

Sun pursues Taro

Pricing risk remains in Taro; acquisition would likely be earnings accretive

August 15, 2012

Rating Remains	Neutral
Target price Remains	INR 690
Closing price August 13, 2012	INR 682
Potential upside	+1.2%

Action: Sun pursues 100% stake in Taro

Sun Pharma has increased its offer price for Taro (TARO US, not rated) by 61% to USD39.5/sh to acquire the 34% stake it does not own. As has occurred on previous occasions, Taro's minority shareholders have raised objections that may stall the deal. Strategically, Sun would like to have 100% control as management believes it would bring operational efficiency; hence, we think it may be willing to pay some premium and deviate from its extreme conservative approach towards acquisitions in the past. Considering the Fougera-Sandoz deal as a benchmark and the potential risk we see to Taro's current earnings, we believe a further increase in the offer price is possible, but anything beyond USD66/sh is unlikely. Assuming a payout of USD600-1bn for Taro, we estimate the acquisition could be earnings accretive for Sun by 5-10%. In this report, we analyse Taro's portfolio and highlight that price hikes have been sharp and concentrated. We will watch Fougera under Sandoz, which is the main competitor for Taro. We believe a 14-20% reduction in Taro's US sales over time from current levels is a possibility.

Catalyst

Positive: Value-accretive acquisitions, positive surprises from US pipeline;
Negative: Protonix liability, pricing control in India, US pricing pressure.

Valuation: Premium valuation; maintain Neutral

Our 12m target price is INR690/sh based on 20x FY14E EPS. The stock is trading at 19.3x FY14F EPS and 22.7x FY14F EPS ex Taro vs a sector average of 16.2x, based on our estimates.

31 Mar	FY11	FY12F		FY13F		FY14F	
Currency (INR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	57,214	80,057	80,057	116,411	116,411	122,725	122,725
Reported net profit (mn)	18,162	25,928	25,928	36,765	36,765	35,731	35,731
Normalised net profit (mn)	18,162	25,928	25,928	36,765	36,765	35,731	35,731
FD normalised EPS	17.54	25.04	25.04	35.50	35.50	34.50	34.50
FD norm. EPS growth (%)	37.8	39.9	42.8	41.8	41.8	-2.8	-2.8
FD normalised P/E (x)	38.0	N/A	26.7	N/A	18.8	N/A	19.3
EV/EBITDA (x)	34.0	20.4	20.1	12.6	12.4	12.6	12.4
Price/book (x)	7.3	N/A	5.8	N/A	4.6	N/A	3.8
Dividend yield (%)	0.6	N/A	0.6	N/A	0.6	N/A	0.6
ROE (%)	21.0	24.3	24.3	27.3	27.3	21.4	21.4
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash	net cash	net cash

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart.

Anchor themes

SUNP is a play on the growth in IPM and opportunities in the US. Sun's strong balance sheet provides leverage for potentially accretive mergers and acquisitions.

Nomura vs consensus

We believe earnings upgrades are in the offing. We are 12% ahead of consensus' FY14F EPS.

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Key data on Sun Pharmaceutical Industries

Income statement (INRmn)

Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Revenue	40,074	57,214	80,057	116,411	122,725
Cost of goods sold	-10,977	-14,607	-16,367	-23,675	-26,059
Gross profit	29,097	42,607	63,689	92,736	96,666
SG&A	-17,002	-24,948	-33,898	-45,103	-52,366
Employee share expense	0	0	0	0	0
Operating profit	12,095	17,659	29,792	47,633	44,300
EBITDA	13,628	19,700	32,703	51,197	48,169
Depreciation	-1,533	-2,041	-2,912	-3,564	-3,869
Amortisation	0	0	0	0	0
EBIT	12,095	17,659	29,792	47,633	44,300
Net interest expense	-62	-577	-282	-451	-451
Associates & JCEs	0	0	0	0	0
Other income	1,782	3,277	4,099	3,000	4,500
Earnings before tax	13,815	20,359	33,609	50,183	48,349
Income tax	-679	-1,284	-3,826	-8,531	-8,219
Net profit after tax	13,136	19,075	29,783	41,652	40,130
Minority interests	41	-913	-3,855	-4,887	-4,399
Other items	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Normalised NPAT	13,177	18,162	25,928	36,765	35,731
Extraordinary items					
Reported NPAT	13,177	18,162	25,928	36,765	35,731
Dividends	-3,321	-4,245	-4,245	-4,245	-4,245
Transfer to reserves	9,856	13,917	21,684	32,521	31,486

Valuation and ratio analysis

Reported P/E (x)	52.4	38.0	26.7	18.8	19.3
Normalised P/E (x)	52.4	38.0	26.7	18.8	19.3
FD normalised P/E (x)	52.4	38.0	26.7	18.8	19.3
FD normalised P/E at price target (x)	54.2	39.3	27.6	19.4	20.0
Dividend yield (%)	0.5	0.6	0.6	0.6	0.6
Price/cashflow (x)	83.6	28.9	39.0	19.9	14.4
Price/book (x)	8.8	7.3	5.8	4.6	3.8
EV/EBITDA (x)	50.1	34.0	20.1	12.4	12.4
EV/EBIT (x)	56.5	37.9	22.1	13.3	13.5
Gross margin (%)	72.6	74.5	79.6	79.7	78.8
EBITDA margin (%)	34.0	34.4	40.9	44.0	39.2
EBIT margin (%)	30.2	30.9	37.2	40.9	36.1
Net margin (%)	32.9	31.7	32.4	31.6	29.1
Effective tax rate (%)	4.9	6.3	11.4	17.0	17.0
Dividend payout (%)	25.2	23.4	16.4	11.5	11.9
Capex to sales (%)	7.1	7.8	9.8	4.3	4.1
Capex to depreciation (x)	1.9	2.2	2.7	1.4	1.3
ROE (%)	17.7	21.0	24.3	27.3	21.4
ROA (pretax %)	16.1	19.0	26.5	36.6	33.6

Growth (%)

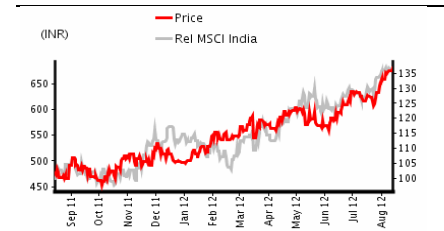
Revenue	-4.2	42.8	39.9	45.4	5.4
EBITDA	-26.9	44.6	66.0	56.6	-5.9
EBIT	-30.5	46.0	68.7	59.9	-7.0
Normalised EPS	-27.5	37.8	42.8	41.8	-2.8
Normalised FDEPS	-27.5	37.8	42.8	41.8	-2.8

Per share

Reported EPS (INR)	12.72	17.54	25.04	35.50	34.50
Norm EPS (INR)	12.72	17.54	25.04	35.50	34.50
Fully diluted norm EPS (INR)	12.72	17.54	25.04	35.50	34.50
Book value per share (INR)	75.60	91.57	114.42	145.82	177.20
DPS (INR)	3.21	4.10	4.10	4.10	4.12

Source: Company data, Nomura estimates

Relative performance chart (one year)



Source: ThomsonReuters, Nomura research

(%)	1M	3M	12M
Absolute (INR)	8.3	15.5	40.2
Absolute (USD)	7.2	11.5	14.1
Relative to index	5.6	7.3	35.6
Market cap (USDmn)	12,336.0		
Estimated free float (%)	52.8		
52-week range (INR)	689.9/448.5		
3-mth avg daily turnover (USDmn)	8.41		
Major shareholders (%)			
Promoter	63.7		

Source: Thomson Reuters, Nomura research

Notes

Sun trades at ~19x FY13F unadjusted EPS

Cashflow (INRmn)

Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
EBITDA	13,628	19,700	32,703	51,197	48,169
Change in working capital	-3,590	1,085	-8,415	-7,237	8,477
Other operating cashflow	-1,776	3,110	-6,555	-9,169	-8,740
Cashflow from operations	8,262	23,894	17,733	34,791	47,907
Capital expenditure	-2,841	-4,454	-7,812	-5,000	-5,000
Free cashflow	5,421	19,440	9,921	29,791	42,907
Reduction in investments	0	0	0	0	0
Net acquisitions					
Reduction in other LT assets	-13,399	2,289	-4,302	-518	-429
Addition in other LT liabilities	34	1,685	5,511	0	0
Adjustments	13,947	-21,006	1,301	3,638	5,020
Cashflow after investing acts	6,004	2,409	12,430	32,912	47,498
Cash dividends	-3,328	-3,314	1,266	-4,245	-4,245
Equity issue	0	0	0	0	0
Debt issue	-77	-3,787	-1,606	354	0
Convertible debt issue	0	0	0	0	0
Others	-13,216	20,555	-2,150	-5,337	-4,849
Cashflow from financial acts	-16,621	13,455	-2,490	-9,228	-9,094
Net cashflow	-10,618	15,864	9,940	23,684	38,404
Beginning cash	16,690	6,073	21,936	31,877	55,561
Ending cash	6,073	21,936	31,877	55,561	93,966
Ending net debt	-4,361	-17,681	-29,227	-52,557	-90,961

Source: Company data, Nomura estimates

Notes

Strong free cash flows provide flexibility to make inorganic moves

Balance sheet (INRmn)

As at 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Cash & equivalents	6,073	21,936	31,877	55,561	93,966
Marketable securities	0	0	0	0	0
Accounts receivable	11,748	11,716	19,261	24,830	17,541
Inventories	10,739	14,794	20,870	25,542	22,146
Other current assets	0	0	0	0	0
Total current assets	28,559	48,446	72,008	105,933	133,653
LT investments	0	0	0	0	0
Fixed assets	16,776	27,940	32,841	34,277	35,407
Goodwill	4,060	7,720	7,720	7,720	7,720
Other intangible assets	0	0	0	0	0
Other LT assets	41,325	39,036	43,338	43,856	44,285
Total assets	90,721	123,142	155,907	191,785	221,064
Short-term debt					
Accounts payable	2,907	4,808	8,401	10,152	8,865
Other current liabilities	1,188	4,395	6,009	7,261	6,341
Total current liabilities	4,095	9,203	14,410	17,413	15,206
Long-term debt	1,712	4,256	2,650	3,004	3,004
Convertible debt					
Other LT liabilities	4,693	6,379	11,889	11,889	11,889
Total liabilities	10,500	19,838	28,949	32,307	30,100
Minority interest	1,932	8,472	8,472	8,472	8,472
Preferred stock	0	0	0	0	0
Common stock	1,036	1,036	1,036	1,036	1,036
Retained earnings	58,656	75,681	99,334	131,855	163,340
Proposed dividends					
Other equity and reserves	18,598	18,117	18,117	18,117	18,118
Total shareholders' equity	78,289	94,833	118,486	151,007	182,493
Total equity & liabilities	90,721	123,142	155,907	191,785	221,064

Notes

Sun has a strong balance sheet which could be leveraged, if need be

Liquidity (x)

Current ratio	6.97	5.26	5.00	6.08	8.79
Interest cover	196.7	30.6	105.6	105.7	98.3

Leverage

Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash

Activity (days)

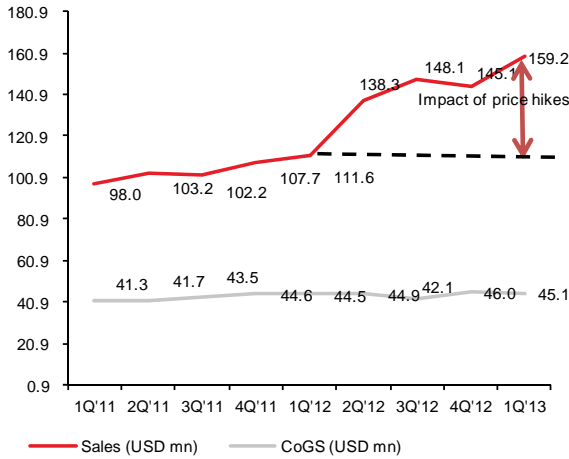
Days receivable	93.6	74.8	70.8	69.1	63.0
Days inventory	340.7	319.0	398.8	357.8	334.0
Days payable	90.6	96.4	147.7	143.0	133.2
Cash cycle	343.7	297.4	321.9	283.9	263.8

Source: Company data, Nomura estimates

Taro's revenue growth has been led by unprecedented price hikes

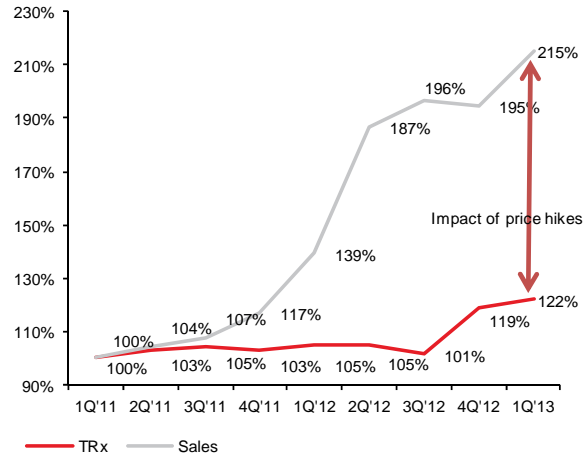
Taro's performance over the past four quarters has largely been driven by unprecedented price increases. The expanding gap between reported sales and COGS (CoGS has largely remained flat) or the rising gap in prescription volumes and sales as reported by IMS, indicate a steep rise in realisation over the last four quarters.

Fig. 1: Taro: Reported sales and CoGS gap indicates price hikes



Source: Company data, Nomura research

Fig. 2: Taro: IMS data suggests rising gap in TRx and sales



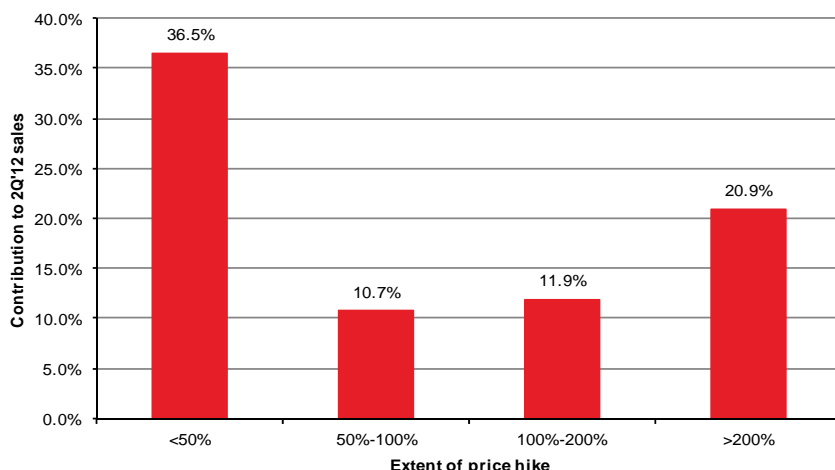
Source: IMS, Nomura research

Taro's sales increase, as shown above, is characterised by a steep and concentrated rise in prices, in our view. To derive pricing, we divide the sales by prescription as reported by the IMS. Given that competition in Taro's product portfolio is limited, we believe the change in pricing, as implied by the IMS data, is a close approximation of the pricing realised by the company. For instance, Taro's Jun 12 quarter sales increased by 54% y-y as per IMS, which is in line with the 59% rise reported by Taro in its reported financials.

In Figure 3, we plot the price hikes over the past one year vs the corresponding contribution to current sales. We found that almost 80% of current sales are from products that witnessed price hikes greater than 50%. Based on IMS data, almost 21% of portfolio sales are from products that recorded a 3x increase in prices over the last one year.

Fig. 3: Taro: Significant price hikes

Almost 80% of Taro's current sales are from products that registered >50% price rise in last one year

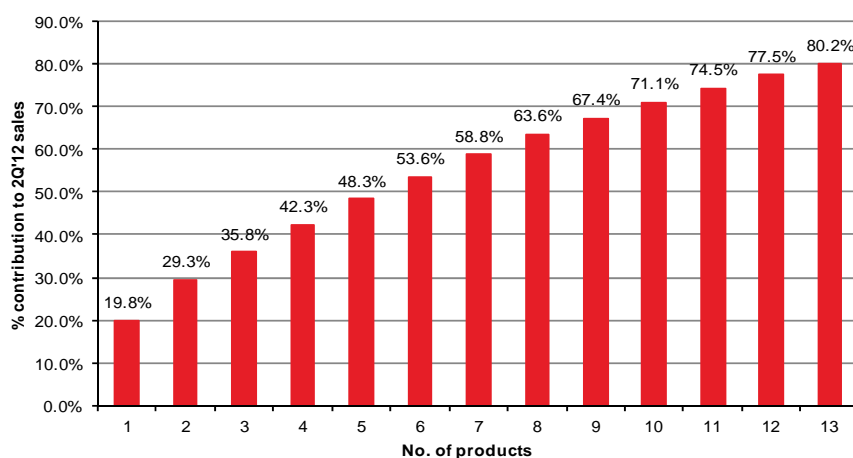


Source: IMS, Nomura research

Further, the growth in sales over the past one year was very concentrated. In Figure 4, we present the cumulative contribution to sales growth over the last one year (Q1FY13 vs Q1FY12), based on the same IMS data. The largest contributor to growth has been Nystatin Triam cream, which recorded a 320% price hike over the past one year and contributed ~20% to the overall sales increase. Over the past year, 13 products contributed 80% of Taro's sales growth and all of them registered an average price increase of 200%.

Fig. 4: Taro: Concentrated contribution to growth

Top 13 products (out of 148 marketed products) contributed ~80% of y-y sales growth in 2Q'12

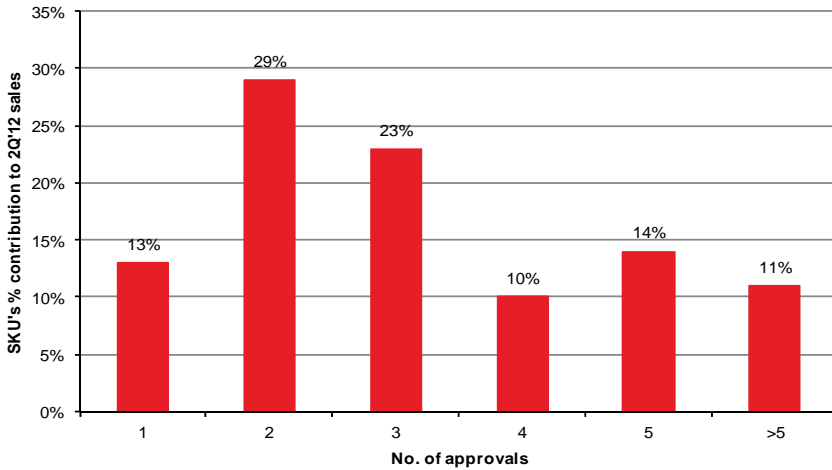


Source: IMS, Nomura research

Can these price hikes be sustained?

Dermatology, which contributed 67% of Taro's revenues in 2011, is a niche segment with limited competition. Analysis of Taro's products suggests that the company is the only generic in the market on certain products; based on IMS data, these products contribute 13% of its US sales. For 89% of Taro's portfolio, the number of ANDA approvals is less than or equal to five (Fig 5). Thus, we believe the price hikes are driven by low competition, supply issues and not-so-aggressive competition.

Fig. 5: Almost 90% of Taro's products have 5 or less approved competitors



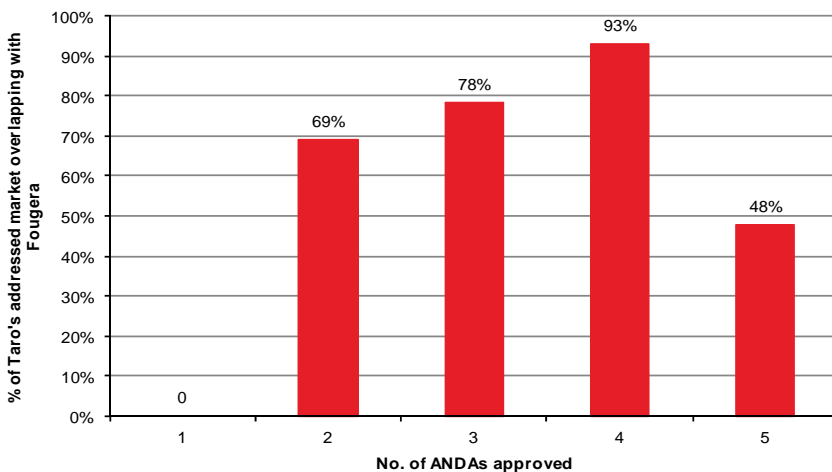
Source: www.fda.gov, Nomura research

Over time, we believe current prices will not be sustained. We see two reasons for prices to moderate: 1) we expect new players like Glenmark and Lupin to enter the space; and 2) we look for some existing players to become more aggressive. Two key competitors in the space – Fougera and Actavis – were recently acquired by Sandoz and Watson, respectively. Under Sandoz and Watson, we expect competition to get more aggressive.

We believe in the near term, the pricing environment will be determined to a great extent by actions of Fougera (Sandoz). Based on the approvals in place, our analysis suggests that significant overlap exists between Taro's and Fougera's portfolios. This is highlighted below. For instance, in a two-player market (Taro and another player), Fougera has a presence in the same products which account for 69% of Taro's sales. Overall, where competition is limited to 2-5 players, Fougera's has a presence in products that account for 71% of Taro's sales.

Fig. 6: Fougera competes with Taro

Fougera has presence in products that account for ~70% of Taro's sales.



Source: www.fda.gov, Nomura research

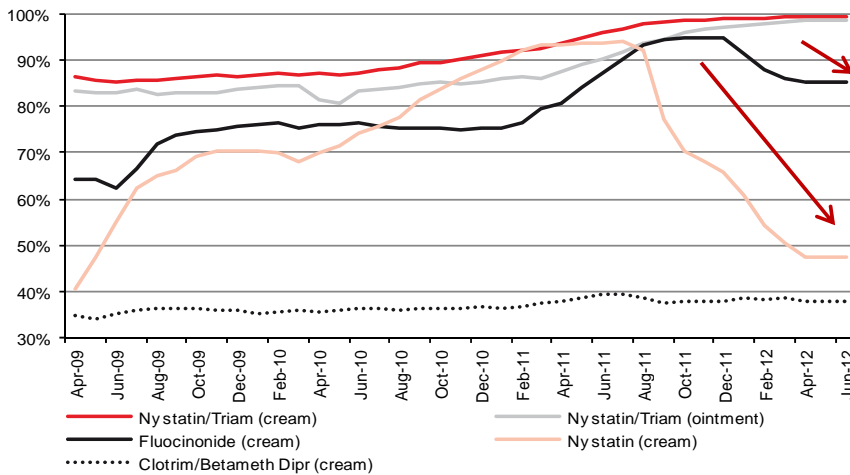
What could the potential price correction be?

Taro's sales have increased by ~USD 200m on an annual basis over the last one year, largely due to price hikes. Further price increases in the near term can't be completely ruled out (as Q1FY13 was a surprise), in our view, however, over time, we expect some correction in pricing and sales from current levels.

Thus far, we haven't witnessed any major drop in pricing as such, but in some products, a decline in Taro's market share as lower-priced competition has gained share (Fig 7). In Fig 8, we list Taro's top 24 products and the current competitive landscape for each, based on IMS data. These products contribute 73% to Taro's US sales. In this list we highlight seven instances where price hikes have been significant (i.e., >130%) and additional competition is expected to step in the near term (approvals are in place but product is not in the market). Assuming Taro sees sales declines in these products that range from 80% to 19% (based on competition), overall US sales for Taro could decline by 15%, on our analysis. Given the possibility of declines in other products not considered in the computation, we believe a decline of 14-20% in US sales is a possibility for Taro in FY13/14F. Based on the Q1FY13 financials, we believe US sales have an annual run rate of USD560mn; therefore, the sales decline could be USD 80-110mn, based on our calculation. Currently, our estimates factor in a USD70mn decline in Taro's base business over the next two years.

Fig. 7: Competition has returned in some of Taro's products

Teva's ramp up in Fluocinonide cream and Actavis' launch in Nystatin cream have eroded Taro's share



Source: IMS, Nomura research

Fig. 8: Key products at Taro

Contribution to growth, sales and price increases are for 2Q'12 over 2Q'11.

Product Sum	Form (desc)	Contr to growth	Contr to sales	Taro market share	Price Increase	No. of players on market	No of approvals	Players off market	Approvals	Potential erosion in Sales due to additional competition
Nystatin/triam	Crm	19.8%	9.1%	100%	320%	1	2	Fougera	Fougera and Taro	65%
Clotrim/betam eth dipr	Crm	9.5%	6.9%	38%	99%	3	3		Actavis, Fougera and Taro	0%
Fluocinonide	Crm	6.5%	3.0%	84%	314%	2	4	Actavis and Fougera	Taro, Teva, Actavis and Fougera	65%
Hydrocortisone val	Oint	6.5%	3.7%	100%	133%	1	2	Fougera	Fougera and Taro	65%
Nystatin/triam	Oint	6.0%	2.7%	99%	292%	1	2	Fougera	Fougera and Taro	65%
Fluocinonide	Soln	5.3%	2.1%	100%	198%	1	4	Teva, Actavis and Fougera	Teva, Actavis, Taro and Fougera	80%
Calcipotriene	Oint	5.2%	3.9%	100%	16%	1	1		Taro / Glenmark	0%
Nystatin	Crm	4.8%	3.2%	45%	292%	4	5	Fougera	Actavis, Perrigo, Endo, Taro and Fougera	19%
Clobetasol prop	Crm	3.8%	2.1%	57%	192%	3	3		Taro, Hi Tech and Fougera	0%
Metronidazole	Gel	3.4%	1.5%	45%	303%	4	4		Tolmar, Fougera, GW Labs and Taro	0%
Clobetasol prop	Oint	3.1%	1.7%	58%	162%	3	4	Teva	Teva, Taro, Fougera and Hi Tech	19%
Triamcinolone actn	Crm	2.6%	1.5%	20%	36%	5	5		Actavis, Endo, Fougera, Perrigo and Taro	0%
Fluorouracil	Crm	1.5%	3.3%	40%	-7%	3	3		Taro, Valeant and Spear.	0%
Adapalene	Gel	1.5%	1.4%	43%	21%	3	3		Teva, Glenmark and Tolmar	0%
Hydrocortisone val	Crm	1.1%	1.5%	63%	32%	2	2		Perrigo and Taro	0%
Etodolac	Tab	1.1%	1.4%	79%	29%	2	6	Apotex, Mylan, Sandoz and Prosam Labs	Taro, Teva, Apotex, Mylan, Sandoz and Prosam Labs	0%
Ovide	Lotion	1.1%	1.7%	100%	39%	1	1		Taro	0%
Desoximetasone	Oint	0.9%	4.0%	100%	17%	1	1		Taro	0%
Triamcinolone actn	Paste dental	0.4%	1.7%	56%	11%	2	2		Rising and Taro	0%
Malathion	Lotion	0.4%	2.2%	100%	0%	1	1		Taro	0%
Phenytoin sod extd	Cap	-0.3%	1.3%	31%	31%	5	5		Amneal, Wockhardt, Taro, Sun and Mylan	0%
Desoximetasone	Crm	-0.8%	5.1%	64%	6%	2	3	Fougera	Taro, Perrigo and Fougera	0%
Warfarin sod	Tab	-1.0%	5.0%	64%	-36%	3	5	Mylan and Invagen	Taro, Teva, Zydus, Mylan and Invagen	0%
Carbamazepine er	Tab sa 12hr	-1.1%	3.2%	59%	1%	2	2		Taro and Sandoz	0%

Source: IMS, www.fda.gov, Nomura estimates

Fig. 9: Selected products with higher possibility of price correction

Contribution to growth, sales and price increases are for 2Q'12 over 2Q'11.

Product	Formulation	Contr to growth	Contr to sales	Taro market share	Price Increase	No. of players on market	Approvals	Players off market	Potential erosion in Sales due to additional competition
Nystatin/triam	Cream	19.8%	9.1%	100%	320%	1	Fougera and Taro	Fougera	65%
Fluocinonide	Cream	6.5%	3.0%	84%	314%	2	Taro, Teva, Actavis and Fougera	Actavis and Fougera	65%
Hydrocortisone val	Oint	6.5%	3.7%	100%	133%	1	Fougera and Taro	Fougera	65%
Nystatin/triam	Oint	6.0%	2.7%	99%	292%	1	Fougera and Taro	Fougera	65%
Fluocinonide	Soln	5.3%	2.1%	100%	198%	1	Teva, Actavis, Taro and Fougera	Teva, Actavis and Fougera	80%
Nystatin	Cream	4.8%	3.2%	45%	292%	4	Actavis, Perrigo, Endo, Taro and Fougera	Fougera	19%
Clobetasol prop	Oint	3.1%	1.7%	58%	162%	3	Teva, Taro, Fougera and Hi Tech	Teva	19%

Source: IMS, www.fda.gov, Nomura estimates

Sun Pharma continues to pursue 100% control of Taro

Sun Pharma announced that it has revised its offer for Taro's minority shareholders from USD24.5/sh to USD39.5/sh. Sun currently holds a 66% share of Taro and intends to acquire the remaining 34%, according to management. Taro's board has accepted Sun's latest proposal on the basis of a report from an independent evaluator. The proposal now needs to be accepted by majority of the minority shareholders that participate in voting for the proposal. As has occurred on earlier occasions, some of Taro's minority shareholders have raised objections to the proposal and are demanding even higher valuations. On 13 August, Bloomberg reported that Taro's minority shareholder, Grand Slam, wrote a letter to Taro's shareholders urging them to reject Sun Pharma's revised offer. Grand Slam cites comparisons that are being drawn with the valuations of other listed companies.

The offer price of USD39.5/sh implies an EV/EBITDA valuation of 4.8x LTM EBITDA

At USD 39.5/sh, Taro is valued at USD1.76bn. This implies a cash outflow of ~USD 600mn for Sun Pharma. The latest offer price implies a valuation of 7x annualised EPS based on the Q1FY13 financials or 7.6x LTM EPS. On EV/EBITDA, we calculate the valuation at 4.33x annualised EBITDA based on Q1FY13 financials and 4.8x LTM EBITDA.

We believe it is inappropriate to compare Taro's valuation to Sun Pharma's standalone valuation or that of other listed Indian companies as there are significant differences in business mix and growth prospects. Sun Pharma trades at 22x P/E and 14.3 EV/EBITDA on FY13F base business. Other front-line Indian generic companies we cover are trading at ~20x P/E and ~13-15x EV/EBITDA on FY13F base business.

In terms of business mix, we refer to the recent acquisition of Fougera by Sandoz. Fougera is a specialty dermatology business with 2011 net sales of USD429mn, somewhat lower than that of Taro (USD590mn LTM sales). Fougera's EBITDA margin was 40% in 2011 compared to 50.8% for Taro over the LTM. Sandoz acquired Fougera for a consideration of USD1.525bn, implying a valuation multiple of 8.8x LTM EBITDA. At 8.8x LTM EBITDA, we estimate the valuation for Taro could increase to USD66/sh.

Based on Fougera-Sandoz deal multiple, Taro's offer price could increase to USD66/sh

As we highlighted earlier, Taro's financials over the past few quarters have been boosted by price gains which may not be sustained over the longer term. Thus, Taro's valuation should be a discount to the Fougera acquisition, in our view. We highlight that based on IMS data, we think Taro's US sales could correct by USD 80-110mn over the next few quarters depending on competitive activity. Assuming the midpoint of a USD95mn correction in sales and EBITDA and applying a valuation multiple of 8.8x EV/EBITDA, we arrive at a value of USD 47.5/sh, which implies a 20% increase over the current offer price.

Adjusting for potential price correction in Taro, a 20% premium to the offer is a possibility

Will Sun Pharma pay a premium to acquire Taro?

We believe strategically Sun would like to acquire a 100% stake in Taro, as Sun management believes it could bring significant operational flexibility. The operations of Taro and the rest of Sun Pharma could be better integrated in terms of resources. Further, having been involved with Taro for last two years, Sun management has greater comfort with and understanding of the business, in our view. Historically, Sun has been very conservative on acquisitions; however for the remaining stake in Taro, we think Sun may be willing to pay a premium, given potential synergies recognized by management. Historically, management had stated that it would look for a payback of five years from an acquisition. If we were to assume Taro could sustain the cash earnings (net profit + depreciation) reported in Q1FY13 (which is optimistic assumption, given our price hike discussion above), the current valuation would imply a pay back of just above five years. Though additional premium cannot be ruled out, we think anything beyond USD66/sh (as implied for Fougera deal) is unlikely. For instance, according to the August 13 Bloomberg article, Grand Slam has argued for a price in excess of USD100/sh based on comparable trading multiple of Sun Pharma and other Indian companies, which is unlikely to be realised, in our assessment.

Acquisition would be earnings accretive by 5-10%, we believe

Assuming a payout of USD600mn-1bn for the remaining stake in Taro, we believe the deal would be earnings accretive on our current estimates for Sun. We estimate the earnings accretion at 5-10%.

Fig. 10: Estimated earnings accretion from possible acquisition of remaining 34% of Taro

Purchase consideration	Earnings accretion	
	FY13F	FY14F
USD600m	9.60%	8.50%
USD1bn	7.10%	5.90%

Source: Nomura estimates

Appendix A-1

Analyst Certification

I, Aditya Khemka, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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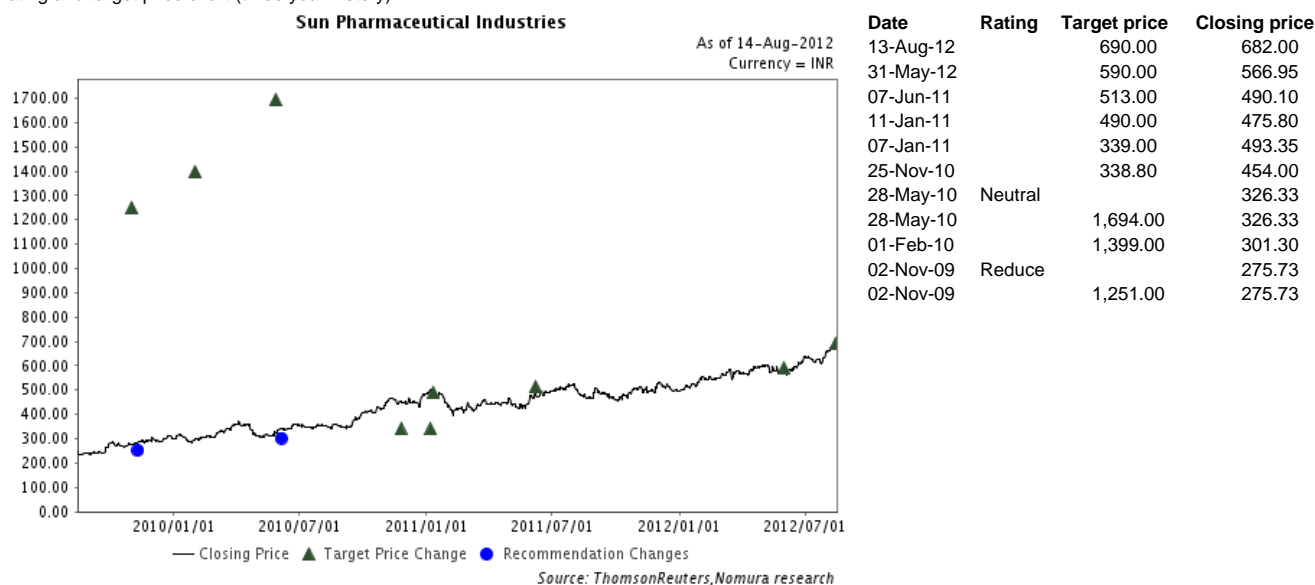
Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Sun Pharmaceutical Industries	SUNP IN	INR 682	13-Aug-2012	Neutral	Not rated	

Previous Rating

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

Sun Pharmaceutical Industries (SUNP IN) INR 682 (13-Aug-2012) Neutral (Sector rating: Not rated)

Rating and target price chart (three year history)



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

Valuation Methodology Our INR690 target price is based on 20x FY14F EPS of INR34.5/sh.

Risks that may impede the achievement of the target price The key upside risks to our call include: Value-accretive acquisitions, positive surprises from US pipeline; Downside: Protonix liability, pricing control in India, pricing pressure in key products at Taro and Sun Pharma.

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STOCKS

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