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SYSTEMATIX INSTITUTIONAL EQUITIES

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Institutional Equities

24 April 2023

## Sun Pharma

**Non-compliance letter on Mohali facility – Expect 2-3% earnings impact in worst case scenario**

### COMPANY UPDATE

**Sector:** Pharmaceuticals **Rating:** BUY

**CMP:** Rs 988 **Target Price:** Rs 1,232

### Stock Info

Sensex/Nifty	59,655/17,624
Bloomberg	SUNP IN
Equity shares	2.4bn
52-wk High/Low	Rs 1,072/790
Face value	Rs 1
M-Cap	Rs 2,373bn/ USD 29bn

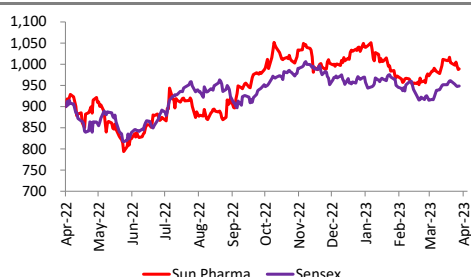
### Financial Snapshot (Rs mn)

Y/E March	FY23E	FY24E	FY25E
Sales	4,40,917	4,82,631	5,24,302
Gross profit	3,28,956	3,58,764	3,90,287
Gross Margin %	74.6%	74.3%	74.4%
EBITDA	1,18,851	1,32,183	1,46,259
Margin %	27.0%	27.4%	27.9%
PAT	86,357	98,934	1,09,467
EPS	36.0	41.2	45.6
DPS(Rs)	11.5	13.2	14.6
ROE(%)	16.0	16.3	16.1
P/E(x)	27.5	24.0	21.7
EV/EBITDA (x)	19.1	16.8	14.6

### Shareholding pattern (%)

	Sep-22	Dec-22	Mar-23
Promoter	54.48	54.48	54.48
–Pledged	2.53	1.92	1.78
FII	15.99	16.87	16.88
DII	19.64	19.14	19.24
Others	9.89	9.51	9.40

### Stock Performance (1-year)



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In Nov'22, the US FDA had classified Sun Pharma's (SUNP) Mohali facility under Official Action Indicated (OAI) status, which impacted its ability to receive approvals for its pending filings. The US FDA has now issued a Consent Decree Correspondence / Non-Compliance Letter, which causes a temporary halt to products exported from SUNP's Mohali facility to the US until SUNP takes certain corrective actions. One of the corrective actions include – Retaining an independent CGMP expert to conduct batch certifications of drugs manufactured at the Mohali facility. We estimate that about 15 products are manufactured and exported to the US from this facility and they contribute to 1-1.5% of overall sales of the company. In the base case, we expect SUNP to put the desired corrective actions in place over the next 3 months and in such a situation, impact on FY24E net earnings should be less than 1%. In the worst case scenario (assuming a 6 – 12 month delay), we expect an adverse impact of 2 to 3.5% on SUNP's FY24E earnings. We have retained our "BUY" rating and target price of Rs 1,232, valuing the company at 27x FY25E EPS. We await clarity on the resolution timeline at the Mohali facility before revising our earnings estimates. We believe that if SUNP is able to execute a potential high value complex generic approval, the same can help SUNP more or less offset this adverse impact, which we are currently not building in our numbers. A larger than expected ramp-up in gRevlimid can also lead to an earnings surprise in FY24/FY25.

**Key products from Mohali facility and anticipated benefits for competitors:** SUNP manufactures three important products from this facility – gPentasa 500mg, gProtonix for oral suspension and gRanolazine extended release tablet. SUNP is the sole generic in gPentasa and gProtonix for oral suspension market. Ajanta Pharma (AJP, BUY) could benefit from the compliance action at SUNP's Mohali facility as the company has an approval for gProtonix but has not yet launched the product. AJP also has a meaningful presence in the gRanolazine extended release tablet market in the US. SUNP's US generic sales contribution from Mohali and Halol facilities is around 14% of total US sales and ~60% of SUNP's ex-Taro US generics business. Notably, SUNP's Halol facility was classified under "import alert" in Dec'22.

**Site transfer of products may be an option but technical / regulatory challenges in the process cannot be ruled out:** We believe the US FDA action at the Mohali facility can cause a temporary disruption in supplies for 1-2 quarters. Nevertheless, if SUNP plans on site transferring products, it could take 9 months. SUNP's largest product from the Mohali facility is gPentasa 500mg. The company may look at site transferring this product to its Dadra and Nagar Haveli facility, which has capabilities in manufacturing mesalamine products. **Since mesalamine products are considered complex, the site transfer process can be challenging and unviable too.**

**In the base case, we expect supplies from Mohali to normalize within 3 months:** The largest product from Mohali facility is gPentasa, where SUNP is the sole generic supplier with 60% market share. Likewise, SUNP is also the sole generic in gProtonix oral suspension. Considering the potential risk of any shortages, SUNP and US FDA would desire a quick implementation of remedial action. We expect SUNP's supplies to be reinitiated before end of 1QFY24. In such a situation, we do not expect a material impact on SUNP's consolidated earnings.

**Scenario analysis indicates limited impact to earnings**

**Base case:** US exports from Mohali facility are disrupted for 3 months in FY24. Expect less than 1% impact on earnings.

**Bull case:** US exports from Mohali facility are disrupted for less than a month in FY24. Expect negligible impact on earnings.

**Bear case:** US exports from Mohali facility are disrupted for six to twelve months in FY24. Expect 2 to 3.5% impact on earnings.

**Exhibit 1: Mohali portfolio**

Products exported from Sun Pharma's Mohali facility	Indian exporters to the US
Droxidopa capsule	Alkem, Annora, MSN Labs
Atorvastatin Calcium tablet	Piramal Pharma, Mylan, Graviti Pharma, Zydus, MSN Labs, Dr. Reddy's, Lupin
Fenofibrate tablet	Mankind, Torrent, Ajanta, Cipla, Mylan, Amneal, Lupin, Alembic
Pregabalin tablet, extended release	MSN Labs, Alembic
Ranolazine tablet, extended release	Ajanta, Mankind, Alkem, Glenmark
Drizalma sprinkle (duloxetine) capsule, delayed release	-
Mesalamine capsule, extended release	-
Risedronate sodium tablet, delayed release	Aurobindo, Macleods
Aspruzo sprinkle (ranolazine) granule	-
Bupropion Hydrochloride tablet, extended release	Lupin, Intas, Graviti, Hetero
Pantoprazole Sodium granule, delayed release	-
Diltiazem Hydrochloride capsule, extended release	Zydus, Intas, Glenmark, Piramal, Maiva, Zydus
Repaglinide tablet	Aurobindo, Biocon
Loperamide HCL and Simethicone tablet	-
Clozapine tablet	Aurobindo, Mylan

Source: Company, Systematix Institutional Research

## FINANCIALS

## Profit &amp; Loss Statement

YE: Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
<b>Net Revenues</b>	<b>3,34,981</b>	<b>3,86,545</b>	<b>4,40,917</b>	<b>4,82,631</b>	<b>5,24,302</b>
YoY gr. (%)	2.0%	15.4%	14.1%	9.5%	8.6%
Cost of Goods Sold	86,901	1,03,515	1,11,961	1,23,866	1,34,015
Gross Profit	2,48,081	2,83,030	3,28,956	3,58,764	3,90,287
Margin (%)	74.1%	73.2%	74.6%	74.3%	74.4%
Employee Cost	68,622	73,008	81,536	91,633	1,01,713
Other Expenses	94,545	1,06,044	1,28,569	1,34,948	1,42,316
<b>EBITDA</b>	<b>84,914</b>	<b>1,03,977</b>	<b>1,18,851</b>	<b>1,32,183</b>	<b>1,46,259</b>
YoY gr. (%)	21.5%	22.5%	14.3%	11.2%	10.6%
Margin (%)	25.3%	26.9%	27.0%	27.4%	27.9%
Depreciation & Amortization	20,800	21,437	25,179	25,179	30,809
EBIT	64,114	82,540	93,673	1,07,005	1,15,449
Margin (%)	19.1%	21.4%	21.2%	22.2%	22.0%
Net Interest	1,414	1,274	1,254	1,254	1,254
Other Income	8,355	9,215	3,912	11,717	15,664
Exceptional Items	-43,061	-45,668	-	-	-
Profit Before Tax	27,994	44,813	96,331	1,17,467	1,29,859
Margin (%)	8.4%	11.6%	21.8%	24.3%	24.8%
Total Tax	5,147	10,755	9,204	17,620	19,479
Effective tax rate (%)	18.4%	24.0%	9.6%	15.0%	15.0%
Minority Interest & Share of					
Loss from Associates	-6,191	1,331	770	913	913
<b>Profit after tax</b>	<b>29,038</b>	<b>32,727</b>	<b>86,357</b>	<b>98,934</b>	<b>1,09,467</b>
EPS	12.1	13.6	36.0	41.2	45.6
YoY gr. (%)	-22.9%	12.7%	163.9%	14.6%	10.6%

Source: Company, Systematix Institutional Research

## Cash Flow

YE: Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
PBT	27,994	44,813	96,331	1,17,467	1,29,859
Depreciation	20,800	21,437	25,179	25,179	30,809
Interest	1,414	1,274	1,254	1,254	1,254
Others	-4,115	-2,961	-3,912	-11,717	-15,664
Working capital	25,641	15,591	-8,038	-15,506	-14,892
Direct tax	-10,029	9,692	-9,204	-17,620	-19,479
<b>Net cash from Op. activities</b>	<b>61,704</b>	<b>89,845</b>	<b>1,01,609</b>	<b>99,057</b>	<b>1,11,887</b>
Net Capital expenditures	-11,701	-14,950	-58,815	-17,000	-17,000
Others	17,064	-42,297	1,912	9,717	13,664
<b>Net Cash from Inv. activities</b>	<b>5,362</b>	<b>-57,247</b>	<b>-56,902</b>	<b>-7,283</b>	<b>-3,336</b>
Issue of share cap. / premium	-	-	-	-	-
Debt changes	-43,170	-28,718	55,766	2,329	3,441
Dividend paid	-15,595	-21,589	-15,595	-21,589	-27,647
Others	-1,040	-1,628	-38,324	-4,759	-2,079
<b>Net cash from Fin. activities</b>	<b>-59,805</b>	<b>-51,935</b>	<b>1,847</b>	<b>-24,019</b>	<b>-26,286</b>
<b>Net change in cash</b>	<b>7,261</b>	<b>-19,337</b>	<b>46,554</b>	<b>67,755</b>	<b>82,266</b>

Source: Company, Systematix Institutional Research

## Balance Sheet

YE: Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Equity Share Capital	2,399	2,399	2,399	2,399	2,399
Reserves & Surplus (Ex OCI)	4,62,229	4,77,713	5,36,423	6,03,683	6,78,105
<b>Net Worth</b>	<b>4,64,628</b>	<b>4,80,112</b>	<b>5,38,822</b>	<b>6,06,083</b>	<b>6,80,504</b>
Short term debt	24,449	8,086	68,352	75,181	81,522
Long term debt	8,981	4,817	2,817	817	417
Trade payables	39,737	44,793	61,349	67,872	73,433
Other Provisions	45,827	91,478	66,138	72,395	78,645
Other liabilities	93,046	68,712	66,982	65,395	63,808
<b>Total Liabilities</b>	<b>6,76,667</b>	<b>6,97,999</b>	<b>8,04,459</b>	<b>8,87,742</b>	<b>9,78,329</b>
Net block	2,15,530	2,24,597	2,58,233	2,50,055	2,36,245
CWIP	15,668	12,868	12,868	12,868	12,868
Other Non-current asset	76,225	58,237	58,237	58,237	58,237
Investments	64,824	52,147	57,147	62,147	67,147
Cash and Cash Equivalents	64,455	50,334	96,564	1,63,997	2,45,940
Debtors	90,614	1,05,929	1,20,799	1,32,228	1,43,644
Inventories	89,970	89,968	99,691	1,10,292	1,19,328
Other current asset	59,382	1,03,919	1,00,919	97,919	94,919
<b>Total Assets</b>	<b>6,76,667</b>	<b>6,97,999</b>	<b>8,04,459</b>	<b>8,87,742</b>	<b>9,78,329</b>

Source: Company, Systematix Institutional Research

## Key Financial Metrics

YE: Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Per Share(Rs)					
EPS	12.1	13.6	36.0	41.2	45.6
CEPS	20.8	22.6	46.5	51.7	58.5
BVPS	193.6	200.1	224.6	252.6	283.6
DPS	6.5	9.0	11.5	13.2	14.6
Return Ratio(%)					
RoCE	12.9	16.7	15.4	15.7	15.1
RoE	6.2	6.8	16.0	16.3	16.1
Balance Sheet					
Net Debt : Equity (x)	-0.1	-0.2	-0.2	-0.3	-0.3
Net Working Capital (Days)	164.9	154.1	141.3	137.9	138.8
Valuation(x)					
PER	81.7	72.5	27.5	24.0	21.7
EV/EBITDA	27.2	21.7	19.1	16.8	14.6
EV/Sales	6.9	5.8	5.2	4.6	4.1

Source: Company, Systematix Institutional Research

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Disclosure of Interest Statement	Update
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