

September 1, 2008

Rating	Outperformer
Price	Rs1,476
Target Price	Rs1,634
Implied Upside	10.7%
Sensex	14,565

(Prices as on August 29, 2008)

Trading Data

Market Cap. (Rs bn)	350.7
Shares o/s (m)	207.2
Free Float	36.3%
3M Avg. Daily Vol ('000)	58.2
3M Avg. Daily Value (Rs m)	82.9

Major Shareholders

Promoters	63.7%
Foreign	20.2%
Domestic Inst.	4.9%
Public & Others	11.2%

Stock Performance

(%)	1M	6M	12M
Absolute	2.3	20.9	59.2
Relative	4.6	39.5	65.8

Annual Report 2008



■ **Good performance in domestic as well as international markets:** Sun Pharmaceuticals has been showing robust performance in the domestic market due to introduction of new and differentiated product launches and enhancing brand awareness amongst the medical community. Sales from exports increased from Rs22.3bn to Rs39.9bn (78% YOY growth). The company showed phenomenal growth in FY08 due to FTF opportunities and 'At-Risk' launch. Export sales grew at a CAGR of 38.4% over the last three years. Domestic sales increased from Rs12.6bn to Rs15.6bn (23% YOY growth) and at a CAGR of 29% over the last three years.

■ **Various costs (as % of sales) declined notably:** Various costs (as % of sales) which had increased due to acquisition have reduced from 68.5% to 53.8% during FY08, due to higher sales figure. These costs are expected to stabilize at higher levels due to fewer exclusivities.

■ **RoCE increased, but RoE stable:** RoCE which was on declining trend till FY06, have started improving due to higher asset turnover. It increased drastically from 22% to 33.2% in FY08, due to higher sales. However, in the future it is expected to improve gradually due to lesser one-time potential upsides. RoE has been higher than RoCE mainly due to the leverage impact. As the debt amount reduced, RoE increased by 100bps to 38.8% in FY08 and is expected to move in tandem with the RoCE.

■ **Valuation:** At the CMP of Rs1,476, the stock trades at 19.5x FY09E earnings and 17.4x FY10E earnings. We reiterate Outperformer rating on the stock with a price target of Rs1,634 (20x FY10 base business and 5x FTF earnings) with an implied upside of 10.7% over the next 12 months.

Key financials (Y/e March)	FY07	FY08	FY09E	FY10E
Revenues (Rs m)	21,359	33,565	38,498	44,092
Growth (%)	30.5	57.1	14.7	14.5
EBITDA (Rs m)	6,720	15,511	16,772	18,974
PAT (Rs m)	7,842	14,869	15,675	17,565
EPS (Rs)	37.9	71.8	75.7	84.8
Growth (%)	36.6	89.6	5.4	12.1
Net DPS (Rs)	6.7	10.5	11.5	12.5

Source: Company Data; PL Research

Profitability & valuation	FY07	FY08	FY09E	FY10E
EBITDA margin (%)	31.5	46.2	43.6	43.0
RoE (%)	37.9	38.8	28.2	25.6
RoCE (%)	22.0	33.2	27.5	25.3
EV / sales (x)	13.9	9.2	8.0	6.9
EV / EBITDA (x)	44.1	19.8	18.3	16.1
PE (x)	39.0	20.6	19.5	17.4
P / BV (x)	10.1	5.9	4.7	3.9
Net dividend yield (%)	0.5	0.7	0.8	0.8

Source: Company Data; PL Research

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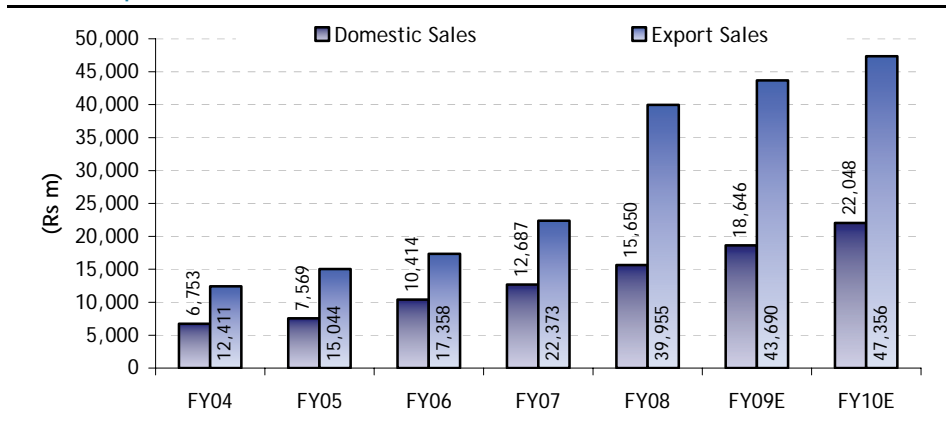
Consistently outperforming domestic industry

Domestic formulations: In FY08, 37 new products were brought to the market. Of them, 16 used a technology-based differentiation and 15 were integrated to API. This resulted in the domestic formulation sales to grow from Rs12.6bn to Rs15.6bn (23% YOY growth). Neuro-Psychiatry, Cardiology, Diabetology continue to remain major contributors to sales.

In addition to newer products, following activities were also responsible for increase in business:

- Creation of Interactive learning situations, workshops and update sessions, interdisciplinary lectures to help specialists in one therapy to recognize and treat presenting symptoms related to different speciality area for specialist consultants across the country.
- In psychiatry and neurology, camps for diagnosis and treatment of Epilepsy, bipolar mood disorders and Parkinson’s disease were initiated, which helped build mindshare with doctors, in addition to the above mentioned activities. Educational and knowledge-sharing programs with bodies like American Diabetic Association and American College of Cardiology helped to reach out to top-notch specialists.

Sales Composition



Source: Company Data, PL Research



Excellent growth in exports of formulation expected to reduce, due to fewer FTF opportunities

US Generics: In FY08, sales from exports increased from Rs22.3bn to Rs39.9bn (78% YOY growth). Such phenomenal growth in this segment was primarily on account of exclusivities received on Trileptal, Protonix and Ethyol. At the end of March 2008, 89 ANDAs awaited approval as compared to 65 in the previous year. These products are a mix of simple generics, complex generics and few Para IV challenges. Sun Pharmaceuticals received 13 approvals and Caraco received 11 approvals during the year. The company received 'Not to Sue' Covenant on Effexor XR. It has got 'Non-AB' rated approval for the same. It is likely to launch this product in Q3FY09.

Continuous effort to build a presence in the European and emerging market

In European market like UK, France and Germany, Sun Pharmaceuticals continued to register selected products. The company is also looking for an appropriate partner to bring their generics to these markets.

In an emerging market, the company is following business model similar to that in India. It has a team of 450 trained personnel (previous year 316) to perform activities such as Doctor-Group meeting, conference participation and symposia etc. to establish presence. The company continues to emphasize on prescription-based trade sales.

API continues to form small segment of total sales. The company continues to file DMFs for peptides, steroids and hormones.

The company is expected to continue to show similar performance. However, export may not grow at such high pace due to fewer FTF opportunities and reduction in sales of products which were launched at risk.

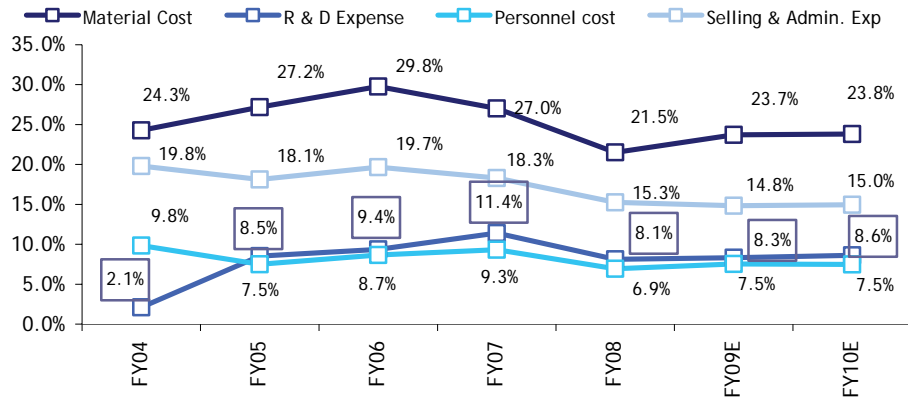
Taro-litigation is time consuming, impacting synergized business expected after acquisition

The acquisition of Taro has been delayed as the Taro management has terminated the merger agreement. But the company is determined for the acquisition. As of now the company has invested Rs3.8bn and has acquired 34% of Taro's shares.



Declining cost (as % of Sales) expected to stabilize at higher levels

Various cost as % of Sales

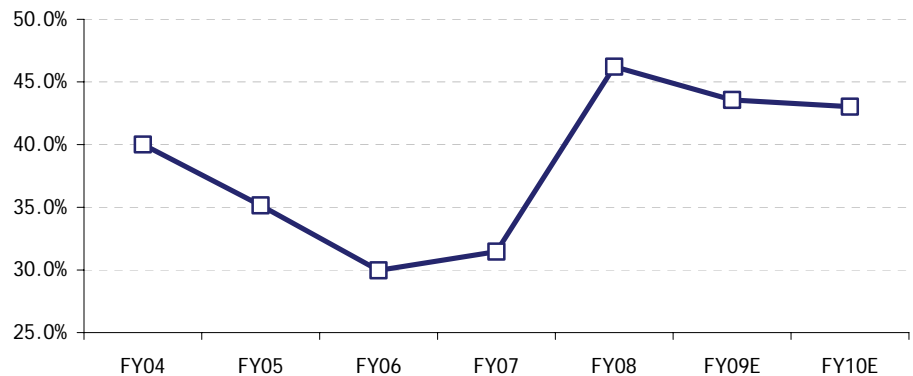


Source: Company Data, PL Research

As it can be seen in the graph, various costs (as % of sales) declined due to FTF opportunities and 'At Risk' launch, which are high margin businesses. Material cost (as % of sales) peaked in FY06 due to different cost structures at acquired site at Bryan and Cranbury. Going forward, the same is expected to increase, while the staff cost is expected to normalize due to few FTF opportunities. R & D expenses peaked in FY07 due to increased cost for generic filings that begun from newly acquired sites. The R & D cost is likely to come down due to de-merger of NCE and NDDS related R & D activities to SPARC (Sun Pharma Advanced Research Company Ltd). The R & D expenses are expected to stabilize in 8-10% range.

Significant improvement in EBIDTA margin

EBITDA Margin



Source: Company Data, PL Research



As it can be seen in the graph, EBIDTA margin has reduced till FY06 and then increased to 47.6% in FY08. In FY05, it reduced due to external factors like VAT, issues about psychotropic documentation and MRP-based excise. In FY06, margins were lower due to acquisition of companies having lower margins. Since then, due to successful turnaround of acquired companies and FTF opportunities, the company showed higher EBIDTA margin in FY08. The company is expected to show lower margins as compared to FY08 because of reduction in sales of non-recurring high margin items.

Improvement in RoCE, but no effect on RoE

RoE Decomposition

Y/e March	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E
EBIT Margin	38.8%	35.4%	36.5%	39.0%	47.6%	44.7%	44.0%
Asset Turnover	75.0%	38.7%	45.4%	53.1%	62.9%	58.0%	55.3%
Tax Impact	86.8%	95.1%	96.0%	100.8%	97.0%	95.4%	95.1%
RoCE	26.3%	18.2%	17.2%	22.0%	33.2%	27.5%	25.3%
Leverage Impact	162.1%	267.1%	222.1%	142.8%	102.9%	102.3%	100.5%
Interest Impact	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
RoE	40.9%	40.8%	41.5%	37.9%	38.8%	28.2%	25.6%

Source:

From FY04 to FY06, RoCE declined mainly due to reduction in asset turnover at the time of acquisition. In FY08, it improved drastically owing to higher profits and is expected to improve gradually through continuous streamlining, up-gradation and expansion across several sites. But at the same time, due to reduced potential upside in FY09 and FY10, RoCE is expected to reduce to 25.3% by FY10. RoE has been higher than RoCE mainly due to the leverage impact. Interest impact has been stable at 100% because interest income earned on fixed deposits (FCCB amount which would be used for acquisition of Taro if the case turns in favor of Sun Pharmaceuticals) has been higher than interest on loan. In FY08, FCCB's worth Rs15.7bn (US\$350m) were converted into 21,600,761 equity shares, upon conversion option exercised by FCCB holders. As a result, debt amount has reduced significantly. Hence RoE is expected to move in tandem with RoCE.



Financials

Income Statement

(Rs m)

Y/e March	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E
Total Sales	9,830	11,853	16,368	21,359	33,565	38,498	44,092
<i>Growth (%)</i>		<i>20.6</i>	<i>38.1</i>	<i>30.5</i>	<i>57.1</i>	<i>14.7</i>	<i>14.5</i>
Operating Expenses	5,897	7,686	11,463	14,639	18,054	21,726	25,118
(Inc) / Dec in stock	(713)	(597)	(1,908)	(1,344)	(343)	(469)	(400)
Material Cost	3,099	3,819	6,779	7,115	7,564	9,600	10,900
<i>as % of net sales</i>	<i>24.3</i>	<i>27.2</i>	<i>29.8</i>	<i>27.0</i>	<i>21.5</i>	<i>23.7</i>	<i>23.8</i>
Indirect taxes	388	420	424	528	656	785	918
<i>as % of net sales</i>	<i>3.9</i>	<i>3.5</i>	<i>2.6</i>	<i>2.5</i>	<i>2.0</i>	<i>2.0</i>	<i>2.1</i>
Staff Cost	968	888	1,416	1,990	2,331	2,900	3,300
<i>as % of net sales</i>	<i>9.8</i>	<i>7.5</i>	<i>8.7</i>	<i>9.3</i>	<i>6.9</i>	<i>7.5</i>	<i>7.5</i>
R & D expenses	208	1,010	1,534	2,440	2,725	3,200	3,800
<i>as % of net sales</i>	<i>2.1</i>	<i>8.5</i>	<i>9.4</i>	<i>11.4</i>	<i>8.1</i>	<i>8.3</i>	<i>8.6</i>
Other Expenses	1,947	2,147	3,218	3,911	5,120	5,710	6,600
<i>as % of net sales</i>	<i>19.8</i>	<i>18.1</i>	<i>19.7</i>	<i>18.3</i>	<i>15.3</i>	<i>14.8</i>	<i>15.0</i>
Operating Profit	3,933	4,166	4,905	6,720	15,511	16,772	18,974
<i>Operating Margin (%)</i>	<i>40.0</i>	<i>35.2</i>	<i>30.0</i>	<i>31.5</i>	<i>46.2</i>	<i>43.6</i>	<i>43.0</i>
Other Income	165	433	1,684	2,428	1,451	1,520	1,620
EBIDTA	4,098	4,600	6,589	9,148	16,962	18,292	20,594
<i>EBIDTA Margin (%)</i>	<i>41.7</i>	<i>38.8</i>	<i>40.3</i>	<i>42.8</i>	<i>50.5</i>	<i>47.5</i>	<i>46.7</i>
Depreciation	286	406	610	813	969	1,078	1,199
EBIT	3,812	4,194	5,979	8,335	15,994	17,215	19,395
Tax Provision	367	207	239	(67)	485	790	950
<i>Effective Tax Rate (%)</i>	<i>9.6</i>	<i>4.9</i>	<i>4.0</i>	<i>-0.8</i>	<i>3.0</i>	<i>4.6</i>	<i>4.9</i>
Profit After Tax before EO	3,446	3,987	5,740	8,401	15,509	16,425	18,445
Prior period adjustments	(188)	2	-	-	-	-	-
Profit of Caraco	50	-	-	-	-	-	-
Net Profit	3,308	3,989	5,740	8,401	15,509	16,425	18,445
Minority interest	151	42	(3)	559	640	750	880
Net profit after minority interest	3,157	3,947	5,743	7,842	14,869	15,675	17,565
<i>Net Margin (%)</i>	<i>32.1</i>	<i>33.3</i>	<i>35.1</i>	<i>36.7</i>	<i>44.3</i>	<i>40.7</i>	<i>39.8</i>
Equity Capital	464	928	929	967	1,036	1,036	1,036
Face Value (Rs)	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Equity Shares	93	186	186	193	207	207	207
EPS-fully diluted (Rs)	15.2	19.1	27.7	37.9	71.8	75.7	84.8



Balance Sheet

(Rs m)

Y/e March	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E
SOURCES OF FUNDS :							
Equity Share Capital	464	928	929	967	1,036	1,036	1,036
Preference Share Capital	155	14	14	14			
Reserves & Surplus	7,541	10,352	14,959	26,747	48,879	61,891	76,413
Minority int-share capital	39	161	332	438	1,886	1,886	1,886
Minority int-Res & surplus	45		-	-	-	-	-
Networth	8,088	11,454	16,220	28,152	51,800	64,813	79,335
Total Debt	4,130	18,230	18,745	11,144	1,436	1,427	327
Deferred Tax Liability	741	896	1,053	895	92	92	92
Total	13,113	30,595	36,032	40,205	53,328	66,331	79,753
APPLICATION OF FUNDS :							
Gross Block	6,232	7,806	12,342	14,252	15,960	18,000	19,000
Less: Accum. Depreciation	1,714	2,087	3,779	4,738	5,607	6,684	7,883
Net Block	4,518	5,719	8,563	9,514	10,354	11,316	11,117
Capital Work in Progress	410	493	414	608	686	350	450
Goodwill on consolidation	1,612	1,538	507	697	1,729	1,729	1,729
Investments	1,765	6,485	3,541	2,543	6,565	8,928	13,271
Current Assets, Loans & Advances	6,924	18,946	26,520	29,889	40,368	50,828	61,544
Inventories	2,542	3,173	5,117	6,645	7,728	12,500	10,500
Sundry Debtors	2,250	2,511	3,609	6,789	14,177	7,759	13,000
Cash and Bank Balance	946	11,809	15,323	13,802	13,382	26,529	33,135
Other current assets				389	320	320	320
Loans and Advances	1,186	1,454	2,471	2,264	4,762	3,720	4,590
Less: Current Liab. & Prov.	2,116	2,587	3,515	3,046	6,373	6,819	8,358
Current Liabilities	1,383	1,741	2,279	2,966	3,722	4,019	5,315
Provisions	734	845	1,236	80	2,651	2,800	3,043
Net Current Assets	4,808	16,360	23,006	26,843	33,995	44,008	53,186
Total	13,113	30,595	36,031	40,205	53,328	66,331	79,753



Key Ratios

Y/e March	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E
Growth (%)							
Net sales	-	20.6	38.1	30.5	57.1	14.7	14.5
EBIDTA	-	5.9	17.7	37.0	130.8	8.1	13.1
Net Profit	-	20.6	43.9	46.4	84.6	5.9	12.3
Diluted EPS	-	25.0	45.5	36.6	89.6	5.4	12.1
Asset Based Ratio (%)							
ROCE	26.3	18.2	17.2	22.0	33.2	27.5	25.3
ROE	40.9	40.8	41.5	37.9	38.8	28.2	25.6
Gearing							
Debt/Equity	0.5	1.6	1.2	0.4	0.0	0.0	0.0
Per share (Rs)							
Diluted EPS	15.2	19.1	27.7	37.9	71.8	75.7	84.8
Book Value	87.2	61.7	87.3	145.6	250.1	312.9	383.0
DPS	6.5	3.8	5.5	6.7	10.5	11.5	12.5
CEPS	16.6	21.0	30.7	41.8	76.5	80.9	90.6
Margin (%)							
EBIDTA	40.0	35.2	30.0	31.5	46.2	43.6	43.0
PAT	32.1	33.3	35.1	36.7	44.3	40.7	39.8
Tax Rate	9.6	4.9	4.0	(0.8)	3.0	4.6	4.9
Div. payout	42.6	19.7	19.9	17.8	14.6	15.2	14.7
Velocity (days)							
Debtors	83.5	73.3	68.2	88.8	114.0	104.0	85.9
Inventory	94.4	88.0	92.4	100.5	78.1	95.9	95.2
Creditors	85.6	74.2	64.0	65.4	67.6	65.0	67.8
Valuations (x)							
P/E	96.8	77.5	53.2	39.0	20.6	19.5	17.4
P/CEPS	88.8	70.2	48.1	35.3	19.3	18.2	16.3
P/BV	16.9	23.9	16.9	10.1	5.9	4.7	3.9
Market Cap/Sales	13.9	23.1	16.7	13.4	9.1	7.9	6.9
EV/EBIDTA	34.4	63.5	44.4	32.4	18.1	16.8	14.9
EV/Sales	14.3	24.6	17.9	13.9	9.2	8.0	6.9



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PL's Recommendation Nomenclature

BUY	: > 15% Outperformance to BSE Sensex	Outperformer (OP)	: 5 to 15% Outperformance to Sensex
Market Performer (MP)	: -5 to 5% of Sensex Movement	Underperformer (UP)	: -5 to -15% of Underperformance to Sensex
Sell	: <-15% Relative to Sensex		
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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