



Sun Pharmaceutical

STOCK INFO.	BLOOMBERG
BSE Sensex: 19,243	SUNP IN
	REUTERS CODE
S&P CNX: 5,702	SUN.BO

26 October 2007

Buy

Previous Recommendation: Buy

Rs1,042

		YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
		END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
Equity Shares (m)	193.4	03/07A	20,792	7,842	37.9	36.8	27.5	7.3	35.9	22.7	9.4	29.2
52-Week Range	1,196/886	03/08E	24,820	8,805	42.5	12.3	24.5	4.5	23.3	22.5	6.9	19.5
1,6,12 Rel. Perf. (%)	-4/-38/-38	03/09E	29,106	10,528	50.8	19.6	20.5	3.8	20.2	22.0	5.6	16.1
M.Cap. (Rs b)	201.5											
M.Cap. (US\$ b)	5.1											

Sun Pharma's 2QFY08 operating performance was above estimates. Key highlights:

- Net sales grew by 23% to Rs6.5b led by a 31% jump in domestic business to Rs3.7b (54% of total revenues) and 38% growth in formulation exports (to Rs2.5b, ~36% of sales). While EBITDA margins improved by 470bp to 37.3%, lower than expected other income (at Rs111m) restricted PAT growth.
- US pipeline gaining strength:** SPIL (along with Caraco) has 87 ANDAs (for 71 products) awaiting approval with the US FDA. It expects to file about 30 ANDAs in FY08E between itself and Caraco taking the total pending pipeline to over 100 by end-FY08. We note that there is now increased visibility on the company's Para-IV pipeline with the company receiving 3 approvals with shared exclusivity in the recent past targeting US\$3b in innovator sales.
- Update on Taro acquisition:** SPIL's proposed acquisition of Taro Pharma has been contested by some of Taro's minority shareholders. A decision on this is expected post Taro's EGM (dates not disclosed). SPIL has till date invested US\$58m in Taro. Total investment in Taro will be in the range of US\$250-500m depending on the structuring for the acquisition.

With Sun Pharma's domestic business progressing well and increasing traction on the US front (both in Caraco and from India), the possibility of a rapid scale-up over the next couple of years is high. While valuations at 24.5x FY08E and 20.5x FY09E EPS (excl. Taro acquisition) appear rich, they do not fully factor in the ramp-up in US, the expected value unlocking by leveraging acquired companies (Taro, Able Labs & Valeant) and incremental upsides from its Para-IV pipeline. Maintain **Buy**.

QUARTERLY PERFORMANCE (CONSOLIDATED)

(Rs Million)

Y/E MARCH	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Revenues	4,987	5,239	5,263	5,313	6,153	6,465	6,256	5,946	20,792	24,820
YoY Change (%)	31.8	27.4	24.2	33.5	23.4	23.4	18.9	11.9	30.4	19.4
EBITDA	1,811	1,708	1,733	1,545	2,148	2,409	2,188	2,035	6,798	8,780
Margins (%)	36.3	32.6	32.9	29.1	34.9	37.3	35.0	34.2	32.7	35.4
Depreciation	202	204	212	201	226	230	245	259	818	959
Net Other Income	274	402	636	942	606	111	505	594	2,253	1,816
PBT	1,883	1,906	2,157	2,286	2,528	2,290	2,448	2,370	8,233	9,637
Tax	2	-22	-29	-18	98	1	49	45	-67	193
Rate (%)	0.1	-1.1	-1.3	-0.8	3.9	0.0	2.0	1.9	-0.8	2.0
Profit after Tax	1,882	1,928	2,186	2,304	2,430	2,289	2,399	2,325	8,300	9,444
Share of Minority Partner	115	64	198	183	158	104	185	192	559	639
Adj Net Profit	1,767	1,864	1,989	2,121	2,272	2,185	2,214	2,134	7,741	8,805
YoY Change (%)	29.9	26.1	35.8	48.4	28.6	17.2	11.4	0.6	35.0	13.8
Margins (%)	35.4	35.6	37.8	39.9	36.9	33.8	35.4	35.9	37.2	35.5

E: MOST Estimates; * Quarterly results have been recasted and hence do not tally with full year results

Domestic formulations drive revenue growth

Consolidated net sales grew by 23% to Rs6.5b led by a 31% jump in domestic business to Rs3.7b (54% of total revenues) and 38% growth in formulation exports (to Rs2.5b, ~36% of sales). Formulation exports were boosted by 46% YoY growth in Caraco sales (in dollar terms).

SUN PHARMA - BUSINESS BREAK UP (RS M)

	2QFY08	2QFY07	YOY (%)	1QFY08	QOQ (%)
Domestic Sales					
Formulation	3,720	2,834	31.2	3,669	1.4
Bulk	211	278	-24.3	274	-23.2
Others	2	1	64.3	4	-34.3
Total Domestic Sales	3,933	3,114	26.3	3,947	-0.4
Contribution (%)	56.6	55.2		60.2	
International Sales					
Formulation	2,478	1,796	38.0	1,939	27.8
Bulk	529	726	-27.2	663	-20.2
Others	6	6	-9.8	5	10.0
Total Internl. Sales	3,013	2,528	19.2	2,607	15.6
Contribution (%)	43.4	44.8		39.8	
Gross Sales	6,945	5,642	23.1	6,554	6.0

Source: Company/Motilal Oswal Securities

Improvement in business mix boosts EBITDA margins

EBITDA margins improved by 470bp to 37.3%, driven by improvement in business mix in favor of domestic formulation business (54% of sales vs 50% in 2QFY07), as reflected in lower raw material cost (at 27.8% of sales vs 30.1% in 2QFY07). However, lower than expected other income (at Rs111m) due to lower treasury book and translation loss on forex assets restricted PAT growth to 17.2% at Rs2.2b.

Caraco continues with good performance, guides 30% sales growth for FY08E

Caraco reported strong 2QFY08 top-line growth of 46% to US\$41.4m and gross margins of 43.6% (down 670bp). Sales growth was partly driven by products marketed under marketing agreement with SPIL. However, higher R&D spend (including non-cash) at 12.3% of sales (vs 8.3% in 2QFY07) resulted in muted EBITDA margins of 10.7% (up 320bp). It reported PAT of \$4.62m (up 100%). In addition to its own product development program and

marketing agreement with SPIL, Caraco has implemented development strategies with other players that will complement SPIL's development pipeline and also eliminate future gaps in approval. Caraco management has maintained its guidance of 30% revenue growth for FY08 led mainly by new launches and some of the niche low-competition products launched recently.

Generic pipeline being strengthened

SPIL (along with Caraco) has 87 ANDAs (for 71 products) awaiting approval with the US FDA. It expects to file about 30 ANDAs in FY08E between itself and Caraco taking the total pending pipeline to over 100 by end-FY08.

Para-IV pipeline becoming more visible, reflects well planned strategy

We note that SPIL's Para-IV pipeline is gaining more visibility with three Para-IV applications getting US FDA approval in the past few months. All of these products are eligible for shared 180-day exclusivity as SPIL was one of FTFs. These include approvals for generic Protonix, Trileptal and Exelon (cumulative ~US\$3b branded sales), of which it has already launched Trileptal in October. The company is still evaluating all its options for launch of other two products as it may involve launch-at-risk. In addition to these products, SPIL has also received a "will-not-sue" covenant from Wyeth for Effexor XR (US\$2.6b market). Teva has already entered into an out-of-court settlement for its version of generic Effexor in the past. SPIL's product may not get an AB rating as the filing is for tablets while the RLD is for capsules.

We believe that the above Para-IV filings reflect a well planned strategy for patent challenges without taking any major risks (shared exclusivities will involve lower risks in case of adverse litigation outcome).

Update on Taro Pharma acquisition

SPIL's proposed acquisition of Taro Pharma has been contested by some of Taro's minority shareholders. A decision on this is expected post Taro's EGM (dates not

disclosed). Taro Pharma has rescheduled its EGM in order to give additional time to shareholders, to fully consider the takeover proposal from SPIL and to declare CY06 and 1HCY07 results. SPIL has till date invested US\$58m in Taro. Total investment in Taro will be in the range of US\$250-500m depending on the structuring for the acquisition.

Past acquisitions to be leveraged from FY09E onwards

Product filings are likely to pick up out of the acquired Valeant facility (situated at Ohio, USA) and Able Labs facility. The Valeant facility gives SPIL the capability to manufacture liquids and semi-solids. It is pertinent to note that Caraco does not have such capabilities and that it would have been economically uncompetitive for SPIL to transport such products from India to USA. The acquisition of Valeant's Hungary facility is expected to help SPIL in filings for the European markets.

SPIL had also acquired the assets of US-based Able Laboratories Ltd. for \$23.15m. Able Labs had filed for bankruptcy as per US regulations and had invited bids for its assets. SPIL will be acquiring the manufacturing facilities of Able Labs through this acquisition. The purchase also includes a lease for Able's premises in New Jersey, some contracts and purchase of another property in New Jersey. Able Labs had faced problems with US FDA compliance in the past and had to recall all of its 30 products from the US market. In August-2005, the US FDA denied Able's proposal that it be permitted to revalidate its data and re-launch its product line without full US FDA review.

Able was in the process of transferring its manufacturing lines to a new 225,000 sq ft facility from its old 50,000 sq ft plant. We believe that this new facility will be utilised by SPIL to launch its own products in the US generics market. SPIL will also have the option of re-launching Able's products after rectifying the deficiencies identified by the US FDA. Able Labs had generated sales of about \$100m from its generic portfolio in 2004 (value of this portfolio

would have reduced significantly due to competitive forces). We, however, do not have details on Able's product portfolio and hence are not aware about any possible overlaps with SPIL's existing portfolio.

We believe that SPIL is cautiously acquiring generic assets (with specific focus on distress assets). This is evident from SPIL's recent acquisitions of Valeant Pharma's facilities in Hungary and USA (both costing about \$10m each). The acquisition of Able Labs assets is also a step in this direction.

While we do not expect any immediate financial benefits to SPIL from the acquisition of Able Lab's facilities (since it will have to rectify the deficiencies identified by the US FDA), we believe that it will be long-term positive for the company going by SPIL's past track record of acquisitions. SPIL is currently in the process of re-filing some of the products of Able Labs with the US FDA and we expect these products to start contributing to SPIL's revenues from FY09E onwards.

Acquisitions to adversely impact FY08 consolidated earnings

All the acquisitions made by Sun Pharma in the past 12-18 months have been for distress assets. While these acquisitions will have positive implications for the company in the long term, we believe they are likely to drag down consolidated earnings in FY08. Sun Pharma has indicated a timeline of at least 18 months for effecting a turnaround at these units. Our estimates have been accordingly adjusted to take into account the impact of these acquisitions.

Proposed fund raising plans to fund future acquisitions

SPIL has proposed to raise up to Rs35b for future acquisitions in the generic space. However, pending Taro Pharma acquisition, the company is unlikely to go in for any large acquisitions in the near term. The proposed fund raising will entail an equity dilution of about 15-20% at current stock price. It is also likely to pull down the return ratios till the funds are effectively deployed. This will be in

addition to the short-term adverse impact of the Taro acquisition. However, given Sun Pharma's past track record of entering into value-adding M&As, we believe that it can generate value for shareholders in the long-term by deploying these funds effectively.

Guidance

Sun Pharma has maintained its guidance of sales growth of 15-18% (in rupee terms) for FY08E, generic R&D expenses at 8-10% of sales (including R&D capex) and overall capex of Rs1.25b. It expects to maintain EBITDA margins at 32-33% for FY08E. It targets to file 30 ANDAs with the US FDA in FY08E to strengthen its generic pipeline (which will also result in higher R&D costs).

Valuation and outlook

An expanding generic portfolio coupled with change in product mix in favor of high-margin exports is likely to bring in long-term benefits for SPIL. SPIL's ability to sustain high growth rates at superior margins even on a high base is a clear positive. With the domestic business progressing well and increasing traction on the US front (both in Caraco and from India), the possibility of a rapid scale-up over the next couple of years is high.

While current valuations at 24.5x FY08E and 20.5x FY09E EPS (excl. Taro acquisition) appear rich, they do not fully factor in the ramp-up in US, the expected value unlocking by leveraging acquired companies (Taro, Able Labs & Valeant) and incremental upsides from its Para-IV pipeline. Maintain **Buy** with revised target price of Rs1,120.

Sun Pharmaceuticals: an investment profile

Company description

Sun Pharma is among the largest players in the domestic formulations market and the most profitable one. It makes and markets specialty medicines and APIs for chronic therapy areas such as cardiology, psychiatry, neurology, etc. Sun has forayed into regulated markets by acquiring majority stake in Caraco Pharma and intends to look at inorganic means to get a foothold in Europe, as well.

Key investment arguments

- ☞ Ability to identify niches in long term therapy areas with high entry barriers and build strong franchise to ensure sustainable growth and high margins.
- ☞ Well-diversified portfolio de-risks its portfolio against any slowdown in a particular category.
- ☞ Among the few Indian companies to have a direct presence in the US market (through Caraco).

Key investment risks

- ☞ Highly dependent on new product launches for growth in domestic market.
- ☞ Has not demonstrated the ability to build any big brand so far – a key driver for growth going forward.
- ☞ Capability to scale up exports, particularly to unregulated markets, is yet to be fully demonstrated.

Recent developments

- ☞ Received 180 days shared marketing exclusivity for generic Protonix, Trileptal and Exelon (cumulative ~US\$3b branded sales).

Valuation and view

- ☞ Multiples of 24.5x FY08E and 20.5x FY09E earnings do not reflect the potential leverage arising out of overseas acquisitions and ramp up in US business.
- ☞ Re-iterate **Buy** with revised price target of Rs1,120.

Sector view

- ☞ Regulated markets would remain the key sales and profit drivers in the medium term. Europe is expected to emerge as the next growth driver, particularly for companies with a direct marketing presence.
- ☞ We are overweight on companies that are towards the end of the investment phase, with benefits expected to start coming in from the next fiscal.

COMPARATIVE VALUATIONS

		SUN PHARMA	RANBAXY	DRL
P/E (x)	FY08E	24.5	21.9	15.7
	FY09E	20.5	21.6	14.6
P/BV (x)	FY08E	4.5	16.8	2.2
	FY09E	3.8	4.7	2.0
EV/Sales (x)	FY08E	6.9	2.3	2.2
	FY09E	5.6	2.4	1.9
EV/EBITDA (x)	FY08E	19.5	14.8	13.2
	FY09E	16.1	14.0	10.6

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	66.3	67.0	70.9
Domestic Inst	4.8	5.0	3.0
Foreign	18.3	17.6	16.4
Others	10.6	10.3	9.8

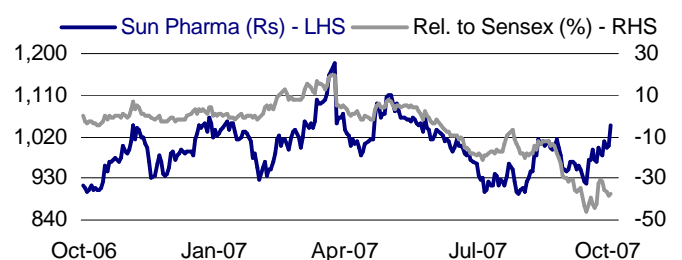
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	42.5	45.0	-5.5
FY09	50.8	55.6	-8.6

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,042	1,120	7.5	Buy

STOCK PERFORMANCE (1 YEAR)



CONSOLIDATED INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
Net Sales	11,448	15,945	20,792	24,820	29,106
Change (%)	21.0	39.3	30.4	19.4	17.3
Total Expenditure	7,266	11,050	14,069	16,039	18,915
EBITDA	4,182	4,895	6,723	8,780	10,191
Margin (%)	36.5	30.7	32.3	35.4	35.0
Depreciation	406	610	813	959	1,028
EBIT	3,776	4,285	5,910	7,821	9,163
Int. and Finance Charges	129	0	0	213	80
Other Income - Rec.	563	1,684	2,425	2,028	2,520
PBT	4,209	5,969	8,334	9,637	11,603
Tax	207	239	-67	193	348
Tax Rate (%)	4.9	4.0	-0.8	2.0	3.0
Profit after Tax	4,002	5,730	8,401	9,444	11,255
Change (%)	16.2	43.2	46.6	12.4	19.2
Margin (%)	35	36	40	38	39
Less: Minority Interest	42	-3	559	639	727
Net Profit	3,960	5,733	7,842	8,805	10,528

CONSOLIDATED BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
Equity Share Capital	928	929	967	1,036	1,036
Preference Share Capital	14	14	14	14	14
Total Reserves	10,366	14,959	26,747	46,791	55,545
Net Worth	11,307	15,902	27,728	47,840	56,594
Minority Interest	161	332	438	1,077	1,804
Deferred Liabilities	896	1,053	895	963	1,160
Total Loans	18,230	18,745	11,144	1,000	1,000
Capital Employed	30,595	36,031	40,205	50,879	60,558
Gross Block	7,806	12,342	14,252	14,952	16,202
Less: Accum. Deprn.	2,087	3,779	4,738	5,697	6,725
Net Fixed Assets	5,719	8,563	9,514	9,255	9,477
Capital WIP	493	414	608	608	608
Goodwill	1,538	507	697	697	697
Investments	6,485	3,541	2,543	4,892	4,892
Curr. Assets	18,946	26,520	29,889	39,353	49,267
Inventory	3,173	5,117	6,645	3,978	4,665
Account Receivables	2,511	3,609	6,789	5,440	6,379
Cash and Bank Balance	11,809	15,323	13,802	26,331	33,996
Curr. Liability & Prov.	2,587	3,515	3,046	3,925	4,382
Account Payables	1,741	2,279	2,966	2,224	2,608
Provisions	845	1,236	80	1,701	1,775
Net Current Assets	16,360	23,006	26,843	35,428	44,884
Appl. of Funds	30,595	36,031	40,205	50,879	60,558

E: Most Estimates

RATIOS					
Y/E MARCH	2005	2006	2007	2008E	2009E
Basic (Rs)					
EPS	21.3	30.9	40.6	42.5	50.8
Fully Diluted EPS	19.1	27.7	37.9	42.5	50.8
Cash EPS	23.5	30.6	41.8	47.1	55.8
BV/Share	60.9	85.5	143.3	230.9	273.2
DPS	3.8	5.5	6.7	7.0	7.3
Payout (%)	18.2	20.4	17.7	18.0	15.8
Valuation (x)					
P/E		37.6	27.5	24.5	20.5
Cash P/E		34.0	24.9	22.1	18.7
P/BV		12.2	7.3	4.5	3.8
EV/Sales		12.6	9.4	6.9	5.6
EV/EBITDA		41.1	29.2	19.5	16.1
Dividend Yield (%)		0.5	0.6	0.7	0.7
Return Ratios (%)					
RoE	40.7	42.1	35.9	23.3	20.2
RoCE	20.7	18.6	22.7	22.5	22.0
Working Capital Ratios					
Asset Turnover (x)	0.4	0.4	0.5	0.5	0.5
Debtor (Days)	84	87	126	84	84
Inventory (Days)	107	124	123	62	62
Working Capital T/O (Days)	550	555	497	550	594
Leverage Ratio					
Debt/Equity (x)	16	12	0.4	0.0	0.0

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
Oper. Profit/(Loss) before Tax	4,271	4,168	6,723	8,780	10,191
Interest/Dividends Recd.	247	1,025	2,425	2,028	2,520
Direct Taxes Paid	-107	-165	-91	-125	-151
(Inc)/Dec in WC	-658	-3,177	-5,358	3,944	-1,791
CF from Operations	3,754	1,852	3,699	14,627	10,769
(inc)/dec in FA	-1,623	-3,384	-2,148	-700	-1,250
(Pur)/Sale of Investments	-4,908	5,173	998	-2,349	0
CF from investments	-6,531	1,789	-1,150	-3,049	-1,250
Issue of Shares	0	0	5,015	13,008	1
(Inc)/Dec in Debt	14,349	801	-7,601	-10,144	0
Interest Paid	-84	-156	0	-213	-80
Dividend Paid	-625	-772	-1,483	-1,701	-1,775
CF from Fin. Activity	13,640	-127	-4,070	950	-1,854
Inc/Dec of Cash	10,864	3,514	-1,521	12,529	7,665
Add: Beginning Balance	945	11,809	15,323	13,802	26,331
Closing Balance	11,809	15,323	13,802	26,331	33,996

Note: Cashflows do not tally due to acquisition

N O T E S



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Sun Pharmaceutical Industries

1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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