

Sun Pharmaceutical Industries Ltd.

SELL
CMP Rs1,751
TP Rs1,500

2 September 2010

More trouble with the USFDA

Sun Pharma (SUNP) has reported that its facility in Cranbury, New Jersey received a warning letter on August 25th, 2010. This facility does not meaningfully contribute to SUNP's current revenues and hence SUNP has also not changed its guidance for FY11. However this facility is an important for the launch of controlled substances in US. Controlled substances (addressable market of US\$4-5bn) are an important growth driver for SUNP's base business in US in FY12. To that extent we believe street estimates for the base business for FY12 could be at risk. Re-iterate SELL.

USFDA warning letter highlights some difficult issues

A quick examination of the letter indicates some serious and some procedural issues at the facility. The USFDA has highlighted some lapses wherein it wants SUNP to conduct an investigation {observation 2(a)} while in some other cases it wants standard operating procedures to be set and approved by the USFDA{observation 4}. We believe such issues will take time to get resolved even as it is difficult to set a hard time frame to it.

What now?

SUNP has 15 days to respond to the letter with the specific requirement as highlighted in the letter after which the USFDA will decide the future course of action.

FY12 estimates for base business could be at risk

We believe street estimates (as well as ours) for FY12e factor in a resolution of the issues with the Caraco facility in Detroit and also do not factor in any issues at any other facility. To the extent of delay in resolving these issues and consequent delay in getting product approvals (more so for the controlled substances) the FY12 estimates could be at risk.

VALUATIONS AND RECOMMENDATION

We re-iterate our 'SELL' with a TP of Rs1,500 (22x Sept'11 earnings). We retain our FY12 estimates as we await greater clarity on the issue. With the base business in US under pressure due to the ongoing issues with the USFDA there is little margin of safety at current valuations of 24x FY12e recurring estimates.

KEY FINANCIALS (Rs mn)

	FY08	FY09	FY10P	FY11E	FY12E
Recurring Sales	24,063	32,079	30,182	38,745	47,039
YoY Gr.(%)	12.9	33.3	(5.9)	28.4	21.4
Op. Profit	8,355	10,071	5,856	12,367	14,404
Op. Marg(%)	34.7	31.4	19.4	31.9	30.6
Recurring PAT	8,410	9,609	5,758	13,179	15,281
YoY Gr.(%)	7.2	14.3	(40.1)	128.9	15.9

KEY RATIO

Recurring EPS (Rs)	40.6	46.4	27.8	63.6	73.8
ROCE (%)	16.0	13.9	5.5	11.9	12.3
RoE (%)	21.7	16.0	7.6	14.9	15.0
PER (x)*	43.1	37.7	63.0	27.5	23.7
EV/ Net Sales (x)	14.3	10.3	10.8	8.3	6.7
EV/EBDITA (x)	41.2	32.7	55.6	25.9	21.9

* Based on recurring earnings

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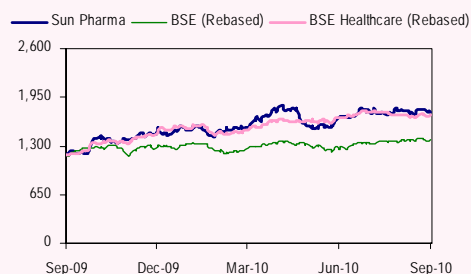
STOCK DATA

Market cap	Rs363bn
Book Value per share	Rs395
Shares O/S (F.V. Rs5)	207mn
Free Float	36.3%
Avg. Trade Value (6 months)	Rs358mn
52 week High/Low	Rs1,846/1,122
Bloomberg Code	SUNP IN
Reuters Code	SUN.BO

PERFORMANCE (%)

	1M	3M	12M
Absolute	(1.0)	4.0	47.1
Relative	(2.9)	(4.3)	25.0

RELATIVE PERFORMANCE



Event Update

Year Ended March (Figures in Rs mn)

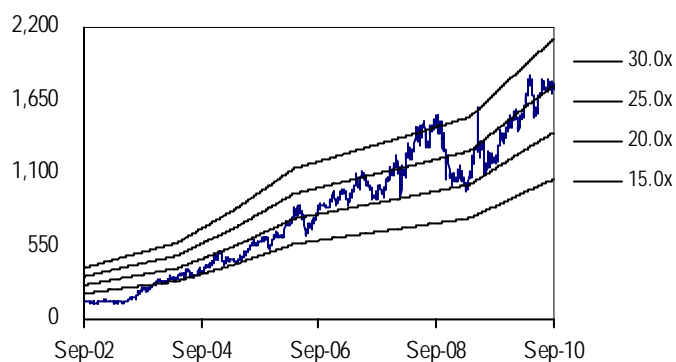
Income Statement	FY08	FY09	FY10P	FY11E	FY12E
Recurring sales	24,063	32,079	30,182	38,745	47,039
Growth (%)	12.9	33.3	(5.9)	28.4	21.4
One time opportunities	9,541	10,710	9,814	5,330	-
Total Revenue	33,603	42,789	39,996	44,075	47,039
Growth (%)	57.6	27.3	(6.5)	10.2	6.7
Reported EBITDA	15,511	18,639	13,707	15,685	14,404
Recurring EBITDA	8,355	10,071	5,856	12,367	14,404
Growth (%)	24.3	20.5	(41.9)	111.2	16.5
Depreciation	969	1,233	1,533	1,626	1,710
Other Income	1,451	2,085	2,072	3,262	3,499
PBT	8,838	10,924	6,395	14,004	16,194
Tax Provision	485	712	678	1,039	972
E/o income/(loss)	640	603	(41)	(49)	(59)
Reported Net Profit	14,869	18,177	13,609	16,331	15,281
Recurring Net Profit	8,410	9,609	5,758	13,179	15,281
Growth (%)	7.2	14.3	(40.1)	128.9	15.9
Recurring Diluted EPS (Rs)	40.6	46.4	27.8	63.6	73.8
Diluted EPS Growth (%)	7.2	14.3	(40.1)	128.9	15.9

Cash Flow Statement	FY08	FY09	FY10P	FY11E	FY12E
Pre-tax profit	15,993	19,492	14,246	17,322	16,194
Depreciation	969	1,233	1,533	1,626	1,710
Total Tax Paid	(1,822)	(1,690)	(678)	(1,039)	(972)
Chg in working capital	(9,340)	31	(6,812)	(7,564)	(7,144)
Other operating activities	(753)	2,585	(2,072)	(3,262)	(3,499)
Cash flow from oper (a)	5,047	21,651	6,217	7,082	6,288
Capital Expenditure	(1,995)	(5,900)	(2,571)	(2,571)	(2,571)
Chg in invetments	(5,242)	(9,740)	(11,405)	(5,000)	-
Other investing activities	1,177	797	2,072	3,262	3,499
Cash flow from inv.(b)	(6,060)	(14,844)	(11,904)	(4,309)	928
Free cash flow (a+b)	(1,013)	6,807	(5,687)	2,773	7,217
Equity raised/(repaid)	(14)	-	-	-	-
Debt raised/(repaid)	(27)	351	(1,789)	-	-
Change in Minority Int	808	(518)	-	-	-
Dividend (incl. Tax)	(18)	(2,422)	(2,290)	(2,748)	(2,569)
Other financing activities	(88)	(78)	-	-	-
Cash flow from fin. (c)	661	(2,667)	(4,079)	(2,748)	(2,569)
Net chg in cash (a+b+c)	(352)	4,140	(9,766)	25	4,648

Balance Sheet	FY08	FY09	FY10P	FY11E	FY12E
Equity Share Capital	1,036	1,036	1,036	1,036	1,036
Reserves & surplus	48,878	69,414	80,733	94,317	107,029
Shareholders' funds	49,914	70,449	81,769	95,353	108,065
Minorities interests	1,886	1,970	1,929	1,880	1,821
Total Debt	1,438	1,789	-	-	-
Capital Employed	53,238	74,209	83,698	97,233	109,886
Net fixed assets	12,769	19,450	20,488	21,433	22,294
Cash & Cash Eq.	12,389	16,690	6,925	6,950	11,598
Net Other current assets	20,614	18,797	25,609	33,173	40,317
Investments	7,560	18,595	30,000	35,000	35,000
Net Deferred tax Assets	(92)	679	679	679	679
Total Assets	53,238	74,209	83,698	97,233	109,886

Key Ratios	FY08	FY09	FY10P	FY11E	FY12E
OPM (%)	34.7	31.4	19.4	31.9	30.6
Net Margin (%)	35.0	30.0	19.1	34.0	32.5
Div. Yield (%)	0.7	0.9	0.6	0.8	0.7
Net debt/Equity (x)	(0.4)	(0.5)	(0.5)	(0.4)	(0.4)
Net Working Capital (days)	223.9	160.3	233.7	274.7	312.8
ROCE (%)	16.0	13.9	5.5	11.9	12.3
RoE (%)	21.7	16.0	7.6	14.9	15.0
EV/Net Sales (x)	14.3	10.3	10.8	8.3	6.7
EV/EBITDA (x)	41.2	32.7	55.6	25.9	21.9
PER (x)	43.1	37.7	63.0	27.5	23.7
PCE (x)	22.9	18.7	23.9	20.2	21.3
Price/Book (x)	7.3	5.1	4.4	3.8	3.4

P/E Band



Key Assumptions	FY09	FY10E	FY11E	FY12E
Domestic formulations (% Change)	31.9	(6.4)	33.9	21.7
Recurring US Exports (% chg YoY)	18.1	(76.6)	113.3	10.0
Non US exports (% change YoY)	41.1	35.0	40.0	30.0
One time opportunities (Rs mn)	10,710	9,814	5,330	0
Bulk Drugs - exports (% chg YoY)	47.2	17.5	12.0	15.0
Bulk Drugs - domestic (% chg YoY)	18.5	(2.0)	15.0	15.0
EPS - excluding exclusivities (Rs)	46.4	27.8	63.6	73.8
Recurring growth (%)	14.3	(40.1)	128.9	15.9

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