

## RESULTS FIRST LOOK

Sun's 2QFY12 Net sales were 4.3% ahead of our est and Core EBITDA was reported 19% ahead. On an ex-Taro basis, Sun's net sales were 4% below our est and EBITDA was 5% below. The miss was primarily due to lower than expected RoW sales. Core EBITDA margins (ex-Taro) came in 69bps below our est. The mgmt reiterated its FY12 guidance of 28-30% growth on top line despite Taro's revenues including certain unsustainable revenues. The company also indicated that the tax rate (ex-Taro) would be 9% (vs. our est of 2%). Sun trades at 22x FY13E earnings i.e. 13% premium to the sector. Maintain Neutral.

Price target: 513.0 INR

Price (14 Nov 2011): 510.8 INR

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## Taro saves the quarter for Sun

- Earnings vs. our Forecast: **IN LINE**

## Likely Impact:

- Earnings Estimates: **NO CHANGE**
- Dividend Estimates: **NO CHANGE**
- Price Target: **NO CHANGE**
- Long-term View: **CONFIRMED**

Fig 1: 2QFY12 earnings review

Income Statement							
(in INR mn)	Q2FY12	YoY Chg (%)	2QFY11	QoQ Chg (%)	Q1FY12	vs. Nom. Est	Q2FY12E
<b>Domestic</b>	<b>8,653</b>	<b>13.4%</b>	<b>7,628</b>	<b>10.1%</b>	<b>7,861</b>	<b>0.5%</b>	<b>8,613</b>
Formulation	7,046	15.4%	6,105	10.4%	6,385	-0.6%	7,088
Bulk	1,603	7.5%	1,491	8.6%	1,476	6.9%	1,500
Others	4	-	-	-	-	-	-
<b>Exports</b>	<b>10,558</b>	<b>79.0%</b>	<b>5,899</b>	<b>20.8%</b>	<b>8,741</b>	<b>7.5%</b>	<b>9,822</b>
RoW	2,567	85.0%	1,388	1.8%	2,521	-8.4%	2,804
US	7,991	92.8%	4,144	28.5%	6,220	13.9%	7,018
Others	1	-	-	-	0	-	-
<b>Total Sales</b>	<b>19,211</b>	<b>42.0%</b>	<b>13,527</b>	<b>15.7%</b>	<b>16,602</b>	<b>4.2%</b>	<b>18,435</b>
Excise duty	265	24.7%	213	7.6%	246	-3.1%	274
<b>Net Sales</b>	<b>18,946</b>	<b>42.3%</b>	<b>13,314</b>	<b>15.8%</b>	<b>16,357</b>	<b>4.3%</b>	<b>18,161</b>
Raw Materials	3,639	-4.1%	3,794	-10.6%	4,071	-12.9%	4,177
Staff costs	2,727	87.3%	1,456	-2.1%	2,786	-6.0%	2,900
Other expenditure	4,740	39.7%	3,393	17.7%	4,026	5.3%	4,500
<b>Total expenses</b>	<b>11,106</b>	<b>28.5%</b>	<b>8,644</b>	<b>2.0%</b>	<b>10,883</b>	<b>-4.1%</b>	<b>11,577</b>
<b>Core EBITDA</b>	<b>7,840</b>	<b>67.9%</b>	<b>4,671</b>	<b>43.2%</b>	<b>5,474</b>	<b>19.1%</b>	<b>6,584</b>
Other Income	1,183	28.0%	924	22.1%	969	68.9%	700
EBITDA	9,023	61.3%	5,594	40.0%	6,443	23.9%	7,284
Depreciation	668	89.8%	352	3.2%	647	-4.6%	700
<b>PBT</b>	<b>8,355</b>	<b>59.4%</b>	<b>5,243</b>	<b>44.2%</b>	<b>5,796</b>	<b>26.9%</b>	<b>6,584</b>
Taxes	1,281	644.3%	172	797.7%	143	289.1%	329
PAT	7,074	39.5%	5,070	25.1%	5,653	13.1%	6,255

Minority interest	1,097	-	34	70.6%	643	-	650
<b>Net profit</b>	<b>5,977</b>	<b>18.7%</b>	<b>5,037</b>	<b>19.3%</b>	<b>5,010</b>	<b>6.6%</b>	<b>5,605</b>
	<b>Q2FY12</b>	<b>YoY Chg</b>	<b>2QFY11</b>	<b>QoQ Chg</b>	<b>Q1FY12</b>	<b>vs. Nom. Est</b>	<b>Q2FY12E</b>
Material cost	19.2%	-929bps	28.5%	-568bps	24.9%	-379bps	23.0%
Staff Cost	14.4%	346bps	10.9%	-264bps	17.0%	-158bps	16.0%
Other Expenditure	25.0%	-47bps	25.5%	41bps	24.6%	24bps	24.8%
<b>Core EBITDA Margin</b>	<b>41.4%</b>	<b>630bps</b>	<b>35.1%</b>	<b>792bps</b>	<b>33.5%</b>	<b>513bps</b>	<b>36.3%</b>
R&D Expenses	4.7%	-71bps	5.4%	-71bps	5.4%		

Source: Company data, Nomura estimates

### Domestic formulations up 15% y-y as expected

Sun's domestic formulations revenues were up 15% y-y for 2QFY12, in line with our expectations. Ex contract manufacturing revenues that were booked in the previous quarter, the revenue growth was at 18% y-y. Sun has launched Januvia and Janumet in-licensed from MSD in 2QFY12. Sun has also launched Starhaler which is in-licensed from SPARC.

Regarding the impact of the proposed pricing regulation in India, the management commented that in their view, the policy would hinder Indian companies' ability to invest in research and development and expand in to other geographies.

### **Fig 2: Taro earnings review**

<b>Taro Review (US\$ '000)</b>	<b>2QFY12</b>	<b>2QFY11</b>	<b>Y-Y</b>	<b>1QFY12</b>	<b>Q-Q</b>
<b>Net Sales</b>	<b>138,251</b>	<b>103,215</b>	<b>33.9%</b>	<b>111,584</b>	<b>23.9%</b>
Cost of Sales	44,945	41,736	7.7%	44,524	0.9%
<b>Gross Profit</b>	<b>93,306</b>	<b>61,479</b>	<b>51.8%</b>	<b>67,060</b>	<b>39.1%</b>
Research and Development	6,934	9,592	-27.7%	7,807	-11.2%
Selling and Administrative	24,436	27,797	-12.1%	25,092	-2.6%
Operating Income	61,936	24,090	157.1%	34,161	81.3%
<b>EBITDA</b>	<b>66,643</b>	<b>28,590</b>	<b>133.1%</b>	<b>38,915</b>	<b>71.3%</b>
Depreciation & Amortization	4,707	4,500		4,754	
Interest and Other Financial Expenses	1,507	2,767		624	
Foreign Exchange Expense	(16,072)	2,104		2,431	
Other Income	171	284		752	
<b>Income before Income Taxes</b>	<b>76,672</b>	<b>19,503</b>	<b>293.1%</b>	<b>31,858</b>	<b>140.7%</b>
Income Tax Expense/(Benefit)	18,317	643		(4,719)	
<b>Net Income</b>	<b>58,355</b>	<b>18,860</b>	<b>209.4%</b>	<b>36,577</b>	<b>59.5%</b>
Gross Margin % of Sales	67.5%	59.6%	793bps	60.1%	739bps
R&D % of Sales	5.0%	9.3%	-428bps	7.0%	-198bps
SG&A % of Sales	17.7%	26.9%	-926bps	22.5%	-481bps
EBITDA Margin	48.2%	27.7%	2,050bps	34.9%	1,333bps

Source: Company data, Nomura estimates

### **Fig 3: Sun (ex-Taro) earnings review**

INR mn	2QFY12 Actuals			2QFY12 Nomura Estimates			Delta vs. Nomura Estimates		
	Sun (Cons.)	Sun (ex-Taro)	Taro	Sun (Cons.)	Sun (ex-Taro)	Taro	Sun (Cons.)	Sun (ex-Taro)	Taro
<b>Sales</b>	18946	12612	6334	18161	13091	5070	4%	-4%	25%
<b>Core EBITDA</b>	7840	4790	3050	6584	5063	1521	19%	-5%	101%
<b>Net Profit</b>	5977	3280	2698	5605	4535	1070	7%	-28%	152%
<b>Tax rate</b>	15.3%	9.1%	23.9%	5.0%	2.0%	20.0%	1033bps	714bps	386bps

Source: Company data, Nomura estimates

### US revenues (ex-Taro) down 26% y-y

Revenues from US were 93% y-y due to consolidation of Taro during 2QFY12 while 2QFY11 had only 10 days of Taro sales. Ex-Taro, the US revenues were down 26% y-y. This was due to one off revenues booked in 2QFY11 from sales of generic Eloxatin. The tailwind from currency movements during 2QFY12 was at 2-3%, as per mgmt.

Taro's US revenues were substantially ahead of our estimates. The mgmt commented that the revenues included certain opportunistic sales which were not sustainable going forward. However, the extent of the unsustainable revenues was not disclosed.

On Caraco cGMP resolution, the management said that the FDA is yet to review the Detroit facility. Sun has filed for site transfer of several products including Prandin (US\$200mn). Sun has FTF on Prandin and would launch with 180 day exclusivity. Although litigation is still ongoing on Prandin, Sun has not received final approval yet.

### EBITDA margin surprise of 513bps led by Taro; R&D to ramp up going forward

Sun reported core EBITDA margins of 41.4% vs. our estimate of 36.3%. Ex-Taro, EBITDA margins came in 69bps below our estimates. Taro's EBITDA margin came in at 48.2% which up 13.3% q-q. The surprise in margin was led by higher unsustainable revenues and low R&D expenditure. The management guided to a higher R&D spend from Taro going forward.

### Higher tax rate for Sun (ex-Taro)

The management guided to a tax rate of 9% going forward for Sun on an ex-Taro basis. This is substantially higher than the historical levels of 2-3%.

**Valuation Methodology and Investment Risks:** See below

Note: Ratings and Price Targets are as of the date of the most recently published report (<http://go.nomuranow.com/research/globalresearchportal>) rather than the date of this email.

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Issuer name	Ticker	Price	Price date	Stock rating	Disclosures
Sun Pharmaceutical Industries	SUNP IN	510.8 INR	14 Nov 2011	Neutral	

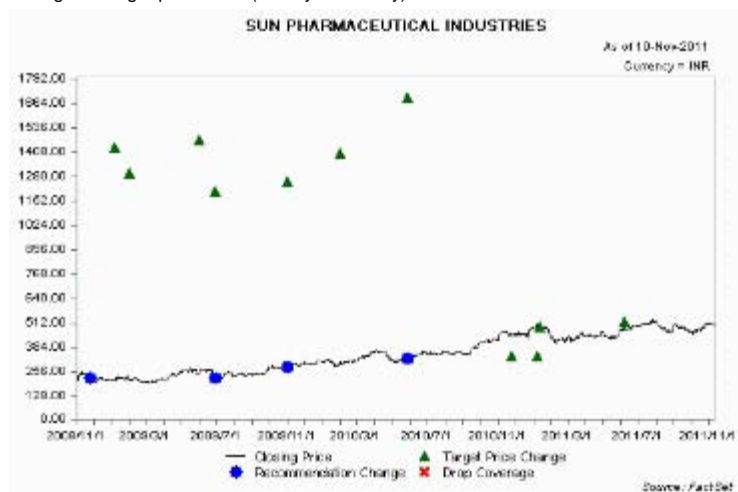
### Previous Rating

Issuer name	Previous Rating	Date of change
Sun Pharmaceutical Industries	Reduce	28 May 2010

### Sun Pharmaceutical Industries (SUNP IN)

510.8 INR (14 Nov 2011) Neutral

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
07-Jun-2011		513.00	490.35
11-Jan-2011		490.00	478.00
07-Jan-2011		339.00	492.15
25-Nov-2010		338.80	456.25
28-May-2010		1694.00	326.36
28-May-2010	Neutral		326.36
01-Feb-2010		1399.00	301.51
02-Nov-2009		1251.00	276.33
02-Nov-2009	Reduce		276.33
29-Jun-2009		1200.00	220.07
29-Jun-2009	Neutral		220.07
02-Jun-2009		1467.00	245.94
02-Feb-2009		1298.00	209.27
06-Jan-2009		1431.00	208.24
26-Nov-2008	Buy		220.88

For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** We expect Sun Pharma to trade at 20-25x one-year forward earnings as it has done in the recent past. We value Sun Pharma at 22.5x FY13F EPS of INR22.6/sh to arrive at our base-business price target of INR508 and INR5/sh for one off Imatinib opportunity. This gives us our price target of INR513.

**Risks that may impede the achievement of the target price** The key upside risks to our call include: 1) a quicker resolution of FDA issues and a stronger pick-up in the base business and 2) higher realisation from product-specific opportunities. If the upside is not sustainable it shall not change our view. The key downside risks include: 1) regulatory issues continuing beyond the expected timeline; 2) a delay in product approvals and 3) slowdown in the domestic market.

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