

February 1, 2011

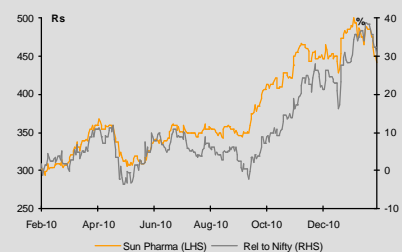
| | |
|--------------------------|----------------------|
| Reco | Previous Reco |
| Hold | Hold |
| CMP | Target Price |
| Rs441 | Rs460 |
| EPS change FY11E/12E (%) | NA |
| Target Price change (%) | NA |
| Nifty | 5,506 |
| Sensex | 18,328 |

Price Performance

| (%) | 1M | 3M | 6M | 12M |
|---------------|-----|----|----|-----|
| Absolute | (9) | 5 | 24 | 50 |
| Rel. to Nifty | 1 | 14 | 23 | 33 |

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

| | |
|-----------------------------|-----------------|
| Sector | Pharmaceuticals |
| Bloomberg | SUNP@IN |
| Equity Capital (Rs mn) | 1030 |
| Face Value(Rs) | 1 |
| No of shares o/s (mn) | 1030 |
| 52 Week H/L | 511/286 |
| Market Cap (Rs bn/USD mn) | 454/9,877 |
| Daily Avg Volume (No of sh) | 916681 |
| Daily Avg Turnover (US\$mn) | 9.2 |

Shareholding Pattern (%)

| | D'10 | S'10 | J'10 |
|--------------|------|------|------|
| Promoters | 63.7 | 63.7 | 63.7 |
| FII/NRI | 19.1 | 19.1 | 19.7 |
| Institutions | 6.7 | 6.5 | 6.0 |
| Private Corp | 5.0 | 5.0 | 5.1 |
| Public | 5.5 | 5.6 | 5.6 |

Source: Capitaline

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- **Sun Pharma's Q3'11 results were in-line except on PAT front with a) Revenues at Rs16bn (est. Rs15.9bn) b) EBITDA at Rs4.4bn (est. Rs4.45bn) and c) PAT at Rs3.5bn (est. Rs3.9bn)**
- **Taro contributed 29% to the top-line at US\$102mn; Caraco continues to disappoint with revenues at US\$40mn (down 22% YoY) and loss at the PBT level**
- **APAT at Rs3.5bn was lower than our est. of Rs3.9bn on account of higher depreciation and tax outgo largely led by Taro consolidation**
- **Taro remains the key to future performance; Maintain Hold and target price of Rs460**

Revenue growth in-line with estimates

Sun Pharma has registered in-line growth in Q3FY11 on account of a) 20% increase in domestic formulations (estd. 17% growth), and b) 12% increase in export formulations (excluding Taro). In the exports formulation space, Caraco continues to disappoint (revenues at US\$40mn, down 22% YoY), with revenues from distributed products declining significantly to US\$35mn this quarter from US\$49mn in Q3FY10 (Caraco had stopped shipping certain Paragraph-IV products prior to the quarter). Taro delivered in-line numbers at US\$102mn, contributing 29% to the total sales. Higher growth in the domestic formulation business (above industry rates of 17%) was on account of 9 new product launches this quarter taking the total to 30 during 9MFY11. In the US, Effexor XR tablets (market share 30-40%) and Rivastigimine continued to do well. Emerging markets (ex Caraco & Taro) sales were up by 7% YoY during the first 9MFY11. Regarding Taro, audit of the financial accounts for CY08 got over this quarter.

Revenue Break-up

| | Q3 FY10 | Q2 FY11 | Q3 FY11 | Gr. YoY | Gr. QoQ | YTD'10 | YTD'11 | Gr. YoY |
|-----------------|--------------|--------------|--------------|-------------|------------|--------------|--------------|-------------|
| Domestic | 5615 | 6707 | 6677 | 19% | 0% | 19708 | 14025 | -29% |
| Formulations | 5326 | 6409 | 6403 | 20% | 0% | 18796 | 13165 | -30% |
| Bulk | 287 | 293 | 270 | -6% | -8% | 899 | 851 | -5% |
| Others | 2 | 5 | 4 | 70% | -25% | 13 | 8 | -37% |
| Exports | 4783 | 7206 | 9548 | 100% | 33% | 24641 | 16483 | -33% |
| Formulations | 3648 | 5960 | 8661 | 137% | 45% | 21403 | 12981 | -39% |
| Bulk | 1125 | 1218 | 887 | -21% | -27% | 3209 | 3474 | 8% |
| Others | 9.9 | 28 | 0 | -96% | -99% | 29.0 | 28.0 | -4% |
| Total | 10398 | 13913 | 16225 | 56% | 17% | 44348 | 30508 | -31% |

Financials (including Taro)

| YE- | Net Sales | EBITDA (Core) | EBITDA (%) | APAT | EPS (Rs) | EPS % chg | RoE (%) | P/E | EV/ EBITDA | P/BV |
|-------|-----------|---------------|------------|--------|----------|-----------|---------|------|------------|------|
| FY09 | 41,870 | 18,676 | 44.6 | 18,178 | 17.5 | 22.3 | 31.2 | 25.1 | 23.6 | 6.5 |
| FY10 | 40,103 | 13,662 | 34.1 | 12,590 | 12.2 | (30.7) | 18.1 | 36.3 | 33.1 | 5.8 |
| FY11E | 56,239 | 19,686 | 35.0 | 17,884 | 17.3 | 41.8 | 20.7 | 25.5 | 22.4 | 4.9 |
| FY12E | 67,890 | 22,809 | 33.6 | 21,394 | 20.7 | 19.6 | 20.3 | 21.4 | 18.8 | 4.2 |

Quarterly break-up

| Rs mn | Q3FY10 | Q4FY10 | Q1FY11 | Q2FY11 | Q3FY12 | YoY (%) | QoQ (%) | YTD'10 | YTD'11 | YoY (%) |
|----------------------|---------------|---------------|---------------|---------------|---------------|-------------|---------------|---------------|---------------|-------------|
| Revenue | 10,209 | 11,092 | 13,997 | 13,701 | 16,011 | 56.8 | 16.9 | 28,982 | 43,708 | 51% |
| Expenditure | 6,525 | 6,907 | 7,837 | 9,030 | 11,605 | 77.9 | 28.5 | 20,493 | 28,473 | 39% |
| <i>as % of sales</i> | 63.9 | 62.3 | 56.0 | 65.9 | 72.5 | | | 70.7 | 65.1 | |
| Consumption of RM | 2,857 | 2,662 | 3,357 | 3,794 | 4,324 | 51.3 | 14.0 | 8,317 | 11,475 | 38% |
| <i>as % of sales</i> | 28.0 | 24.0 | 24.0 | 27.7 | 27.0 | | | 28.7 | 26.3 | |
| Employee Cost | 1,163 | 1,160 | 1,246 | 1,456 | 2,754 | 136.9 | 89.2 | 3,662 | 5,456 | 49% |
| <i>as % of sales</i> | 11.4 | 10.5 | 8.9 | 10.6 | 17.2 | | | 12.6 | 12.5 | |
| Other expenditure | 2,505 | 3,085 | 3,235 | 3,780 | 4,528 | 80.8 | 19.8 | 8,514 | 11,542 | 36% |
| <i>as % of sales</i> | 24.5 | 27.8 | 23.1 | 27.6 | 28.3 | | | 29.4 | 26.4 | |
| EBITDA | 3,684 | 4,185 | 6,160 | 4,670 | 4,405 | 19.6 | (5.7) | 8,489 | 15,235 | 79% |
| Depreciation | 359 | 419 | 402 | 352 | 805 | 124.2 | 128.7 | 1,114 | 1,559 | 40% |
| EBIT | 3,325 | 3,766 | 5,758 | 4,319 | 3,601 | 8.3 | (16.6) | 7,375 | 13,677 | 85% |
| Other Income | 325 | 909 | 115 | 924 | 580 | 78.8 | (37.2) | 1,916 | 1,619 | -16% |
| Non-recurring income | 0 | 0 | 0 | 0 | 0 | | | 963 | 0 | |
| PBT | 3,650 | 4,675 | 5,873 | 5,242 | 4,181 | 14.5 | (20.3) | 10,254 | 15,296 | 49% |
| Total Tax | 261 | (12) | 97 | 172 | 545 | 109.1 | 216.6 | 700 | 814 | 16% |
| Adjusted PAT | 3,389 | 4,687 | 5,776 | 5,070 | 3,636 | 7.3 | (28.3) | 10,441 | 14,482 | 39% |
| Minority Interest | 0 | -8 | 133 | 33.7 | 134.4 | - | | -11 | 301 | - |
| APAT after MI | 3,389 | 4,695 | 5,643 | 5,037 | 3,502 | 3.3 | (30.5) | 10,452 | 14,181 | 36% |
| Extra ordinary items | 0 | 0 | 0 | 0 | 0 | | | 0 | 0 | |
| Reported PAT | 3,389 | 4,695 | 5,643 | 5,037 | 3,502 | 3.3 | (30.5) | 9,565 | 14,181 | 48% |
| Reported EPS | 3.3 | 4.5 | 5.4 | 4.9 | 3.4 | 3.3 | (30.5) | 9.9 | 13.7 | -56% |

| Margins (%) | | | | | | (bps) | (bps) | | | (bps) |
|--------------------|------|-------|------|------|------|---------|---------|------|------|-------|
| EBIDTA | 36.1 | 37.7 | 44.0 | 34.1 | 27.5 | (857) | (657) | 29.3 | 34.9 | 557 |
| EBIT | 32.6 | 33.9 | 41.1 | 31.5 | 22.5 | (1,008) | (903) | 25.4 | 31.3 | 584 |
| EBT | 35.8 | 42.1 | 42.0 | 38.3 | 26.1 | (964) | (1,215) | 35.4 | 35.0 | (39) |
| PAT | 33.2 | 42.3 | 40.3 | 36.8 | 21.9 | (1,133) | (1,489) | 36.1 | 32.4 | (362) |
| Effective Tax rate | 7.1 | (0.3) | 1.7 | 3.3 | 13.0 | 589 | 975 | 6.8 | 5.3 | (151) |

EBITDA in-line; PAT at Rs3.5bn below estimates

EBITDA for the quarter was up 20% YoY to Rs4.4bn (in-line). However, Taro consolidation led the EBITDA margins to contract by 857bps YoY to 27.5% led by a) 51% increase in raw material cost b) 137% increase in staff cost and c) 81% increase in other expenses (includes write-back of Pantoprazole inventory in the US). We estimate Taro to have lower EBIT margins to the tune of 21%. We believe that Sun pharma's base business margins are in the range of 31-32% which will improve further as the company is going to monetize some limited competition opportunities such as Taxotere (docetaxel) and Gemzar (gemcitabine) going forward.

APAT growth of 3% YoY to Rs3.5bn was below our estimates due to a) higher tax provisioning (13% of PBT vs. our assumption of 7% of PBT) and b) higher depreciation (includes one-time impairment charge of US\$4.5mn on account of Taro). The EPS for Q3FY11 and YTD'11 is Rs3.4 and Rs13.7, respectively. Our EPS estimate for FY11E stands at Rs17.3.

Taro remains the key to future performance

Management has raised FY11E revenue guidance from 35% to 42%, mainly on account of Taro consolidation. We believe Taro consolidation should start beginning to contribute materially from FY12 onwards.

Caraco's recovery will be gradual

Caraco in its recent press release has indicated that it won't be able to begin the manufacturing and distribution of products from the USFDA banned manufacturing sites till the end of CY11E. However, a quicker resolution of the issue may lead to manufacturing of 4-5 products as early as CY12E. Caraco management believes that it will take significant time before it reaches its previous level of manufacturing in its Detroit facility. We have build US\$316mn and US\$309mn revenue in FY11E and FY12E respectively from Caraco operations.

Maintain Hold and target price of Rs460

Sun Pharma continues to remain a good long-term fundamental story in our view, however stock valuations are likely to limit upside. We value Sun pharma's base business at 22x FY12E and the NPV of Para-IV pipeline at Rs6 per share, to arrive at a fair value of Rs460. We have valued the company in-line with its comparable peers on account of a) strong franchises in domestic markets especially in chronic segment, b) niche and strong portfolio in the US market, c) best in class operating margins and d) strong balance sheet with US\$845mn cash in hand. We expect Sun's revenue and earnings (ex Taro) to grow at a CAGR of 20% and 21% (on a higher base effect from Pantoprazole sales in FY10) respectively over FY10-12E. However, owing to limited upside opportunity, we maintain our Hold rating on the stock. With ~USD845m of cash on books, Sun Pharma is in the process to explore another inorganic acquisition.

Our EPS (incl. Taro) for FY11/12E works out to Rs17.3 and Rs20.7, respectively. At CMP, the stock trades at 21x FY12E earnings.

Financials (excluding Taro)

Income Statement

| Y/E, Mar (Rs. mn) | FY09 | FY10 | FY11E | FY12E |
|--------------------------------|---------------|---------------|---------------|---------------|
| Net Sales | 41,870 | 40,103 | 51,342 | 57,984 |
| <i>Growth (%)</i> | 27.1 | -4.2 | 28.0 | 12.9 |
| Expenditure | 23,194 | 26,441 | 33,028 | 37,361 |
| Raw Materials | 8,556 | 10,977 | 15,137 | 16,054 |
| SGA | 9,354 | 9,146 | 10,480 | 12,848 |
| Employee Cost | 3,401 | 4,008 | 4,729 | 5,439 |
| Other Exp | 1,882 | 2,311 | 2,681 | 3,020 |
| EBITDA | 18,676 | 13,662 | 18,313 | 20,623 |
| <i>Growth (%)</i> | 20.2 | -26.8 | 34.0 | 12.6 |
| EBITDA margin (%) | 44.6 | 34.1 | 35.7 | 35.6 |
| Depreciation | 1,233 | 1,533 | 1,591 | 1,716 |
| EBIT | 17,443 | 12,129 | 16,722 | 18,907 |
| EBIT margin (%) | 41.7 | 30.2 | 32.6 | 32.6 |
| Other Income | 2,049 | 1,686 | 2,171 | 2,873 |
| Interest expenses | 0 | 0 | 0 | 0 |
| PBT | 19,492 | 14,148 | 18,894 | 21,780 |
| Tax | 712 | 679 | 1,228 | 1,416 |
| <i>Effective tax rate (%)</i> | 3.7 | 4.8 | 6.5 | 6.5 |
| Adjusted PAT | 17,575 | 12,631 | 16,606 | 19,142 |
| (Profit)/loss from JV's/Ass/MI | -603 | 41 | -530 | -611 |
| Adjusted PAT after MI | 18,178 | 12,590 | 17,136 | 19,753 |
| <i>Growth (%)</i> | 22.3 | -30.7 | 36.1 | 15.3 |
| Net Margin (%) | 43.4 | 31.4 | 33.4 | 34.1 |
| E/O items | 0 | 334 | 0 | 0 |
| Reported PAT | 18,178 | 13,511 | 17,136 | 19,753 |
| <i>Growth (%)</i> | 22.3 | -25.7 | 26.8 | 15.3 |

Cash Flow

| Y/E, Mar (Rs. mn) | FY09 | FY10 | FY11E | FY12E |
|------------------------------|----------------|----------------|---------------|---------------|
| PBT (Ex-Other income) | 17,443 | 12,462 | 16,722 | 18,907 |
| Depreciation | 1,233 | 1,533 | 1,591 | 1,716 |
| Interest Provided | 0 | 0 | 0 | 0 |
| Other Non-Cash items | 0 | 0 | 0 | 0 |
| Chg in working cap | 1,816 | -4,675 | -3,798 | -5,388 |
| Tax paid | -1,192 | -1,106 | -1,228 | -1,416 |
| Operating Cashflow | 19,300 | 8,214 | 13,287 | 13,820 |
| Capital expenditure | -7,914 | -2,920 | -1,052 | -2,000 |
| Free Cash Flow | 11,386 | 5,295 | 12,235 | 11,820 |
| Other income | 2,049 | 1,686 | 2,171 | 2,873 |
| Investments | -11,035 | -12,069 | 0 | 0 |
| Investing Cashflow | -16,900 | -13,302 | 1,120 | 873 |
| Equity Capital Raised | 0 | 0 | 0 | 0 |
| Loans Taken / (Repaid) | 353 | -77 | -500 | 0 |
| Interest Paid | 0 | 0 | 0 | 0 |
| Dividend paid (incl tax) | -3,215 | -3,321 | -3,100 | -3,574 |
| Others | 4,764 | -2,131 | 0 | 0 |
| Financing Cashflow | 1,902 | -5,529 | -3,600 | -3,574 |
| Net chg in cash | 4,302 | -10,618 | 10,806 | 11,119 |
| Opening cash position | 12,389 | 16,690 | 6,073 | 16,879 |
| Closing cash position | 16,690 | 6,073 | 16,879 | 27,998 |

Balance Sheet

| Y/E, Mar (Rs. mn) | FY09 | FY10 | FY11E | FY12E |
|--------------------------------|---------------|---------------|---------------|----------------|
| Equity share capital | 1,036 | 1,036 | 1,036 | 1,036 |
| Reserves & surplus | 69,414 | 77,254 | 91,289 | 107,469 |
| Net worth | 70,449 | 78,289 | 92,325 | 108,504 |
| Minority Interest | 1,970 | 1,932 | 2,462 | 3,073 |
| Secured Loans | 227 | 479 | 479 | 479 |
| Unsecured Loans | 1,562 | 1,233 | 733 | 733 |
| Loan Funds | 1,789 | 1,712 | 1,212 | 1,212 |
| Net deferred tax liability | -679 | -890 | -890 | -890 |
| Total Liabilities | 73,530 | 81,042 | 95,108 | 111,898 |
| Gross Block | 24,730 | 27,401 | 29,401 | 31,401 |
| Less: Depreciation | 6,851 | 8,013 | 9,603 | 11,320 |
| Net block | 17,879 | 19,388 | 19,797 | 20,081 |
| Capital work in progress | 1,571 | 1,448 | 500 | 500 |
| Investment | 18,595 | 30,664 | 30,664 | 30,664 |
| Current Assets | 42,683 | 37,121 | 53,825 | 71,280 |
| Inventories | 9,757 | 10,739 | 12,315 | 14,417 |
| Sundry debtors | 8,811 | 11,748 | 15,394 | 18,022 |
| Cash & bank balance | 16,690 | 6,073 | 16,879 | 27,998 |
| Loans & advances | 7,425 | 8,562 | 9,236 | 10,843 |
| Other current assets | 0 | 0 | 0 | 0 |
| Current liab & Prov | 7,198 | 7,579 | 9,678 | 10,627 |
| Current liabilities | 3,767 | 4,095 | 6,389 | 6,835 |
| Provisions | 3,431 | 3,484 | 3,290 | 3,791 |
| Net current assets | 35,485 | 29,542 | 44,146 | 60,653 |
| Total Assets | 73,530 | 81,042 | 95,108 | 111,898 |

Key Ratios

| Y/E, Mar | FY09 | FY10 | FY11E | FY12E |
|----------------------------|------|------|-------|-------|
| Profitability (%) | | | | |
| EBITDA Margin | 44.6 | 34.1 | 35.7 | 35.6 |
| Net Margin | 43.4 | 31.4 | 33.4 | 34.1 |
| ROCE | 31 | 18 | 21 | 21 |
| ROE | 31 | 18 | 21 | 20 |
| RoIC | 49.9 | 29.9 | 36.5 | 37.2 |
| Per Share Data (Rs) | | | | |
| EPS | 17.6 | 12.2 | 16.5 | 19.1 |
| CEPS | 18.7 | 13.3 | 18.1 | 20.7 |
| BVPS | 68.0 | 75.6 | 89.2 | 104.8 |
| DPS | 3.2 | 3.2 | 3.0 | 3.5 |
| Valuations (x) | | | | |
| PER | 25.1 | 36.2 | 26.6 | 23.1 |
| P/CEPS | 23.5 | 33.1 | 24.4 | 21.3 |
| P/BV | 6.5 | 5.8 | 4.9 | 4.2 |
| EV / Sales | 10.5 | 11.3 | 8.6 | 7.4 |
| EV / EBITDA | 23.6 | 33.1 | 24.1 | 20.8 |
| Dividend Yield (%) | 0.7 | 0.7 | 0.7 | 0.8 |
| Gearing Ratio (x) | | | | |
| Net Debt/ Equity | -0.2 | -0.1 | -0.2 | -0.2 |
| Net Debt/EBITDA | -0.7 | -0.3 | -0.8 | -1.1 |

Recommendation History: Sun Pharma – SUNP IN

| Date | Reports | Reco | CMP | Target |
|------------|---|------|-------|--------|
| 10/11/2010 | Sun Pharma Q2FY11 Result Update | Hold | 2,318 | 2,300 |
| 29/07/2010 | Sun Pharma Q1FY11 Result Update | Hold | 1,775 | 1,866 |
| 08/09/2010 | Sun Pharma Event Update | Hold | 1,756 | 1,866 |
| 25/05/2010 | Sun Pharma Q4FY10 Result Update | Buy | 1,550 | 1,730 |

Recent Research Reports

| Date | Reports | Reco | CMP | Target |
|------------|--|------------|-------|--------|
| 28/01/2011 | Lupin Q3FY11 Result Update | Accumulate | 420 | 496 |
| 27/01/2011 | Ipca Laboratories Q3FY11 Result Update | Accumulate | 312 | 336 |
| 27/01/2011 | Dr Reddy's Lab Q3FY11 Result Update | Accumulate | 1,584 | 1,750 |
| 20/01/2011 | Torrent Pharma Q3FY11 Result Update | Buy | 583 | 650 |

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