

## Company Results Review

19 October 2006 | 8 pages

# Ranbaxy (RANB.BO)

## Positive Trends

- Steady Showing** — Ranbaxy's 3QCY06 results were steady, albeit marginally below our estimates. While sales growth was robust at 26% YoY, reported net profit of Rs1.4bn was pulled down by extraordinary items of Rs226m and forex loss of Rs400m. Recurring net profit grew 34% QoQ to Rs1.63bn.
- Positive trends** — Ranbaxy has been able to drive revenue growth (c.19% organic growth) while keeping costs under control (R&D cost down 28% YoY; SG&A cost down 548bp YoY). Growth was robust across most markets – while simvastatin was the key driver in the USA, India, Latin America and CIS also witnessed healthy growth.
- Key conference call takeaways** — a) Management expects stronger 4Q and to achieve guidance; b) France to turn EBIDTA positive by CY06 end; c) Already addressed the issues at Paonta Sahib – awaiting US FDA response; d) filings for simva (10, 20, 40 mg) made from US and India – expects to launch post exclusivity; e) M&As critical, but only if it meets strategic and financial hurdles.
- Maintain Buy/Medium Risk** — Ranbaxy is one of the few geographically diversified and fully integrated global generic companies. We believe that its costs are still skewed toward the higher side, relative to its global peers, and it has sufficient room to reduce them further – which, in our view, provides significant leverage to improve profitability as revenues continue to grow.
- Key risks & catalysts** — Apart from the business risks related to pricing and policy changes, the ability to resolve the manufacturing issues at Paonta Sahib with the US FDA is key over the near term.

<b>Buy/Medium Risk</b>	<b>1M</b>
Price (19 Oct 06)	Rs411.00
Target price	Rs505.00
Expected share price return	22.9%
Expected dividend yield	1.2%
<b>Expected total return</b>	<b>24.1%</b>
Market Cap	Rs153,174M US\$3,381M

Price Performance (RIC: RANB.BO, BB: RBXY IN)



Figure 1. Statistical Abstract

Year to	Net Profit	EPS	EPS Growth	P/E	RoAE
31-Dec	(Rs Mils.)	(Rs)	(%)	(x)	(%)
2003	7,594	20.5	17.3	20.1	38.6
2004	6,986	18.8	-8.2	21.9	29.9
2005E	2,617	7.0	-62.6	58.5	10.6
2006E	6,094	15.3	117.0	26.9	23.0
2007E	8,033	20.1	31.8	20.4	25.9
2008E	9,854	24.7	22.7	16.7	26.6

Source: Company Reports and Citigroup Investment Research

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Fiscal year end 31-Dec	2004	2005	2006E	2007E	2008E
<b>Valuation Ratios</b>					
P/E adjusted (x)	21.9	58.5	26.9	20.4	16.7
EV/EBITDA adjusted (x)	15.9	53.2	17.0	13.3	11.4
P/BV (x)	6.1	6.3	5.8	4.9	4.1
Dividend yield (%)	2.1	1.5	1.2	1.7	1.7
<b>Per Share Data (Rs)</b>					
EPS (adjusted)	18.79	7.03	15.25	20.10	24.66
EPS (reported)	18.79	7.03	15.25	20.10	24.66
BVPS	67.53	65.70	71.24	83.98	101.28
DPS	8.51	6.00	5.00	7.00	7.00
<b>Profit &amp; Loss (RsM)</b>					
Net sales	54,512	52,816	61,612	74,278	85,276
Operating expenses	-45,722	-51,149	-53,548	-63,381	-72,286
<b>EBIT</b>	<b>8,790</b>	<b>1,667</b>	<b>8,063</b>	<b>10,897</b>	<b>12,991</b>
Net interest expense	-335	-671	-1,247	-1,746	-1,650
Non-operating/exceptionals	437	762	647	679	713
<b>Pre-tax profit</b>	<b>8,892</b>	<b>1,758</b>	<b>7,463</b>	<b>9,831</b>	<b>12,054</b>
Tax	-1,881	885	-1,343	-1,770	-2,170
Extraord./Min.Int./Pref.div.	-26	-25	-26	-28	-30
<b>Reported net income</b>	<b>6,986</b>	<b>2,617</b>	<b>6,094</b>	<b>8,033</b>	<b>9,854</b>
Adjusted earnings	6,986	2,617	6,094	8,033	9,854
Adjusted EBIT	8,790	1,667	8,063	10,897	12,991
<b>Growth Rates (%)</b>					
EPS (adjusted)	-8.2	-62.6	117.0	31.8	22.7
EBIT (adjusted)	-8.1	-81.0	383.8	35.1	19.2
Sales	13.0	-3.1	16.7	20.6	14.8
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>4,314</b>	<b>3,470</b>	<b>10,418</b>	<b>9,373</b>	<b>11,367</b>
Depreciation/amortization	1,215	1,445	2,341	2,907	3,042
Net working capital	-4,216	-934	1,957	-1,595	-1,559
<b>Investing cash flow</b>	<b>-8,373</b>	<b>-8,310</b>	<b>-24,380</b>	<b>-5,344</b>	<b>-6,075</b>
Capital expenditure	-5,285	-9,204	-19,910	-5,000	-5,000
Acquisitions/disposals	-3,388	712	-4,066	699	-167
<b>Financing cash flow</b>	<b>-1,047</b>	<b>7,460</b>	<b>11,635</b>	<b>-5,423</b>	<b>-6,592</b>
Borrowings	2,677	11,622	14,983	-736	-2,000
Dividends paid	-3,571	-3,612	-2,101	-2,941	-2,941
<b>Change in cash</b>	<b>-5,106</b>	<b>2,620</b>	<b>-2,326</b>	<b>-1,395</b>	<b>-1,299</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>53,274</b>	<b>59,637</b>	<b>84,832</b>	<b>94,019</b>	<b>102,972</b>
Cash & cash equivalent	1,339	2,430	1,000	1,000	1,000
Net fixed assets	18,170	26,187	44,107	46,552	48,861
<b>Total liabilities</b>	<b>27,988</b>	<b>35,001</b>	<b>56,177</b>	<b>60,244</b>	<b>62,254</b>
Debt	8,527	20,043	35,026	34,290	32,290
<b>Shareholders' funds</b>	<b>25,286</b>	<b>24,636</b>	<b>28,655</b>	<b>33,775</b>	<b>40,718</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	18.4	5.9	16.9	18.6	18.8
ROE adjusted	29.9	10.6	23.0	25.9	26.6
ROIC adjusted	22.7	6.5	12.7	14.3	15.8
Net debt to equity	28.4	71.5	118.7	98.6	76.8
Total debt to capital	25.2	44.9	55.0	50.4	44.2

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## Positive Trends

Ranbaxy reported steady 3QCY06 results, albeit marginally below our expectations. While sales growth was robust at 26% YoY and 13% QoQ, recurring net profit grew 34% QoQ. Ranbaxy continues to be able to drive revenue growth while correcting its cost structure. We believe that Ranbaxy has sufficient room to reduce costs further, which would provide significant leverage to improve profitability further as revenues continue to grow. Maintain Buy.

Figure 2. 3QCY06 Earnings Summary (Rs in Million, percent)

Year to 31st December	3QCY05	3QCY06	% Change YoY	2QCY06	% Ch QoQ	CIR Comments
Sales	13,039	16,404	25.8	14,464	13.4	Organic growth (excluding Terapia & allied businesses) is 23% YoY
Excise Duty	209	133	(36.4)	125	6.4	
<b>Net sales</b>	<b>12,830</b>	<b>16,271</b>	<b>26.8</b>	<b>14,339</b>	<b>13.5</b>	
Other Operating Income	755	(184)	(124.4)	223	(182.5)	Negative figure is a surprise – represents loss on account of forex charges
Total Net revenues	13,585	16,087	18.4	14,562	10.5	
Cost of sales	7,109	7,456	4.9	6,978	6.9	
<b>Gross Profit</b>	<b>6,476</b>	<b>8,815</b>	<b>36.1</b>	<b>7,361</b>	<b>19.8</b>	Improvement led by exclusivity sales of simvastatin 80mg, first full quarter of Terapia consolidation and cost control initiatives
<i>Gross margins (%)</i>	<i>50.5</i>	<i>54.2</i>	<i>370 bps</i>	<i>51.3</i>	<i>284 bps</i>	
SG&A	4,517	4,836	7.1	4,117	17.5	First full quarter of Terapia business; run rate likely to go up a bit, as the company invests in the Terapia business. However cost as a % of sales would trend down
- as a % of sales	35.2	29.7	-548 bps	28.7	101 bps	
R&D	1,532	1,098	(28.3)	819	34.1	YoY decline driven by cost control initiatives and some one time items in the previous year; ANDA filings to spike up in 4Q, but cost to be only marginally higher
- as a % of sales	11.9	6.7	-519 bps	5.7	104 bps	
<b>EBITDA</b>	<b>427</b>	<b>2,697</b>	<b>531.6</b>	<b>2,648</b>	<b>1.9</b>	
<i>EBITDA Margin (%)</i>	<i>3.1</i>	<i>16.8</i>	<i>1,362 bps</i>	<i>18.2</i>	<i>-142 bps</i>	
Depreciation/ Amortization	355	496	39.7	457	8.5	Rise due to first full quarter of Terapia consolidation
Interest Cost	159	299	88.1	277	7.9	
Forex (Gain)/Loss	115	(39)	nm	506	(107.7)	Mark to Market of FCCB funds
Other Income	48	67	39.6	151	(55.6)	
PBT	(154)	2,008	nm	1,559	28.8	
Tax	(341)	378	nm	336	12.5	
<i>Tax Rate</i>	<i>221.4</i>	<i>18.8</i>	<i>nm</i>	<i>21.6</i>	<i>-273 bps</i>	
PAT	187	1,630	771.7	1,223	33.3	
Minorities	3	11	266.7	12	(8.3)	
<b>Recurring Net Income</b>	<b>184</b>	<b>1,619</b>	<b>779.9</b>	<b>1,211</b>	<b>33.7</b>	
Exceptional	-	(226)	nm	-	nm	Non recurring item – incurred on settlement of contract manufacturing arrangements for a molecule that is under litigation
Reported Net Income	184	1,393	657.1	1,211	15.0	

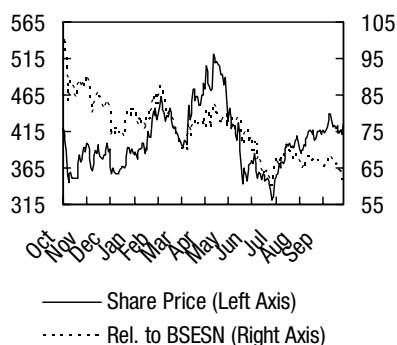
Source: Company Reports and Citigroup Investment Research

Figure 3. Sales Breakup (Rs in Millions, percent)

Sales	3QCY05	3QCY06	% Change YoY	2QCY06	% Ch QoQ	CIR Comments
<b>Dosages</b>						
India	69.4	78.8	13.5	71.9	9.6	Growth in INR stands at +20%, Ranbaxy is now No. 1 with 5.27% market share
Europe	49.5	49.0	(1.0)	37.0	32.4	Challenging conditions in UK, France and Germany led to 11% decline in these countries; Eastern Europe sees robust growth off a low base
CIS & Africa	33.0	65.3	98.2	51.1	27.8	Driven by Terapia acquisition (revenues of US\$20m in 3Q)
Asia Pac & M. East	16.3	24.2	48.6	22.5	7.2	3 <sup>rd</sup> product launched in Japan – a key focus market
Latin America	10.6	13.4	25.9	10.3	29.7	Brazil beginning to do well; company expects momentum to continue
North America	76.2	98.5	29.3	90.9	8.4	Simva 80mg drives growth, Base business pricing under pressure, but volumes improve
<b>Total Dosage</b>	<b>255.0</b>	<b>329.2</b>	<b>29.1</b>	<b>283.8</b>	<b>16.0</b>	
API	33.1	25.9	(21.7)	31.8	(18.5)	
Allied Business	10.1	-	nm	-	-	Business has been divested
<b>Total Sales</b>	<b>298.2</b>	<b>355.1</b>	<b>19.1</b>	<b>315.6</b>	<b>12.5</b>	

Source: Company Reports and Citigroup Investment Research

Figure 4. Price Performance



Source: Datacentral

Figure 5. Stock Performance

(%)	3M	6M	12M
<b>Absolute</b>	30.9	(8.9)	1.3
<b>Rel. to .BSESN</b>	4.1	(16.3)	(36.0)

Source: Datacentral

## Ranbaxy

### Company Description

Ranbaxy is a leading domestic pharmaceutical company with a strong export business complementing the domestic business. It has a vision of becoming a leading generics pharmaceutical company in the global market and, in the long term, a research-led pharmaceutical company. The company already has a presence in several countries, and has developed a complex business model, perhaps the first of its kind from a developing country. Over the past few years, Ranbaxy has grown rapidly and established itself firmly as a leading generics company globally. While the core pharmaceutical business is growing, the company has also invested in R&D. The company also has a strong chemicals and animal healthcare business in India.

### Investment Thesis

We rate Ranbaxy Buy/Medium Risk (1M) with a target price of Rs505/share. We believe the stock price now factors in most negatives - viz. difficult global market dynamics, manufacturing related issues with the FDA, slowdown in product approvals, and loss of the Pravastatin 80mg opportunity. Moreover, we believe that these negatives and the declining stock price mask the positive steps that Ranbaxy has been taking since the beginning of CY06 to effect a turnaround in its fortunes. Benefits of its restructuring initiatives were visible in 1QCY06 operating profit margins, the EU foray has gained momentum with a series of acquisitions and revenues should scale up faster once the manufacturing issues are resolved. In the interim, we expect strong earnings momentum driven by exclusivity launch of Simvastatin 80mg to provide support to stock valuations and restrict downside.

### Valuation

We prefer to value Ranbaxy using EV/Sales methodology as against P/E that we were using earlier, as the former reflects a much fairer value of Ranbaxy's business today, in our view. We believe that Ranbaxy's current cost structure and profitability are not normalized. Its cost structure is highly fixed cost oriented and is a legacy of the heady days of very high profitability in global generics.

We believe this is being corrected now, and the benefits of the aggressive cost reduction initiatives have started coming through in their financials in CY06. With its presence across multiple geographies and wide basket of products, we believe the business is not fairly valued at 2.5xSales – this is primarily on account of the fact that profitability is currently under par. A large part of the costs are discretionary and related to pipeline building measures for future growth, which do not contribute to revenues in the near term.

Our fair value multiple of 3xSept'07 EV/Sales is at a discount to its peers such as Cipla and Sun and towards the lower end of the company's EV/Sales range of 2-4.6x over the last five years. Since the company is still coming out of a period of poor sales growth and sub-optimal profitability, we prefer to wait for growth to come back before using a higher multiple. At 3x Sept 07 EV/Sales we have target price of Rs 505 per share

## **Risks**

We rate Ranbaxy Medium Risk based on our quantitative risk-rating system. The key upside risks to our target price include: (1) New ANDA approvals above the expected three to four per quarter; (2) Upside from simvastatin 80mg being higher than we expected (3) News on the NCE development program; and (5) Any new paragraph IV challenges. The key downside risks include: (1) Intensifying pricing pressure in the US and European markets; (2) The company paying high multiples to acquire more businesses in Europe and USA; and (3) Inability to resolve the manufacturing issues with the US FDA by the end of the current fiscal.

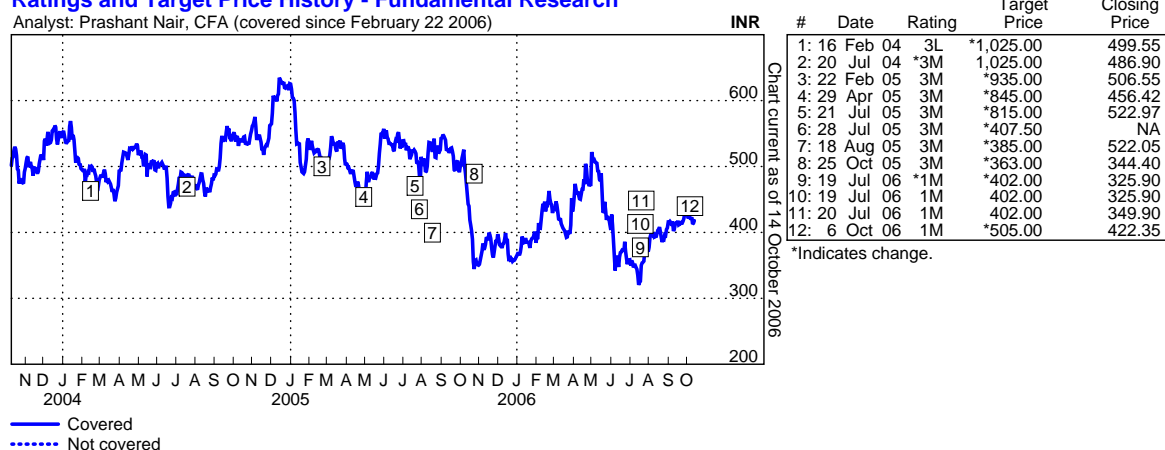
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Analyst: Prashant Nair, CFA (covered since February 22 2006)



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52%

65%

38%

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