Company

7 January 2010 | 6 pages

Ranbaxy (RANB.BO)

Equity ☑

Buy: Teva's Nexium Sett. – Lower Risk Offsets Valuation Impact

- **Lower Risk & Lower Value** — We believe the impact of Astra's settlement with Teva (for Nexium) on Ranbaxy should be viewed from the risk & valuation perspectives. While it could entail a modest impact (cRs11/sh) on fair value, it also significantly lowers the risk of Ranbaxy's exclusivity being triggered earlier. This protects the more valuable leg (4.5 yr supply contract) of Ranbaxy's deal with Astra. We believe the lower risk more than makes up for the lower value. Maintain Buy.
- **Teva settles patent litigation with Astra** — Teva & AstraZeneca have settled all patent disputes for generic versions of Astra's Nexium. Astra has granted Teva with a license to launch generic version of Nexium delayed release capsules, subject to regulatory approval, on or before May 27, '14.
- **How does it affect Ranbaxy?** — Ranbaxy's settlement with Astra allows it to launch generic Nexium on or before May 27, '14, with 180 days exclusivity. The settlement with Teva essentially means that there will be two players (Ranbaxy & Teva) in the market during the exclusivity period. We had assigned Rs22/sh in our valuation towards the 6m exclusivity. This would have to be shared with Teva.
- **Risk overhang lifted** — While the exclusivity upside could be lower, we believe this also lowers one key risk w.r.t. the Nexium settlement. Ranbaxy's deal with Astra includes a supply contract (upto May '14, valued at Rs35/sh) and a launch with 180 days exclusivity (in May '14, valued at Rs22/sh). If Teva had won its litigation with Astra, it would have triggered Ranbaxy's exclusivity earlier – thus impairing the supply part of the deal. It also ensures that Ranbaxy has time on its side to get approval for Nexium (relevant, given its issues with the FDA).
- **Potential impact on valuation is modest** — Our target price includes Rs22/sh towards exclusivity sales of Nexium. If one assumes that this is shared with Teva, it could entail an impact of Rs11/sh (assuming Teva takes away half of the upside) or c2% on our fair value for the stock.

Buy/Medium Risk	**1M**
Price (07 Jan 10)	Rs525.20
Target price	Rs620.00
Expected share price return	18.1%
Expected dividend yield	0.0%
Expected total return	**18.1%**
Market Cap	Rs220,803M
	US$4,832M

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

Statistical Abstract

Year to 31 Dec	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2007A	4,745	11.86	11.7	44.3	7.5	17.6	1.6
2008A	5,878	13.98	17.9	37.6	5.1	16.6	0.0
2009E	910	2.17	-84.5	nm	4.4	2.0	0.0
2010E	4,025	9.58	342.3	54.8	3.3	6.9	1.6
2011E	9,772	23.25	142.8	22.6	2.0	11.2	1.6

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

Ranbaxy

Company description

Ranbaxy is a leading Indian pharmaceutical company with a strong export business complementing its 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 in a developing country.

Investment strategy

We rate Ranbaxy Buy/Medium Risk with a target price of Rs620. The timely approval & launch of Valtrex (generic valacyclovir) in the US market with exclusivity and trends in the last two quarters indicate that the worst is behind for Ranbaxy. There has been tangible improvement in emerging markets, which were severe pressure at the beginning of the year and signs that Daiichi sees a key role for Ranbaxy in its future strategy. The impact of the US FDA action on its facilities (Dewas & Paonta Sahib) is also well understood and built into estimates and valuations. With the approval for Valtrex coming through on time, we also have more comfort on Ranbaxy's ability to successfully change sites and get approvals in time for its other FTF opportunities, reinforcing our positive stance on the stock.

Valuation

We have a target price of Rs620 for Ranbaxy, comprising Rs435 for the base generics business and Rs185 for the company's patent challenge pipeline. We use EV/Sales to value the core business as we believe Ranbaxy's current profitability is skewed downwards by the unabsorbed overheads at Paonta Sahib & Dewas as well as the high legal & consultancy charges being incurred towards resolving the FDA issues at these plants. We value the core generics business (excluding exclusivity upsides) at 2.4x Mar 11E recurring sales, which is at a 10% discount to the median of the band in which it has traded over the past 8-9 years. We believe this discount is warranted given the uncertainty in its business following issues with the US FDA. We value the company's patent challenge pipeline using a probability-adjusted NPV approach and applying a discount rate of 15%.

Risks

We rate Ranbaxy Medium Risk as opposed to the High Risk rating as suggested by our quant-based rating system, which tracks 260-day historical share price volatility. The recent high volatility in the stock was largely driven by the FDA actions on its facilities at Paonta Sahib & Dewas. We believe that the impact of the FDA action is now well understood and built into estimates and valuations, as such the risk is lower going forward. The key downside risks to our target price include: 1) Slower than expected resolution of the US FDA issues; 2) Setbacks on its already monetized patent challenge pipeline, in form of litigation wins by other generic companies or delay in approvals/launches; 3) Intensifying pricing pressure in the US and European markets.

Appendix A-1

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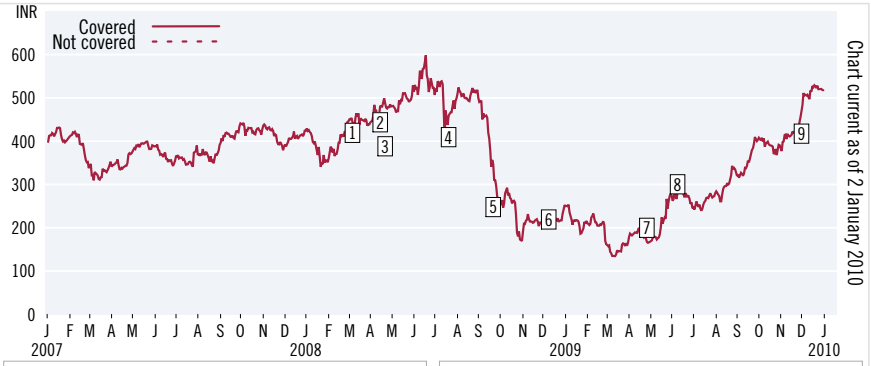
Ranbaxy (RANB.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Prashant Nair, CFA



	Date	Rating	Target Price	Closing Price
1	6-Mar-08	1M	*545.00	453.60
2	15-Apr-08	1M	*595.00	481.80
3	22-Apr-08	1M	*620.00	487.15
4	21-Jul-08	*1H	*604.00	458.20
5	21-Sep-08	*3H	*373.00	356.85
6	9-Dec-08	*2H	*241.00	213.05
7	26-Apr-09	*3H	*141.00	175.75
8	9-Jun-09	3H	*235.00	283.15
9	1-Dec-09	*1M	*620.00	469.10

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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