

August 13, 2010

REDUCE

Price	Target Price
Rs445	Rs395
Sensex	18,074

Price Performance

(%)	1M	3M	6M	12M
Absolute	(3)	(3)	7	54
Rel. to Sensex	(4)	(8)	(4)	28

Source: Bloomberg

Stock Details

Sector	Pharmaceuticals
Reuters	RANB.BO
Bloomberg	RBXY@IN
Equity Capital (Rs mn)	2102
Face Value (Rs)	5
No of shares o/s (mn)	420
52 Week H/L (Rs)	538/274
Market Cap (Rs bn/USD mn)	187/4,025
Daily Avg Vol (No of shares)	961840
Daily Avg Turnover (US\$ mn)	9.2

Shareholding Pattern (%)

	J'10	M'10	D'09
Promoters	63.9	63.9	63.9
FII/NRI	8.3	8.9	8.2
Institutions	11.6	11.6	11.8
Private Corp	3.7	3.1	3.5
Public	12.5	12.5	12.6

Source: Capitaline

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Ranbaxy Labs

In-line; maintain reduce

- Ranbaxy's Q2CY10 performance is driven by higher than expected contribution from one-off such as Valtrex and growth across the key geographies
- Ex-one off, Operating performance of the company is in-line; recurring EPS of Rs2.1 for the quarter (in-line)
- Management has indicated that composite resolution with FDA is few months away, possibly in 2010 itself
- DoJ settlement is critical to stock performance; Maintain Reduce with a price target of Rs395

Revenue growth of 17% is largely driven by one-offs in the US

Ranbaxy's revenue for the quarter grew by 17% (22% growth in dollar term) to Rs21bn (est. of Rs20.8bn), driven by ~US\$80mn contribution from generic Valtrex (one-off; est. of US\$60mn). Ex-one-off, the recurring revenue was at Rs17.3bn. Though most of the emerging markets excl. Asia pacific has shown growth however the growth in India and Lat Am markets were lower than expected. The decline in Asia Pacific was mainly on account of divestment of businesses in few territories such as China, Vietnam and Japan. In the domestic market, growth was largely impacted because of ARV tender business in Q2CY09. Excluding this, revenue grew by 11% during the quarter. Going forward company is confident to attain 15-20% growth from India as the benefit from project Viraat will start kicking in. Ranbaxy is aiming to become no 1 company in India in the next 3 years. The US business for the quarter grew by 135% to US\$146mn driven by ~US\$80mn revenue from generic Valtrex.

Base business EBITDA margins expanded by 580bps to 8.8%; in-line

EBITDA (ex-fx loss/gain) for the quarter was Rs4.2bn; higher than our expectations of Rs3.7bn. The higher operating margin is largely driven by higher than expected contribution of generic Valtrex. Ex-one-off, the operating margin at 8.9% was in-line with our estimate of 9%. Despite higher investment in Indian operation as company is ramping up its field force and lower profitability from its US base business, 580 bps expansions in operating margin is largely driven by a) higher contribution from high margin emerging markets, b) cost optimization across various levels and c) closure of non-profitable business.

APAT at Rs3.4bn driven by one-offs and higher other income

Ranbaxy APAT of Rs3.4bn is higher than our est. of Rs2.35bn. Ranbaxy's PAT was largely driven by a) Rs1.8bn contribution from Valtrex, b) Rs1.27bn contribution of other income and c) strong base business performance driven by emerging markets. Company has booked ~US\$12mn as non-recurring income such as forex gain and reversal of provisions in the other income. On like to like basis, base business PAT was at Rs881mn (Rs855mn in Q1CY10) vs. Rs190mn in Q2CY09. The EPS for the recurring business is at Rs2.1 is in-line with our expectations. The reported PAT for the quarter was Rs3.25bn. During the quarter, company had a tax write back of Rs2.5mn vs. tax provision of Rs3.9bn in corresponding quarter last year.

Financials

YE-	Net	EBITDA		EPS	EPS	RoE		EV/	
Mar	Sales	(Core)	(%)	APAT	(Rs)	% chg	(%)	P/E	EBITDA P/BV
FY09	74,214	5,001	6.7	2,231	5.3	(71.2)	6.3	86.6	41.8 4.5
FY10	74,529	6,107	8.2	2,882	6.9	29.2	6.6	67.1	33.6 4.3
FY11E	87,895	18,552	21.1	11,373	27.1	294.6	23.2	17.0	10.8 3.7
FY12E	91,615	16,727	18.3	10,013	23.8	(12.0)	18.2	19.3	12.1 3.4

Revenue break-up

	Q2CY10	Q2CY09	Gr y-o-y	Q1CY10	Gr Q-o-Q
U.S.A	146	62	135%	158	-8%
Canada	14	17	-18%	17	-18%
Europe, CIS, Africa, Romania	128	114	12%	139	-8%
Europe	45	43	5%	61	-26%
Romania	24	21	14%	19	26%
Africa	39	35	11%	28	39%
CIS	20	15	33%	31	-35%
Latin America	19	17	12%	21	-10%
Asia inc. middle east	27	32	-16%	32	-16%
India	86	81	6%	72	19%
OTC	12	11	10%	16	-22%
API	26	35	-26%	28	-7%
Total	458	369	24%	483	-5%
Exch Rate	45.9	48.65	-6%	47	-2%

Resolution of FDA issue will be a big trigger

Ranbaxy appears to be making steady progress towards resolving the FDA issues at its Devas and Paonta Sahib facilities, especially the former. With Daiichi's increasing involvement, we believe that Ranbaxy should be able to convince the FDA on its commitment to rectify its past errors and uphold the cGMP standards, going forward. Management has indicated in the concall that the composite resolution of FDA is few months away, possibly in 2010 itself.

Our understanding is that DoJ issue will settle first and then Devas. There could be one time penalty which DoJ might impose on Ranbaxy and after that US FDA may re-inspect the Devas and Paonta Sahib facilities. Though the quantum of penalty is not known but the past history suggest that DoJ can put maximum penalty of 18.5% of three years revenue made on drugs produced in the facility under question prior to import alert or equivalent to 3 years profit earned from the facility, whichever is higher. Assuming Ranbaxy had revenue of US\$1bn from the facilities in question in last three years before the import alert; the penalty could be in the range of US\$185-200mn (Rs20-25/share). I am of the view that with this one time penalty, the overhang on the stock will go away.

Though it is difficult to determine the time line, we believe that it would be relatively easier for Ranbaxy to get clearance for its Devas facility (no AIP invoked at this plant) compared to the Paonta Sahib plant.

Key highlights on the concall

- Mr. Atul Sobti has resigned and Mr. Arun Sawhney has taken over as the MD of the company (working with Ranbaxy since April 2008). Mr. Sobti has cited difference of opinions as a reason to his resignation. Though the reason behind the exit of Mr. Sobti can not be ascertained, however we believe that it could be sentimental dampener in the shorter term.
- Ranbaxy has transferred its New Drug Discovery Research (NDDR) Unit to Daiichi Sankyo for a total consideration of Rs1450mn. Ranbaxy will be recognizing this profit (Rs850mn) over the next two years after adjusting the value of transferred assets. Ranbaxy will continue to work independently on malarial molecule (currently in Phase III) and GSK tie-up. The annual saving to Ranbaxy because of hiving of NCE business will be in the range of Rs1.5-1.6/ share.
- Actual commercial shipment of Nexium API will start any time now, however, formulation shipment will start from Jan'11 onwards.
- Ranbaxy has once again started building a robust ANDA pipeline for the US market and expect to file more than 10 ANDAs in next 12 months.

- Management has indicated that apart from France, EU business is doing well and they are confident of achieving 10% growth in these territories.
- The net debt of the company is US\$260mn and they have guided a tax rate of 25-26% for the year.
- Company has spent US\$50mn in capex and guided for a total capex of US\$125mn in CY10.

DoJ settlement is critical to stock performance; maintain Reduce with a price target of Rs395

On the back of in-line performance in the base business, we maintain our base business earning estimates for CY10E and CY11E respectively. We expect base business earnings to grow from Rs0.6 in CY09 to Rs13.7 in CY11E on the back of a) 14% revenue CAGR and b) 900bps expansion in base business margins. The NPV of our Para IV pipeline is Rs120/share. We have valued the company on its CY11E base business earnings on account of it fully reflecting the benefits of revival in its base business, strong earnings traction in the domestic market and strong operating performance. Our target price works out to be Rs395/ share (20x CY11E base business and Rs120/ share as NPV). Though we believe that Ranbaxy's base business has already bottomed out and are positive on the long term prospects of the company, we believe that current valuations have already factored the improvement in the business and hence, recommend a Reduce rating on the stock. Earlier than expected resolution of FDA issue at Dewas or clarity on the launch of Lipitor will be the key upside triggers. In our view, the outcome of DoJ/FDA issue is most critical to stock performance.

Quarterly Financials

Rs mn	Q2CY09	Q3CY09	Q4CY09	Q1CY10	Q2CY10	YoY (%)	QoQ (%)
Revenue	18,792	18,858	22,549	27,671	21,505	14.4	(22.3)
Expenditure	18,223	16,431	18,444	16,465	17,336	(4.9)	5.3
<i>as % of sales</i>	<i>97.0</i>	<i>87.1</i>	<i>81.8</i>	<i>59.5</i>	<i>80.6</i>		
Consumption of RM	11,178	10,052	1,735	7,512	7,723	(30.9)	2.8
<i>as % of sales</i>	<i>59.5</i>	<i>53.3</i>	<i>7.7</i>	<i>27.1</i>	<i>35.9</i>		
Employee Cost	-	-	10,950	3,812	3,752		(1.6)
<i>as % of sales</i>	<i>0.0</i>	<i>0.0</i>	<i>48.6</i>	<i>13.8</i>	<i>17.4</i>		
Other expenditure	7,045	6,379	5,759	5,141	5,861	(16.8)	14.0
<i>as % of sales</i>	<i>37.5</i>	<i>33.8</i>	<i>25.5</i>	<i>18.6</i>	<i>27.3</i>		
EBITDA	569	2,427	4,105	11,205	4,168	632.6	(62.8)
Depreciation	644	654	739	1,005	695	7.9	(30.8)
EBIT	-75	1,773	3,366	10,200	3,473	(4,731.0)	(65.9)
Other Income	400	163	1,915	399	1,273	218.1	219.0
Interest	197	121	146	248	111	(43.8)	(55.4)
PBT	128	1,815	4,635	10,351	4,635	3,521.2	(55.2)
Total Tax	176	418	3,533	3,312	1,159	559.9	(65.0)
Adjusted PAT	190	1,171	1,102	7,039	3,476	1,726.5	(50.6)
(Profit)/loss from JV's/Ass/MI				25.59	62.91		
APAT after MI	190	1,171	1,102	7,013	3,413	1,693.5	(51.3)
Extra ordinary items (net of tax)	6741	-5	801	2592	1318		(94.0)
Reported PAT	6,931	1,166	1,904	9,605	3,257	(53.0)	(66.1)
AEPS	0.4	2.6	2.6	16.7	8.3	1830.2	(50.6)

Margins (%)						(bps)	(bps)
EBIDTA	3.0	12.9	18.2	40.5	19.4	1,636	-2111
EBIT	(0.4)	9.4	14.9	36.9	16.2	1,655	-2071
EBT	0.7	9.6	20.6	37.4	21.6	2,087	-1585
PAT	1.0	6.2	4.9	25.3	15.9	1,486	-947
Effective Tax rate	137.2	23.0	76.2	32.0	25.0	(11,219)	-700

Financials

Income Statement

Y/E, Mar (Rs. mn)	CY08	CY09	CY10E	CY11E
Net Sales	74,214	74,529	87,895	91,615
<i>Growth (%)</i>	<i>9.4</i>	<i>0.4</i>	<i>17.9</i>	<i>4.2</i>
Expenditure	69,213	68,423	69,344	74,888
Raw Materials	27,704	31,657	30,694	34,696
SGA	21,011	22,591	16,762	16,998
Employee Cost	9,670	14,175	15,934	16,991
Other Exp	10,828	0	5,954	6,203
EBITDA	5,001	6,107	18,552	16,727
<i>Growth (%)</i>	<i>-45.3</i>	<i>22.1</i>	<i>203.8</i>	<i>-9.8</i>
EBITDA margin (%)	6.7	8.2	21.1	18.3
Depreciation	2,825	2,676	2,931	3,091
EBIT	2,176	3,430	15,621	13,636
EBIT margin (%)	2.9	4.6	17.8	14.9
Other Income	2,706	1,398	1,592	843
Interest expenses	2,055	710	751	1,004
PBT	-15,000	10,098	16,461	9,554
Tax	-5,648	6,991	4,938	2,388
<i>Effective tax rate (%)</i>	<i>37.7</i>	<i>69.2</i>	<i>30.0</i>	<i>25.0</i>
Adjusted PAT	2,071	2,741	11,223	9,919
(Profit)/loss from JV's/Ass/MI	-160	-142	-150	-93
Adjusted PAT after MI	2,231	2,882	11,373	10,013
<i>Growth (%)</i>	<i>-71.2</i>	<i>29.2</i>	<i>294.6</i>	<i>-12.0</i>
Net Margin (%)	3.0	3.9	12.9	10.9
E/O items	-17,827	5,980	0	-3,920
Reported PAT	-9,512	2,965	11,373	7,072
<i>Growth (%)</i>	<i>-222.8</i>	<i>-131.2</i>	<i>283.5</i>	<i>-37.8</i>

Cash Flow

Y/E, Mar (Rs. mn)	CY08	CY09	CY10E	CY11E
PBT (Ex-Other income)	-17,706	8,700	14,869	8,711
Depreciation	2,825	2,676	2,931	3,091
Interest Provided	2,055	710	751	1,004
Other Non-Cash items	0	0	0	0
Chg in working cap	-3,234	3,494	-1,685	-5,429
Tax paid	5,648	-6,991	-4,938	-2,388
Operating Cashflow	-10,413	8,590	11,928	4,989
Capital expenditure	-6,813	-4,387	-4,566	-3,671
Free Cash Flow	-17,226	4,203	7,362	1,318
Other income	2,706	1,398	1,592	843
Investments	-3,028	0	0	0
Investing Cashflow	-7,135	-2,989	-2,974	-2,828
Equity Capital Raised	34,949	0	0	0
Loans Taken / (Repaid)	1,699	-6,000	-5,000	-15,380
Interest Paid	-2,055	-710	-751	-1,004
Dividend paid (incl tax)	0	-1,011	-3,324	-2,926
Income from investments	0	0	0	0
Others	2,533	0	0	-1
Financing Cashflow	37,125	-7,721	-9,075	-19,311
Net chg in cash	19,577	-2,120	-121	-17,150
Opening cash position	4,379	23,956	21,836	21,715
Closing cash position	23,956	21,836	21,715	4,565

Balance Sheet

Y/E, Mar (Rs. mn)	CY08	CY09	CY10E	CY11E
Equity share capital	2,102	2,102	2,102	2,102
Reserves & surplus	40,861	42,815	50,864	55,009
Net worth	42,962	44,917	52,966	57,111
Minority Interest	675	816	966	1,059
Secured Loans	33,639	32,639	28,639	11,259
Unsecured Loans	9,476	4,476	3,476	5,476
Loan Funds	43,114	37,114	32,114	16,735
Net deferred tax liability	-12,229	-12,229	-12,229	-12,229
Total Liabilities	74,522	70,618	73,817	62,676
Gross Block	61,942	66,761	71,351	75,250
Less: Depreciation	17,042	18,628	21,328	24,208
Net block	44,900	48,133	50,023	51,042
Capital work in progress	4,707	3,185	2,930	2,491
Investment	5,432	5,432	5,432	5,432
Current Assets	66,922	65,221	67,871	52,826
Inventories	19,643	19,643	21,385	21,909
Sundry debtors	13,310	13,397	14,522	15,485
Cash & bank balance	23,956	21,836	21,715	4,565
Other current assets	10,012	10,345	10,250	10,868
Current lia & Prov	47,438	51,352	52,439	49,114
Current liabilities	39,719	40,912	40,623	40,783
Provisions	7,720	10,440	11,815	8,331
Net current assets	19,484	13,869	15,433	3,711
Misc. exp & Def. Assets	0	0	0	0
Total Assets	74,522	70,618	73,817	62,676

Key Ratios

Y/E, Mar	CY08	CY09	CY10E	CY11E
Profitability (%)				
EBITDA Margin	6.7	8.2	21.1	18.3
Net Margin	3.0	3.9	12.9	10.9
ROCE	3	4	18	17
ROE	6.3	6.6	23.2	18.2
Per Share Data (Rs)				
EPS	5.3	6.9	27.1	23.8
CEPS	12.0	13.2	34.0	31.2
BVPS	102.2	106.9	126.0	135.9
DPS	0.0	2.1	6.8	6.0
Valuations (x)				
PER	86.6	67.1	17.0	19.3
P/CEPS	38.2	34.8	13.5	14.8
P/BV	4.5	4.3	3.7	3.4
EV / Sales	2.9	2.8	2.4	2.3
EV / EBITDA	41.8	33.6	10.8	12.1
Dividend Yield (%)	0.0%	0.4%	1.5%	1.3%
Gearing Ratio (x)				
Net Debt/ Equity	0.4	0.3	0.2	0.2
Net Debt/EBITDA	3.8	2.5	0.6	0.7
Working Cap Cycle (days)	16	12	23	30

Recommendation History: Ranbaxy Labs – RBXY IN

Date	Reports	Reco	CMP	Target
12.05.2010	Ranbaxy Q1CY10 Result Update	Reduce	458	395
10.03.2010	Generic Pharma Sector Report	Sell	453	329

Recent Research Reports

Date	Reports	Reco	CMP	Target
11.08.2010	Piramal Healthcare Q1FY11 Result Update	Hold	482	531
02.08.2010	Torrent Pharma Q1FY11 Result Update	Buy	565	650
29.07.2010	Sun Pharma Q1FY11 Result Update	Hold	1,775	1,866
29.07.2010	Lupin Pharma Q1FY11 Result Update	Accumulate	1,920	2,111

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