

RANBAXY LABORATORIES

INR 417

Steady performance

BUY



Ranbaxy Laboratories' (Ranbaxy) Q3CY07 results were in line with our expectations, with Y-o-Y operating income growth of 10.2% and net profit growth of 47.7%. The net profit was boosted by other income (including forex gain) of INR 543 mn and extraordinary gain of INR 223 mn from sale of land. Adjusting for this other income, the profit would have been INR 1,441 mn (in line with our expectations). The company has maintained its guidance of 20% topline growth in dollar terms (including small acquisitions) and that of 16% EBITDA margin. Ranbaxy also recorded other operating income of INR 1,316 mn which included ~ INR 731 mn from forex hedge. EBITDA margin for the quarter at 16% was higher due to higher other operating income. The revenue growth for Ranbaxy was slightly disappointing. An appreciating rupee had a negative impact on the company's operating performance.

Ranbaxy has also announced that it will be hiving off its Drug Discovery Research business; this will result in cost reduction of ~ USD 20-25 mn per year. We believe this is a significant positive development for the stock and it will help unlock value in the company's R&D pipeline. The management also guided that by January 2008 it will announce monetization of a Para IV opportunity for CY08. The company already has one time Para IV opportunity, each for CY09 and CY10, in Valtrex and Liptor. We believe these announcements will significantly help the stock's price movement in the near future. Though the operating level performance for the quarter was disappointing, we believe there is still upside in the stock.

At CMP of 417, the stock trades at 21.2x CY08E earnings. In addition, we have valued the Lipitor and Valtrex opportunity at INR 58. We maintain our 'BUY' recommendation.

* US generics: Strong growth in base business

Ranbaxy's US sales stood at USD 102 mn, a 7% Y-o-Y growth. The base business grew at ~35%, excluding sales of FTF products; it was further boosted by the addition of the recently acquired dermatology products of BMS.

Ranbaxy received 10 ANDA approvals in the quarter which included nine final approvals and one tentative approval including Hydrocodone Bitartrate and Acetaminophen tablets, Metformin tablets, Hydrochlorothiazide tablets, Amlodopine Besylate tablets, Carvedilol tablets, and Clarithromycin for oral suspension.

The company has filed 20 FTF Para IV which have a branded market size of ~ USD 26 bn. We do not expect any of these FTF opportunities to materialize in CY07. We expect the company to announce the CY08 FTF opportunity in January 2008.

Financials

Year to December	Q3CY07	Q3CY06	Growth (%)	Q2CY07	% change	CY07E	CY08E
Revenues (INR mn)	17,730	16,087	(9.3)	16,853	(4.5)	66,932	74,794
EBITDA (INR mn)	2,831	2,471	(12.7)	2,265	9.1	8,642	11,739
Net profit (INR mn)	2,074	1,404	(32.3)	2,635	(46.7)	6,805	7,866
EPS (INR)	5.2	3.8	(27.5)	6.6	(42.9)	17.1	19.7
P/E (x)						24.5	21.2
EV/EBITDA (x)						20.9	15.0

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Reuters : RANB.BO
Bloomberg : RBXY.IN

Market Data

52-week range (INR) : 459 / 306
Share in issue (mn) : 372.9
M cap (INR bn/USD mn) : 155.5 / 3,912.5
Avg. Daily Vol. BSE/NSE ('000) : 1,508.7

Share Holding Pattern (%)

Promoters : 34.8
MFs, Fls & Banks : 23.6
Fls : 14.9
Others : 26.7

Going forward, we believe, growth in Ranbaxy's US business is likely to be flat since in CY06 Ranbaxy had exclusivity revenues from Simvastatin and to add to this higher base, product approvals in CY07E are also expected to be muted on account of delay in facility approval at Paonta Sahib.

Table 1: Revenues break up (INR mn)

	Q3CY07	Q3CY06	Growth (%)	Q2CY07	Growth (%)
Dosage forms	15,387	15,256	0.9	15,256	0.9
India & Middle East	3,938	3,849	2.3	3,824	3.0
Europe (Incl Romania)	3,167	3,385	(6.4)	3,536	55.0
CIS, Russia	934	974	(4.1)	740	
Africa	1,380	927	48.8	1,275	
Rest of Asia Pacific	812	927	(12.4)	946	(14.1)
Latam	731	603	21.2	740	(1.3)
North America	4,425	4,591	(3.6)	4,194	5.5
APIs	1,056	1,206	(12.4)	1,028	2.7
Total revenues	16,443	16,461	(0.1)	16,284	1.0

Source: Company, Edelweiss research

* **Europe: Romania may become a cause of concern**

Europe registered sales of USD 78 mn, an 8% Y-o-Y growth. In the quarter, European revenues included USD 23 mn from Romania (majority from Terapia) which was not a part of Ranbaxy in 3QCY06. Uncertainty over the pricing and re-imburement policy in Romania had a negative impact and more clarity on the issues is expected by November. The key UK market had revenues of USD 11 mn, growth of 16%, driven by improved sales in the existing product basket and new product introductions. In the German market, the company recorded revenue of USD 11 mn; strong sales from the products listed with AOK—the largest insurance provider—resulted in 53% growth in revenues on a Y-o-Y basis.

* **India and other markets: Slower growth in India**

Indian formulations business recorded revenues of USD 81 mn (Y-o-Y growth of 15%). Though growth in the quarter was lower, we believe Ranbaxy is likely to continue to maintain this run rate in Indian formulations going forward and have estimated growth of 15% for Ranbaxy's domestic formulations business in CY07E and CY08E.

The CIS markets, for the first nine months period, had an impressive growth rate of 27% with revenues of USD 59 mn. Revenues from Africa increased by 23% to USD 34 mn and those from Latin American markets were at USD 18 mn, a growth rate of 34%. We expect this momentum to continue going forward.

* **R&D de-merger: Will result in cost savings of USD 20-25 mn**

Ranbaxy's board of directors in principle approved the de-merger of the Drug Discovery Research arm into a separate company which will result in an USD 20-25 mn cost reduction in R&D from CY08 post de-merger. Ranbaxy plans to retain the 'Novel Drug Delivery System' (NDDS) set-up under its fold. The R&D expenditure for this arm is significantly lesser than for innovative R&D. We believe retention of the NDDS arm is a strategically sound move as it will allow Ranbaxy to monetize numerous opportunities in oncology, pain management, and dermatology. The specifics of the demerger will be clear by the end of the year.

* **Financials: 'Other income' and extraordinary items boost net profit**

The company had a significant other income (including forex gain) in the quarter of INR 543 mn and extraordinary gains through sale of land. Adjusted for other income, net profit stood INR 1,441 mn. EBITDA margins increased by 60bps on a Y-o-Y basis to 16%. The other operating income also had treasury gains of ~ INR 720 mn, which was responsible for boosting net profits.

* **Outlook and valuations: Significant triggers exist; maintain 'BUY'**

We believe developments in Romania and lower growth rate in Indian markets are a cause for concern, especially since these are the most profitable markets for Ranbaxy. We believe the growth in Indian markets will be on track from next quarter onwards as the higher base in 3Q06 was primarily the reason for the flat growth. We are more concerned about the Romanian market, though the management has indicated that growth will be back on track as some of the issues in Romania have been sorted out.

We are enthused about the management's guidance that another announcement of monetizing of a Para IV opportunity for CY08 would be made by January 2008. In addition, the demerger of R&D unit will also reduce costs for Ranbaxy and will help unlock significant value.

At CMP 419 the stock trades at 21.2x on CY08E earnings. We have used the sum-of-the-parts (SOTP) methodology to value the business with base business valued at INR 407 and the Lipitor and Valtrex opportunities at INR 58 per share. We believe at these levels there is limited downside to the stock price and additional announcements of another Para IV opportunity for 2008 and reduction in R&D costs after the hive off will provide significant triggers for the stock. We maintain our **'BUY'** recommendation.

Financial snapshot							(INR mn)	
Year to December	Q3CY07	Q3CY06	Y-o-Y Growth (%)	Q2CY07	Q-o-Q Growth (%)	CY07E	CY08E	
Total operating income	17,730	16,087	10.2	16,853	5.2	66,932	74,794	
Gross sales	16,520	16,404	0.7	16,238	1.7	66,932	74,794	
Less: Excise duty	106	133	(20.3)	128	(17.2)	-	-	
Net sales	16,414	16,271	0.9	16,110	1.9	63,806	71,667	
Other operating income	1,316	(184)	(815.2)	743	77.1	3,127	3,127	
Total expenses	14,899	13,616	9.4	14,588	2.1	58,290	63,055	
Cost of goods sold	8,702	7,682	13.3	9,009	(3.4)	32,964	36,462	
Raw mat. cost (incl. adj. to stock)	8,702	7,682	13.3	9,009	(3.4)	32,964	36,462	
Gross profit	9,028	8,405	7.4	7,844	15.1	33,968	38,332	
Other expenses	6,197	5,934	4.4	5,579	11.1	25,326	26,593	
R&D	1,106	1,098	0.7	937	18.0	3,681	3,865	
Selling, admin and general exp.	5,091	4,836	5.3	4,642	9.7	12,134	12,740	
EBITDA	2,831	2,471	14.6	2,265	25.0	8,642	11,739	
Other income	543	106	412.3	2,051	(73.5)	2,622	1,010	
PBDIT	3,374	2,577	30.9	4,316	(21.8)	11,264	12,749	
Depreciation	613	496	23.6	565	8.5	1,915	1,945	
Interest	394	299	31.8	351	12.3	1,059	909	
PBT	2,367	1,782	32.8	3,400	(30.4)	8,290	9,895	
Extra ordinary items	(223)	-	-	-	-	(223)	-	
Tax (including deferred tax)	516	378	36.5	738	(30.1)	1,658	1,979	
PAT	2,074	1,404	47.7	2,662	(22.1)	6,855	7,916	
Minority interest	-	-	-	27	(100.0)	50	50	
Net profit	2,074	1,404	47.7	2,635	(21.3)	6,805	7,866	
Equity capital (FV INR 5)	1,862	1,862	-	1,862	-	1,995	1,995	
Dividend	-	-	-	-	-	2,729	2,729	
Dividend per share (INR)	-	-	-	-	-	6	6	
Number of shares (mn)	399	372	-	399	-	399	399	
EPS (INR)	5.2	3.8	(27.5)	6.6	-	17.1	19.7	
P/E (x)	-	-	-	-	-	24.5x	21.2x	
EV/EBITDA (x)	-	-	-	-	-	21.1x	15.1x	
M. cap/Revenues (x)	-	-	-	-	-	2.5x	2.3x	
as % of net revenues								
Other expenses	37.5	36.2	-	34.4	-	37.8	35.6	
Other income	3.3	0.6	-	12.6	-	3.9	1.4	
Total expenses	90.2	83.0	-	89.8	-	87.1	84.3	
Depreciation	3.7	3.0	-	3.5	-	2.9	2.6	
Gross profit	54.6	51.2	-	48.3	-	50.8	51.3	
EBITDA	16.0	15.4	-	13.4	-	12.9	15.7	
Net profit	12.6	8.6	-	16.4	-	10.7	11.0	
Tax rate	21.8	21.2	-	21.7	-	20.0	20.0	

Company Description

Ranbaxy is the largest player in the domestic market with a market share of more than ~4.7%. Exports contribute about 79% to total revenues. The US generics market is the key market for the company which contributes about 29%. It has pursued inorganic growth opportunities in the past year when it acquired seven different companies. It has presence in several developed as well as developing markets.

Investment Theme

We believe that Ranbaxy will have steady growth in the coming quarters because: (1) increased contribution of the branded generic segment to total revenues; (2) steady ~15% growth in India; and (3) one-time positive upsides from Valtrex and Lipitor.

Key Risks

Positive developments in some of the Para IV opportunities that are not available in the public domain could provide some upside to the stock.

A significantly big acquisition could give short term spurt to the company.

Price cut in the domestic market on account of a new pharma policy.

Financial Statements

Income statement					(INR mn)
Year to December	CY04	CY05	CY06	CY07E	CY08E
Income from operations	54,321	52,816	61,434	66,932	74,794
Total operating expenses	44,507	49,705	52,609	58,290	63,055
Materials cost	19,090	22,213	23,733	32,964	36,462
Employee cost	6,382	6,786	7,955	8,035	8,437
R&D cost	3,376	4,925	3,955	3,681	3,865
Other expenses	15,659	15,781	16,966	13,610	14,291
EBITDA	9,814	3,111	8,825	8,642	11,739
Depreciation and amortisation	1,215	1,445	1,843	1,915	1,945
Interest	335	671	1,036	1,059	909
Other income	1,000	616	564	2,622	1,010
Extraordinary items [exp./gain]	372	(333)	-	(223)	-
Profit before tax	8,892	1,945	6,510	8,513	9,895
Provision for tax	1,881	(698)	1,357	1,658	1,979
PAT(inc. exce. & pre minority int.)	7,011	2,642	5,153	6,855	7,916
Minority interest & others	26	25	50	50	50
PAT (inc. exc.) for equity shre.hdrs.	6,985	2,617	5,103	6,805	7,866
Shares outstanding (mn)	372	372	373	399	399
Dividend per share (INR)	6.0	6.0	6.0	6.0	6.0
Dividend payout (%)	32.0	85.4	43.8	35.2	30.4

Common size metrics- as % of net revenues

Year to December	CY04	CY05	CY06	CY07E	CY08E
Material cost	35.1	42.1	38.6	49.3	48.8
Employee cost	11.7	12.8	12.9	12.0	11.3
Other expenses	28.8	29.9	27.6	20.3	19.1
Depreciation	2.2	2.7	3.0	2.9	2.6
Interest expenditure	0.6	1.3	1.7	1.6	1.2
EBIDTA margins	18.1	5.9	14.4	12.9	15.7
Net profit margins	12.9	5.0	8.3	10.2	10.5

Growth metrics (%)

Year to December	CY04	CY05	CY06	CY07E	CY08E
Revenues (%)	12.6	(2.8)	16.3	8.9	11.7
EBITDA (%)	(8.9)	(68.3)	183.7	(2.1)	35.8
Net profit (%)	(7.9)	(62.5)	95.0	33.3	15.6
EPS (%)	(8.1)	(62.6)	94.9	24.6	15.6

Cash flow statement

Cash flow statement					(INR mn)
Year to December	CY04	CY05	CY06	CY07E	CY08E
Cash flow from operations	8,220	2,892	6,443	9,021	10,132
Cash for working capital	959	(951)	(3,712)	(2,519)	(2,379)
Net operating cash flow	9,180	1,940	2,731	6,502	7,753
Net purchase of fixed assets	(5,258)	(7,770)	(1,500)	(500)	(500)
Net purchase of investments	(3,115)	(540)	(18,231)	-	-
Net cash flow from investing	(8,373)	(8,310)	(19,731)	(500)	(500)
Proceeds from equity capital	(3,390)	(3,491)	17,254	(2,549)	(2,729)
Proceeds from LTB/STB	2,343	10,951	(700)	(1,700)	(2,500)
Net cash flow from financing	(1,047)	7,460	16,554	(4,249)	(5,229)
Free cash flow	806	(6,370)	(17,000)	6,002	7,253

Balance sheet					(INR mn)
As on 31st December	CY04	CY05	CY06	CY07E	CY08E
Shareholders funds	25,077	24,467	46,822	50,898	56,035
Capital	1,859	1,862	2,002	2,002	2,002
Reserves & surplus	23,218	22,605	44,821	48,896	54,033
Borrowings	8,527	20,043	19,343	17,643	15,143
Secured loans	3,839	6,079	5,879	5,379	4,879
Unsecured loans	4,688	13,964	13,464	12,264	10,264
Deferred tax liability (net)	842	(49)	800	800	800
Minority interest	180	166	166	166	166
Other term liabilities	28	3	3	3	3
Sources of funds	34,655	44,629	67,134	69,509	72,146
Gross block	23,132	29,920	31,420	31,920	32,420
Depreciation	7,838	9,329	11,172	13,087	15,032
Net block	15,294	20,591	20,249	18,833	17,388
Capital work in progress	2,876	5,595	5,595	5,595	5,595
Investments	184	172	19,252	19,252	19,252
Inventories	14,351	13,624	14,305	19,869	21,977
Sundry debtors	11,357	11,404	15,148	16,504	18,442
Cash and bank balances	1,339	2,430	1,984	3,737	5,760
Loans and advances	7,579	4,571	4,571	4,571	4,571
Other current assets	844	1,250	1,250	1,250	1,250
Total current assets	35,470	33,279	37,258	45,931	52,001
Current liabilities	12,693	10,600	11,314	15,714	17,382
Provisions	6,475	4,408	3,906	4,387	4,708
Total current liab. and prov.	19,168	15,008	15,220	20,102	22,090
Net current assets	16,302	18,271	22,038	25,829	29,911
Uses of funds	34,655	44,629	67,134	69,510	72,146
Book value per share (INR)	67	66	126	128	140

Ratios

Year to December	CY04	CY05	CY06	CY07E	CY08E
ROE (%)	27.9	10.7	10.9	13.4	14.0
ROCE (%)	26.6	5.9	11.2	13.8	15.0
Inventory days	274	224	220	220	220
Debtors days	76	79	90	90	90
Fixed assets T/o (x)	2.3	1.8	2.0	2.1	2.3
Debt/equity	0.3	0.8	0.4	0.3	0.3

Valuation parameters

Year to December	CY04	CY05	CY06	CY07E	CY08E
EPS, post exceptionals (INR.)	18.8	7.0	13.7	17.1	19.7
Y-o-Y growth (%)	(8.1)	(62.6)	94.9	24.6	15.6
CEPS (INR)	22.1	10.9	18.6	21.9	24.6
P/E (x)	20.8	55.5	30.8	24.7	21.4
Price/BV (x)	5.8	5.9	3.4	3.3	3.0
EV/Sales (x)	2.8	3.1	2.8	2.7	2.4
EV/EBITDA (x)	15.5	52.3	19.8	21.1	15.1

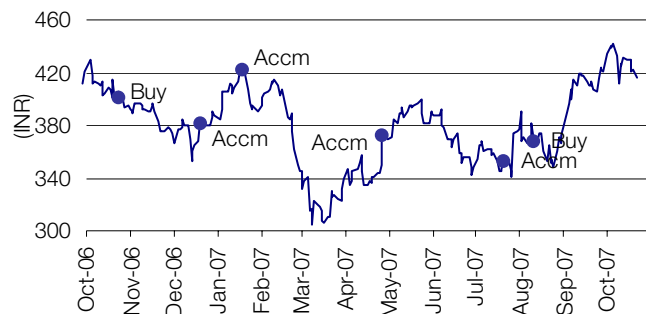
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Coverage group(s) of stocks by primary analyst(s): Pharmaceuticals:

Aurobindo Pharma, Cadila Healthcare, Cipla, Dishman Pharmaceuticals and Chemicals, Dr.Reddy's Laboratories, Glaxosmithkline Pharmaceuticals, Glenmark, Ipca Laboratories, Jubilant Organosys, Lupin, Nicholas Piramal India, Ranbaxy Laboratories, Sun Pharmaceuticals Industries, Torrent Pharmaceuticals and United Phosphorus.

Ranbaxy Laboratories



Recent Research

Date	Company	Title	Price (INR)	Recos
18-Oct-07	Jubilant Organosys	On course; Result Update	304	Buy
11-Oct-07	Pharma	Fact Sheet		
17-Sep-07	Pharma	Fact Sheet		
03-Sep-07	Nicholas Piramal	Unlocking value...; Event Update	288	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	101	44	24	6	183

* 6 stocks under review / 2 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	86	66	31

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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