

19 October 2011

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## Buy

Target price  
Rs525.00

Price  
Rs466.40

Equity | India | Pharma, Biotech & Life

# Flashnote

# Sun Pharmaceutical

## Sun offers to buyout Taro

**Sun's offer to buyout remaining stake in Taro at US\$ 24.5/share valuing Taro at US\$1bn (valued at 7.25x EV/EBITDA and 10x PE) is a positive in our view. Sun holds 66.3% stake in Taro at a total investment of US\$ 260m. We expect more value-accretive deals as Sun holds US\$1bn in cash and cash equivalents.**

### Sun offers to buyout remaining 33.7% stake in Taro - a positive

- Sun Pharma has proposed to acquire all outstanding shares of Taro Pharma (Sun's subsidiary) for a per share consideration of US\$24.50 in cash representing a 26% premium over the 17 October 2011 closing price of US\$19.45 (post the offer, Taro's stock closed 23% higher at US\$24/share). This offer, however, is subject to the approval of Taro Board and such other authorities as may be required and subject to completion of necessary compliances/formalities as may be required.
- Sun currently holds a 66.3% equity stake (with 77% voting rights) in Taro with a total investment of US\$260m till date (the company bought a 9.4% stake from Brandes Investments Partners on 19 February 2008 for US\$38m (valued at US\$10.24/share) and a 12% stake from Templeton Asset Management on 1 November 2010 for US\$82m (valued at US\$16/ share).
- With Taro reporting US\$106m of PAT in the last four quarters, Sun's offer values Taro at US\$1bn (at 7.25x EV/EBITDA and 10x PE).

### While the offer seems lucrative for Sun, there are some hurdles

- However, this has been objected by Grand Slam Master Fund, LTD (Grand Slam) which has expressed its dissatisfaction with the offer by Sun Pharma as Taro has traded in the public markets at a discount to its peers despite having strong free cash flows, great operating margins and double digit revenue growth. This was caused by the Board's failure to have Taro's shares trade on a nationally recognized exchange despite qualifying to do so. In no way does the offer at a 23.80% premium to current share price fairly value the shares.
- The fund believes a fair offer would be at a minimum of US\$48.5 per share (which would be valued at ~15x EV/EBITDA and ~20x PE) based on the deals happened in the past ranging

(Continued on page 2)

### Key forecasts

	FY10A	FY11A	FY12F	FY13F	FY14F
Revenue (Rsm)	38086	57214	75136	86637	103074
EBITDA (Rsm)	12416	19700	25843	29760	35303
Reported net profit (Rsm)	13511	18161	22300	25667	30195
Normalised net profit (Rsm)	14205	18161	22300	25667	30195
Normalised EPS (Rs)	13.72	17.54	21.53	24.79	29.16
Dividend per share (Rs)	2.75	3.50	3.50	3.50	3.50
Dividend yield (%)	0.59	0.75	0.75	0.75	0.75
Normalised PE (x)	34.00	26.60	21.66	18.82	16.00
EV/EBITDA (x)	38.6	23.6	17.7	14.9	12.1
Price/book value (x)	6.17	5.09	4.28	3.59	3.01
ROIC (%)	18.1	21.5	24.7	24.9	26.8

Post-goodwill amortisation and pre-exceptional items  
Accounting standard: Local GAAP  
Source: Company data, RBS forecasts

year to Mar, fully diluted

### Analyst

**Prakash Agarwal**  
+91 22 6715 5314  
prakash.agarwal@rbs.com

83/84 Sakhar Bhawan, Nariman  
Point, Mumbai 400 021, India

<http://research.rbsm.com>

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from 15x EBITDA on the low end to 24x on the upper end of the range.

- Thus the fund believes that Sun's offer is at a healthy discount to the EV/EBITDA of Taro's competitors despite the fact that Taro is growing more quickly and has higher margins than these companies.

**We expect more value-accretive deals**

- Sun made eight acquisitions in 1996-2001, but has made fewer since. The company raised US\$350m in 2004 to fuel further growth and made a few small acquisitions. However, we believe, it could make no large acquisitions because of expensive valuations.
- Sun acquired a controlling stake in Taro in September 2010 after three years of litigation. In June 2011, it has acquired the 24.5% of Caraco that it did not previously own for US\$46.8m (or US\$5.25/share), and now owns 100% of Caraco.
- We believe Sun is now well positioned to make value-accretive deals, despite the ongoing global slowdown, as the company has US\$1bn in cash and cash equivalents.

**Structurally well positioned; maintain Buy**

- Sun looks structurally well positioned for growth, as 83% of its revenues are from the US (benefiting from a robust ANDA pipeline, improvement in Taro and a depreciating INR) and India (above industry growth). Moreover, with US\$1bn in cash, Sun looks well poised to achieve value-accretive deals.
- We value Sun's core business at Rs518 (20.9x FY13F, at a 10% premium to the sector) and one-offs at Rs7 (after a 20% execution discount) resulting in an SOTP-based TP of Rs525. maintain Buy.

## Income statement

Rsm	FY10A	FY11A	FY12F	FY13F	FY14F
Revenue	38086	57214	75136	86637	103074
Cost of sales	-10206	-14607	-19802	-22872	-27314
Operating costs	-15464	-22908	-29491	-34005	-40456
<b>EBITDA</b>	<b>12416</b>	<b>19700</b>	<b>25843</b>	<b>29760</b>	<b>35303</b>
DDA & Impairment (ex gw)	-1533	-2041	-2896	-3246	-3595
<b>EBITA</b>	<b>10883</b>	<b>17659</b>	<b>22947</b>	<b>26514</b>	<b>31707</b>
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
<b>EBIT</b>	<b>10883</b>	<b>17659</b>	<b>22947</b>	<b>26514</b>	<b>31707</b>
Net interest	1139	1341	1408	1478	1552
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	2897	1358	1531	1861	2482
<b>Reported PTP</b>	<b>14920</b>	<b>20358</b>	<b>25886</b>	<b>29853</b>	<b>35742</b>
Taxation	-755.7	-1284	-2071	-2448	-3574
Minority interests	41.0	-913.1	-1515	-1738	-1972
Exceptionals (post-tax)	-694.0	0.00	0.00	0.00	0.00
Other post-tax items	0.00	0.00	0.00	0.00	0.00
<b>Reported net profit</b>	<b>13511</b>	<b>18161</b>	<b>22300</b>	<b>25667</b>	<b>30195</b>
Normalised Items Excl. GW	-694.0	0.00	0.00	0.00	0.00
<b>Normalised net profit</b>	<b>14205</b>	<b>18161</b>	<b>22300</b>	<b>25667</b>	<b>30195</b>

Source: Company data, RBS forecasts

year to Mar

## Balance sheet

Rsm	FY10A	FY11A	FY12F	FY13F	FY14F
Cash & market secs (1)	5089	21936	26068	39719	54291
Other current assets	31923	41888	50434	58154	70881
Tangible fixed assets	15328	25234	27838	30093	32822
Intang assets (incl gw)	4060	7720	7720	7720	7720
Oth non-curr assets	33112	25016	24768	25312	26090
<b>Total assets</b>	<b>89512</b>	<b>121794</b>	<b>136829</b>	<b>160997</b>	<b>191803</b>
Short term debt (2)	n/a	n/a	n/a	n/a	n/a
Trade & oth current liab	7579	14234	13117	14897	17748
Long term debt (3)	708.0	2452	0.00	0.00	0.00
Oth non-current liab	1004	1804	804.3	0.30	0.00
<b>Total liabilities</b>	<b>9291</b>	<b>18489</b>	<b>13921</b>	<b>14897</b>	<b>17748</b>
Total equity (incl min)	80221	103305	122907	146100	174055
<b>Total liab &amp; sh equity</b>	<b>89512</b>	<b>121794</b>	<b>136829</b>	<b>160997</b>	<b>191803</b>
Net debt	-3377	-17681	-25264	-39718	-54291

Source: Company data, RBS forecasts

year ended Mar

## Cash flow statement

Rsm	FY10A	FY11A	FY12F	FY13F	FY14F
EBITDA	12416	19700	25843	29760	35303
Change in working capital	-4870	-3311	-9662	-5940	-9875
Net interest (pd) / rec	1139	1341	1408	1478	1552
Taxes paid	-755.7	-1284	-2071	-2448	-3574
Other oper cash items	1873	10678	15.9	122.8	510.5
<b>Cash flow from ops (1)</b>	<b>9803</b>	<b>27123</b>	<b>15533</b>	<b>22973</b>	<b>23915</b>
Capex (2)	-2548	-27097	-6348	-6044	-7102
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	-13069	9354	1095	0.00	0.00
<b>Cash flow from invest (3)</b>	<b>-15617</b>	<b>-17743</b>	<b>-5253</b>	<b>-6044</b>	<b>-7102</b>
Incr / (decr) in equity	0.00	0.00	0.00	0.00	0.00
Incr / (decr) in debt	-77.4	2544	-3452	-804.0	-0.30
Ordinary dividend paid	-3321	-4213	-4213	-4213	-4213
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	-2389	9136	1515	1738	1972
<b>Cash flow from fin (5)</b>	<b>-5787</b>	<b>7467</b>	<b>-6149</b>	<b>-3278</b>	<b>-2241</b>
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
<b>Inc/(decr) cash (1+3+5+6)</b>	<b>-11601</b>	<b>16847</b>	<b>4132</b>	<b>13650</b>	<b>14572</b>
Equity FCF (1+2+4)	7254	25.9	9185	16929	16813

Lines in bold can be derived from the immediately preceding lines.  
Source: Company data, RBS forecasts

year to Mar

## Recommendation structure

Absolute performance, short term (trading) recommendation: A Trading Buy recommendation implies upside of 5% or more and a Trading Sell indicates downside of 5% or more. The trading recommendation time horizon is 0-60 days. For Australian coverage, a Trading Buy recommendation implies upside of 5% or more from the suggested entry price range, and a Trading Sell recommendation implies downside of 5% or more from the suggested entry price range. The trading recommendation time horizon is 0-60 days.

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and, except as follows, only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. For UK-based Investment Funds research, the recommendation structure is not based on upside/downside to the target price. Rather it is the subjective view of the analyst based on an assessment of the resources and track record of the fund management company. For research on Australian listed property trusts (LPT) or real estate investment trusts (REIT), the recommendation is based upon total return, ie, the estimated total return of capital gain, dividends and distributions received for any particular stock over the investment horizon.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

## Distribution of recommendations

The tables below show the distribution of recommendations (both long term and trading). The first column displays the distribution of recommendations globally and the second column shows the distribution for the region. Numbers in brackets show the percentage for each category where there is an investment banking relationship. These numbers include recommendations produced by third parties with which RBS has joint ventures or strategic alliances.

### Long term recommendations (as at 19 Oct 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Buy	867 (11)	567 (3)
Hold	417 (7)	225 (4)
Sell	90 (6)	49 (0)
Total (IB%)	1374 (9)	841 (3)

Source: RBS

### Trading recommendations (as at 19 Oct 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Trading Buy	1 (100)	1 (100)
Trading Sell	1 (0)	1 (0)
Total (IB%)	2 (50)	2 (50)

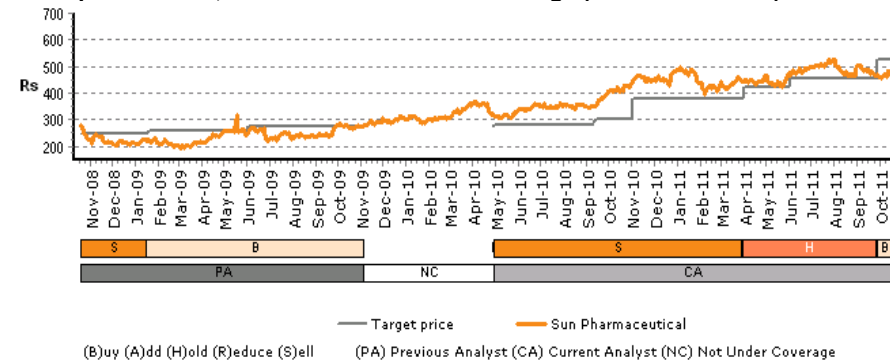
Source: RBS

## Valuation and risks to target price

**Sun Pharmaceutical (RIC: SUN.BO, Rec: Buy, CP: Rs466.40, TP: Rs525.00):** Key upside risks to our SOTP-based target price for Sun Pharma are: 1) damages in the case of its 'at risk' launch of gProtoix; and 2) longer than expected resolution in Caraco (we expect it to start from FY13 onwards)

## Sun Pharma coverage data (SUN.BO, SUNP IN)

### Stock performance, recommendations and coverage (as at 19 Oct 2011)



(B)uy (A)dd (H)old (R)educe (S)ell (PA) Previous Analyst (CA) Current Analyst (NC) Not Under Coverage

Prakash Agarwal started covering this stock on 29 Apr 10. Moved to new recommendation structure between 1 November 2005 and 31 January 2006. Source: RBS

### Trading recommendation history

Date	Rec	Analyst
n/a	n/a	n/a

Source: RBS

### Price perf (at Close 18 Oct 2011)

	(1M)	(3M)	(12M)
Price (Rs)	486.0	500.7	409.8
Absolute (%)	-4.0	-6.9	13.8
Rel market (%)	-3.0	2.9	37.0
Rel sector (%)	-1.4	0.5	18.6

Source: Bloomberg  
Market: Sensex  
Sector: Pharmaceuticals

## Regulatory disclosures

None

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