Ranbaxy Laboratories

Buy

CMP: Rs348

Target Price: Rs475 (12 Months)

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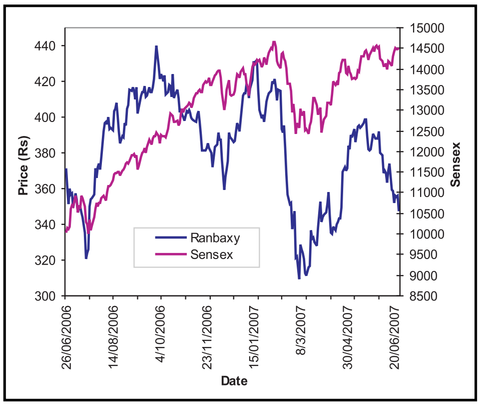
Stock Info

Sector	Pharmaceutical
Market Cap (Rs cr)	12,962
Beta	0.68
52 Week High / Low	445/306
Avg Daily Volume	340585
Face Value (Rs)	5
BSE Sensex	14,501
Nifty	4,286
BSE Code	500359
NSE Code	RANBAXY
Reuters Code	RANB.BO
Bloomberg Code	RBXY@IN

Shareholding Pattern (%)

Promoters	34.9
MF / Banks / Indian FIs	20.2
FII / NRIs / OCBs	24.0
Indian Public / Others	21.0



Investment Highlights

- **US - Robust product pipeline:** The US, which constitutes the single largest market for Ranbaxy, is expected to register a CAGR of 15.5% over CY2006-08E. Ranbaxy currently has a robust product pipeline (second largest) with 88 ANDAs pending approvals, of which the company has 20 FTF Para-IV opportunities. Overall, these products have an addressable market of $56bn and $25bn, respectively. The company expects to launch at least one Para-IV each year.
- **Non-US regions to aid 20% growth in Sales:** Management has guided towards a 20% ($ terms) growth in CY2007. We expect, Ranbaxy to post a CAGR of 18.9% ($ terms) over CY2006-08E. Growth would be mainly aided by the non-US regions like Europe and Africa, which are expected to clock growth of 43.6% and 22.3%, respectively. Overall contribution of the European, CIS and African regions would increase to 35% in CY2009 from 27% in CY2006.
- **Improvement on Operating front to continue:** In CY2005, the company hit its nadir in terms of operating performance with its core margins declining to a low of 2.6%. During CY2006, significant cost containment measures aided the company to improve its operating performance. Going into CY2007-08, improvement on the operating front is likely to continue. Overall, we expect Ranbaxy to end the year with operating margins of 15.2%, an improvement of 263bp. Improvement on the operating front would aid the company's Net Profit outpace sales growth at a CAGR of 27.4% over CY2006-08E.

Valuation

At the CMP, the stock trades at 22.3 x CY2007E and 16.8x CY2008E (excluding any upside from inorganic growth and major FTF product launches in CY2008) earnings. **We maintain a Buy on the stock. However, on account of pruning our Earnings estimate factoring in Rupee appreciation, we are downgrading our Target Price to Rs475.**

Key Financials (Consolidated)

Y/E December (Rs cr)	CY2005	CY2006	CY2007E	CY2008E
Net Sales	**5,099.1**	**6,012.6**	**6,543.3**	**7,861.2**
% chg	*(2.6)*	*17.9*	*8.8*	*20.1*
Net Profit	**261.7**	**510.9**	**623.8**	**829.8**
% chg	*(62.6)*	*95.2*	*22.1*	*33.0*
EPS (Rs)	**7.0**	**13.7**	**15.6**	**20.8**
EBITDA Margin (%)	2.6	12.6	14.3	15.2
P/E (x)	49.4	25.4	22.3	16.8
P/CEPS (x)	31.4	18.5	16.3	13.0
RoE (%)	10.5	19.5	21.0	24.3
RoCE (%)	7.0	13.8	16.1	18.4
P/BV (x)	5.2	4.9	4.3	3.8
EV/Sales (x)	2.9	2.8	2.5	2.1
EV/EBITDA (x)	57.4	19.1	15.5	12.4

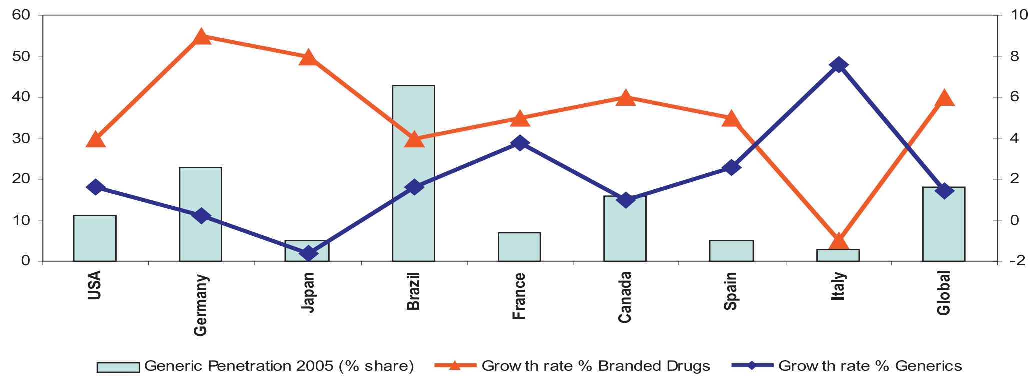
Source: Company, Angel Research

Global Generic Industry – In consolidation Mode

Over the last few years, the generics market has been able to outpace overall growth of the branded pharmaceutical industry on the back of a large number of patent expiries and more countries encouraging generics to aid cost containment measures. At $77bn, the generic market registered a growth of 10% in 2006. This is higher than the 8% growth registered by the overall $550bn branded pharmaceutical industry.

Going ahead too, the generic segment is expected to continue to grow at higher rates aided by more blockbuster products going off patents. Over the next five years, drugs worth $10bn are likely to go off patents thereby making way for generic competition. According to IMS estimates, overall generic industry is expected to grow at 15% to touch $124bn in size by 2011 vis-à-vis the 9% growth expected to be posted by the branded pharmaceutical segment. Majority or 60% of the contribution is expected to come from the RoW and the US markets whereas the European and Asian markets would contribute the balance 40%.

Exhibit 1: Generic Penetration and growth in Key Markets



Source: Sandoz

While growth continues to be robust, high competitive pressures in the industry has seen CY2006 to be a year of consolidation. The current pace of consolidation has been primarily focused on the US markets and the Top-5 generic players control 39.4% of the market. Going ahead, the M&A activity is likely to continue but action could be more in the European markets where the generic penetration continues to be lower than the other regions.

Exhibit 2: M&A Activity in the Generics space

Acquirer	Target	Region	EV/EBDITA (x)	EV/Sales (x)
Teva	Ivax	Florida	32.1	4.3
Mylan	Matrix	India	19.6	5.0
Ranbaxy	Terepia	Romania	12.0	4.2
Watson	Andrx	USA	21.7	1.7
DRL	Beta	Germany	12.6	2.9
Ranbaxy	Be Tab	South Africa	7.7	2.2
Mylan	Merck	Germany	21.1	2.7

Source: Angel Research; Note: Valuations are calculated on cost at which the transactions were carried out

Investment Argument

Robust growth in key markets to aid 20% growth over CY2006-08

US Markets: A robust pipeline

Intensifying pricing pressures on the back of competition in the US markets has slowed the growth momentum of the company in the US markets in the last three years. Ranbaxy's US sales during the period declined by 4.2% while it registered a CAGR of 60% in the five years ending CY2004. Going ahead however, Ranbaxy is looking at new product introductions and niche product opportunities through FTF Para IV filings to drive growth in the region. Overall, the company has 88 pending approvals, having an addressable market of $56bn and well-balanced mix of plain vanilla generics, niche and potential first-to-file (FTF) opportunities. Ranbaxy's product pipeline in the US market is second largest after Teva. Amongst these, the company has around FTFs on around 20 Para IV ANDA filings. These Para-IV filings address a market opportunity in excess of $25bn. The company expects 10-12 product launches and a Para-IV product launch in the US markets every year. Thus, while pricing pressure in the US markets continues, Para-IV launches are expected to mitigate the same to some extent. We expect the company to post a CAGR of 15.5% during CY2006-08E in the region mainly aided by new product launches. We expect growth to further accelerate, if the company's Ponta-Sahib facility gets the much awaited USFDA nod.

In terms of Para-IV opportunity, currently we have factored in only upsides from *Pravastatin* (80mg). The product has an addressable market of $209mn. During the 180-day exclusivity period, we expect the company to gross sales of $30mn. Another near term opportunity for the company is *Valtrex*. A $973bn opportunity, the company has got the FTF status on the product. The product has already received USFDA approval and is eligible for 180-day exclusivity. The company is expected to launch the product post trial of the case in August 2007. The product could be commercialised by CY2008 and could gross sales of around $120mn during the 180-day exclusivity period and provide an upside of around 18% to Ranbaxy's CY2008E earnings. Currently, we have not factored in any upsides from the product in our estimates.

***Lipitor* opportunity to materialise through CY2007-10**

Atorvastain (*Lipitor*) currently sold by Pfizer is a $10bn drug globally with US accounting for a major chunk with sales of $8bn. Apart from US, Canada, Japan and the key European countries including UK, Spain, Germany and France provide a sizeable opportunity. In the US, the drug has patent expiries from CY2010-13. Ranbaxy has asserted non-infringement of the basic patent (US Patent No.4,681,893) expiring in 2010 and invalidity of the patent covering enantiomeric form of the drug (US Patent No.5,273,995), which expires in 2011. In 2003, Pfizer filed suits in the US District Court of the District of Delaware against Ranbaxy for infringement of basic product patent and the patent covering the active enantiomeric form of the drug.

In the much-awaited verdict, the US District Court of Delaware ruled against Ranbaxy in its case for non-infringement and invalidation of two Pfizer patents on *Atorvastatin*.The judge held that Ranbaxy's *Atorvastatin* infringes Pfizer's US Patent No.4,681,893 and also upheld validity of Pfizer's US Patent 5,273,995. Ranbaxy plans to go in appeal against the decision. The US company is in litigation in some other global markets too.

Exhibit 3: *Atorvastatin* litigation in other markets

Country	Market Size US$ Mn	Litigation status
Austria	27	The Austrian patent office has ruled in favour of Ranbaxy invalidating the company's Enantiomer patent covering Atorvastatin Calcium. Pfizer has appealed the decision.
Canada	68	The product has been launched in the market.
Finland	40	Court of Appeal in Finland granted a preliminary injunction against Ranbaxy, which prohibits the company from marketing a generic version of Lipitor. The ruling involves Pfizer's patent (FI94958) that covers processes and intermediate compounds used to make Atorvastatin, whose patent expires in 2009.
Australia	450	The Court upheld exclusivity of the basic patent (which expiries in May 2012), while the patent covering the calcium salt, which expires in September 2012 was ruled to be inavlied. Pfizer has decided to appeal the ruling.
Peru	-	The crystalline form of Atorvastatin patent was upheld and Ranbaxy was enjoined from selling the product.
Denmark	30	The company had launched the product, however, the court granted Preliminary injunction against the wholesaler.
Norway	45	Patent covering the process of manufacture of the intermediary compound (used for manufacturing the product) was found to be infringed. However, patents covering conversion of the crystalline form to amorphous form was held to be valid, but not infringed. Ranbaxy has appealed the decision.
Malaysia	29	Product launched in the market.
United Kingdom	450	The lower court affirmed the UK High Court ruling, in which the company was held to infringe the basic product patent, which expires in Nov 2011, whereas Pfizer's patent on the calcium salt was (patent expiry in July'10) ruled to be invalid.

Source: Company

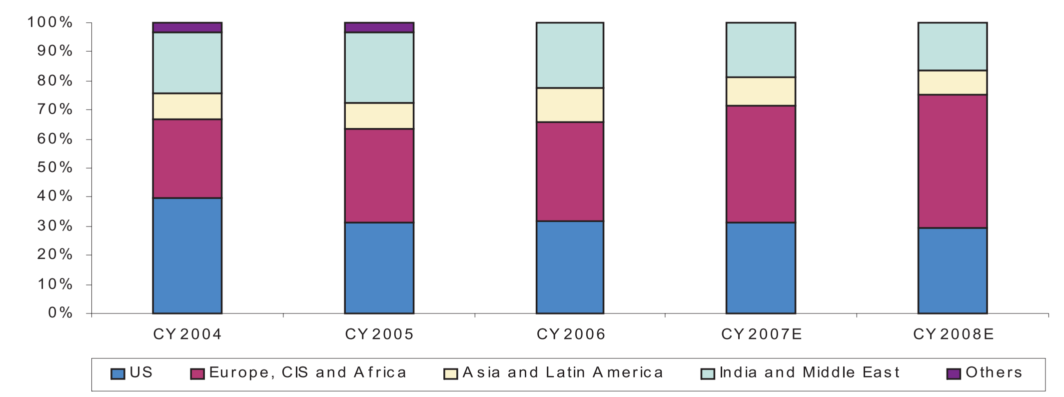
In recent decisions in ex-US geographies, Ranbaxy was held to have infringed the basic patents while the Enantiomeric patent was held to be invalid. The product would start contributing from CY2007 with the launch of the product in niche markets like Canada and Malaysia. During CY2008-09, the company can launch the product in other markets also. However, major upside from the product would accrue with the launch of the product in the US in CY2010. Currently, we have not factored in any upsides from the product in our estimates barring the markets where the company has already launched the product.

European, CIS and African Markets – Acquisitions to drive growth

Ranbaxy has been very active in the M&A space since the last one year. Overall, the company has spent around $450mn towards its M&A activities. The acquisitions were mainly funded through the FCCB proceeds of $440mn. However, unlike its peers who have concentrated on big-ticket size acquisitions especially in the US, Ranbaxy has been targeting companies in the niche markets of Italy, Romania and South Africa. Significant among these being Terapia of Romania. Terapia, with sales of around $80mn, was acquired by Ranbaxy for $324mn. Terapia has EBDITA margins in excess of 35%. Romania is the fastest growing market in the central eastern European region having an annual growth of around 34%.

We expect the European, CIS and African regions to register a CAGR of 36.8% over CY2006-08E mainly aided by the contribution from these acquisitions with Europe and Africa registering a growth of 22.3% and 43.6%, respectively. We estimate contribution of the region in the overall sales mix of the company to increase from 27% in CY2006 to 35% in CY2008. Further, higher contribution from the emerging markets is expected to improve overall profitability of the company.

Exhibit 4: Region-wise Sales mix



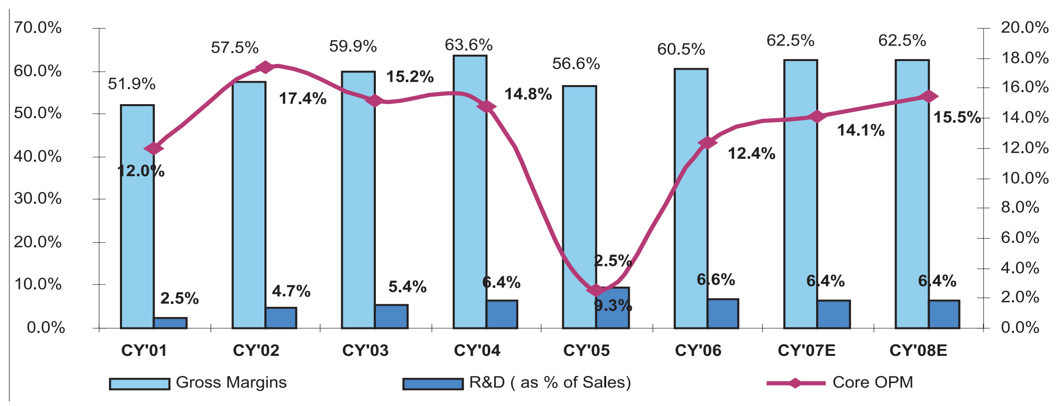
Source: Company, Angel Broking

Financial Performance - Profitability set to improve

Robust growth in ex-US geographies would aid the company to register a CAGR of 14.3% over CY2006-08E with the European, CIS and African regions expected to register a growth of 36% in the mentioned period. Further, higher contribution from the emerging markets would aid improvement on the operating front. We have factored in 263bp on the operating front. This improvement is expected to be on the back of an improvement in gross margins, lower R&D expenses and containment of other cost elements. Higher operating margins would aid the company to post a CAGR growth of 27.4% in Net Profits over CY2006-08E.

Along with expansion in operating margins, capex requirements are expected to reduce. It is expected to be a moderate $50-60mn from an average of $160mn spent by the company in the last three years. This is expected to improve the return ratios of the company. The RoE and RoCE of the company is expected to improve to 24.3% and 18.4% in CY2008 from 19.5% and 13.8% in CY2006, respectively.

Exhibit 5: Profitability trend



Source: Company, Angel Research

Research &Development – Upsides to accrue through CY2007

Ranbaxy expects its long-term growth to be driven by innovative drugs, which would be a combination of New Drug Delivery Systems' (NDDS) and New Chemical Entities' (NCE) products. The company's R&D revenue expenditure stood at 6.6% for CY2007 with more than 60% being accounted by Basic Research. On the NCE front, the company is mainly focused on infectious, metabolic, inflammatory and respiratory diseases and oncology segments.

Apart from its own pipeline, the company also has research alliances predominant being with GSK. Ranbaxy and GSK have expanded the original agreement and Ranbaxy now has the responsibility of advancing select compounds to 'proof of concept' in man, whereby the total milestone payments, excluding royalties, could exceed over US $100mn. Recently, the joint steering committee of the two companies approved a respiratory inflammation compound for further development through pre-clinical studies by Ranbaxy to support the application of an Investigational New Drug (IND). Ranbaxy will also be responsible for conducting Phase I and Phase II clinical studies through to 'proof of concept.' GSK will then have the option to conduct further development up to the final commercialisation stage. The company expects upsides from the same to accrue in CY2007, however, we have not factored in the same in our financials.

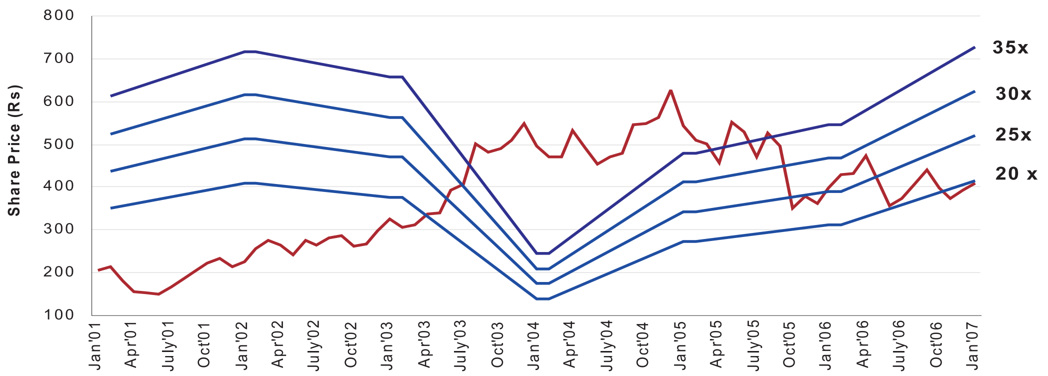
Concerns

- Ranbaxy would continue to look at M&As to enhance its presence in the global generic markets. The company has already utilised the funds raised from the FCCB. Hence, any sizeable acquisition would require further fund raising. The company has an enabling resolution to raise around $1.5bn through the equity route. Nevertheless, impact on earnings on account of equity dilution would be dependent on the profitability of the acquired company.

Outlook and Valuation

At the CMP, the stock trades at 22.3x CY2007E and 16.8x CY2008E (excluding any upsides from inorganic growth and major FTF product launches in CY2008) Earnings. At current valuations, the company trades at the lower end and at a significant discount to its historical valuations. With the operating performance of the company expected to be on improvement path coupled robust earnings growth of 27.4%, we expect the stock to be an Outperformer on the bourses. **We maintain a Buy on the stock. However, on account of pruning our Earnings estimate factoring in Rupee appreciation, we are downgrading our Target Price to Rs475.**

Exhibit 6: P/E Band



Source: Sandoz

Profit & Loss Statement (Consolidated) — Rs crore

Y/E December (Rs cr)	CY2005	CY2006	CY2007E	CY2008E
Net Sales	**5109.9**	**6012.6**	**6543.3**	**7861.2**
% chg	*(2.4)*	*17.7*	*8.8*	*20.1*
Total Expenditure	4927.5	5255.2	5604.9	6664.1
EBIDTA	**182.4**	**757.4**	**938.4**	**1197.1**
(% of Net Sales)	*3.6*	*12.6*	*14.3*	*15.2*
Other Income	232.5	182.1	177.9	190.2
Depreciation& Amortisation	150.2	184.3	222.9	230.7
Interest	66.2	103.6	107.4	113.1
PBT	**198.5**	**651.6**	**786.0**	**1043.6**
(% of Net Sales)	*3.9*	*10.8*	*12.0*	*13.3*
Extraordinary Expense/(Inc.)	(28.5)	0.0	0.0	0.0
Tax	(34.0)	135.7	157.2	208.7
(% of PBT)	*(17.1)*	*20.8*	*20.0*	*20.0*
PAT	**259.1**	**510.9**	**623.8**	**829.8**
% chg	*(63.0)*	*97.2*	*22.1*	*33.0*

Balance Sheet (Consolidated) — Rs crore

Y/E December (Rs cr)	CY2005	CY2006	CY2007E	CY2008E
SOURCES OF FUNDS				
Equity Share Capital	186.2	186.2	186.2	186.2
Reserves& Surplus	2,277.4	2,433.0	2,786.0	3,228.0
Shareholders Funds	**2,463.6**	**2,619.2**	**2,972.2**	**3,414.2**
Total Loans	2,004.3	3,955.6	3,971.3	4,072.8
Deffered Tax Liability	269.9	255.5	268.6	280.3
Total Liabilities	**4,738**	**6,830**	**7,212**	**7,767**
APPLICATION OF FUNDS				
Gross Block	2,992.0	5,117.4	5,667.9	5,918.0
Less: Acc. Depreciation	932.9	1,222.1	1,460.3	1,669.9
Net Block	**2,059.1**	**3,895.3**	**4,207.6**	**4,248.0**
Provision for written down value	-	-	-	-
Capital Work-in-Progress	559.5	358.1	46.9	46.9
Investments	**17.2**	**36.2**	**36.2**	**36.2**
Current Assets	3,327.9	4,110.2	4,674.2	5,580.8
Current liabilities	1,500.8	1,759.7	1,891.8	2,306.9
Net Current Assets	**1,827.1**	**2,350.6**	**2,782.4**	**3,273.9**
Deferred Tax Asset	274.8	190.0	139.1	162.4
Total Assets	**4,738**	**6,830**	**7,212**	**7,767**

Cash Flow Statement (Consolidated) — Rs crore

Y/E December (Rs cr)	CY2005	CY2006	CY2007E	CY2008E
Profit before tax	227.0	651.6	786.0	1,043.6
Depreciation	150.2	184.3	222.9	230.7
Change in Working Capital	88.0	471.3	212.5	412.4
Direct taxes paid	40.1	53.5	93.2	220.3
Cash Flow from Operations	**249.1**	**311.1**	**703.2**	**641.6**
Inc./ (Dec.) in Fixed Assets	950.7	1,923.9	239.3	250.1
Free Cash Flow	**(701.6)**	**(1,612.8)**	**463.9**	**391.5**
Inc./ (Dec.) in Investments	(1.2)	19.1	-	-
Issue of Equity	-	-	-	-
Inc./(Dec.) in loans	1,151.5	1,951.4	15.7	101.5
Dividend Paid (Incl. Tax)	316.7	316.9	249.5	331.9
Others	(7.0)	(49.5)	10.8	81.9
Cash Flow from Financing	**840.7**	**1,703.0**	**(244.6)**	**(312.4)**
Inc./(Dec.) in Cash	139.1	90.2	219.4	79.1
Opening Cash balances	133.9	243.0	295.1	514.5
Closing Cash balances	243.0	295.1	514.5	593.6

Key Ratios (Consolidated)

Y/E December (Rs cr)	CY2005	CY2006	CY2007E	CY2008E
Per Share Data (Rs)				
EPS	7.0	13.7	15.6	20.8
Cash EPS	11.0	18.7	21.2	26.5
DPS	2.5	8.5	6.7	8.9
Book Value	66.1	70.3	79.8	91.7
Operating Ratio (%)				
Raw Material / Sales (%)	43.4	39.5	37.5	38.0
Inventory (days)	96.2	96.5	98.6	98.6
Debtors (days)	80.5	94.1	92.5	92.5
Debt / Equity (x)	0.8	1.5	1.3	1.2
Returns %				
ROE	10.5	19.5	21.0	24.3
ROCE	7.0	13.8	16.1	18.4
Dividend Payout	35.9	62.0	42.9	42.9
Valuation Ratio (x)				
P/E	50.0	25.4	22.3	16.8
P/E (Cash EPS)	31.7	18.6	16.4	13.1
P/BV	5.3	4.9	4.4	3.8
EV / Sales	2.9	2.8	2.5	2.1
EV / EBITDA	57.4	19.1	15.5	12.4

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Commodities	:	e-mail : commodities@angeltrade.com	Tel : (022) 4000 3900 / 01
Brand Promotion & PR Helpdesk	:	e-mail : brandpromotion@angeltrade.com	Tel : (022) 4000 3600
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Regional Offices:

Ahmedabad - Harshit Bhavsar
101, Mahalay Complex, Opp. Hotel President
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Hyderabad - Shiva Shankar
Osman Plaza, 6-3-352, 3rd Floor
Rd No - 1, Banjara Hills, Hyderabad - 500 001
Tel: (040) 6673 3573 / 74

Kolkata - Vijay Kothari
Lords, 1st Floor, Suite No. 106 & 108
7/1, Lord Sinha Road, Kolkata - 700 071
Tel: (033) 4009 9899

Pune - Sunita Magnani
2nd Floor, Dealing Chambers Above Portico
Restaurant, J.M.Road, Pune - 411 005
Tel: (020) 2551 3143 / 2553 0912 - 14

Bangalore - Nandish Rao B.
No.92, Kedia Arcade,
Infantry Road, Bangalore - 560 001
Tel: (080) 4153 6700 - 03

Indore - Rohit Pateria
UG No. 16 - 19, Commerce House
7 - Race Course Road, Indore - 452 003
Tel: (0731) 3013 360 - 65

Nashik - Sagar Jadhav
10 - A Wing, 2nd Floor, Parshuram Apts
College Road, Opp. Times of India,
Nashik - 422 005. Tel: (0253) 6611 201 - 206

Rajkot - Vijay Popat
101, Race Course Plaza
Near Income Tax Office, Race Course Ring Rd
Rajkot - 360 001 Tel :(0281) 6451929 / 1910

Chennai - D. Loganathan
Gr. Floor, 45 TTK Road, Alwarpet
Chennai - 600 018
Tel: (044) 4226 9000 Fax: 2498 1742

Jaipur - Ranveer Singh
2/3, 1st Floor, Multi-Story Complex
1st M. I. Road, Opp. Amrapura Temple
Jaipur - 302 001 Tel: (0141) 222 3334

New Delhi - Anshit Khanna
Ugf 4, Kanchanjunga Bldg
18, Barakhamba Road, New-Delhi -110 001
Tel: (011) 4605 6600 / 4151 2555 / 2666

Surat - Pinky Kothari
202, Empire State Bldg
Ring Road, Surat - 395 002
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Private Client Group Offices:

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3rd Floor, Acme plaza, M. V. Rd., Opp.
Sangam Cinema, Andheri (E), Mumbai - 59.
Tel: (022) 4040 3800 Fax: (022) 4040 3899

Ahmedabad(C. G. Road) - Preyash Shah
5/6 Chandan Complex, Swastik Cross Road,
C. G. Road, Ahmedabad - 380 009.
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Surat - Ali Asgar Rasiwala
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Acme Plaza - Pankaj Mungre
712 - B, Acme Plaza, M. V. Road, Opp. Sangam
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Branch Offices:

Andheri (Lokhandwala) - Muskaan Doultani
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Andheri (W) - Dinesh Nihalani
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Bandra (W) - Anit Hake
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Bandra (W) - Faruq Wakani
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Borivali (W) - Gyan P. Joshi
Tel:(022) 2895 2600 / 1 / 2

Borivali (W) - Tarun Dhami
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Chembur - Rajesh Mehta
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Malad (W) - Tushar Shah
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Mulund (W) - Niraj Anand
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Santacruz (W) - Rakesh Vadodaria
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Thane (W) - Diksha Khushalani
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Vile Parle (W) - Manish Negandhi
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Ahmedabad (C. G. Road) - Ritesh Patel
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Ahmedabad (Gurukul) - Kaivalya Shah
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Ahmedabad (Maninagar) - Ashok Kumar
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Ahmedabad (Ramdevnagar) - Krunal Pandya
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Ahmedabad (Satellite) - Rishi Parghi
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Ankleshwar - Durgesh Singh
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Baroda (Akota) - Manisha Tandel
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Bhopal - Sandeep Kothana
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Mehsana - Bhavesh Patel
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Nadiad - Vipul Patel
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Nashik - Vikram Tidke
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New Delhi(Lawrence Rd.) - A. Gupta / S. Kumar
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New Delhi(Pitampura) - Rajiv Khanna
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New Delhi(Preet Vihar) - Ratik Arora
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Porbandar - Ketan Thanki
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Rajkot (Star Chambers) - Manish Baradia
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