)	13.6	(8,524)	92.5
Purchase of stocks	(1,976)	(7,215)	(72.6)	(9,177)	(78.5)
Staff	(15,688)	(14,950)	4.9	(13,413)	17.0
Other expenses	(27,396)	(19,267)	42.2	(21,823)	25.5
OPM (%)	14.2	27.8	(1,362)	24.1	(994) bps
Depreciation	(4,541)	(4,711)	(3.6)	(4,552)	(0.3)
Interest	(1,500)	(1,448)	3.6	(1,554)	(3.4)
Other income	2,815	1,931	45.8	3,028	(7.0)
Tax	288	(2,709)	-	2,102	(86.3)
Minority & Associate	(872)	(2,173)	(59.9)	(2,436)	-
Reported PAT	6,359	12,419	(48.8)	13,422	(52.6)

Source: Company, YES Sec - Research

CONCALL HIGHLIGHTS

- ✓ Higher expenses in specialty led to higher other expenses
- ✓ Aditya Medisales impact of Rs11bn otherwise consolidated sales up 21% yoy
- ✓ US sales boosted by a 6-month generic supply to a customer but otherwise seen no improvement in underlying generics business
- ✓ Started DTC promotions in Q4 and will continue and will be a material cost in FY20; satisfied with formulary coverage for Ilumya
- ✓ Have put patients on early access program on Ilumya as company negotiates with payors and delayed revenue recognition has dampened revenues since the product is free to patients and funded by company
- ✓ 1,200 doctors out of 8k possible prescribers of biologics for Ilumya but of these only 2,000 are heavy prescribers of biologics; targeted docs would cover all decile of users
- ✓ Investment phase in specialty business would continue; Ilumya peak sales seen within next 4-5 years though breakeven would depend on additional costs incurred for new indications
- ✓ Mid-teens growth in FY20 on reported base, capex of US\$200mn and R&D at 9% of sales
- ✓ Once current with all approvals, should get a meaningful business from new launches
- ✓ Xelpros: In the market for 3 months but will not be a huge product in the overall scheme of things. Over 10% market share in Odomzo

Exhibit 2: Key costs breakup

% of net sales	Q4 FY19	Q3 FY19	bps qoq	Q4 FY18	bps yoy
RM + inventory	22.9	18.7	425	12.2	1,069
Purchase of goods	2.8	9.3	(656)	13.2	(1,039)
Staff	21.9	19.3	258	19.2	267
Other expenses	38.2	24.9	1,335	31.3	696
Total costs	85.8	72.2	1,362	75.9	994
Gross profit Rs mn	53,252	55,745	(4.5)	52,070	2.3
GM (%)	74.3	72.0	231	74.6	(30)

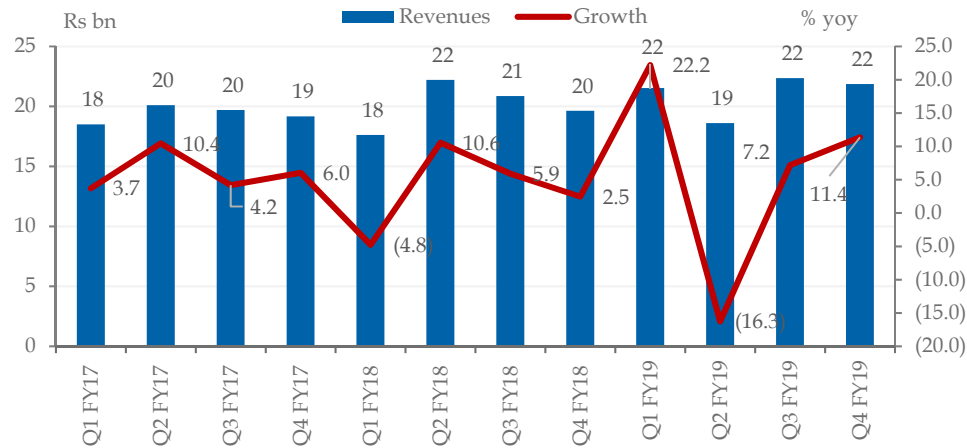
Source: Company, YES Sec – Research

Exhibit 3: Revenue distribution

US\$ mn	Q4 FY19	Q3 FY19	% qoq	Q4 FY18	% yoy
India (Rs mn)	11,010	22,350	(50.7)	19,630	(43.9)
US formulations	443	362	22.4	368	20.4
Taro	180	176	2.3	175	2.9
Ex-Taro	263	186	41.4	193	36.3
EM	173	203	(14.8)	199	(13.1)
ROW	153	125	22.4	116	31.9
API (Rs mn)	4,840	4,260	13.6	3,320	45.8

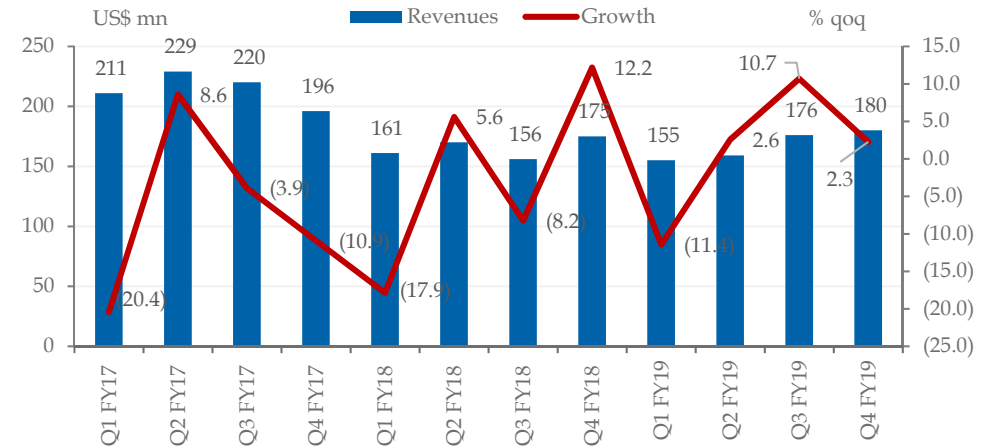
Source: Company, YES Sec – Research

Exhibit 4: Adjusted India sales up 11% yoy



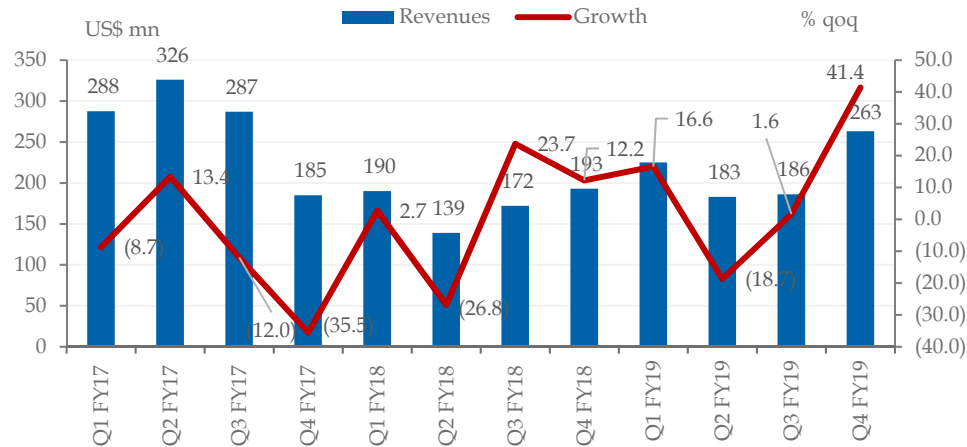
Source: Company, YES Sec - Research

Exhibit 6: Taro revenues driven by volumes yoy



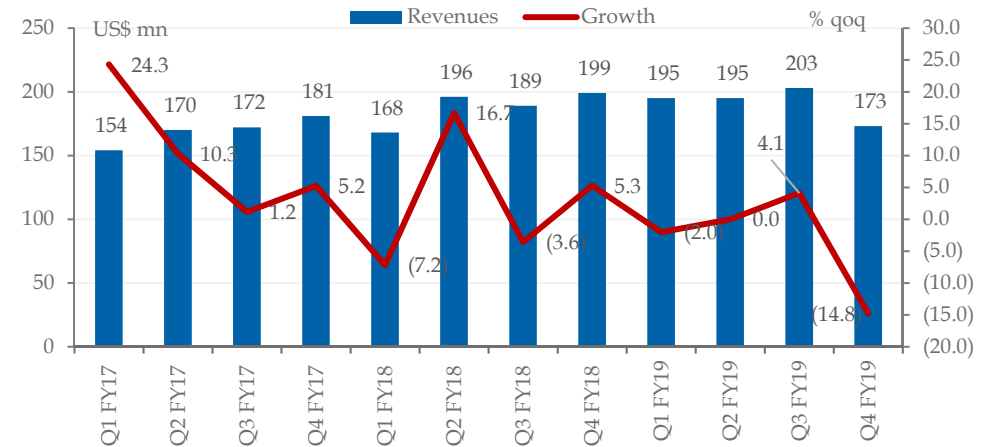
Source: Company, YES Sec - Research

Exhibit 5: Ex-Taro US surges on one-off supply contribution



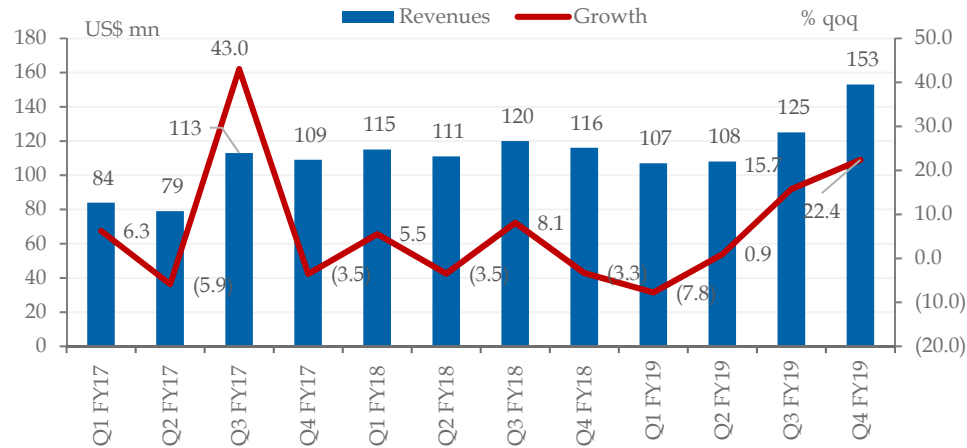
Source: Company, YES Sec - Research

Exhibit 7: Trend in EM sales



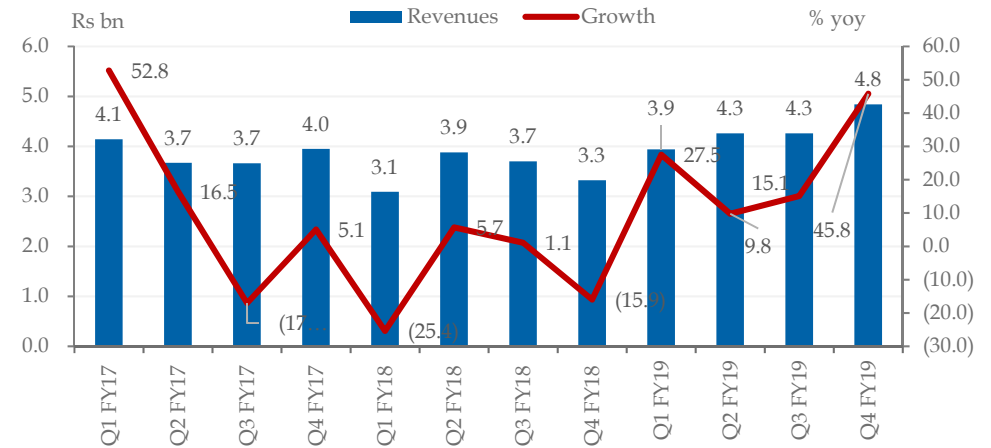
Source: Company, YES Sec - Research

Exhibit 8: ROW sales finish FY19 on strong note



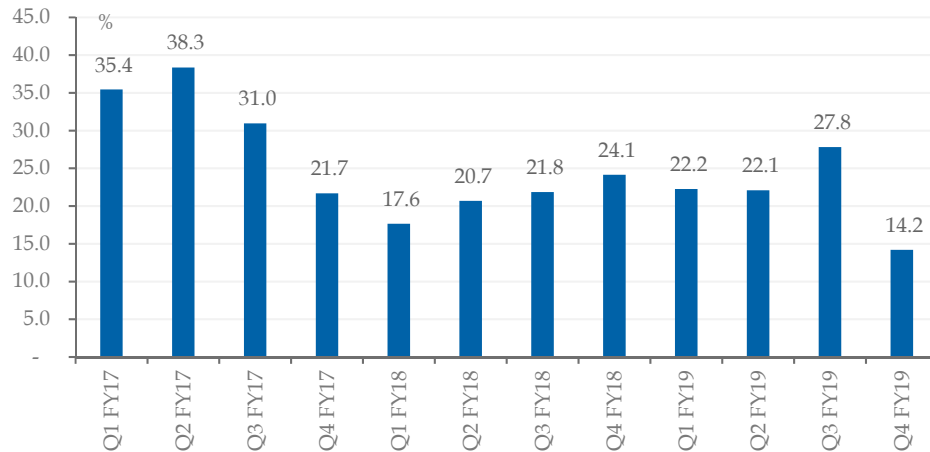
Source: Company, YES Sec - Research

Exhibit 10: API remains on a strong footing



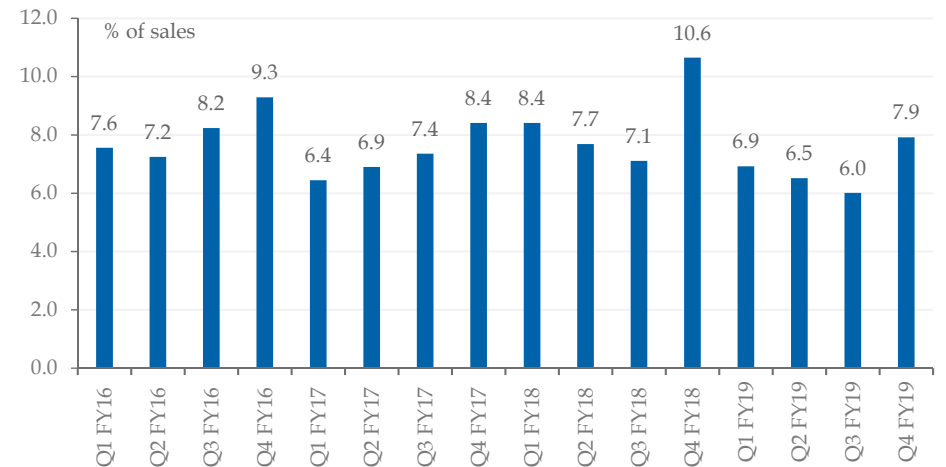
Source: Company, YES Sec - Research

Exhibit 9: Reported margin comes off on AML, specialty costs



Source: Company, YES Sec - Research

Exhibit 11: R&D inches up in Q4; guidance of 9% in FY20



Source: Company, YES Sec - Research

Exhibit 12: Financial summary

Y/e 31 Mar (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
Revenues	315,784	264,895	290,659	329,266	373,329
yoy growth (%)	10.9	(16.1)	9.7	13.3	13.4
Operating profit	100,893	56,082	63,076	77,512	90,214
OPM (%)	31.9	21.2	21.7	23.5	24.2
Reported PAT	69,644	21,616	26,654	46,777	55,132
yoy growth (%)	53.2	(69.0)	23.3	75.5	17.9
EPS (Rs)	28.9	9.0	11.1	19.4	22.9
P/E (x)	14.3	46.0	37.3	21.2	18.0
P/BV (x)	2.7	2.6	2.4	2.2	1.9
EV/EBITDA (x)	8.6	15.6	14.2	10.8	8.8
Debt/Equity (x)	0.1	0.1	0.1	0.1	0.0
ROE (%)	19.0	5.7	6.4	10.2	10.8
ROCE (%)	24.0	12.3	12.7	14.5	15.4

Source: Company, YES Sec – Research

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ADD 5% to 15%

HOLD -15% to +5%

SELL > - 15%

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