Annual Report 2015-16

SUN PHARMACEUTICAL INDUSTRIES LTD.

SUN PHARMA

EVOLVING BETTER

BEING STRONGER

MOVING FASTER

As the world's fifth largest specialty generic pharmaceutical enterprise and India's leading pharmaceutical company, we are leveraging the advantages of deeper integration and economies of scale globally. Our global presence is supported by advanced manufacturing facilities, state-of-the-art R&D centres and a multi-cultural workforce comprising over 50 nationalities. We have recently forayed into the Japanese market, further reinforcing our global footprint. Simultaneously, we continue to invest significant resources in enhancing our presence in the specialty segment.

CONTENTS

Our business in India and the world continues to strengthen, despite challenges; and FY16 was a year of consolidation for us.

During the year, we identified improvement areas in existing processes; and worked towards encouraging outcomes. We reinforced focus on global compliance, production processes, people potential, supply chain consistency and being first time right.

We strengthened our competencies in the realms of cost efficiencies, sales force productivity and plant productivity, in line with the evolving market and regulatory environment.

We accelerated execution through improved intra- and inter-functional collaboration.

We continued to invest aggressively in our R&D backbone. The R&D spend enables the development of future product pipeline, including specialty and differentiated products.

The implementation of the integration with Ranbaxy is well on its way; and we are on track to generate targeted synergies of US$ 300 million by FY18.

We are committed to our mandate of providing high-quality and affordable medicines, trusted by customers and patients worldwide.

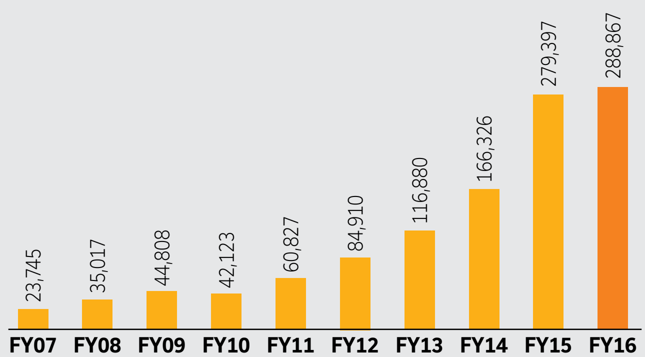
WE ARE EVOLVING BETTER, EMERGING STRONGER AND MOVING FASTER.

AND PUTTING PATIENTS FIRST ACROSS ALL OUR STRATEGIES.

KEY PERFORMANCE INDICATORS (CONSOLIDATED)

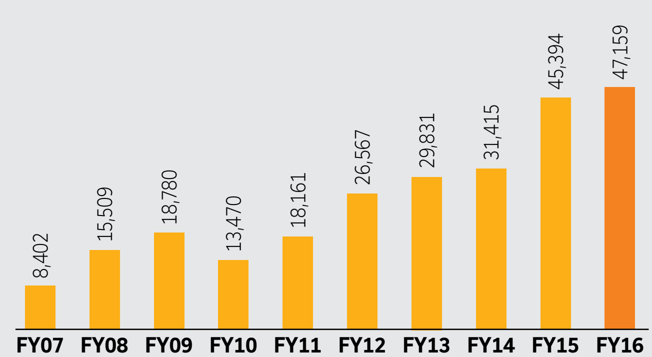
Total Income

(₹ in million)



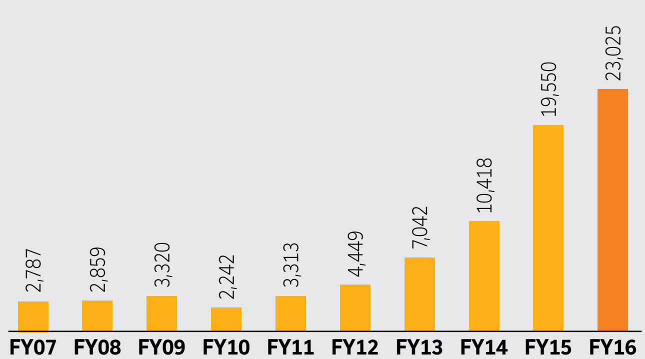
Profit After Tax

(₹ in million)



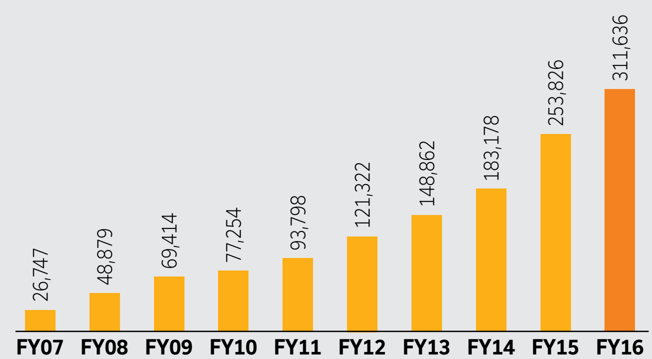
R&D Expenditure

(₹ in million)



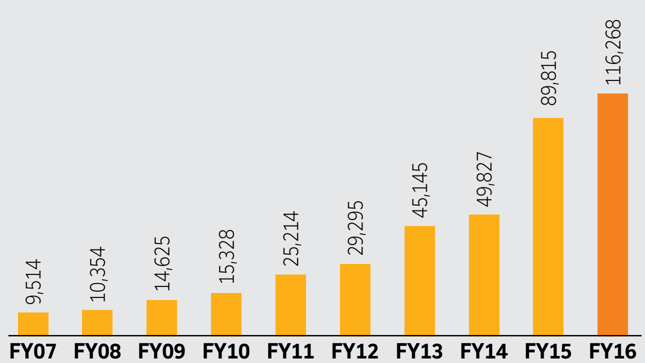
Reserve & Surplus

(₹ in million)



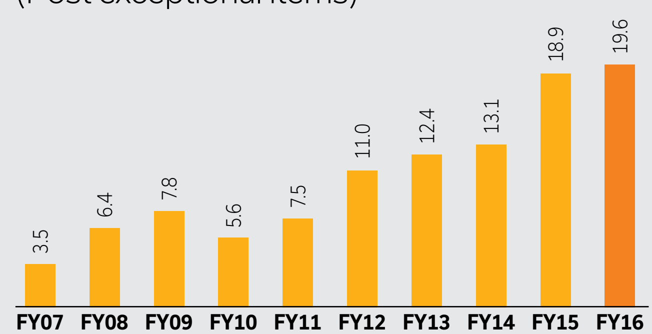
Net Block

(₹ in million)



Adjusted Earning per Share (Post exceptional items)*

(₹ per share)



* During FY05, the Company issued bonus shares in the ratio of one equity share of ₹ 5/- for every share held.
* During FY11, each equity share of ₹ 5/- was split into five equity shares of ₹ 1/- each.
* During FY14, the Company issued bonus shares in the ratio of one equity share of ₹ 1/- for every share held.
* During FY15, the Company's equity shares have increased to 2,406 million due to the merger of erstwhile Ranbaxy Laboratories Ltd. (RLL) with the Company, wherein 0.80 equity share of ₹ 1 each of the Company have been allotted to the shareholders of RLL for every 1.00 share of ₹ 5 each held by them.

TEN YEAR FINANCIAL HIGHLIGHTS

CONSOLIDATED

(₹ in million)

Particular	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16
Operating Performance										
Income from Operations	22,373	34,606	43,751	38,086	57,279	80,195	112,999	160,804	273,920	282,697
Total Income	23,745	35,017	44,808	42,123	60,827	84,910	116,880	166,326	279,397	288,867
Profit for the year (after minority interest)	8,402	15,509	18,780	13,470	18,161	26,567	29,831	31,415	45,394	47,159
R&D Expenditure	2,787	2,859	3,320	2,242	3,313	4,449	7,042	10,418	19,550	23,025
a) Capital	347	134	222	159	236	362	427	556	1,178	783
b) Revenue	2,440	2,725	3,098	2,083	3,077	4,088	6,616	9,862	18,373	22,242
c) % of Turnover	13%	9%	8%	6%	6%	6%	6%	7%	7%	8%
Financial Position										
Equity Share Capital	967	1,036	1,036	1,036	1,036	1,036	1,036	2,071	2,071	2,407
Reserve and Surplus	26,747	48,879	69,414	77,254	93,798	121,322	148,862	183,178	253,826	311,636
Gross Block	14,252	15,960	21,476	23,340	45,473	54,269	75,763	86,505	167,059	209,998
Net Block	9,514	10,354	14,625	15,328	25,214	29,295	45,145	49,827	89,815	116,268
Investments	2,543	6,565	18,595	31,664	26,557	22,129	24,116	27,860	27,163	13,086
Net Current Assets	26,843	33,995	35,485	28,542	58,622	76,749	86,618	126,969	127,689	176,169
Stock Information										
Number of Shares (million)	193	207	207	207	1,036	1,036	1,036	2,071	2,071	2,407
Adjusted Earning per Share (post exceptional items) (In ₹)*	3.5	6.4	7.8	5.6	7.5	11.0	12.4	13.1	18.9	19.6
Reported Earnings per Share-Basic (In ₹)*	41.7	74.7	87.8	65.2	17.5	25.7	28.8	15.2	18.9	19.6
Reported Earning per Share-Diluted (In ₹)*	38.9	71.8	87.8	65.2	17.5	25.7	28.8	15.2	18.9	19.6

* During FY05, the Company issued bonus shares in the ratio of one equity share of ₹ 5/- for every share held.
* During FY11, each equity share of ₹ 5/- was split into five equity shares of ₹ 1/- each.
* During FY14, the Company issued bonus shares in the ratio of one equity share of ₹ 1/- for every share held.
* During FY15, the Company's equity shares have increased to 2,406 million due to the merger of erstwhile Ranbaxy Laboratories Ltd. (RLL) with the Company, wherein 0.80 equity share of ₹ 1 each of the Company have been allotted to the shareholders of RLL for every 1.00 share of ₹ 5 each held by them.

MANAGING DIRECTOR'S LETTER

Dear Shareholders,

The Global Pharmaceutical Market is expected to touch US$ 1.4 trillion by 2020, compared to US$ 1.0 trillion in 2015 as per IMS. Demographics, increased incidence of chronic ailments, ageing population, increasing income levels and improved access to healthcare will be the key drivers of pharmaceutical demand in the coming years. However, globally rising health care costs continue to be a major concern for everyone from patients to policymakers. Population growth, ageing citizens and slower global economic growth are likely to pressurise global healthcare budgets. In such an environment, generic drugs are an essential part of any solution to sustaining the healthcare system and are the key drivers of increasing patient access to modern medicines.

However, the global healthcare industry is changing rapidly. Product differentiation is becoming a key driver of success in an ever competitive and demanding industry. Businesses will need to be more innovative as well highly cost competitive to ensure long-term sustainable value for shareholders. At the same time, with increased expectations of various regulators, cGMP compliance is also becoming a key determinant of future success. This requires focused efforts and investments on the part of the industry to remain 24x7 compliant with cGMP norms. Large companies like ours have the capabilities and resources to ensure that we are able to adhere to these norms.

Highlights of FY16

After many years of sustainable growth, our business for FY16 witnessed muted growth and was in line with our annual guidance. We faced anticipated supply constraints and delays in product approvals at the Halol facility driven by the cGMP compliance remediation efforts. This impacted our US revenues for the year. We expect to eventually resolve this in future. However, this did not deter us from continuing to invest heavily in building the specialty business in the US. These investments, as of now, do not have commensurate revenue streams and hence they depress our profitability. Current profitability is after accounting for these investments. Our R&D efforts continue to be directed towards building a strong and differentiated product pipeline. These R&D efforts include a pragmatic mix of initiatives directed towards generating short-term, medium-term and long-term cash flows.

Our subsidiary, Taro has done well, despite increased competition for some of its products. Adverse currency movements in certain emerging markets coupled with a conscious decision to reduce focus on certain non-remunerative businesses impacted our international revenues outside the US. Hence, our overall consolidated revenues were almost flat for the year.

Enhancing presence in the specialty segment

We continue to allocate significant resources towards building the specialty business in the US. The main objective behind this is our intent of building a business, which can generate sustainable value for all our stakeholders. These are long-gestation projects and there are many milestones yet to be crossed to achieve this objective. Our initiatives in this segment cover the entire value-chain, from in-licensing early-to-late stage clinical candidates, as well as getting access to on-market patented products. Dermatology and Ophthalmic are the key segments targeted through these initiatives, besides a few other segments. Today, we are amongst the leading branded companies in the US dermatology segment driven by innovative products like Absorica, Kerastick and the Topicort range of products.

During the year, we invested heavily in the development of Tildrakizumab, which we had in-licensed from Merck in 2014. In May 2016, we announced positive results from the Phase-3 trials of Tildrakizumab to treat chronic plaque psoriasis. We expect to announce the detailed results of these Phase-3 trials at an upcoming medical conference. Post the completion of these Phase-3 trials; we have commenced steps towards filing the Biologics License Application (BLA) for this product with the US FDA.

During the year, we proceeded further with steps towards establishing the required specialty teams for the US market as well as commenced steps towards building the front-end distribution network necessary for the specialty segment.

Ranbaxy Integration

The integration of Ranbaxy into Sun Pharma is on track. Post the Ranbaxy acquisition in FY15, our organisation size had nearly doubled, mandating a significant integration effort to implement common values, systems and processes across the merged entity. The synergy benefits from this integration have started reflecting in our financials in FY16; and we expect to build further on these synergy benefits in FY17. We continue to target US$ 300 million in synergy benefits from this acquisition by FY18 and are on track to achieve this significant milestone. The key objective of this merger is to accelerate growth and create opportunities for all stakeholders. The combined organisation will benefit from substantial synergies that lie in our technologies, combined pipeline and R&D expertise, wider product portfolio and rationalisation of manufacturing footprint, driven by our larger talent pool.

Global cGMP Compliance

Adherence to the stringent cGMP requirements of global regulators is a non-compromising objective for us. Compliance to these standards has become a key determinant of future success for the pharmaceutical industry. Our Halol facility, which was impacted by cGMP deviations in FY15, underwent a very significant remediation effort in FY16. These efforts are likely to culminate in to a request for re-inspection which we are likely to put in with the US FDA by June 2016. This remediation process has temporarily impacted our supplies and product approvals from this facility, which we expect to improve, once the entire remediation process is completed and the facility gets recertified.

We are gradually progressing on the remediation process at the erstwhile Ranbaxy facilities, which were found to be non-compliant in the past. While significant efforts to make these facilities compliant are on, this will be a time-consuming process. We expect to complete the remediation steps in at least one of these facilities in FY17.

We continue to invest significant time and resources in ensuring that we remain committed to 24x7 cGMP compliance. Over the past year, our cGMP capabilities have been strengthened significantly. Talent with long-standing global expertise has enhanced our abilities in this pertinent area. We are also targeting appropriate technology-based solutions to facilitate cGMP compliance, coupled with an increased focus on requisite manpower training.

Transformation

It is obvious that to generate long-term sustainable value for shareholders, businesses will need to continuously evolve and transform themselves to build a strong foundation for future growth. The key is to improve the underlying fundamentals so that we can aim for delivering much more from our current levels. At Sun Pharma, we have embarked on a transformational journey to make Sun Pharma a **Better, Stronger and Faster** Company. This should help us drive a stable and consistent growth in cash flows, which is a key objective of our corporate philosophy.

Better

It is imperative and expected of us that, as an organisation, we consistently deliver Better quality products. We must become Better by improving the quality of what we do in each of our businesses and functions. Sustained efforts are being made for improving manufacturing and sales processes. Getting it right the first time is the key objective and it can make a difference between success and failure. For this, care needs to be taken to ensure that right from product development to each of our processes, quality standards and compliance principles are adhered to.

Stronger

Our customers expect us to deliver quality products at highly competitive prices. To achieve this, focus on becoming Stronger through productivity enhancement becomes a key driver. Productivity improvement mandates "doing more with less" and reducing costs and wastages. Cost leadership has been a critical determinant of our past success and will continue to do so in future as well. Sales productivity, throughput and yield will be the key contributors to this overall productivity improvement.

Faster

A better and stronger organisation can do well only if it is Fast in responding to customer requirements. Time-to-market and minimum cycle times are extremely critical in our business. We have to ensure that increasing size does not limit our agility and flexibility. Our ability to make our products available on time consistently to our customers determines our service standards to customers. A responsive organisation requires seamless cross-functional collaboration across all the markets which we service, in order to serve the customer. This helps us in devising the most optimum response to business opportunities.

Overall Outlook

The transformation to a Better, Stronger and Faster company will involve crossing critical milestones over the next few years. As we transition, we have guided for our overall consolidated revenues to grow by 8-10% for FY17.

Persistently working for patients across the world, we are targeting to increase the share of complex generics and specialty products to our overall business in the coming years. This objective will be driven by a combination of our own efforts coupled with relevant inorganic initiatives as well as external partnerships. Our specialty strategy coupled with the benefits from the Ranbaxy merger and the targeted productivity improvements, should favourably impact our profitability in the long-term. Our capable and committed employees will be the key drivers of this profitability.

As a shareholder, you have continuously supported our endeavours over the past many years. As always, we are grateful to you for this confidence.

Warm regards,

Dilip Shanghvi
Managing Director
Sun Pharmaceutical Industries Ltd.

MANAGEMENT DISCUSSION AND ANALYSIS

GLOBAL PHARMACEUTICAL INDUSTRY[1]

The global pharmaceutical industry is showing signs of recovery, with several positive factors projected for the next five years. Global spending on medicines is expected to reach US$ 1.4 trillion by 2020, an increase of US$ 349 billion from 2015.

Spending will be concentrated in developed markets and focused on non-communicable diseases. Specialty therapies will continue to be more significant in developed markets than in pharmerging markets[#].

Global demand for pharmaceuticals will be driven by:

- Demographic trends
- Rise in diagnosis and treatment of chronic conditions
- Ageing and growing global population
- Improved access to healthcare
- Increasing per capita income

The key contributors of the US$ 349 billion in growth over the next five years will be:

1. Improving access to modern medicines in pharmerging countries;
2. Enhanced use of more expensive branded medicines in developed markets; and
3. Use of cheaper alternatives when loss of exclusivity happens

CHART 1

Global pharmaceutical spending and growth 2010-2020[1]

US$ billion

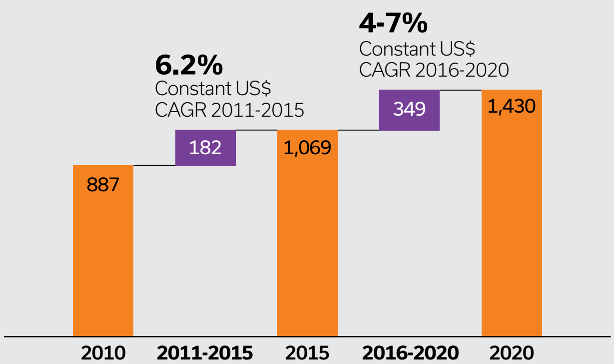
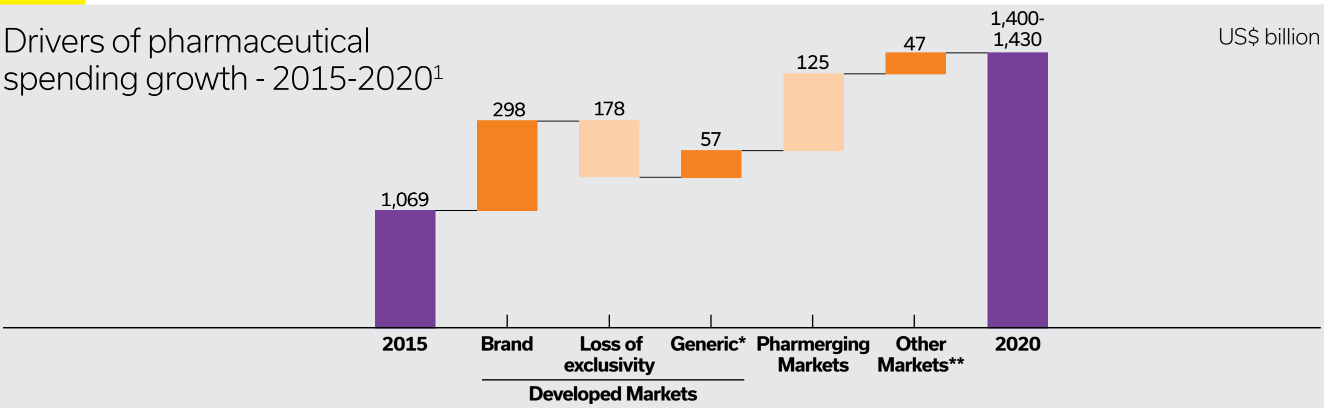


CHART 2

Drivers of pharmaceutical spending growth - 2015-2020[1]

US$ billion



* Generic in developed markets includes Generics US$ 24 Bn, Non-original Brands US$ 23 Bn, OTC US$ 10 Bn
** Other Markets includes Rest of World US$ 21 Bn and exchange rate effects US$ 26Bn

Includes China, Brazil, Russia, India, Venezuela, Poland, Argentina, Turkey, Mexico, Vietnam, South Africa, Thailand, Indonesia, Romania, Egypt, Pakistan, Ukraine, Algeria, Colombia, Nigeria, Saudi Arabia and Russia

TABLE 1

Region Spending[1]

US$ billion

Regions	2015	2011-2015 CAGR	2020	2016-2020 CAGR
Developed Markets	684	4.8%	870-900	3-6%
Pharmerging Markets	249	11.9%	345-375	7-10%
Other Markets	135	5.2%	150-180	1-4%
Global Pharmaceutical Market	1,069	6.2%	1,400-1,430	4-7%

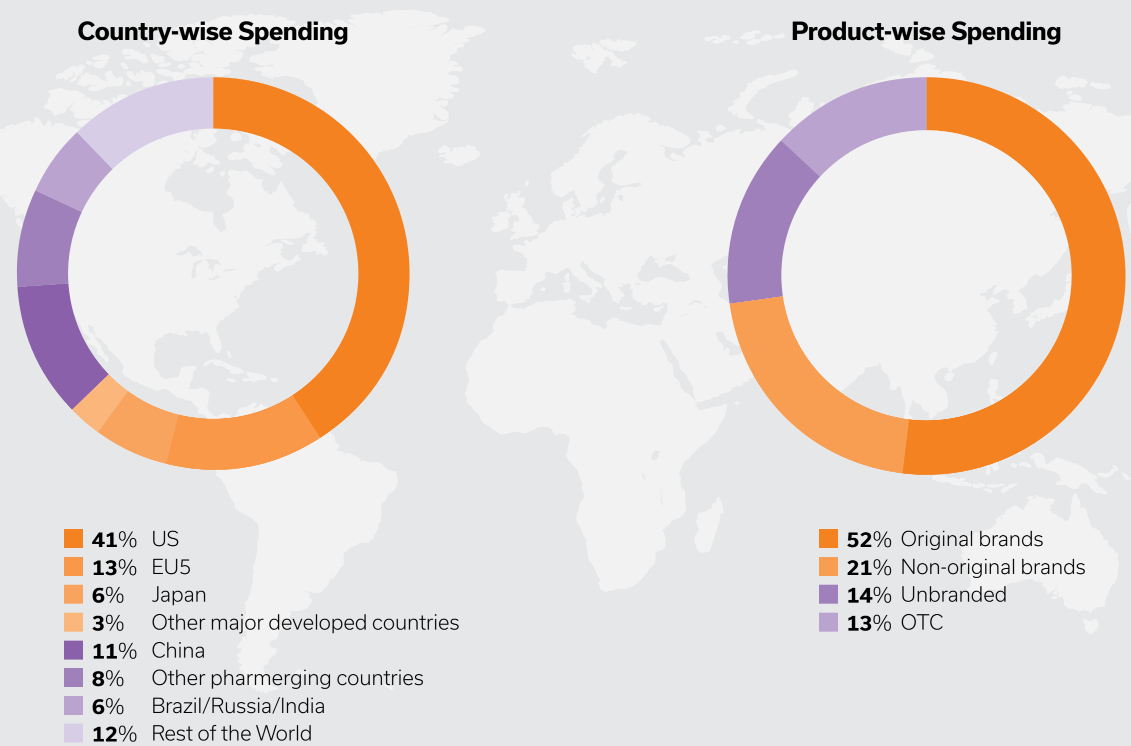
Spending and Growth to 2020

The developed markets will contribute 63% of the spending, driven by the US. Original brands will represent 52% of spending and 85% of global spending will be for medicines to treat non-communicable diseases. These distributions of costs belie the very different perspective on a volume basis where lower-cost/higher-volume medicines dominate the overall use of medicines.

63%
Contribution of developed markets to global pharmaceutical spending

CHART 3

Medicine Spending in 2020 by geography and product type[1]



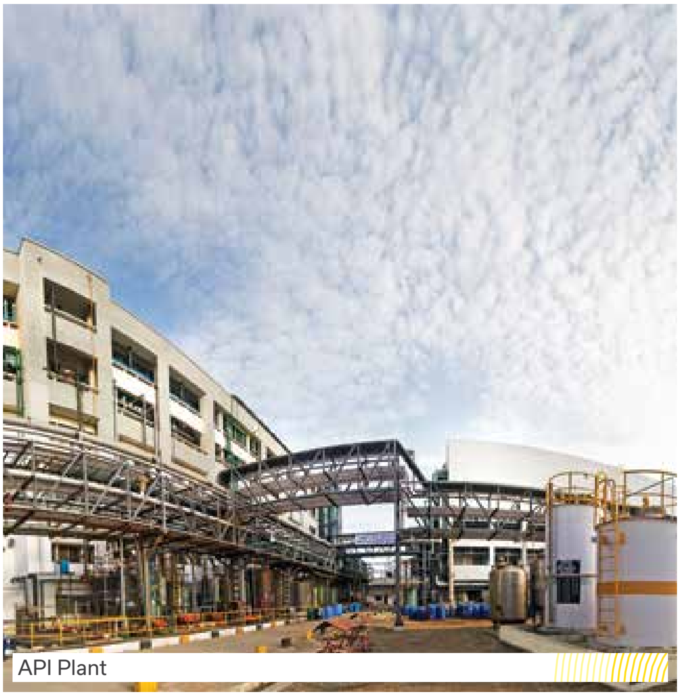
Blender Machine

Specialty and traditional medicines

A rising proportion of medicines are specialty medicines. In 2020, 28% of global spending will be for specialty medicines, up from 26% in 2015. Spending will be more focused on specialty medicines in developed markets, accounting for 36% of spending in 2020, compared to only 12% in pharmerging markets.

The use of traditional medicines (non specialty) account for the majority of medicine spending globally, but there are very different patterns of usage and spending in developed markets compared to pharmerging markets. In developed markets, some of the major classes of medicines will experience reduced spending due to patent expiries, whereas differences in disease morbidity and the adoption of innovation drive the remainder of differences.

CHART 4



API Plant