

## Company Focus

7 March 2008 | 6 pages

# Sun Pharmaceuticals (SUN.BO)

## Buy: From Strength to Strength

- Maintain Buy (1L)** — Sun's track record of delivering consistent & robust growth while maintaining strong profitability & return ratios makes it the best Indian play in the generics space. Improving visibility on a strong patent challenge pipeline, rapid growth across geographies and relatively lower currency risk vis-à-vis peers will help it command a premium in an uncertain market environment. We maintain our Buy (1L) rating.
- Robust domestic franchise lowers currency risk** — Sun's dominance in chronic segments is a key strength, leading to superior growth & profitability vis-à-vis its peers. We expect Sun to be a key beneficiary of the rising growth rates and changing disease mix in India. Besides, with India making up c57% of sales, Sun's exposure to rupee appreciation is also lower than most of its peers.
- Taro nearing closure** — Taro's CY07 numbers were a positive surprise and it has indicated that it continues to work with Sun to conclude the merger agreement. We believe there is a good probability that the deal will go through; however, we have not included it in our estimates yet. While the deal could be dilutive in Yr 1, we expect a strong combined entity over the medium term, with a large product basket/pipeline, integrated operations & multiple synergies.
- Para-IV traction** — The visibility on Sun's patent challenge pipeline has improved significantly. Sun has 1) launched generic Trileptal; 2) settled Exelon with Novartis 3) launched generic Protonix "at-risk" following breakdown of settlement talks between Teva & Wyeth 4) received a "will not sue" covenant from Wyeth for Effexor XR. We expect Sun's patent challenge pipeline to emerge as a key source of option value going forward

<b>Buy/Low Risk</b>	<b>1L</b>
Price (05 Mar 08)	Rs1,328.50
Target price	Rs1,350.00
Expected share price return	1.6%
Expected dividend yield	0.9%
<b>Expected total return</b>	<b>2.5%</b>
Market Cap	Rs271,808M
	US\$6,758M

### Price Performance (RIC: SUN.BO, BB: SUNP IN)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	5,733	27.68	35.7	48.0	17.0	41.4	0.4
2007A	7,843	37.87	36.8	35.1	9.8	35.4	0.5
2008E	11,971	57.80	52.6	23.0	7.2	36.2	1.0
2009E	14,008	67.64	17.0	19.6	5.6	32.0	1.2
2010E	15,788	76.23	12.7	17.4	4.4	28.1	1.4

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
<b>Valuation Ratios</b>					
P/E adjusted (x)	48.0	35.1	23.0	19.6	17.4
EV/EBITDA adjusted (x)	53.6	39.9	22.4	18.7	16.6
P/BV (x)	17.0	9.8	7.2	5.6	4.4
Dividend yield (%)	0.4	0.5	1.0	1.2	1.4
<b>Per Share Data (Rs)</b>					
EPS adjusted	27.68	37.87	57.80	67.64	76.23
EPS reported	27.68	37.87	57.80	67.64	76.23
BVPS	78.32	135.93	183.44	239.26	302.41
DPS	5.52	7.01	13.69	16.08	18.20
<b>Profit &amp; Loss (RsM)</b>					
Net sales	16,380	21,340	29,400	34,223	39,370
Operating expenses	-11,923	-15,410	-18,582	-21,526	-25,489
<b>EBIT</b>	<b>4,457</b>	<b>5,930</b>	<b>10,818</b>	<b>12,697</b>	<b>13,881</b>
Net interest expense	0	0	1,331	1,920	2,569
Non-operating/exceptionals	1,412	2,405	887	1,084	1,315
<b>Pre-tax profit</b>	<b>5,869</b>	<b>8,335</b>	<b>13,036</b>	<b>15,701</b>	<b>17,765</b>
Tax	-239	67	-339	-785	-888
Extraord./Min.Int./Pref.div.	103	-559	-726	-908	-1,090
<b>Reported net income</b>	<b>5,733</b>	<b>7,843</b>	<b>11,971</b>	<b>14,008</b>	<b>15,788</b>
Adjusted earnings	5,733	7,843	11,971	14,008	15,788
Adjusted EBITDA	5,067	6,743	11,724	13,660	14,897
<b>Growth Rates (%)</b>					
Sales	38.0	30.3	37.8	16.4	15.0
EBIT adjusted	18.1	33.0	82.4	17.4	9.3
EBITDA adjusted	21.2	33.1	73.9	16.5	9.1
EPS adjusted	35.7	36.8	52.6	17.0	12.7
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>3,211</b>	<b>3,298</b>	<b>11,182</b>	<b>11,831</b>	<b>13,567</b>
Depreciation/amortization	610	813	906	964	1,016
Net working capital	-3,132	-5,358	-1,695	-3,140	-3,236
<b>Investing cash flow</b>	<b>-1,513</b>	<b>-1,105</b>	<b>-20,765</b>	<b>-9,408</b>	<b>-11,108</b>
Capital expenditure	-4,457	-2,103	-1,608	-1,608	-1,608
Acquisitions/disposals	2,944	998	-19,157	-7,800	-9,500
<b>Financing cash flow</b>	<b>-1,696</b>	<b>6,081</b>	<b>-1,291</b>	<b>-3,357</b>	<b>-3,798</b>
Borrowings	-516	7,603	1,567	0	0
Dividends paid	-1,167	-1,483	-2,858	-3,357	-3,798
<b>Change in cash</b>	<b>2</b>	<b>8,274</b>	<b>-10,874</b>	<b>-933</b>	<b>-1,339</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>39,547</b>	<b>43,250</b>	<b>52,021</b>	<b>64,267</b>	<b>78,170</b>
Cash & cash equivalent	15,628	14,106	825	800	551
Accounts receivable	3,609	6,789	7,461	9,023	10,680
Net fixed assets	8,977	10,122	10,823	11,467	12,059
<b>Total liabilities</b>	<b>23,314</b>	<b>15,085</b>	<b>14,016</b>	<b>14,703</b>	<b>15,527</b>
Accounts payable	2,279	2,966	3,464	4,151	4,975
Total Debt	18,747	11,144	9,577	9,577	9,577
<b>Shareholders' funds</b>	<b>16,233</b>	<b>28,165</b>	<b>38,005</b>	<b>49,564</b>	<b>62,643</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	30.9	31.6	39.9	39.9	37.8
ROE adjusted	41.4	35.4	36.2	32.0	28.1
ROIC adjusted	28.6	29.2	41.8	42.3	40.7
Net debt to equity	19.2	-10.5	23.0	17.7	14.4
Total debt to capital	53.6	28.3	20.1	16.2	13.3

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# Sun Pharmaceuticals

## Company description

Sun Pharma is one of the fastest-growing companies in the domestic pharmaceutical market, growing at about 2x the industry rate. The company has followed a strategy of being the first to enter niche, high-growth segments (both organic and through acquisitions). The company has a presence in the CNS, pain management, ophthalmology, cardiovascular and respiratory segments. Sun is facing stiff competition in its traditional strongholds, but has managed to sustain growth and is focusing on new therapeutic areas. The company is looking to export its top formulation products to drive growth, and has set up marketing and distribution infrastructure in various markets. It is also filing for ANDA approvals through its US subsidiary Caraco and is close to concluding its second key acquisition in the US (Taro Pharma).

## Investment strategy

We rate Sun Pharma as Buy/Low Risk (1L), with a target price of Rs1,350. The recent Taro acquisition, using idle funds on the balance sheet, improves the company's global scale and reach as well as improving quality of earnings. Having taken a big step forward towards being bigger and more geographically spread out, we believe that Sun is now well placed to grow despite the challenges that keep coming the way of global generics companies. Its strong base in India should continue to be a good driver of growth and profitability as well as a source of cash flows, besides providing it with a cushion against an appreciating rupee. At the same time, the growing visibility and success on its patent challenge pipeline improves cash flows as well as its ability to gain traction with the trade.

## Valuation

Our target price of Rs1,350 is based on a sum-of-the-parts approach. We value Sun's base business using a P/E vs. earnings CAGR approach and ascribe an option value for its patent challenge pipeline. We value Sun's base business at 22x FY09E earnings. With a steadily growing profit line, we believe P/E is the best method to value Sun Pharma. We value frontline pharma stocks at a premium of around 40% to the broad market, due to the intellectual property built into the business models, faster growth as well as the potential to deliver positive earnings surprises. This works out to a multiple of 20x that we use for stocks such as Ranbaxy, Glenmark & Cipla. However, since we do not include a few upsides (Effexor XR, Taro acquisition) into our estimates at this point in time, we use a higher multiple of 22x to capture this value. At 22x FY09E earnings, we arrive at a value of Rs1,300 /share for the base business. We also ascribe an option value of Rs50/share to Sun's patent challenge pipeline following the success achieved by Sun in monetizing three patent challenges (Trileptal, Protonix, Exelon), which we value on an NPV basis, and the growing number of patent challenges.

## Risks

We rate Sun Pharma as Low Risk because of its steady growth and visible earnings stream. This is also consistent with our quantitative risk-rating system, which tracks 260-day historical share price volatility. The key risks to our target price are: (1) Price deterioration in any of its key markets; (2) Inability to close / effectively integrate the Taro acquisition and exploit synergies could keep earnings depressed for longer than we have anticipated; (3) A stronger IPR law in India could lead to a gradual slowdown in growth rates for the Indian market; (4) Damages to be paid in case it loses the litigation on Protonix with Wyeth. Upside risks to our target price include a faster-than-expected integration of the Taro acquisition and a win in any patent challenge.

# Appendix A-1

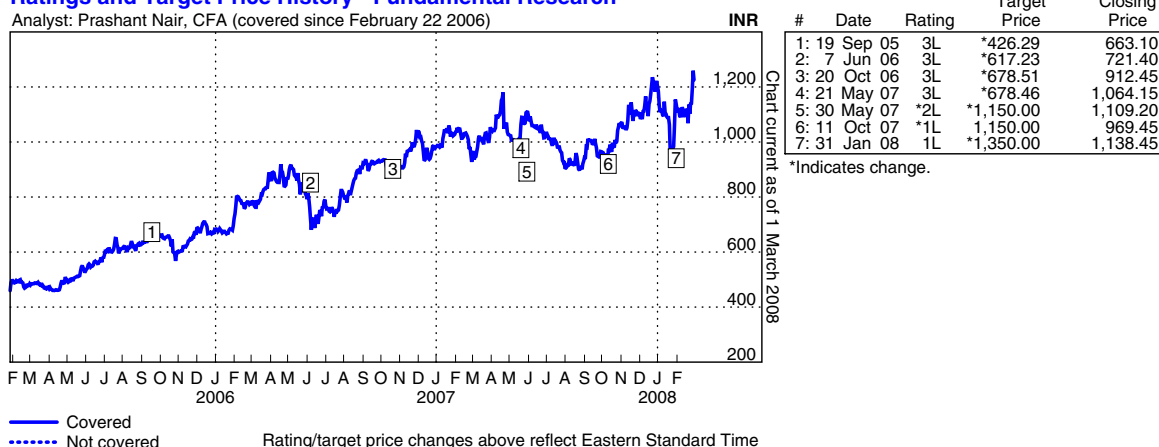
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Analyst: Prashant Nair, CFA (covered since February 22 2006)



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