

# Sun Pharmaceuticals

Bloomberg: SUNP IN EQUITY

Recommendation: BUY

Reuters: SUN.BO

No Change



## EVENT UPDATE

## Conservative 'launch-at-risk' – minimizes probability of damages

Sun's conservative 'launch-at-risk' of generic Protonix reduces probability of damages

Sun Pharma and Teva had challenged the compound patent for Protonix (Innovator: Pfizer/Wyeth) which is due to expire in January 2011 after expiry of the paediatric exclusivity. Sun and Teva had launched a generic version of Protonix DR tabs at-risk in Jan'08 and Dec'07 respectively. The US court had denied Sun's motion for judgment as a matter of law seeking to reverse an earlier jury verdict in a patent litigation over the generic Protonix.

**We believe the probability of claims arising out of this launch-at-risk of the generic Protonix is low for Sun Pharma. The following could reduce the probability of payment of damages:**

- high possibility of settlement for Protonix /other patent litigations
- last entry, launch at high price and low market share
- low probability of entire \$ 200mn claims as damages
- Appeal in a higher court should follow

### 1. Possibility of settlement for Protonix/other litigations is high

- Dwindling pipelines for innovators has led to mega-mergers and settlements with generics in the recent past. We feel that there is high possibility of a settlement on Protonix or other ongoing challenges between Pfizer and Sun in order to protect other patent franchisees.

#### Exhibit 1: Some ongoing patent litigations between Pfizer v/s Sun and Teva

	Sun Pharma	Teva
<b>Pfizer/Wyeth</b>	Lyrica (\$1.5 bn)	Effexor-XR (\$ 2.6 bn)
	Effexor-XR (\$2.6 bn)	Lipitor (\$8bn)
		Viagra (\$1.2bn)

Source: Company, Ambit Capital research

### 2. Last entry, launch at high price & low generic m-share of 15-20%

- Sun Pharma launched its generic after Teva (currently largest market share ~50%) and the authorized generics (Wyeth themselves) launch, at a price which was higher compared with either the Wyeth generic or Teva.
- Sun Pharma's sales can be expected to be between US\$60-100mn a year and a total of US\$150-200mn in the 27-month total sale period.

#### Exhibit 2: Key financials

Rs mn	FY08	FY09	FY10E	FY11E	FY12E
Income	33,565	42,723	41,028	48,387	57,524
EBITDA Margins (%)	46.2	43.6	33.2	34.4	34.9
PAT	14,352	18,177	13,511	15,943	19,212
EPS (Rs)	69.3	87.8	65.2	77.0	92.8
ROE (%)	28.8	25.8	16.8	17.2	17.8
ROCE (%)	29.4	25.9	16.5	17.7	18.4
PE (x)	25.1	19.8	26.7	22.6	18.8
Price/BV(x)	7.2	5.1	4.5	3.9	3.3

Source: Company, Ambit Capital research

Ambit Capital and / or its affiliates do and seek to do business including investment banking with companies covered in its research reports. As a result, investors should be aware that Ambit Capital may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

Please refer to disclaimer section on the last page for further important disclaimer.

## Analyst contact

Anshuman Gupta

Tel: +91 22 3043 3286  
 anshumangupta@ambitcapital.com

Vijay Chugh

Tel.: +91 22 3043 3054  
 vijaychugh@ambitcapital.com

## Recommendation

<b>CMP:</b>	Rs1,740
<b>Target Price:</b>	Rs2,067
<b>Previous TP:</b>	Rs2,067
<b>Upside (%)</b>	19
<b>EPS (FY12E):</b>	Rs93

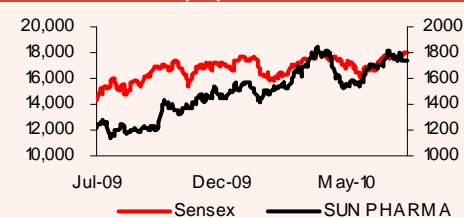
## Stock Information

<b>Mkt cap:</b>	Rs358,450mn/US\$7,691mn
<b>52-wk H/L:</b>	1,853/1,117
<b>3M Avg. daily vol. (mn):</b>	0
<b>Beta (x):</b>	0.5
<b>BSE Sensex:</b>	17956
<b>Nifty:</b>	5394

## Stock Performance (%)

	1M	3M	12M	YTD
<b>Absolute</b>	2.2	-3.8	42.5	15.3
<b>Rel. to Sensex</b>	-0.6	-5.7	13.1	12.2

## Performance (%)



Source: Bloomberg, Ambit Capital research

### 3. Low probability of entire US\$200mn as claims for damages

- Eventually, if Sun Pharma fails to invalidate patent, it might have to pay US\$200mn as damages. Pfizer lost nearly US\$3.2bn in sales in 27 months of generic entry, and at 40% profit, it lost US\$1.3bn of the profits. Sun Pharma's share is at 15% resulting in lost profits of about US\$200mn for Pfizer/Wyeth.
- Since Sun's generic launch is after the entry of Teva and Wyeth generics, and at a higher price than the launched generics, we believe that the damage claims should be far lower.
- Entry of generics has helped to reduce US health expenditure substantially and the overall pro-generic approach of the US should also help limit damage claims. Sun is one of the largest generic players in the US with US as a focus.

### 4. Appeal in the Federal Court should follow

- We believe that Sun Pharma and Teva will decide to challenge the patent invalidity case in the Federal Circuit court which would eventually delay the decision on claims even if Sun Pharma loses the case.

### Investment view

Since Sun's generic launch is after the entry of Teva and Wyeth generics, and at a higher price than the launched generics, we believe that the damage claims should be far lower than expectations. Any downside in the stock price should be used as a buying opportunity.

We believe that concerns to Sun Pharma's business model are receding over. These concerns have weighed heavily on Sun Pharma's stock price over the past one year especially 1) resolution of Caraco's plant issues with FDA – resolution could happen in the next 3-6 months; and 2) completion of the Taro acquisition - US district court has ruled in favour of Sun to go ahead with open offer, awaiting final decision from the Israeli Supreme court.

**Valuations:** We value Sun's core business at Rs2,046 at 22x FY12 EPS estimates of Rs93 and upsides from the Taro acquisition at Rs21 (0.5x Rs42/share). We believe there is greater certainty of growth for Sun Pharma and maintain our BUY recommendation with a target price (TP) of Rs2,067, a 19 % upside from current levels.

**Exhibit 3: Balance sheet****Y/E March (Rsmn)**

	<b>49,915</b>	<b>70,449</b>	<b>80,586</b>	<b>92,753</b>	<b>107,703</b>
<b>Shareholders funds</b>					
Capital	1,036	1,036	1,036	1,036	1,036
Reserves & surplus	48,879	69,414	79,551	91,717	106,667
<b>Borrowings</b>	<b>1,436</b>	<b>1,789</b>	<b>2,164</b>	<b>1,964</b>	<b>1,764</b>
Secured loans	368	364	364	364	364
Unsecured loans	1,068	1,425	1,800	1,600	1,400
Deferred tax liability (net)	1,178	1,228	1,497	1,674	1,857
<b>Sources of funds</b>	<b>54,415</b>	<b>75,436</b>	<b>86,047</b>	<b>98,340</b>	<b>113,958</b>
Gross block	15,960	21,476	23,976	25,976	27,976
Depreciation	5,607	6,851	8,383	10,044	11,832
<b>Net block</b>	<b>10,354</b>	<b>14,625</b>	<b>15,593</b>	<b>15,932</b>	<b>16,144</b>
Capital work in progress	686	1,571	1,571	1,571	1,571
Goodwill on consolidation	1,729	3,253	3,253	3,253	3,253
Investments	<b>7,560</b>	<b>8,518</b>	<b>8,518</b>	<b>8,518</b>	<b>8,518</b>
Deferred tax assets	1,087	1,907	1,907	1,907	1,907
Inventories	7,728	9,757	10,997	13,700	15,661
Sundry debtors	14,177	8,811	11,422	12,440	15,928
Cash and Cash Equivalents	12,389	26,768	34,845	43,611	56,232
Loans and advances	4,759	6,983	7,079	7,984	8,893
Other current assets	320	441	829	497	300
<b>Total current assets</b>	<b>39,372</b>	<b>52,760</b>	<b>65,173</b>	<b>78,232</b>	<b>97,014</b>
Current liabilities	3,722	3,767	5,858	5,596	8,021
Provisions	2,651	3,431	4,109	5,478	6,428
<b>Total current liabilities and provisions</b>	<b>6,373</b>	<b>7,198</b>	<b>9,967</b>	<b>11,074</b>	<b>14,448</b>
Net current assets	32,999	45,562	55,205	67,158	82,566
<b>Uses Of funds</b>	<b>54,414</b>	<b>75,436</b>	<b>86,047</b>	<b>98,340</b>	<b>113,958</b>
Book value per share (INR)	241	340	389	448	520

Source: Company, Ambit Capital research

**Exhibit 4: Income statement**

Y/E March (Rsmn)	FY08	FY09	FY10E	FY11E	FY12E
<b>Income from operations</b>	<b>33,565</b>	<b>42,723</b>	<b>41,028</b>	<b>48,387</b>	<b>57,524</b>
Gross sales	34,606	43,751	41,599	49,315	58,610
Less: Excise	1,040	1,028	571	928	1,086
Net sales	33,565	42,723	41,028	48,387	57,524
Total operating expenses	18,054	24,084	27,400	31,742	37,448
Materials cost	7,222	8,556	10,979	13,064	15,531
Employee cost	2,331	3,401	3,795	4,355	5,062
Mfg Expenses	656	890	923	968	1,150
R&D Expenses	2,725	3,099	2,631	3,726	4,314
Other expenses	5,120	8,138	9,072	9,629	11,390
<b>EBITDA</b>	<b>15,511</b>	<b>18,640</b>	<b>13,628</b>	<b>16,645</b>	<b>20,076</b>
Depreciation and amortisation	969	1,233	1,533	1,661	1,788
Interest	88	58	70	70	70
Other income	1,451	2,143	2,123	2,430	2,660
Profit before tax	15,906	19,492	14,149	17,344	20,877
Provision for tax	914	712	679	1,301	1,566
<b>PAT</b>	<b>14,352</b>	<b>18,177</b>	<b>13,511</b>	<b>15,943</b>	<b>19,212</b>

Source: Company, Ambit Capital research

**Exhibit 5: Cashflow statement**

Y/E March (Rsmn)	FY08	FY09	FY10E	FY11E	FY12E
Cash flow from operations	14,040	17,846	13,864	16,444	19,710
Increase in Cash for working capital	(8,183)	4,148	(1,398)	(2,791)	(1,847)
<b>Net Operating Cash Flow</b>	<b>5,857</b>	<b>21,994</b>	<b>12,465</b>	<b>13,653</b>	<b>17,863</b>
Net purchase of fixed assets	(1,995)	(5,900)	(2,500)	(2,000)	(2,000)
Net purchase of investments	(4,078)	(8,604)	1,139	1,260	1,390
<b>Net cash flow from investing</b>	<b>(6,073)</b>	<b>(14,503)</b>	<b>(1,361)</b>	<b>(740)</b>	<b>(610)</b>
Proceeds from equity capital	-	(796)	-	-	-
Proceeds from LTB/STB	690	571	305	(270)	(270)
Others	(2,547)	(3,332)	(3,332)	(3,877)	(4,362)
<b>Net cash flow from financing</b>	<b>(1,857)</b>	<b>(3,557)</b>	<b>(3,027)</b>	<b>(4,147)</b>	<b>(4,632)</b>
<b>Free cash flow</b>	<b>(2,072)</b>	<b>3,934</b>	<b>8,077</b>	<b>8,766</b>	<b>12,621</b>
<b>Market cap</b>	<b>360,383</b>	<b>360,383</b>	<b>360,383</b>	<b>360,383</b>	<b>360,383</b>
Debt	1,436	1,789	2,164	1,964	1,764
Cash & cash equivalents	12,389	26,768	34,845	43,611	56,232
<b>Enterprise value</b>	<b>349,430</b>	<b>335,404</b>	<b>327,701</b>	<b>318,735</b>	<b>305,914</b>

Source: Company, Ambit Capital research

**Exhibit 6: Ratio analysis**

<b>Y/E March (Rsmn)</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10E</b>	<b>FY11E</b>	<b>FY12E</b>
ROE (%)	28.8	25.8	16.8	17.2	17.8
ROCE (%)	29.4	25.9	16.5	17.7	18.4
Inventory days	363	373	345	345	345
Debtors days	114	98	90	90	90
Fixed assets T/o ratio	2.1	2.0	1.7	1.9	2.1
Debt/equity	0.03	0.03	0.03	0.02	0.02
Net Debt/Equity	(0.22)	(0.35)	(0.41)	(0.45)	(0.51)

Source: Company, Ambit Capital research

**Exhibit 7: Valuation parameters**

<b>Y/E March (Rsmn)</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10E</b>	<b>FY11E</b>	<b>FY12E</b>
EPS, post exeptionals (INR.)	69.3	87.8	65.2	77.0	92.8
yoy growth (%)		26.7	(25.7)	18.0	20.5
Cash EPS (INR)	74.0	93.7	72.6	85.0	101.4
PE (x)	25.1	19.8	26.7	22.6	18.8
Price/BV(x)	7.2	5.1	4.5	3.9	3.3
EV/Sales (x)	10.4	7.9	8.0	6.6	5.3
EV/EBITDA (x)	22.5	18.0	24.0	19.1	15.2

Source: Company, Ambit Capital research

## Explanation of Investment Rating

Investment Rating	Expected return (over 12-month period from date of initial rating)
Buy	>15%
Hold	5% to 15%
Sell	<5%

## Disclaimer

This report or any portion hereof may not be reprinted, sold or redistributed without the written consent of Ambit Capital. AMBIT Capital Research is disseminated and available primarily electronically, and, in some cases, in printed form.

### Additional information on recommended securities is available on request.

#### DISCLAIMER

1. If you are dissatisfied with the contents of this complimentary Report or with the terms of this Disclaimer, your sole and exclusive remedy is to stop using the Report and AMBIT Capital Private Limited ("AMBIT Capital") shall not be responsible and/ or liable in any manner.
2. This Report has been issued by AMBIT Capital for the information of its clients/potential clients only.
3. If this Report is received by any client of an affiliate of AMBIT Capital, in addition to the provisions set out in this Disclaimer, its provision to the recipient is subject to the terms of business in place between the AMBIT Capital and such affiliate.
4. AMBIT Capital is a Stock Broker registered with Securities and Exchange Board of India Limited (SEBI) and so it is regulated by SEBI.
5. This Report is not and should not be construed as an investment advice to any client to acquire, subscribe, purchase, sell, dispose of, retain any securities or an offer to sell or the solicitation of an offer to purchase or subscribe for any investment or as an official endorsement of any investment.
6. If 'Buy', 'Sell', or 'Hold' recommendation is made in this Report such recommendation or view or opinion expressed on investments in this Report is not intended to constitute investment advice and should not be intended or treated as a substitute for necessary review or validation or any professional advice. The views expressed in this Report are those of the analyst which are subject to change and do not represent to be an authority on the subject. AMBIT Capital may or may not subscribe to any and/ or all the views expressed herein.
7. AMBIT Capital makes best endeavour to ensure that the analyst(s) use current, reliable, comprehensive information and obtain such information from sources which the analyst(s) believes to be reliable. However, such information has not been independently verified by AMBIT Capital or the analyst(s).
8. The information, opinions and views contained within this Report are based upon publicly available information and rates of taxation at the time of publication which are subject to change from time to time without any prior notice. Reports may be updated anytime without any prior notice to any and/ or all client(s).
9. AMBIT Capital makes no guarantee, representation or warranty, express or implied; and accepts no responsibility or liability as to the accuracy or completeness or currentness of the information in this Report.
10. Please note that past performance is not necessarily a guide to evaluate future performance.
11. AMBIT Capital and its affiliates and their respective officers directors and employees may hold positions in any securities mentioned in this Report (or in any related investment) and may from time to time add to or dispose of any such securities (or investment).
12. Affiliate(s) of AMBIT Capital may from time to time render advisory and other services to companies being referred to in this Report and receive compensation for the same.
13. AMBIT Capital may act as a market maker or risk arbitrator or liquidity provider or may have assumed an underwriting commitment in the securities of companies discussed in this Report (or in related investments) or may sell them or buy them from clients on a principal to principal basis or may be involved in proprietary trading and may also perform or seek to perform investment banking or underwriting services for or relating to those companies and may also be represented in the supervisory board or on any other committee of those companies.
14. AMBIT Capital may sell or buy any securities or make any investment which may be contrary to or inconsistent with this Report.
15. This Report should be read and relied upon at the sole discretion and risk of the client.
16. The value of any investment made at your discretion based on this Report or income therefrom may be affected by changes in economic, financial and/ or political factors and may go down as well as up and you may not get back the full or the expected amount invested. Some securities and/ or investments involve substantial risk and are not suitable for all investors.
17. This Report is being supplied to you solely for your information and may not be reproduced, redistributed or passed on, directly or indirectly, to any other person or published, copied in whole or in part, for any purpose. Neither this Report nor any copy of it may be taken or transmitted or distributed, directly or indirectly within India or into any other country including United States (to US Persons), Canada or Japan or to any resident thereof. The distribution of this Report in other jurisdictions may be strictly restricted and/ or prohibited by law, and persons into whose possession this Report comes should inform themselves about such restriction and/ or prohibition, and observe any such restrictions and/ or prohibition.
18. Neither AMBIT Capital nor its affiliates or their directors, employees, agents or representatives, shall be responsible or liable in any manner, directly or indirectly, for views or opinions expressed in this Report or the contents or any errors or discrepancies herein or for any decisions or actions taken in reliance on the Report or inability to use or access our service or this Report or for any loss or damages whether direct or indirect, incidental, special or consequential including without limitation loss of revenue or profits or any loss or damage that may arise from or in connection with the use of or reliance on this Report or inability to use or access our service or this Report.

© Copyright 2006 AMBIT Capital Private Limited. All rights reserved.

**Ambit Capital Pvt. Ltd.**

Ambit House, 3rd Floor  
449, Senapati Bapat Marg, Lower  
Parel, Mumbai 400 013, India.  
Phone : +91-22-3043 3000  
Fax : +91-22-3043 3100