September 12, 2008

ACTION
Sell

Ranbaxy Laboratories (RANB.BO)

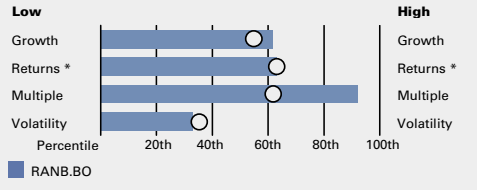
Return Potential: (17%)

Beyond the open offer – expensive multiples on multiple fronts

Source of opportunity

As Daiichi-Sankyo's open offer draws to a close, we look at the road ahead for Ranbaxy and analyze three scenarios which we think could play out for the company. Our analysis suggests that the stock is fully valued as it trades at a significant premium to its peers on a one-year forward earnings multiple (37%-72%) in all three scenarios. This premium leaves no room for either execution errors or an adverse outcome with the FDA, in our view. We reiterate our Sell rating and have revised down our DCF-based 12-month target price by 4% to Rs381, implying 17% downside from current levels.

Investment Profile: Ranbaxy Laboratories



* Returns = Return on Capital

For a complete description of the investment profile measures please refer to the disclosure section of this document.

Catalyst

1) An unfavorable resolution of the ongoing FDA investigation would be negative. **2)** Growth expectations are back-end loaded into the second half of CY2008. The company delivered an EPS of Rs4.3 in H1 CY2008 vs. an EPS of Rs10.5 in H1 CY2007—Q3 results will therefore be key.

Valuation

Ranbaxy trades at a one-year forward earnings multiple of 27X, which is a 50% premium to its peers. A scenario assuming cash injection would change that premium to 45%. A scenario assuming US$260 mn of merger synergies over next three years changes the premium to 37%. Finally, a scenario assuming adverse resolution of the current FDA investigation and a benign loss of 5% of group sales changes the premium to peers to 72%. We believe that these valuations do not reflect the potential downside risks.

Key risks

1) Favorable resolution of the FDA investigation would be viewed positively. **2)** Further settlements on the FTFs that Ranbaxy holds could add to earnings expectations. **3)** Higher-than-expected revenues from ex-US markets may reassure investors as to the company's growth prospects and possibly help them overlook the downside risks in the US market.

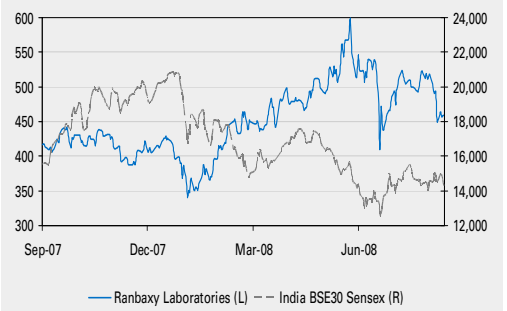
INVESTMENT LIST MEMBERSHIP
Asia Pacific Sell List

Coverage View: Neutral
India:
Pharmaceuticals

Key data	Current
Price (Rs)	459.25
12 month price target (Rs)	381.00
Market cap (Rs mn / US$ mn)	171,114.6 / 3,793.7
Foreign ownership (%)	18.5

	12/07	12/08E	12/09E	12/10E
EPS (Rs)	19.67	16.97	21.27	25.31
EPS growth (%)	49.4	(13.7)	25.3	19.0
EPS (diluted) (Rs)	19.67	16.97	21.27	25.31
EPS (basic pre-ex) (Rs)	21.10	18.21	22.82	27.15
P/E (X)	23.3	27.1	21.6	18.1
P/B (X)	5.7	5.4	4.7	4.1
EV/EBITDA (X)	18.1	17.0	14.0	12.0
Dividend yield (%)	2.0	2.3	2.4	2.6
ROE (%)	28.1	22.0	25.2	25.9

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	(18.1)	1.3	9.4
Rel. to Bombay SE Sensitive Index	(13.2)	14.0	18.7

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 9/11/2008 close.

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Ranbaxy Laboratories: Summary financials

Profit model (Rs mn)	12/07	12/08E	12/09E	12/10E
Total revenue	**66,010.0**	**79,048.6**	**90,498.3**	**103,014.8**
Cost of goods sold	(35,811.8)	(36,523.6)	(40,908.8)	(46,051.7)
SG&A	(21,861.5)	(28,673.3)	(33,007.4)	(37,778.6)
R&D	(4,103.8)	(4,845.7)	(5,547.5)	(6,314.8)
Other operating profit/(expense)	3,546.1	519.1	594.3	676.4
EBITDA	**9,983.1**	**12,229.7**	**14,725.1**	**17,070.7**
Depreciation & amortization	(2,204.1)	(2,704.6)	(3,096.4)	(3,524.6)
EBIT	**7,779.0**	**9,525.1**	**11,628.8**	**13,546.1**
Interest income	354.0	350.3	478.9	658.9
Interest expense	(1,681.6)	(1,764.3)	(1,814.3)	(1,864.3)
Income/(loss) from uncons. subs.	0.0	0.0	0.0	0.0
Others	3,520.0	500.0	500.0	500.0
Pretax profits	**9,971.4**	**8,611.2**	**10,793.4**	**12,840.8**
Income tax	(2,070.0)	(1,827.3)	(2,290.3)	(2,724.8)
Minorities	(38.0)	0.0	0.0	0.0
Net income pre-preferred dividends	**7,863.4**	**6,783.9**	**8,503.1**	**10,116.0**
Preferred dividends	0.0	0.0	0.0	0.0
Net income (pre-exceptionals)	**7,863.4**	**6,783.9**	**8,503.1**	**10,116.0**
Post-tax exceptionals	0.0	0.0	0.0	0.0
Net income	**7,863.4**	**6,783.9**	**8,503.1**	**10,116.0**
EPS (basic, pre-except) (Rs)	21.10	18.21	22.82	27.15
EPS (basic, post-except) (Rs)	21.10	18.21	22.82	27.15
EPS (diluted, post-except) (Rs)	19.67	16.97	21.27	25.31
DPS (Rs)	9.00	10.50	11.00	12.00
Dividend payout ratio (%)	42.6	57.7	48.2	44.2
Free cash flow yield (%)	1.3	1.7	2.4	3.1

Balance sheet (Rs mn)	12/07	12/08E	12/09E	12/10E
Cash & equivalents	4,697.4	5,986.7	8,235.9	11,420.5
Accounts receivable	17,237.9	16,903.5	19,351.8	22,028.3
Inventory	20,126.6	18,297.3	20,494.2	23,070.7
Other current assets	6,321.1	9,041.6	9,041.6	9,041.6
Total current assets	**48,383.1**	**50,229.2**	**57,123.6**	**65,561.1**
Net PP&E	23,846.0	24,101.3	24,809.1	25,614.8
Net intangibles	18,984.3	21,613.1	21,014.5	20,333.1
Total investments	1,343.5	3,696.8	3,696.8	3,696.8
Other long-term assets	0.0	0.0	0.0	0.0
Total assets	**92,556.8**	**99,640.3**	**106,643.9**	**115,205.8**
Accounts payable	8,915.0	9,753.8	11,166.6	12,711.1
Short-term debt	9,939.7	11,762.6	12,762.6	13,762.6
Other current liabilities	8,191.8	11,166.2	11,166.2	11,166.2
Total current liabilities	**27,046.5**	**32,682.6**	**35,095.4**	**37,639.8**
Long-term debt	32,116.5	30,653.2	30,653.2	30,653.2
Other long-term liabilities	2,921.6	4,281.3	4,281.3	4,281.3
Total long-term liabilities	35,038.0	34,934.5	34,934.5	34,934.5
Total liabilities	**62,084.5**	**67,617.1**	**70,029.9**	**72,574.3**
Preferred shares	**0.0**	**0.0**	**0.0**	**0.0**
Total common equity	**30,099.9**	**31,452.7**	**36,043.5**	**42,060.9**
Minority interest	372.4	570.5	570.5	570.5
Total liabilities & equity	**92,556.8**	**99,640.3**	**106,643.9**	**115,205.8**
BVPS (Rs)	**80.82**	**84.45**	**96.78**	**112.93**

Growth & margins (%)	12/07	12/08E	12/09E	12/10E
Sales growth	9.7	19.8	14.5	13.8
EBITDA growth	13.1	22.5	20.4	15.9
EBIT growth	11.4	22.4	22.1	16.5
Net income growth	54.1	(13.7)	25.3	19.0
EPS growth	49.8	(13.7)	25.3	19.0
Gross margin	45.7	53.8	54.8	55.3
EBITDA margin	15.1	15.5	16.3	16.6
EBIT margin	11.8	12.0	12.8	13.1

Ratios	12/07	12/08E	12/09E	12/10E
ROE (%)	28.1	22.0	25.2	25.9
ROA (%)	8.9	7.1	8.2	9.1
ROACE (%)	13.7	11.6	13.6	15.0
Inventory days	184.7	192.0	173.1	172.6
Receivables days	91.1	78.8	73.1	73.3
Payable days	86.9	93.3	93.3	94.6
Net debt/equity (%)	122.6	113.8	96.1	77.4
Interest cover - EBIT (X)	5.9	6.7	8.7	11.2

Cash flow statement (Rs mn)	12/07	12/08E	12/09E	12/10E
Net income pre-preferred dividends	7,863.4	6,783.9	8,503.1	10,116.0
D&A add-back	2,204.1	2,704.6	3,096.4	3,524.6
Minorities interests add-back	0.0	0.0	0.0	0.0
Net (inc)/dec working capital	(4,745.8)	(2,723.2)	(3,232.5)	(3,708.5)
Other operating cash flow	3,520.0	500.0	500.0	500.0
Cash flow from operations	**5,359.7**	**6,765.3**	**8,367.0**	**9,932.1**
Capital expenditures	(2,500.0)	(2,800.0)	(3,205.6)	(3,648.9)
Acquisitions	0.0	0.0	0.0	0.0
Divestitures	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0
Cash flow from investments	**(2,500.0)**	**(2,800.0)**	**(3,205.6)**	**(3,648.9)**
Dividends paid (common & pref)	(3,613.4)	(3,353.4)	(3,912.3)	(4,098.6)
Inc/(dec) in debt	2,500.0	1,000.0	1,000.0	1,000.0
Common stock issuance (repurchase)	0.0	0.0	0.0	0.0
Other financing cash flows	0.0	0.0	0.0	0.0
Cash flow from financing	**(1,113.4)**	**(2,353.4)**	**(2,912.3)**	**(3,098.6)**
Total cash flow	**1,746.3**	**1,612.0**	**2,249.2**	**3,184.6**

Valuation	12/07	12/08E	12/09E	12/10E
P/E (analyst) (X)	23.3	27.1	21.6	18.1
P/B (X)	5.7	5.4	4.7	4.1
EV/EBITDA (X)	18.1	17.0	14.0	12.0
Dividend yield (%)	2.0	2.3	2.4	2.6

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

Analyst Contributors

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Exhibit 1: 12-month DCF-based target prices for our Indian pharma coverage; reality check vs. six other ratios

Goldman Sachs India Pharmaceuticals Coverage (Actionable calls)																
					Price		Potential	One year Forward (x)			TP	Mkt. Implied		GS 3 year CAGR	
	Ticker	Mkt. cap ($mn)	Free float	Rating	Current (Rs)	12-month TP (Rs)	upside / downside	P/E	EV / EBITDA	3 yr PEG	implied P/E (x)	CAP (years)	Growth	Sales	EPS
Dr Reddys	REDY.BO	2224	66%	Buy	579	805	39%	15.7	9.4	0.8	**21.8**	**4**	**6%**	19%	32%
Versus coverage group								*-13%*	*-25%*						
Glenmark *	GLEN.BO	3581	42%	Buy	669	755	13%	19.2	13.7	0.6	**21.7**	**17**	**18%**	34%	32%
Versus coverage group								*7%*	*10%*						
Piramal Healthcare	PIRA.BO	1565	36%	Buy	328	381	16%	15.9	9.6	0.9	**18.5**	**13**	**14%**	13%	20%
Versus coverage group								*-11%*	*-23%*						
Ranbaxy	RANB.BO	3880	55%	Sell	457	381	-17%	26.9	17.1	2.1	**17.9**	**31**	**25%**	14%	9%
Versus coverage group								*50%*	*37%*						
Cipla	CIPL.BO	4095	58%	Sell	234	158	-32%	23.5	19.4	2.2	**15.9**	**29**	**25%**	15%	10%
Versus coverage group								*31%*	*55%*						
Cadila	CADI.BO	956	21%	Sell	336	270	-20%	17.2	10.5		**13.8**	**24**	**21%**	7%	-1%
Versus coverage group								*-4%*	*-16%*						
Biocon	BION.BO	900	30%	Neutral	411	403	-2%	21.2	13.3	2.8	**20.8**	**20**	**20%**	15%	5%
Versus coverage group								*18%*	*7%*						
Lupin	LUPN.BO	1365	43%	Neutral	749	726	-3%	14.2	9.6	1.0	**13.8**	**8**	**10%**	19%	13%
Versus coverage group								*-21%*	*-23%*						
Sun Pharmaceuticals	SUN.BO	6571	34%	Neutral	1525	1243	-18%	19.0	15.4	1.2	**15.5**	**14**	**16%**	21%	12%
Versus coverage group								*6%*	*23%*						
Wockhardt	WCKH.BO	509	24%	Neutral	208	207	0%	6.1	7.0	1.5	**6.1**	**14**	**14%**	14%	7%
Versus coverage group								*-66%*	*-44%*						
Coverage group average								**17.9**	**12.5**	**1.6**	**16.6**	**17.4**	**17%**	**17%**	**14%**

*This stock is on our regional Conviction List .

Note: The 12-month TPs are based on DCF methodology, along with a risk-adjusted NPV for Glenmark's pipeline and NPV of FTF settlements for Ranbaxy.

Risks: 1) The sector faces a risk of collateral damage in case of any adverse ruling in the current motion against Ranbaxy in the US, and 2) adverse changes to domestic drug pricing policy.

For important disclosures, please go to http://www.gs.com/research/hedge.html.

Source: Goldman Sachs Research estimates, Quantum database.

The prices in the body of this report are based on the market close of September 9, 2008, unless otherwise indicated.

Looking beyond the open offer: three possible scenarios for Ranbaxy (cash injection; synergies; FDA investigation)

As Daiichi-Sankyo's open offer draws to a close, we look into the road ahead for Ranbaxy and analyze three scenarios which could play out for the company.

Our analysis suggests that the stock is fully valued as it trades at a significant premium to its peers on all three scenarios. This premium leaves no room for either execution error, or an adverse outcome with the FDA, in our view. Reiterate Sell and TP of Rs381 implying 17% downside potential from current levels.

Scenario 1: Daiichi cash largely offset by equity dilution; 45% P/E premium to peers

Our first scenario involves a cash infusion of $838 mn (Rs35,804 mn) from Daiichi in exchange for preferential shares and warrants (translating to a 9.5% and 4.9% post dilution stake respectively). While this would be accretive to earnings (if fully used to reduce debt, this would reduce interest burden by 85% and gearing from 135% to 10%), its impact would be largely offset by equity dilution. This would leave Ranbaxy trading at a 45% premium to its peers (P/E of 22.8X on CY2009E earnings vs. 15.7X for the sector in FY2010E). We believe this premium would adequately reflect Ranbaxy's superior growth (leaving aside for the moment, the risks from the ongoing FDA investigation).

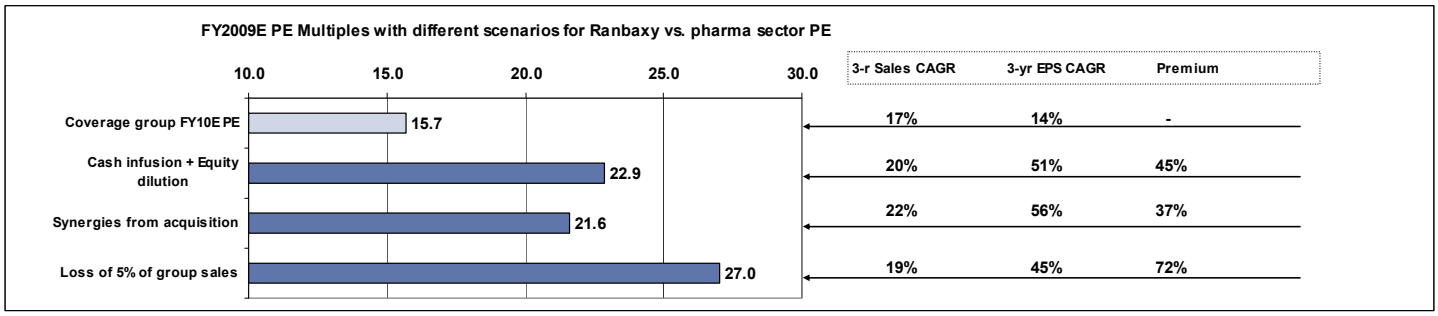
Scenario 2: $260mn in revenue and cost synergies; 37% P/E premium to peers

Hitherto, the market's focus on the open offer and limited comments from Daiichi and Ranbaxy have precluded debate on the prospect of synergies from the acquisition. We feel that cost synergies would be modest due to the complementary nature of their businesses and assume that the bulk of any synergies would be revenue driven. Details are contained in the body of this report, however our scenario assuming synergies of US$260 million over the next three years and would leave the stock trading at a 37% premium to its peers on an FY2009E earnings multiple.

Scenario 3: Manufacturing issues could pose downside risk

Ranbaxy is the subject of allegations of "systematic fraudulent conduct" by the FDA in the US. We have limited visibility over the veracity of the FDA's allegations or of Ranbaxy's assertion of compliance with regulatory standards. Accordingly, we have laid out a range of potential scenarios, ranging from a dismissal of the FDA's allegations to a negative ruling, which would raise the prospect of penalties. We have assessed the loss to earnings if Ranbaxy were to experience a transient disruption to its US business. With that in mind, we estimate that Ranbaxy would deliver an EPS of Rs16.9 for CY2009E. This would put the stock on a one-year forward P/E of 27.0X which is a 72% premium to the sector (see Exhibit 2).

Exhibit 2: Ranbaxy trades at expensive valuations, even with assumptions of revenue and cost synergies



Source: Goldman Sachs Research estimates.

What next? Valuation dynamics beyond the open offer

The open offer for 20% of Ranbaxy's shares by Daiichi Sankyo closed on September 4 and investors are rightfully keen to understand the road ahead for Ranbaxy.

Cash injection from Daiichi to reduce interest expenses

Ranbaxy envisages concluding the acquisition by March 2008, and accordingly expects to receive the cash payment for the fresh shares it has issued to Daiichi and for this cash to appear on its balance sheets before such time. We estimate Ranbaxy to receive US$838 mn (Rs35,804) cash injection from Daiichi. Of this, US$797 mn (Rs34,050 mn) is for the 46.2 mn preferential shares issued to Daiichi, which constitutes 9.5% of fully diluted shares of 485.8 mn. We expect a further US$41 mn (Rs1,754 mn) as the mandatory 10% down-payment for the 23.8 mn share warrants issued on a preferential basis, which constitute 4.9% of 485.8 mn shares (please refer to Exhibit 3).

In line with what the company has stated, we believe that the proposed cash injection could be used primarily for the purpose of eliminating debt and reduce its financial expenses. For CY2009E, we expect interest expense to be reduced by 85% from Rs1,814 mn to Rs264 mn. As a result, for CY2009E, we expect the net income generated to increase by 14% from Rs8,503 mn to Rs9,712 mn. The company has also stated that it may look out for any acquisitions, and in such an event, the above equation may alter. Note that we have not incorporated any acquisitions into our estimates at this stage.

However, equity dilution would lead to potential earnings loss

However, at the EPS level, this rise in net income does not translate into increased earnings for the company, owing to increase in the fully diluted shares from 383 mn to 486 mn. Please see Exhibit 3 below for an estimation of the fully diluted shares and the share composition.

Exhibit 3: We estimate Ranbaxy will receive a cash injection of around US$838 mn (Rs35,804 mn) from Daiichi
Daiichi's acquisition values Ranbaxy at US$8.4 bn (conversion rate as of 12-Jun-2008: US$1 = Rs42.7)

Details	# of shares (mn)	Resulting %	Price/share	INR mn	US$ mn
No. of shares to be acquired from Sellers	136.0	28.0%	737	100,232	2,347
Preferential allotment of equity shares	46.2	9.5%	737	34,049	797
Daiichi Sankyo's exercise of a portion or all of the share warrants to be issued on a preferential basis - 16-18 months	23.8	4.90%	737	17,544	411
Open offer for 20% of Ranbaxy's shares	NA	NA	737	NA	NA
Daiichi's share holding (excl. Warrants and Open offer)	**182.2**	**37.51%**	**737**	**134,281**	**3,145**
Remaining shares of total post diluted shares (incl. potential warrants and open offer)	303.6	62.49%	737	223,753	5,240
Value ascribed to Ranbaxy	**485.8**	**100%**	**737**	**358,035**	**8,385**

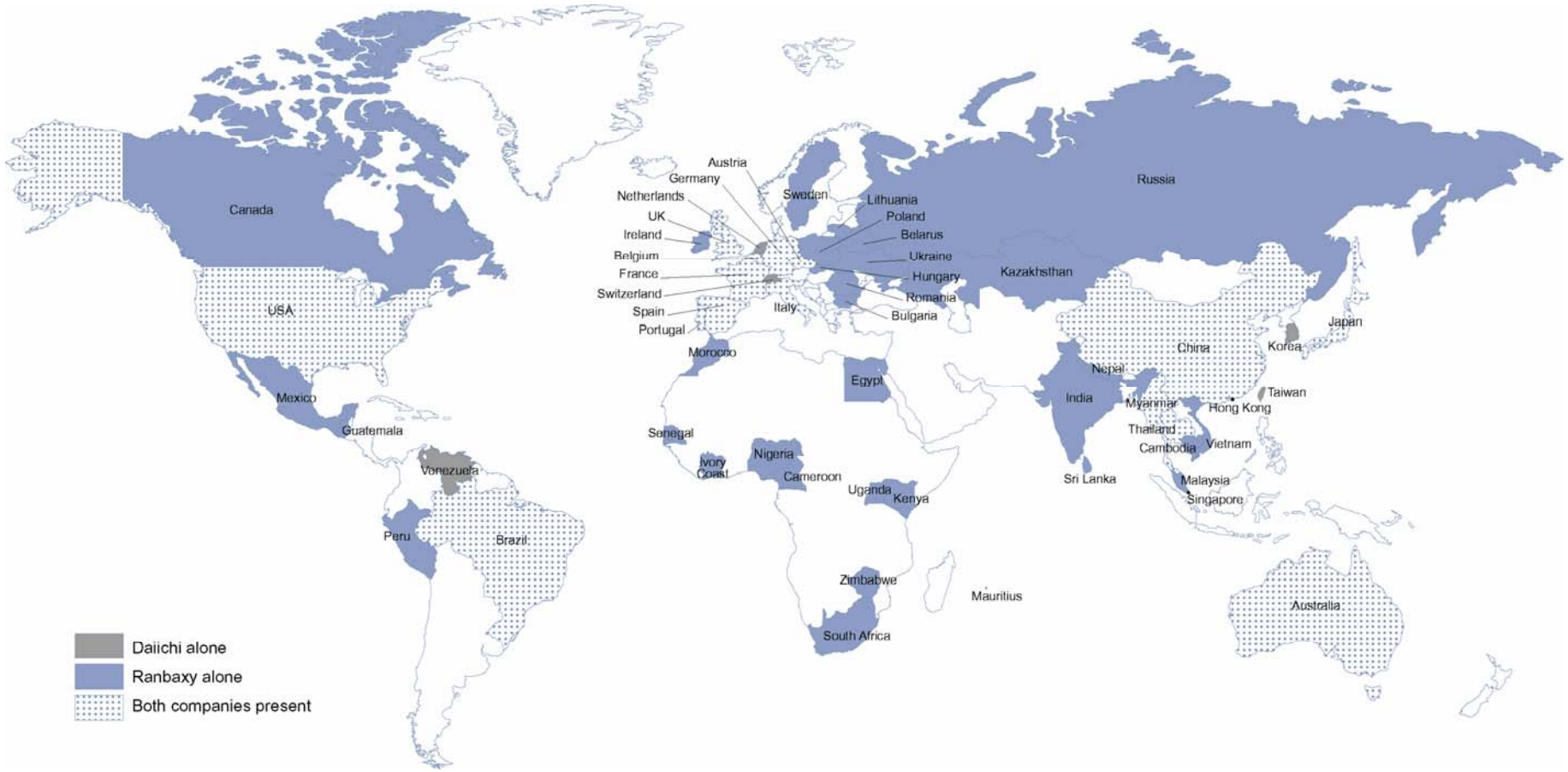
Source: Company data, Goldman Sachs Research estimates.

As every acquisition brings its own set of synergies which could be exploited, we have looked in detail at the various synergies that Ranbaxy could potentially extract from Daiichi. We have then analyzed if the benefits of these synergies could offset the earnings dilution or even manage to boost earnings, providing greater returns to investors.

Widespread geographic presence offers potential synergies to extract

Ranbaxy currently has extensive global presence, having local operations (marketing, sales, and distribution) across 51 countries, with manufacturing facilities in 11 of them. Daiichi Sankyo is present in 21 countries (see Exhibit 4).

Exhibit 4: Revenue and cost synergies across the globe for Daiichi and Ranbaxy – Ranbaxy can potentially reduce costs across 11 countries, while Daiichi potentially gets entry into 37 additional countries.



Source: Goldman Sachs Research (data derived from Daiichi Sankyo and Ranbaxy's respective last annual reports).

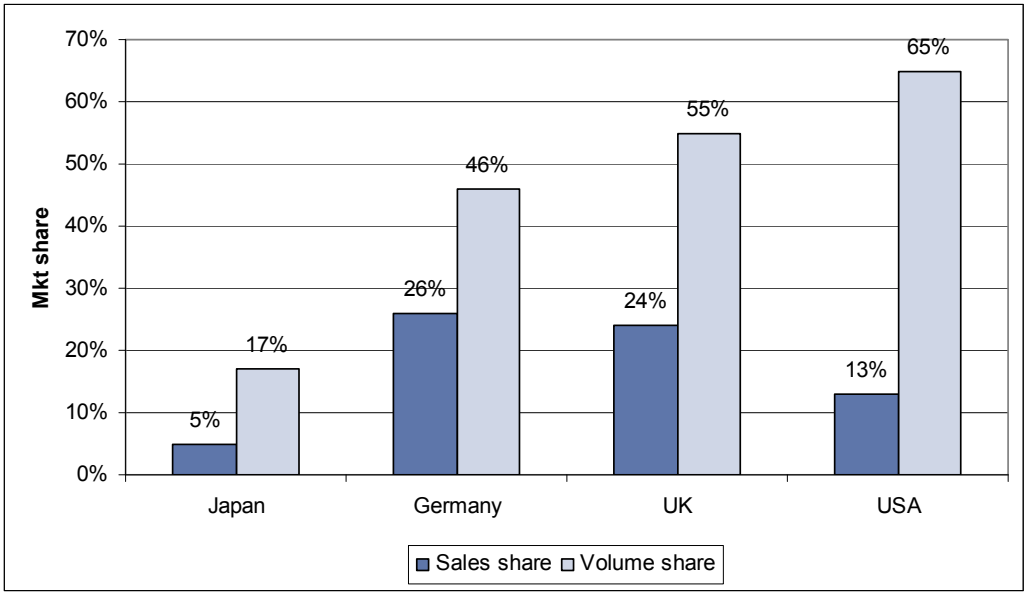
We observe that while Ranbaxy offers Daiichi exposure to 37 new countries, Daiichi likewise offers Ranbaxy the opportunity to launch its generic products in another 6 new geographies. Both companies are present simultaneously in 11 countries. We believe that both the companies can potentially gain additional revenue synergies from exposure to new markets and bring in synergies of scale where they are present together and reduce operational costs.

Revenue synergies for Ranbaxy

We believe synergies can be potentially extracted from the following sources:

1) **Entry to Japanese generics market, which is at an emerging stage:** We believe that this could be the single largest advantage to arise for Ranbaxy in the long run. The Japanese pharma market at US$70 bn is the second largest pharma market globally. The advantage for Ranbaxy is that the generics industry is still in an emerging stage and the government is pushing for greater adoption of generics, as generic penetration is much lower than other developed markets (see Exhibit 5). Currently the generics market is around 5.5% of the total Japan pharma market (US$3.8 bn) as opposed to the US generics market where generics constitute 13% of value and 65% of volume. We estimate the Japanese generics market to grow by 8%-10% yoy, in contrast to the slow growth of the Japanese pharma market at 4.5%. As per our estimates, 1% share of the Japanese generics market by CY2011E could translate into Ranbaxy's sales being boosted by approximately US$49mn.

Exhibit 5: Japanese generics market is at an emerging stage, even compared to developed countries



Source: Goldman Sachs Research estimates.

2) **NCE Research services:** Ranbaxy could potentially provide NCE R&D services to Daiichi at a significantly lower cost than conducting research in Japan, in our view. Hence, we believe that Daiichi would strongly consider making use of Ranbaxy's research facilities going forward and estimate this to generate around US$10 mn by CY2011E.

3) **Marketing Daiichi's products:** Ranbaxy offers Daiichi the opportunity to market its products across 49 countries, of which, we estimate 37 countries to be where Daiichi has

had no presence before. If such opportunity is tapped, we estimate this could provide Ranbaxy with another significant boost to the topline of ~US$40mn by CY2011E.

4) **Authorized generics sale:** AG sale of Daiichi's products going off-patent is another potential opportunity, in our view. However, an analysis of Daiichi's innovative products reveals that there is no significant patent expiry (products with sales >US$250 mn per year) in the next three years. See Exhibit 6 for an overview of Daiichi's product portfolio (only those with sales above ¥25 bn/US$250 mn are considered).

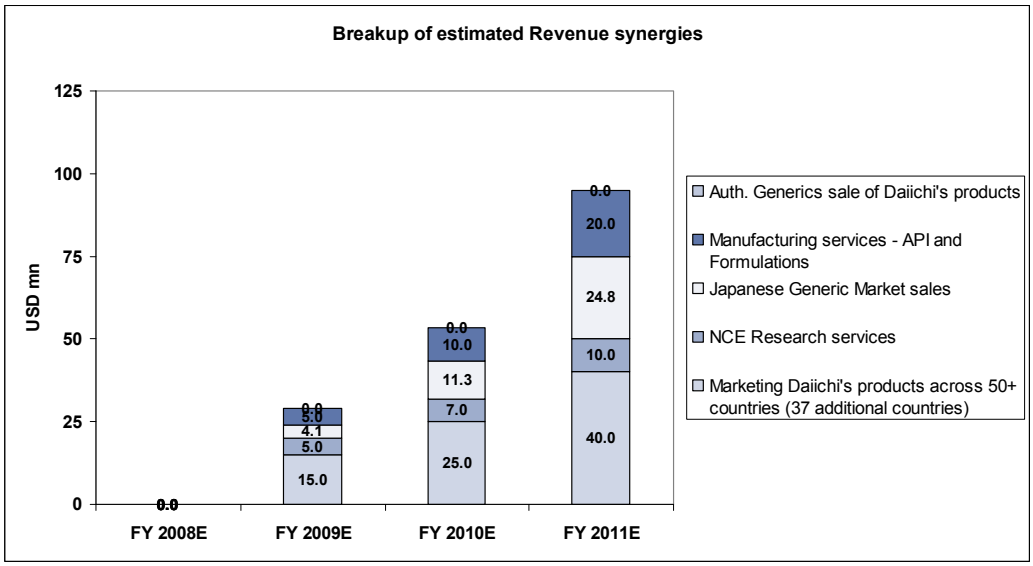
Exhibit 6: Amongst drugs with sales > ¥25 bn

Products (>25 bn Japanese Yen sales)	FY 2007		FY 2008E		Patent Expiry
	In JPN¥ bn	In US$ mn	In JPN¥ bn	In US$ mn	
Olmesartan (Anti Hypertensive)	196	**1810**	214	**1976**	2016
Levofloxacin (Anti Bacterial)	109	**1007**	104	**960**	2012
Pravastatin (Anti Lipid)	76	**702**	62.5	**577**	-
Cardiovascular					
Olmetec	55	**508**	68	**628**	2016
Mevalotin	62	**569**	53	**489**	-
Infectious disease					
Cravit	46	**428**	47	**434**	-
Loxonin	36	**331**	39	**360**	2012
Contrast Agents					
Omnipaque	28	**262**	28	**259**	-
USA					
Benicar	43	**400**	41	**379**	2016

Source: Daiichi-Sankyo 2007 Annual Report, FDA, Goldman Sachs Research estimates.

5) **Manufacturing services:** Although we feel that the probability of Ranbaxy being able to tap into this opportunity in the near future is low, this is still a potential synergy which could be extracted once the overhang of queries on manufacturing is resolved. We believe supplying API and producing dosage formulations could potentially generate US$20mn if Ranbaxy provides manufacturing services from CY2009E onwards.

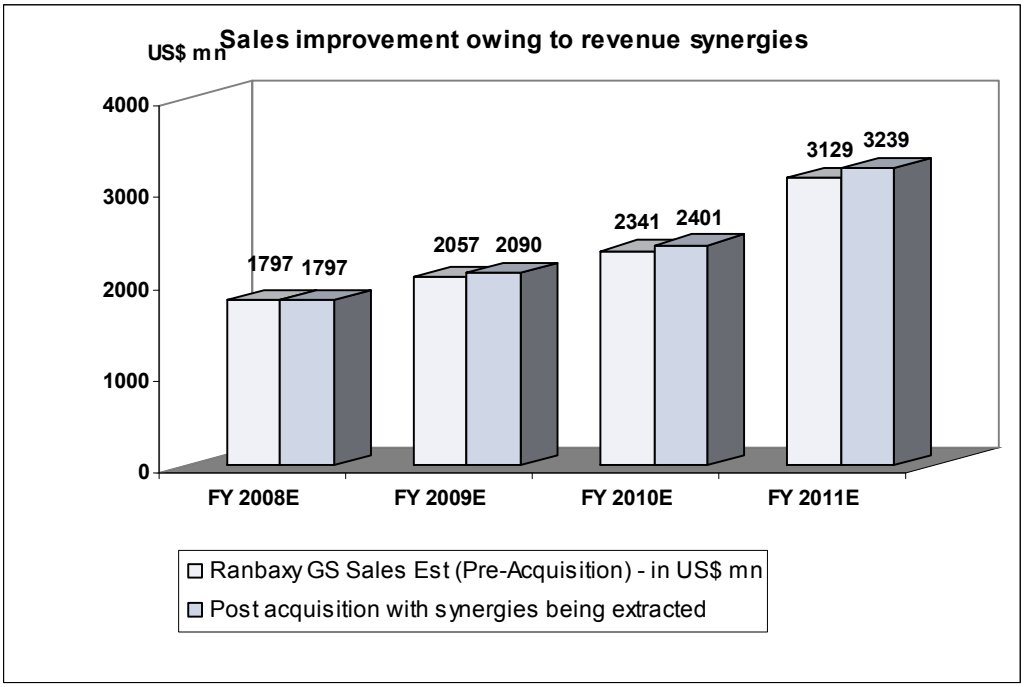
Exhibit 7: We believe entering the Japanese generic market would be the primary benefit



Source: Goldman Sachs Research estimates.

We estimate all these synergies could cumulatively contribute around US$202 mn additionally to Ranbaxy's sales by CY2011E. This is an increase of around 6% of our CY2011E revenue estimates of US$3,129 mn (Rs137,676 mn)

Exhibit 8: Expect sales to increase by 6% by FY2011E, owing to revenue synergies derived



Source: Goldman Sachs Research estimates.

Cost synergies could potentially reduce operating costs for Ranbaxy

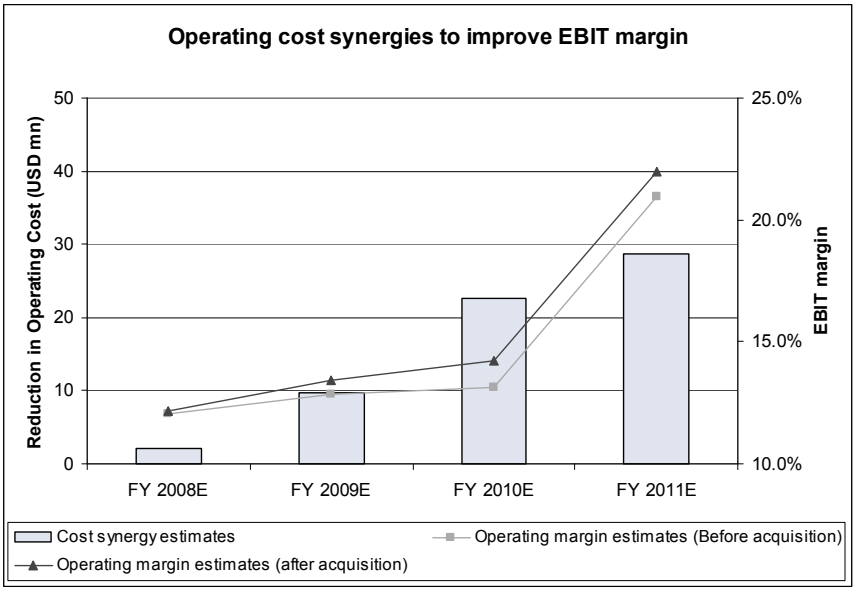
Generally, companies derive cost synergies and reduce operating costs in the range of 2%-8% following an acquisition and change in management control. In the case of Daiichi-Ranbaxy, we feel that the cost savings would be minimal due to the complementary nature of their business and hence would be in the lower end of that range.

With their combined presence in 11 countries currently (see Exhibit 4), we believe Ranbaxy could reduce part of its operating costs and improve its EBIT margin. We believe that these cost synergies would arise from:

- infrastructure integration for marketing and distribution;
- management integration;
- leveraging Daiichi's operational; and
- less likely, elimination of duplication of manufacturing facilities in 4 countries.

We estimate the above could curb operating costs by around US$10 mn in CY2009E to US$29 mn by CY2011E. This would imply a reduction in operating costs from 0.5% in CY2009E to 1.2% in CY2011E based on our current estimates, and a consequent rise in EBIT margin from 57 bps to 105 bps (please refer to Exhibit 9).

Exhibit 9: Operating costs synergies can potentially increase EBIT by 5% by CY2011E, in our view
EBIT margin improvements in the range of 57bps for CY2008E to 105bps by CY2010E



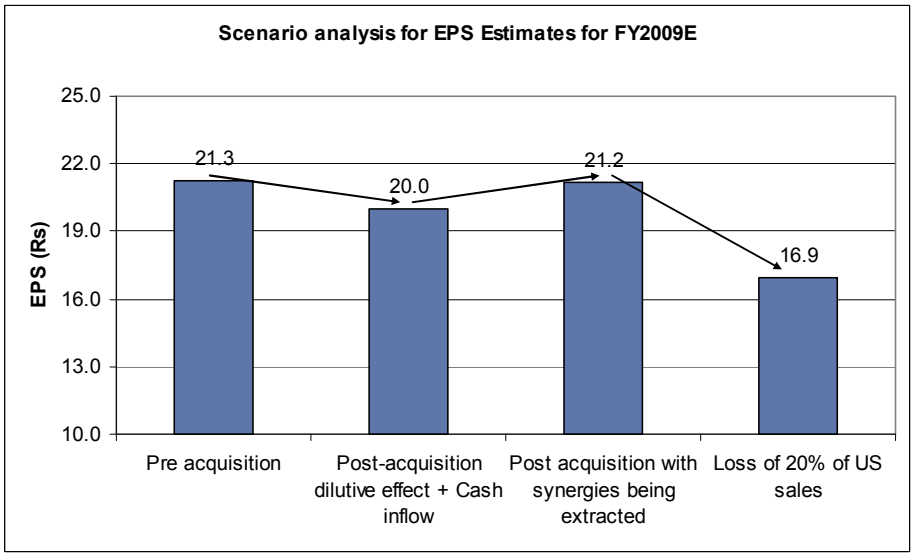
Source: Goldman Sachs Research estimates.

Impact of synergies on EPS and comparative earnings multiples

Assuming cost synergies being extracted, we estimate the FY2009E EPS to be around 21.2X, thus partially offsetting the earnings loss due to equity dilution. This implies a PE multiple of 21.6X which is at a premium of 37% to the sector's FY2010E PE of 15.7X.

We believe that this premium could be justified due to the certainty of revenues that Ranbaxy has lined up with the authorized generics and distribution settlements on Nexium and Lipitor, which ensure a steady revenue stream from 2008E till 2014E

Exhibit 10: Earnings loss due to equity dilution could potentially be offset by synergies extracted, if any, from the acquisition



Source: Goldman Sachs Research estimates.

Overhang of FDA investigation into manufacturing

Exhibit 11 gives a brief chronology of the key events leading up to the latest investigations by the FDA into alleged "systematic fraudulent conduct" at Ranbaxy.

Exhibit 11: Chronology of events leading to FDA allegations of "systematic fraudulent practices"
Sequence of events leading up to the investigation of allegedly fraudulent malpractices

1994	Ranbaxy's US subsidiary, Ranbaxy Pharmaceuticals, established operations in the country in 1994
1998	Ranbaxy begins marketing abbreviated new drug application (ANDA) approved generic products following FDA approval of cefaclor
2004	Ranbaxy learns of issues related to bio-equivalence data provided to the company and other drug firms by an outside contractor VIMTA Laboratories and stops marketing these drugs. Ranbaxy conducts new bio-equivalence studies, which were accepted by WHO.
Nov-04	Ranbaxy begins maintaining documentations of operating conditions and settings used for analysis with relevant raw data.
Feb-06	As per Director of QA, Ranbaxy begins saving electronic data from Feb 2006
20-Feb-06	FDA conducts site inspection at Paonta Sahib; FDA raises questions related to dosage forms plant at Paonta Sahib; FDA froze all new drug applications from the Paonta Sahib plant and launched a criminal investigation, according to court records, that focused on whether Ranbaxy's conduct defrauded Medicaid and the AIDS Relief programs
	All ANDA filings, required for processing any application for American market approval, from Paonta Sahib plant of Ranbaxy remain blocked by USFDA since 2006. The company had re-rooted all its ANDA filings from other plants like OM Labs and its Dewas plant.
May-06	Ranbaxy appoints PAREXEL through its law firm to assist in legal matters, issues related to compliance, and pending ANDA applications
25-May-06	Ranbaxy replies to FDA observations, which FDA finds insufficient
15-Jun-06	FDA issues Warning Letter, stating significant deviations from 21 CFR 210, 211: (A) No proper documentation maintenance (B) No reason for disregarding data in SOPs © Inadequant written stability testing programme (D) Inadequately documented storage conditions (E) Inadequate resources in the QC unit
	the FDA issued Ranbaxy a warning letter that found "serious deviation" from the agency's standards that left medicines too weak, too potent or lacking the advertised shelf-life. Inspectors also noted odd color and markings on HIV/AIDS tablets purchased for distribution in Africa under the Bush administration's Emergency Plan for AIDS Relief.
	FDA inspection office recommends withholding approval for ANDAs and APIs manufactured at Paonta Sahib
1-Jan-07	Ranbaxy still awaits "re-approval" from the FDA after a team re-visits the Paonta Sahib facility
14-Feb-07	FDA raids Ranbaxy's US HQs - full-scale search by "criminal investigators" - searches Ranbaxy's US offices in Princeton and its production plant in New Brunswick
	Ranbaxy states that "The company is not aware of any wrongdoing. It is co-operating fully with the officials."
Sep-07	US government serves first subpoena to Ranbaxy, asking it to produce all documents related to any audit study
Nov-07	Ranbaxy voluntarily recalls 73 million doses of a generic version of the pain pill Neurontin; FDA confirms it is a Class III recall, implying that adverse consequences were unlikely in this case.
Dec-07	Ranbaxy seeks ANDA approval for Clarithromycin in the US; FDA seeks additional information
14-Jul-08	U.S. govt files suit in the Dist. Court of Maryland against Ranbaxy and Parexel alleging that the two systematically hid and falsified data related to an investigation of what the government deemed "substandard" drugs sold in the US
	The US Department of Justice begins investigation into whether Ranbaxy committed "contract fraud and submitted false claims to Federal health benefit programmes, fabricated bio-equivalence and stability data (necessary to prove efficacy of a drug) to support marketing applications filed with the US drug regulator for selling generic drugs in the US."
	FDA further states that APIs from unapproved sources were used by the company in its drugs querying its potency.
	Ranbaxy states that it has not filed ANDAs from the Paonta Sahib plant anymore.
24-Jul-08	Stupak and Ringell send letter to FDA querying approval of Ranbaxy's products for US markets - In their letter, they write that the FDA was aware of these allegations for 18 months but "did nothing to remove the suspect products...."
Jul-08	The Toansa facility continues to operate and is the second largest manufacturing facility of Ranbaxy; Parexel's audit of this facility has also been subpoenaed.

Source: Compiled by Goldman Sachs Research from various sources such as FDA, DoJ committee's letter to FDA, Economic Times, Ranbaxy's website etc.

We have limited visibility over the veracity of the FDA's allegations, or Ranbaxy's assertion of their compliance with regulatory standards. We have set out a range of potential scenarios for Ranbaxy.

Probable outcomes

- **Issues resolved:** There would be no change to our earnings in the event that Ranbaxy addresses the FDA's concerns and the charge of misconduct is found to be invalid. Under this scenario, we think investors could consider Ranbaxy's 45% premium (under the base case of scenario one) to the sector as justified due to is superior growth and the visibility of its earnings (as a function of its FTF pipeline and multiple settlements).
- **Reduction in ANDA approvals till a resolution is reached:** A second scenario could see a reduction to ANDA approvals by the FDA till a decision has been reached on the subject of misconduct. This may not have anything to do with the merit of Ranbaxy's applications, but could be influenced by a risk averse FDA (which is being investigated by the US Dept. of Justice; Committee chaired by Dingell and Stupak).
- **Negative outcome for Ranbaxy in the US:** If the FDA were to make their case against Ranbaxy, it raises the prospect of penalties being imposed on the company. We have no visibility on the materiality of potential fines.
- **Spillover into other geographies:** A serious, negative outcome by the US FDA raises the possibility of increased scrutiny by other regulatory agencies. This could amplify implications for Ranbaxy (beyond the 23% of revenues that it obtains from the US, in our view).

Scenario assuming modest interruption to US sales (5% of group sales for one year)

In order to gauge the possible impact of a negative outcome for Ranbaxy, we have assessed the loss to earnings if Ranbaxy were to experience a transient disruption to its US business. With this in mind, we have assumed a 5% lower group sales for FY2009E, with no aftereffects in FY 2010E and onwards.

Under this relatively benign scenario, we estimate that Ranbaxy would deliver an EPS of Rs16.9 for FY2009E. This would put the stock on a one-year forward P/E of 27X, which is at a 72% premium to the sector.

Reiterate Sell as stock trades expensively, even on best-case scenario

We find that our scenario analysis suggests that the stock is priced to perfection even with the best-case scenarios and with not much upside. However, we believe potential downside risks exist and are significant. We reiterate our Sell rating with a revised 12-month target price of Rs381, with further risks to the downside if Ranbaxy were to run afoul of US regulators.

Reg AC

We, Vikram Sahu and Balaji V. Prasad, hereby certify that all of the views expressed in this report accurately reflect our personal views about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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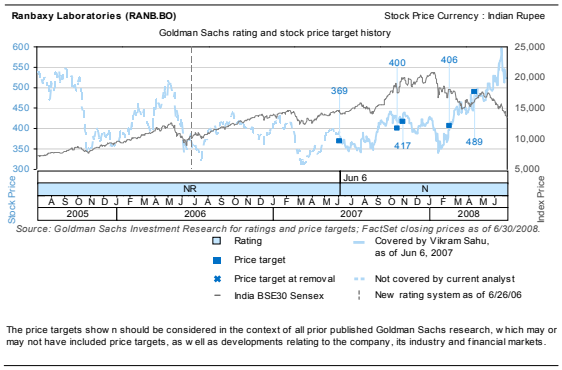
Price target and rating history chart(s)



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