Prabhudas Lilladher

Ranbaxy Laboratories

Results affected by forex loss and write offs

Q3CY08 Result Update

November 3, 2008

Rating	**Reduce**
Price	Rs190
Target Price	Rs212
Implied Upside	11.5%
Sensex	10,338

(Prices as on November 3, 2008)

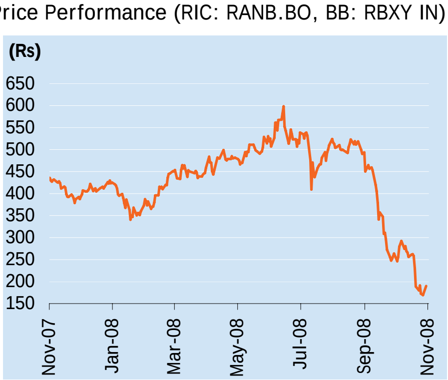
Trading Data	
Market Cap. (Rs bn)	79.7
Shares o/s (m)	418.9
Free Float	65.3%
3M Avg. Daily Vol ('000)	1,150.0
3M Avg. Daily Value (Rs m)	429.0

Major Shareholders	
Promoters	34.7%
Foreign	7.1%
Domestic Inst.	13.5%
Public & Others	44.7%

Stock Performance

(%)	1M	6M	12M
Absolute	(27.9)	(60.5)	(56.6)
Relative	(10.4)	(19.2)	(8.3)

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



Source: Bloomberg

- **Results:** Ranbaxy Laboratories' (RLL) Q3CY08 results were below our expectations due to inventory write-offs and higher forex losses from the US business. Total income grew by 5% YoY, from Rs17.73bn to Rs18.53bn (we expected Rs20.68bn) due to lower other operating income. The other operating income fell from Rs1,316m to Rs(-)288m (we expected Rs1,250m). The company's EBIDTA margin dropped by 820bps, from 16.0% to 7.8% YoY (we expected 16.6%) due to higher cost of sales and an increase in selling, general & administrative (SG & A) expenses. Cost of sales was up by 290bps, from 49.1% to 52.0% of net sales due to a rise in the raw material cost. SG & A expenses increased by 530bps, from 28.7% to 34.0% of net sales due to higher administrative cost pertaining to the US FDA action. RLL's net profit before EO items declined from Rs1,851m to Rs(-)1,504m due to forex losses of Rs3,117m (we estimated Rs2,100m). Net profit after EO items declined from Rs2,074m to Rs(-)3,945m (we expected Rs161m).
- **Capex update:** RLL has plans to spend US$65-70m (Rs3.2-3.4bn) on normal capex during CY08 for its manufacturing facilities.
- **Valuation:** We expect RLL to report 20% CAGR in net sales and 49% CAGR in net profit over CY07-10. We have reduced our CY09 EPS estimates by 18% and CY10 EPS estimates by 12% due to forex losses and uncertainty of US business due to the US FDA action.

  At the CMP of Rs190, the stock trades at 8.2x CY09E EPS of Rs23.1 and 5.2x CY10E EPS of Rs36.5. We change our rating from **'Accumulate'** to **'Reduce'** on the scrip with a price target of Rs212(9x CY10 base EPS of Rs13.4 and 2x CY10E FTF EPS of Rs23.1 and Rs46 for Lipitor) over the next 12 months, which is an upside of 11.5% over the CMP.

Key financials (Y/e Dec)	CY07	CY08E	CY09E	CY10E
Revenues (Rs m)	69,823	73,146	96,462	120,487
Growth (%)	*13.9*	*4.8*	*31.9*	*24.9*
EBITDA (Rs m)	6,619	9,166	17,979	24,018
PAT (Rs m)	5,339	(2,160)	11,136	17,539
EPS (Rs)	10.9	(4.7)	23.1	36.5
Growth (%)	*2.2*	*NA*	*NA*	*57.8*
Net DPS (Rs)	8.5	10.0	11.0	12.0

Source: Company Data; PL Research

Profitability & valuation	CY07	CY08E	CY09E	CY10E
EBITDA margin (%)	*9.5*	*12.5*	*18.6*	*19.9*
RoE (%)	*19.0*	*(8.8)*	*14.3*	*17.0*
RoCE (%)	*9.1*	*(1.5)*	*12.1*	*16.1*
EV / sales (x)	1.6	1.4	0.9	0.8
EV / EBITDA (x)	17.0	10.9	5.1	3.8
PE (x)	17.4	NA	8.2	5.2
P / BV (x)	2.5	1.4	0.9	0.8
Net dividend yield (%)	*4.5*	*5.3*	*5.8*	*6.3*

Source: Company Data; PL Research

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Q2FY09 Result Overview **(Rs m)**

Y/e March	Q3CY08	Q3CY07	YoY gr. (%)	Q2CY08	9MCY08	9MCY07	YoY gr. (%)
Total sales	**18,532**	**17,730**	*4.5*	**19,286**	**54,804**	**50,404**	*8.7*
Expenditure							
Cost of sales	9,639	8,702	*10.8*	9,633	27,788	26,078	*6.6*
as % of total sales	*52.0*	*49.1*		*49.9*	*50.7*	*51.7*	
R&D Expense	1,144	1,106	*3.4*	1,084	3,148	2,854	*10.3*
as % of total sales	*6.2*	*6.2*		*5.6*	*5.7*	*5.7*	
Selling, General & admin. Exp	6,309	5,091	*23.9*	5,308	16,615	14,468	*14.8*
as % of total sales	*34.0*	*28.7*		*27.5*	*30.3*	*28.7*	
Total Expenditure	17,092	14,899	*14.7*	16,025	47,551	43,400	*9.6*
EBIDTA	**1,440**	**2,831**	*(49.1)*	**3,261**	**7,253**	**7,004**	*3.6*
EBIDTA Margin (%)	*7.8*	*16.0*		*16.9*	*13.2*	*13.9*	
Depreciation	643	613	*4.9*	672	1,936	1,735	*11.6*
EBIT	**797**	**2,218**	*(64.1)*	**2,589**	**5,317**	**5,269**	*0.9*
Other income	48	56	*(14.3)*	99	232	138	*68.1*
Interest	595	394	*51.0*	465	1,444	1,058	*36.5*
Foreign Exchange (Gain)/ Loss	3,117	(487)	*NA*	1,931	5,846	(3,060)	
PBT	**(2,867)**	**2,367**	*NA*	**292**	**(1,741)**	**7,409**	*NA*
Prov. For tax	(1,363)	516	*NA*	63	(1,118)	1,609	*NA*
% of PBT	*47.5*	*21.8*		*21.6*	*64.2*	*21.7*	
PAT	**(1,504)**	**1,851**	*NA*	**229**	**(623)**	**5,800**	*NA*
EO items	(2,441)	223	*NA*	-	(1,725)	250	*NA*
Reported PAT	**(3,945)**	**2,074**	*NA*	**229**	**(2,348)**	**5,550**	*NA*

Highlights

Sales growth affected by lower operating income

For Q3CY08, RLL's total income grew by 5% YoY, from Rs17.73bn to Rs18.53bn mainly due to a sharp fall in other operating income. Excluding the other operating income, the sales growth was 14%. Sales growth across various geographies is shown in the following table:

Sales growth across various geographies (Rs m)

Y/e Dec	Q3CY08	Q3CY07	*YoY gr. (%)*	9MCY08	9MCY07	*YoY gr. (%)*
India	4,000	3,704	*8.0*	11,116	10,499	*5.9*
Europe	3,653	3,187	*14.6*	10,647	10,760	*(1.1)*
Asia Pacific & CIS	2,483	1,736	*43.0*	6,469	5,044	*28.3*
ROW	2,732	2,333	*17.1*	7,286	6,291	*15.8*
North America	4,855	4,445	*9.2*	14,202	12,655	*12.2*
API	**1,161**	**1,115**	*4.1*	**3,691**	**3,152**	*17.1*
Net sales	**18,884**	**16,520**	*14.3*	**53,411**	**48,401**	*10.4*
Excise duty	**64**	**106**	*(39.6)*	**242**	**343**	*(29.4)*
Other operating income	**(288)**	**1,316**	*NA*	**1,635**	**2,345**	*(30.3)*
Total income	**18,532**	**17,730**	*4.5*	**54,804**	**50,403**	*8.7*

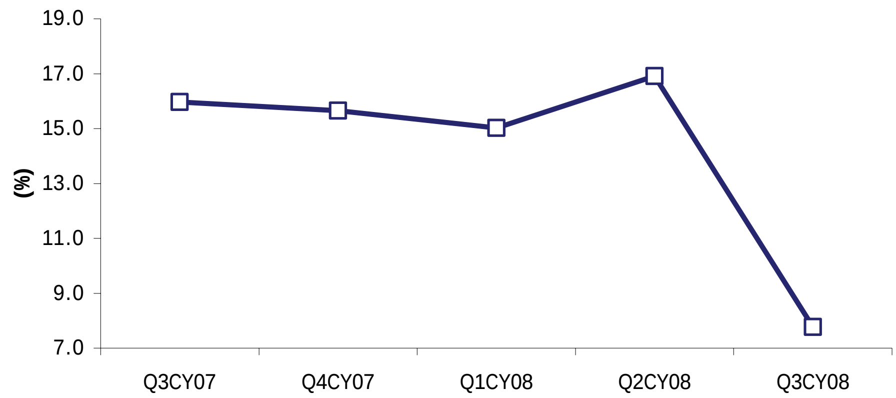
Source: Company Data, PL Research

Sales growth across various geographies was as follows: US 9% (previous quarter 19%), India 8% (previous quarter 24%), Europe 15%, Asia Pacific and CIS 43%, ROW 17%. Some of the other geographies where the company had high growth were: Romania 34%, CIS 54% and Brazil 39%.The company has changed the reporting from sales in $ terms to rupees and also changed the classification of geographies. The lower sales growth can be attributed to a sharp fall in sales in India and US. API business grew by 4% during the quarter.

Margins declined by 820bps

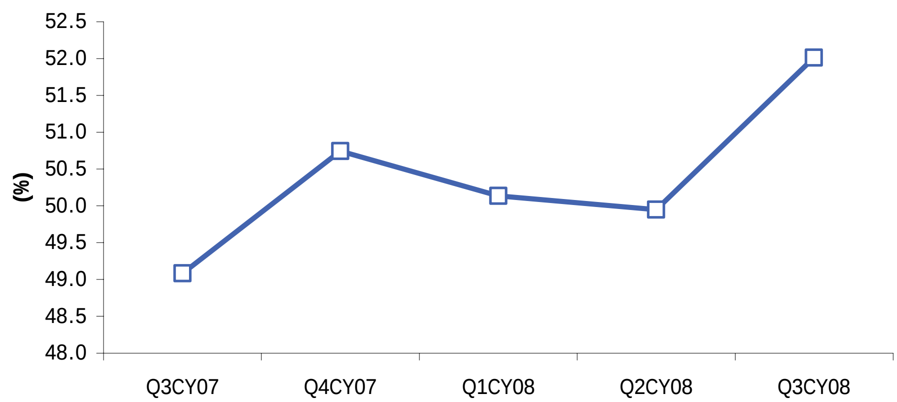
RLL's EBIDTA margin declined by 820bps from 16.0% to 7.8% YoY. The company's cost of sales enhanced by 290bps from 49.1% to 52.0% of total sales due to an increase in the material cost and change in the product mix. SG & A expenses increased by 530bps, from 28.7% to 34.0% of total sales due to the additional expenses related to US FDA action. The SG & A expenses in the current quarter include US$9m (Rs440m) as the sunk cost for its two manufacturing facilities. R & D expenses were maintained at the same level of 6.2% of sales. The company's cost of goods sold and EBIDTA margin over the last five quarters are shown in the following graphs:

EBITDA Margin



Source: Company Data, PL Research

Cost of sales as % sales



Source: Company Data, PL Research

As seen from the above graphs, RLL's EBIDTA margin declined from 16.0% in Q3CY07 to 15.0% in Q1CY08 and later increased to 16.9% in Q2CY08. The EBIDTA margin dropped sharply to 7.9% in Q3CY08, indicating a decline of 910 bps QoQ.

The cost of goods sold increased from 49.1% in Q3CY07 to 50.7% in Q4CY07. However, the same declined to 49.9% during Q2CY08 due to a change in the product mix. The cost of sales increased by 210bps QoQ to 52.0% in Q3CY08. This indicates that the company's performance was adversely affected in Q3CY08 due to an increase in the material cost.

PAT before EO items declined to Rs (-)1,504m

RLL's other income declined by 14%, from Rs56m to Rs48m. The company's depreciation was marginally up by 5%, from Rs613m to Rs643m. RLL's interest cost was up by 51%, from Rs394m to Rs595m due to an increase in the working capital and higher interest rates. RLL has incurred a forex loss of Rs3,117m during Q3CY08, against a forex gain of Rs487m during Q3CY07. The company has foreign currency loans of over US$1.2bn (Rs59bn) (including US$440m FCCB) and the impact was due to depreciation of rupee from Rs43.11 to Rs47.03 (9.1%) during the quarter. It's PBT for the quarter declined from Rs2.37bn to Rs(-)2.87bn. PAT before EO items declined from Rs1.85bn to Rs(-)1.50bn. There was a write back of Rs1.36bn tax during the quarter. RLL has provided Rs2.44bn for the inventory write-off (raw materials, packing materials, WIP and finished goods and the potential return from the customers) pertaining to the 30 products included in the US import alert. This has resulted in a sharp drop in PAT after EO items from Rs2.07bn to Rs(-)3.95bn.

Forex loss

The other operating income included forex gain/ (loss) (other than those relating to foreign currency borrowings). The losses on forward cover were Rs900m during the quarter. RLL uses forward contracts and options as economic hedges and not for speculative purposes.

The company incurred a forex loss of Rs3.12bn during the quarter due to MTM losses on the foreign currency loans (including US$440m FCCB) against a forex gain of Rs487 in the corresponding previous quarter.

Outlook

Generic Amlodipine launch in Japan

RLL has commenced marketing of generic Amlodipine in Japan. The market size for this product is US$2bn and represents a good opportunity for the company in Japan. However, twenty other generic manufacturers have also received the approval which will lead to a stiff competition for this product in the market.

Acquisition of promoter's stake by Daiichi Sankyo

Daiichi Sankyo, Japan (DIS) has agreed to pick up the entire 34.8% stake of RLL promoters at Rs737 per share, of which 22.8% shares have been transferred. DIS has acquired additional 20% stake through the open offer. RLL has made a preferential issue of 46.23m equity shares and 23.83m warrants at Rs737 to DIS. Each warrant will be converted into one equity share at Rs737 per share. DIS now currently holds 52.5% in RLL and is likely to hold around 64.5% on the transfer of balance shares of promoters.

US FDA investigations

Department of Justice (DoJ) has withdrawn the motion with District Court of Maryland against RLL seeking certain documents pertaining to the discrepancies found at the company's Paonta Sahib manufacturing facility. The motion has been withdrawn on RLL providing all the requested documents.

The US FDA has imposed import alert on 30 formulations and seven API's manufactured by RLL at Dewas and Paonta Sahib facilities. The company has made a provision of Rs 2.44bn for the inventory write-off pertaining to these products.

RLL has plans to acquire a manufacturing facility in the US to manufacture the products under the import alert. Alternatively, it has plans to shift the manufacturing of some of these products to its own US FDA facilities and has plans to expand the capacities at these facilities.

Debt-free by 2009

RLL has received Rs35.8bn from DIS as the proceeds of preferential issue and warrants to DIS. The company has plans to repay its debt from this amount and is likely to be debt free by 2009.

Concerns

RLL has a high exposure of over US$1.2bn in foreign currency loans (including US$440m FCCB) which has resulted in a forex loss of Rs3.11bn during the quarter. Hence, any depreciation in rupee will have an adverse impact on the company's financials.

The recent warning letters issued by US FDA for RLL's two manufacturing facilities at Dewas and Paonta Sahib, is likely to delay the ANDA approvals from these sites. Moreover, the import alert on the products manufactured at these facilities have resulted in loss of US sales from these facilities. Till the US FDA clears these two plants, the company will not be able to export products from these two facilities.

The acquisition of majority stake by DIS will result in a change in the management. DIS is likely to announce the growth plans for RLL after gaining full control. RLL future will depend on the future strategies of DIS.

Valuation

We expect RLL to report 20% CAGR in net sales and 49% CAGR in net profit over CY07-10. We also expect the company's EBIDTA margin to improve from 9.5% in CY07 to 19.9% in CY10 due to a change in the product mix and FTF opportunities. We expect cost of sales to decline from 56.6% in CY07 to 48.7% in CY10 due to the change in product mix, with high margin FTF products.

We have lowered our total income estimates for CY09 by 6% (from Rs102.8bn to Rs96.5bn) and CY10 by 8% (from Rs130.6bn to Rs120.5bn) in view of US FDA action and loss of sales in the US business. Our EPS estimates for CY09 have been reduced by 18%, from Rs28.3 to Rs23.1 and for CY10 by 12%, from Rs41.5 to Rs36.5 in view of high forex losses and the expected loss of US sales due to the US FDA action.

At the CMP of Rs199, the stock trades at 8.2x CY09E EPS of Rs23.1 and 5.2x CY10E EPS of Rs36.5. We change our rating from 'Accumulate' to 'Reduce' on the scrip with a price target of Rs212 (9x CY10 base EPS of Rs13.4 and 2x CY10E FTF EPS of Rs23.1 and Rs46 for Lipitor) over the next 12 months, which is an upside of 11.5% over the CMP.

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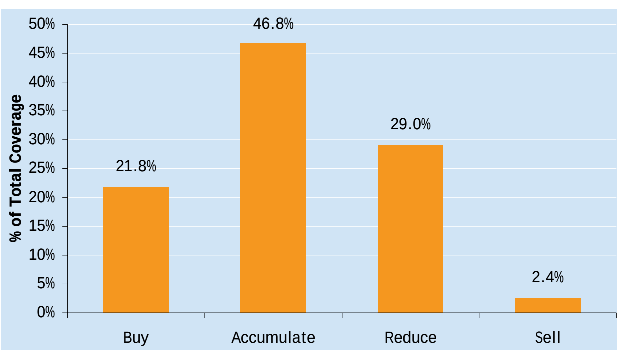
Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	:	Over 15% Outperformance to Sensex over 12-months	**Accumulate**	:	Outperformance to Sensex over 12-months
Reduce	:	Underperformance to Sensex over 12-months	**Sell**	:	Over 15% underperformance to Sensex over 12-months
Trading Buy	:	Over 10% absolute upside in 1-month	**Trading Sell**	:	Over 10% absolute decline in 1-month
Not Rated (NR)	:	No specific call on the stock	**Under Review (UR)**	:	Rating likely to change shortly