INDIA RESEARCH

INITIATING COVERAGE

PHARMACEUTICALS

August 2011

ANTIQUE

Ranbaxy Laboratories Limited

Uncertainities galore

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Recommendation	:	SELL
CMP	:	INR455
Target Price	:	INR385
Potential Return	:	-15%

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Market data

Sector	:	Pharma
Market Cap (INRbn)	:	191
Market Cap (USDbn)	:	4
O/S Shares	:	422
Free Float (m)	:	120
52-wk HI/LO (INR)	:	625/414
Avg Daily Vol ('000)	:	553
Bloomberg	:	RBXY IN
Reuters	:	RANB.BO

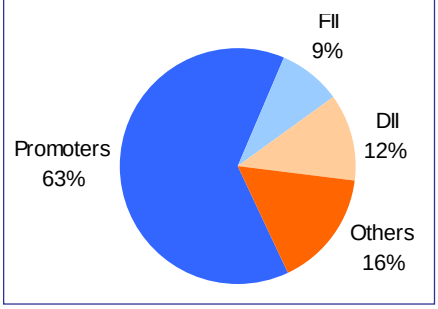
Source: Bloomberg

Returns (%)

	1m	3m	6m	12m
Absolute	(16)	(11)	4	(5)
Relative	(3)	2	17	7

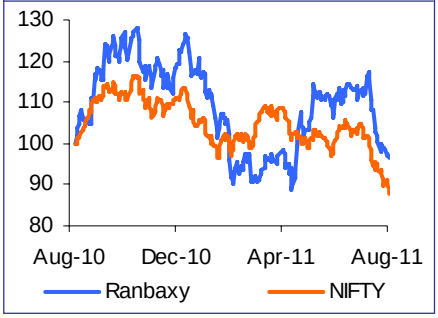
Source: Bloomberg

Shareholding pattern



Source: BSE

Price performance *vs* Nifty



Source: Bloomberg

Investment rationale

FDA resolution - the key near-term trigger

Ranbaxy has submitted a remediation action plan to the US FDA for the resolution of the compliance issues at its two sites i.e., Paonta Sahib and Dewas. With the re-inspection of the sites through in 2QCY11, positive report by the FDA would be the key trigger for the company in near term. However, the quantum of fine would cap the resultant upside to a considerable extent.

Slow recovery in the base business

In the backdrop of FDA alert, Ranbaxy has taken significant amount of time in ramping up its base business. Its first-to-files (FTFs) business has been the key to growth over the last eight quarters. However, we expect the slowing trend to continue.

Project "VirAAT" yet to gain scale

With a strong focus on domestic formulations market so as to compensate for lost sales in the US markets, project VirAAT has enabled Ranbaxy to gain momentum. However, with only 25% of business coming from India, it has still not attained the kind of scale it requires to compete with its peers and grab the market share.

Capitalising on Para IV/FTFs

Ranbaxy has a strong Para IV pipeline to be monetised over the next three years including Lipitor, Caduet, Nexium and Actos, resulting in one-time cash flow for the company. Based on FCF valuation, we value the one time opportunity at INR103 per share.

Valuation and outlook

We value Ranbaxy at INR385 per share based on 15x CY12e base earnings of INR19.5 and INR103 per share for Para IV pipeline. At the CMP of INR455, the stock trades at a PER of 24.7x in CY11e and 23.3x in CY12e on base earnings. We initiate coverage on the stock with a SELL rating and a target price of INR385 resulting in a downside of 15% from current levels.

Key financials

Year ended Dec 31st	CY08	CY09	CY10	CY11e	CY12e
Net revenues (INRm)	74,214	75,970	89,608	84,723	88,512
EBITDA (INRm)	8,438	13,637	29,824	14,335	15,208
EBITDA growth (%)	(19.7)	27.0	162.6	(39.3)	7.5
PAT (INRm)	27,876	2,900	15,947	7,750	8,208
PAT growth (%)	(217.4)	(132.9)	396.1	(47.7)	6.1
EPS (INR)	(22.4)	7.1	35.5	18.4	19.5
EPS growth (%)	(207.7)	(131.5)	404.1	(48.2)	5.9
P/E (x)	(20.3)	64.4	12.8	24.7	23.3
P/BV (x)	4.5	4.4	3.4	3.0	2.7
EV/EBITDA (x)	35.3	27.8	10.6	17.4	16.2
RoE (%)	7.7	14.6	27.7	9.6	9.6

Source: Company, Antique

Company background

Ranbaxy Laboratories Limited (Ranbaxy) is India's largest integrated, research-based and international pharmaceutical company producing a wide range of quality and affordable generic medicines. It has a good brand equity amongst the healthcare professionals and patients across geographies. The company has a strong focus on exports to regulated markets and domestic business. While tapping the huge overseas generic opportunity, Ranbaxy's continued focus on R&D has resulted in several approvals in developed markets and significant progress in New Drug Discovery Research. The company's foray into Novel Drug Delivery Systems has enabled it to develop proprietary platform technologies, resulting in development of large number of in-house products. It presently serves 125 countries and has an expanding international portfolio of affiliates, joint ventures, and alliances, ground operations in 46 countries and manufacturing operations in 7 countries.

The company has established a direct presence across the world in key markets like US, Europe and Asia Pacific. With the company entering into newer regulated markets and product launches over the years, revenue contribution from developed markets of the US and Europe has increased from 47% to over 50% during CY05-10. While share of emerging markets (incl. India) grew from 39% to ~45% during the same period.

Exhibit 1: CY05 revenue break-down (%)

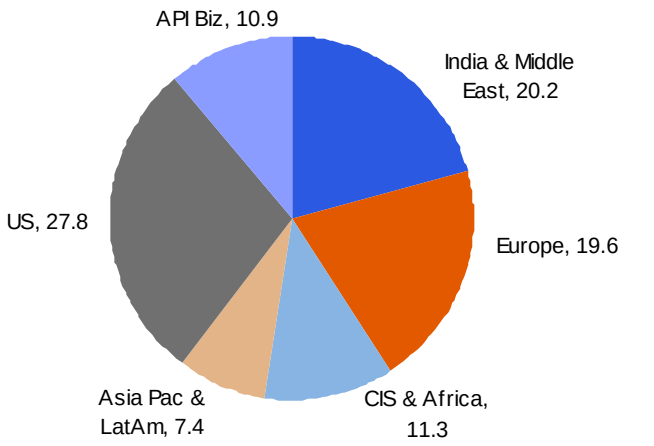
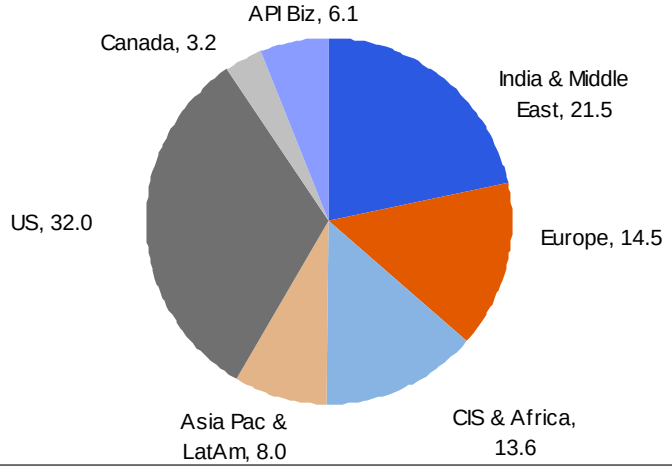


Exhibit 2: CY10 revenue break-down (%)



Source: Company

After the US FDA banned two of its sites for alleged violations of cGMP norms and data integrity issues, the company has made efforts to compensate for the revenue loss by strengthening its hold in existing markets and venturing in to new markets.

In June 2008, Daiichi Sankyo acquired majority of Ranbaxy's stake in a USD4.6bn deal, positioning the former as a major supplier of low-priced generics to Japan's aging population. This move persuaded Japanese pharma companies to enter the emerging Asian markets in order to grab better growth opportunities.

The two companies i.e., Daiichi Sankyo and Ranbaxy, have now developed a Hybrid Business model, where the formed is the innovator and the latter will play the role of low cost generic manufacturer. They have extended the model in the emerging markets of Mexico, Romania and India. We expect the model to gain size only by CY12e when more products are expected to enter the markets.

Investment Arguments

Resolution of FDA compliance - key for revival in base business

Import-ban on Ranbaxy products bring down US sales

US FDA imposed import alert against Ranbaxy, resulting in a ban of 30 products from its Dewas and Paonta Sahib facility

In September 2008, US FDA imposed import alert against Ranbaxy, resulting in a ban of 30 products from its Dewas and Paonta Sahib facility, citing deviations in the Good Manufacturing Practices (cGMP norms).

The FDA in its warning letter issued to the company highlighted the use of raw materials from unapproved sources and also mentioned data-integrity issues in an effort to gain FDA approval on products filed from the facilities. The data-integrity issue was extended to products under the the President's Emergency Plan for AIDS Relief program (PEPFAR) and distributed to foreign countries.

The issues with the company even turned more complicated when Paonta Sahib Facility received an Application Integration Policy (AIP) warning in February 2009, alleging fraudulent practices and inconsistent data.

An AIP warning is more stringent and serious as compared to the issue of warning letters by the US FDA. Issue of AIP resulted in stoppage of review of any new or pending drug approval that contains data generated by that facility and bars the company from selling the same in the US markets. On account of the same, the core earnings in the US witnessed a sharp decline of 54% to USD169m in CY09, though the sales rebound back to earlier levels in the next year largely driven by one-off sales.

Exhibit 3: Adverse FDA actions on Ranbaxy

Sep-08	Issue of warning letters and announcement of import alert by US FDA on Ranbaxy's Dewas and Paonta Sahib facility affecting 30 products
Feb-09	AIP (Application integrity policy) issued; All pending and approved ANDAs from Paonta Sahib's facility added to a list maintained under AIP
May-09	Voluntary recall of all batches of Nitrofuratoin capsules
Dec-09	Warning letter issued to Ohm Labs for its liquid mfg facility in US

Source: Company, Antique

Remediation action plan presented

Ranbaxy in consultation with the FDA since CY08, with no resolution in sight

Ranbaxy has presented corrective action plan to the US FDA for Paonta Sahib and Dewas in May 2009. The management is looking at a composite solution to both Department of Justice (DoJ) investigation and US FDA cGMP issues. However, we believe the following will be the key going ahead:

- **Clearance of Dewas facility**: The site has been recently inspected by the US FDA regulators (in 2QCY11) after discussion with the regulators. The report for which is still awaited. However, clearance of this site will allow the company to apply for revalidation of 30 products that are currently banned for sale in the US.
- **Clearance of Paonta Sahib facility**: This site too has been recently visited by the US FDA (according to 2QCY11 conference call), however we expect clearance on this site to take a little longer as it has to resolve the import alert and data integrity issues.

- **Salvaging the FTFs**: The underlying in the whole process of getting the FDA clearance on sites is salvaging the FTF opportunities. The management has so far not provided any outlook on the same. We estimate these products to contribute ~INR103/share to the overall earnings of the company.

FDA resolution upside capped by penalty claims

Ranbaxy Laboratories and the US health regulator are reportedly negotiating a settlement to lift a ban on the sale of the drugs produced at two of the company's plants in India. Settling the issue with the US FDA is of immense importance to Ranbaxy as it is the first firm to file an ANDA to launch a generic copy of Lipitor, in the US market. We estimate penalty amount to be in the range of ~USD300-400m considering past fines imposed by the FDA on erring companies.

Exhibit 4: Big ticket cGMP penalties

Year	Company	Amount (USDm)
1999	Wyeth	30
Nov-99	Abbott Labs	100
June-02	Schering Plough	500
May-10	Genzyme	175
Oct-10	GSK Plc	750

Source: Industry reports, USFDA website, Antique

Setback to the remediation process with decommissioning of banned FDA site

Decommissioning of Gloversville due to sub-optimal utilisations

Ohm Laboratories Inc (Ohm), a wholly-owned subsidiary of Ranbaxy, is in the process of decommissioning its liquid manufacturing facility located in Gloversville, New York to focus the company's resources on other US-based facilities. This process is expected to be completed by October 2011, after which the plant will no longer be operational. The Gloversville facility was acquired by Ranbaxy on July 23, 2002 to manufacture liquid pharmaceutical formulations.

We estimate this move to reduce losses at its plant in Gloversville, NY, as the company continues to work on the remediation action plan to get the sites out of the import ban and work towards restoring sales to the regulated markets.

We expect the shutdown to be a set back for the company as Gloversville was one of the sites under the US FDA ban as any remediation would have resulted in resumption of sales from the site. However, decommissioning will result in reliance on its beleaguered sites of Dewas and Paonta Sahib which would boost sales in the regulated markets.

Below par performance of core segment

Refocusing on domestic markets

Shifting focus to domestic markets to revive lost sales

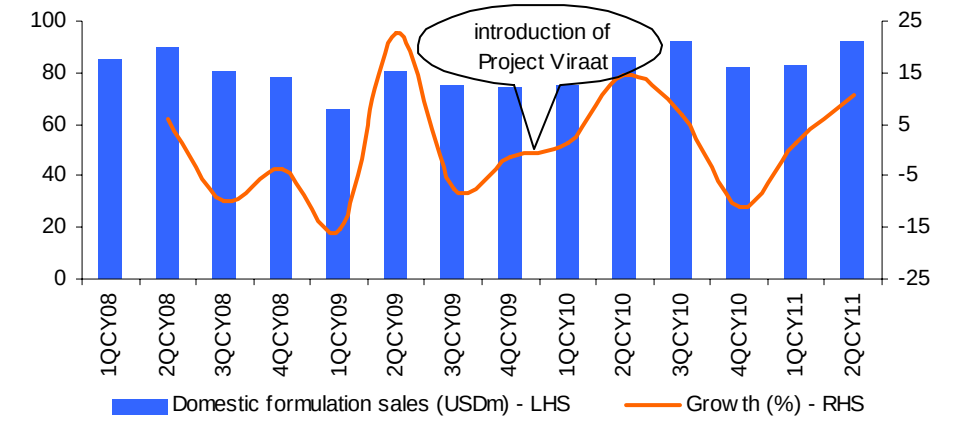
In an effort to compensate loss of sales in the US markets, the management shifted its focus towards the domestic markets. Ranbaxy introduced project 'virAAT' - an initiative targetted to ramp up its presence across the country, especially in the rural areas through introduction of new products and increasing its field force comprising medical representatives.

The project has resulted in re-organisation of operations from 10 SBUs to 26 SBUs with focus on new therapy areas and expanding its reach in Tier II to Tier IV cities. With increased number of product launches, the company expects to revive revenues from the domestic markets.

Ranbaxy's current strategy is to broaden its reach in tier-II to tier-IV cities which will result in higher penetration driven growth. It plans to launch ~35-40 products every year, both through in-house development and in-licensing from the innovators. It has witnessed strong sales in in-licensed brands such as Revital and has in-licensed two drugs from its parent Daiichi too for the local markets.

Despite the launch of Project Viraat - only 6% growth witnessed in 2QCY11

Exhibit 5: Domestic formulations (USDm)



Source: Company, Antique

As can be observed from Exhibit 5, Ranbaxy has witnessed a sluggish growth over the last two years since the launch of Project Viraat with a mere 6% growth in 2QCY11 (vs. 12% for the industry).

In an effort to revive its domestic segment, the company has added ~800 people in its sales force and introduced ~25-30 products including line extensions per year in CY09-CY11. Despite entering into new therapy areas and significant product launches, the company has yet not been in a position to capitalise on the same.

US core earnings driven by continuing para-IVsales

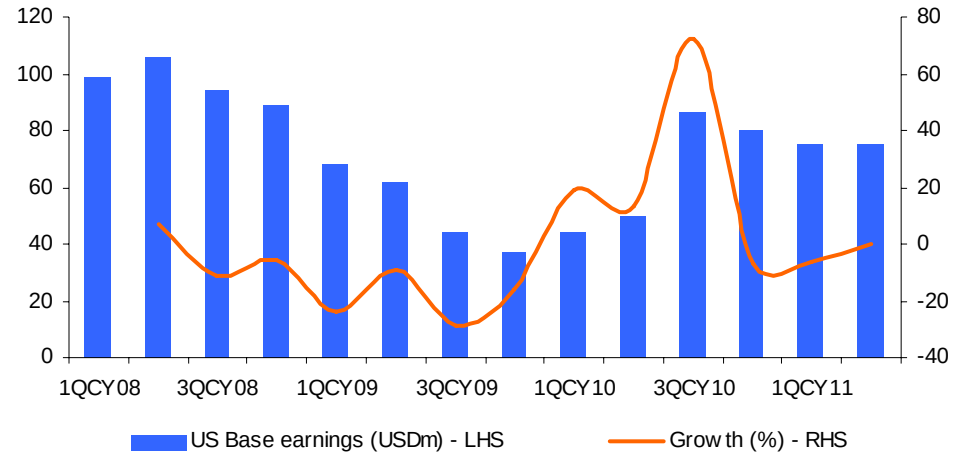
Core earnings driven by only Para IV sales in the earlier quarters

Ranbaxy's generic portfolio in the US has witnessed a sluggish sales since the import alert on the Dewas and Paonta Sahib sites in 3QCY08. The US FDA has not approved any new ANDAs filed from these sites, which is expected to have an adverse impact on core earnings over the next two years. Though the management has not provided any details on the new ANDA filings, we believe the same to be filed from the new site at Mohali. We expect US FDA approval for the plant to come in by CY12e, which would act as catalyst for its core business.

We believe the company still enjoys significant market share in its core business on account of some FTF products which are now genericised. With no new product approvals coming through and loss of market share from existing products in coming quarters, we do not expect any significant ramp-up in revenues of Ranbaxy before any of the sites get FDA approval.

Even if the Dewas and Paonta Sahib sites get clearance, the company will have to reapply for validation of all 30 products that are currently under the ban. The revalidation is expected to take nearly six months before the company re-enters the markets. The market currently vacated by Ranbaxy has been filled by competition and any delay in getting sites approved will take a toll and would require rigorous efforts by the company to regain the lost ground. We expect the Mohali facility to be approved the end of CY12e.

Exhibit 6: Base earnings continue to be sluggish (USDm)



Source: Company, Antique

Para IVs - the next phase of growth

Para IVs key to revive growth

Ranbaxy has a strong Para IV pipeline to be monetised over the next three years including Lipitor, Caduet, Nexium and Actos, resulting in one time cash flow. The company has proven its ability to monetise these opportunities with the launch of Valtrex (with 180-day exclusivity and garnering 60% market share) from Flomax - where the company failed to monetise the same on account of delay in US FDA approval.

The management has been highlighting various steps to monetise other FTF opportunities in its pipeline. However, lack of clarity on the remediation issue and gestation period in getting approval for Mohali site could be a setback in monetising some big-ticket opportunities such as Lipitor and Caduet in CY11e. We value this one-time opportunity in CY11-12e at INR103 per share.

Below exhibit provides the potential Para IV opportunities for the ensuing years:

Exhibit 7: Para IV/limited period opportunities

Molecule	Innovator	Market Size (USDbn)	Status	Year
Simvastatin	Merck (Zocor)	0.5	Launched	2006
Pravastatin	BMS (Pravachol)	0.2	Launched	2007
Sumatriptan	GSK (Imitrex)	1.0	Launched	2007
Valacyclovir	GSK (Valtrex)	1.3	Launched	2009
Esomeprezole	AZN (Nexium)	5.0	Settled	2009-14
Tamosulosin	BI/Astellas (Flomax)	1.2	Settled	2010
Donzepril Hcl	Eisai (Aricept)	2.2	Launched	2010
Amlodipine Besylate	Pfizer (Caduet)	0.4	Settled	2011
Atorvastatin	Pfizer (Lipitor)	6.0	Settled	2011
Modanifil	Cephalon (Provigil)	1.1	Settled	2012
Pioglitazone Hcl	Takeda (Actos)	3.0	Settled	2012
Valsartan	Novartis (Diovan)	2.0	Settled	2012

Source: Company, Antique

FDA clampdown does not hamper ability to monetise FTFs

Ranbaxy has a strong Para IV pipeline with some of the key products such as Lipitor, Nexium, Caduet and Actos in CY11e and CY12e. The company has introduced Flomax, Valtrex (2009) and Aricept (Nov 2010) from the banned Dewas facility. This highlights company's ability to capitalise 180-day exclusivity. The key however remains the ability

to monetise some of the premium Para IV filings such as Lipitor, Nexium and Actos filed from its Paonta Sahib. The company highlighted that they would be able to save these exclusivities from expiring, and appropriate measures would be taken to add one-time income and cash flow.

Exhibit 8: Cash flows from select Para IV opportunities

USDm	Aricept	Lipitor	Actos	Caduet	Nexium	Valcyte	Diovan	Modanifil
Branded sales	2,200	6,000	3,000	389	5,000	300	2,000	1,100
85% price erosion	1870	3000	1500	194.5	2500	150	1000	550
Market Size during excl period	330	3,000	1,500	195	2,500	150	1,000	550
180-day excl sales	165	1,500	750	97.25	1,250	75	500	275
Ranbaxys market share (%)	50	50	40	40	40	50	40	40
Ranbaxys revenues	82.5	750	300	38.9	500	37.5	200	110
PBT margins (%)	70	70	70	70	70	70	70	70
PBT	57.7	525	21	27.2	350	26.2	140	77
PAT @ 20% Tax	11.6	105.0	42.0	5.4	70.0	5.3	28.0	15.4
PAT	46.2	420.0	168.0	21.8	280.0	21.0	112.0	61.6
EPS (INR)*	4.9	44.9	18.0	2.3	29.9	2.2	12.0	6.6

Source: Company, Antique; USD/INR ~45

With a robust pipeline, we expect Ranbaxy to garner significant cash flows and earnings from the exclusivities over the next few years. The launch of Aricept seconds the ability of the management to capitalise on high value Para IVs in the US markets. However, the key will now be the ability to monetise Lipitor, Nexium and Caduet over the next two years.

Valuing the Para IV opportunities with 50% probability, we arrive at an NPV of INR103 per share spread over CY11-12e.

Exhibit 9: Cashflow impact of Para IV opportunities

USDm	CY11e	CY12e
Lipitor	750	750
- Probability of launch (%)	50	50
- Part of cash flows	375	375
Caduet	39	39
- Probability of launch (%)	50	50
- Part of cash flows	19	19
Diovan	-	200
- Probability of launch (%)	50	50
- Part of cash flows	-	100
Nexium	-	500
Probability of launch (%)	50	50
Part of cash flows	-	250
Total value	**394**	**744**
PBT Margin (%)	75	75
PBT	296	558
Tax (%)	20	20
Tax	59	112
PAT	335	633
EPS impact (INR)	**36**	**68**
Total EPS addition in 2 years (INR)	**103**	

Source: Antique; USD/INR ~45

Aricept launch raises expectations from Lipitor

Although Ranbaxy was able to introduce Aricept in the regulated markets despite the FDA issues, we cannot extrapolate the success to the launch of Lipitor. It has to be noted that FDA has not approved Ranbaxy's ANDA filing on account of data integrity issues faced at Paonta Sahib. Even though Pfizer and Ranbaxy have entered into a settlement, delay in approval on the part of the FDA does not give us confidence that they will be able to introduce the drug on time. Watson [which is the authorised generic (AG)] in its latest 2QCY11 earnings call, highlighted that local pharmacies are not placing any orders for Lipitor with any players including the AG, until clarity emerges on Ranbaxy's approval. We have carried out a scenario analysis for launch of Lipitor and based it on a permutation of getting FDA clearance.

Scenario analysis for Lipitor

Scenario 1: Ranbaxy secures approval on Lipitor ANDA and launches the drug in Nov-2011

In this case we have assumed that FDA clears Paonta Sahib and Dewas facilities with a penalty of USD200-400m* (on account of violating cGMP norms) and restores FDA approval on the facility. This will allow Ranbaxy to introduce Lipitor on time in November 2011. This means that Ranbaxy and Watson both will enjoy 180-day exclusivity on the drug. Given that Teva has settled the case with Pfizer means, it will introduce its generic version post exclusivity in May 2012. Other generics, including Mylan and Apotex, can introduce the drugs 'at-risk' (i.e. before the outcome of the FDA verdict); Dr. Reddy's 30-month stay on introducing the product will end by May'12 paving the way for its entry into the generic space. In either case, we believe the competition will be restricted to 5-6 players until the end of 2012, which will help early entrants to extend their gains.

Scenario 2: Ranbaxy does not get FDA clearance; does an Aricept for Lipitor

In this scenario, we have assumed that the FDA does not give out a verdict on the beleaguered facilities. This will not allow Ranbaxy to launch the drug from its sites and will do an Aricept for Lipitor.

On November 2010, Ranbaxy secured FTF status on Pfizer's Alzheimer's drug Aricept. The FDA had also stated that Ranbaxy is the sole FTF and hence will be eligible for a period of exclusivity of 80 days. This was done through a transfer to its own facility in the US paving the way for a timely launch of the drug.

The FDA had earlier (Sep-10) stated that Teva's filing on generic Aricept had been changed from "approved" to "tentatively approved". This had also raised expectations for final approval and a subsequent successful launch from Ranbaxy. Although we cannot assume/extrapolate the Aricept case to Lipitor, it does make a case for timely launch of the drug.

Scenario 3: Adverse DoJ outcome delay's approval; monetises FTF

In this scenario, we have assumed that Department of Justice (DoJ) investigation and validity assessment of the ANDA falls short of timely approval, and DoJ asks for additional data thereby delaying approval. In the event of the same, Ranbaxy will withhold its launch, while it works out a solution and launch by other generics will remain blocked. The only way to trigger Ranbaxy's exclusivity would be to invalidate all patents covering Lipitor through the appeal process, which could take up to 2013 and beyond.

We believe it would be difficult to trigger Ranbaxy's exclusivity in such a case and other generics (except AG) would have to wait until the block is removed by Ranbaxy's launch. In this case, Watson is the only AG and it can introduce the Lipitor generic irrespective of Ranbaxy's situation.

The most likely outcome arising from this situation is monetising the ANDA as in the case of Tamosulosin; Ranbaxy may enter into an agreement to transfer the exclusivity to any generic player.

Scenario 4: Ranbaxy does not get FDA clearance; pays penalty and still is unable to launch the drug due to data integrity issues.

In this scenario, we have assumed that the FDA does not clear the manufacturing sites, DoJ invalidates the data and asks for more to be submitted resulting in delays in launching the drug and FDA annuals exclusivity. We have also assumed that Ranbaxy will have to pay USD200m as penalties towards non-compliance of cGMP norms. We believe this will result in Ranbaxy having no exclusivity on Lipitor. In such a scenario, Watson - the AG and Teva will get a head-start to launch the product in the market, others such as Mylan, Apotex and Dr. Reddy's will launch as per settlement or at-risk. Ranbaxy in such a scenario will have to wait for acceptance from an alternate site and launch with other generics. It is important to note that any delay in FDA approval to Ranbaxy's ANDA will result in delay in introduction of generic versions post patent expiry.

Synergies yet to accrue from Daiichi Sankyo

Parent synergies yet to accrue

Daiichi's acquisition with Ranbaxy has created a hybrid business model (Daiichi is an innovator company and Ranbaxy a successful generic company with global presence). Though we believe there will be significant upside to the revenues and margins once the synergies are outlined, revenues from the synergy model are expected to materialise from 1HCY12 onwards. While Ranbaxy had already transferred its research division to Daiichi Sankyo to create new drugs, the two companies have collaborated to maximize their Hybrid Business Model (HBM), encompassing both innovative and affordable, high quality, generic medicines. The group has agreed to expand their business in Mexico with the launch of Olmesartan Medoxomil.

For the domestic market, the group has introduced two products namely Prasugrel and Ovlance from the innovators basket. We however have not seen any significant synergies between the two companies so far. The following could have been the possible synergies that the two companies could have worked upon:

- Daiichi could use Ranbaxy as an outsourcing partner for manufacturing low cost drugs for the emerging markets.
- Leveraging strong parentage to gain access in the Japanese markets and selling low cost drugs in the local markets. We expect the first generic from the HBM to be introduced by the end of CY12e.
- Launch of branded generic drugs from parents basket in the domestic market.

Financials

Considering lack of clarity on the US FDA resolution, slow recovery in the US base business, inability of Project "VirAAT" to gain scale and momentum in the domestic market, and inability to capitalise on strong parentage, we expect consolidated revenues to grow at a CAGR of 4.3% in CY10-12e. We estimate core operating margins during the same period to be in the range of ~14-15%.

Expect base revenue to grow at CAGR of 4.3% in CY10-12e

Consolidated revenues to grow at a CAGR of 4.3% in CY10-12e.

We expect Ranbaxy's base business (ex para IV opportunities) to grow at a CAGR of 4.3% over CY10-12e on the back of slow sales in the US markets due to non-approval of new ANDAs filed from the Mohali site, non-revival of the base business in the domestic formulation segment, slow sales in the other regulated markets. Excluding exclusivities and other operating income, we expect revenue to register a de-growth of 5% in CY11e and grow by 1.3% in CY12e. We have not factored any exclusivity based earnings in both the years and have considered other para IVs separately for valuation purposes.

Exhibit 10: Revenue break-down (USDm)

Particulars	CY08	CY09	CY10	CY11e	CY12e
India & Middle East	369	359	404	451	503
Europe	330	269	272	297	326
CIS, Africa	241	211	255	285	330
Asia Pacific & LatAm	154	152	150	159	178
Japan	20	20	20	21	24
USA	393	334	600	480	408
Canada	55	63	60	63	68
APIs	120	111	114	118	123
Total Sales	**1,682**	**1,519**	**1,874**	**1,874**	**1,959**

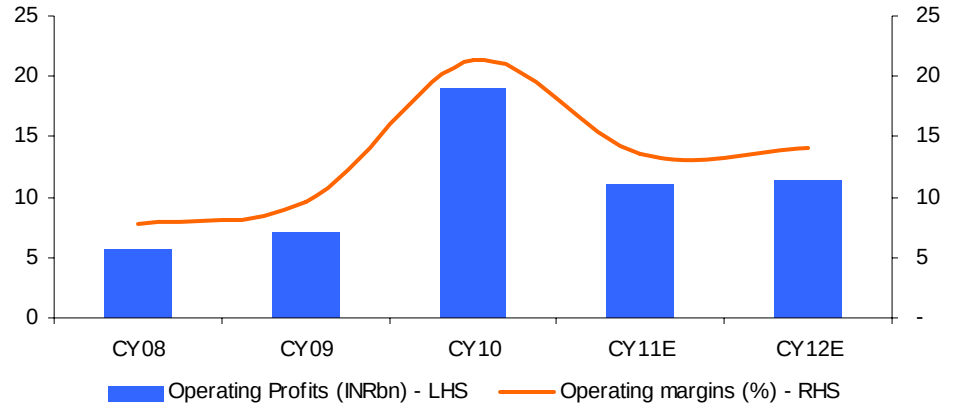
Source: Company, Antique

Operating margins to be under pressure

Margins to be in the range of 13.5-14% during CY10-12e

We expect operating margins to be under pressure as Ranbaxy struggles to introduce any new products in the domestic formulations business through Project VirAAT, and no new products gaining approval for the regulated markets. Higher employee costs, increased R&D spend and costs relating to remediation action for the FDA issues are expected to pressurise overall margins. We expect margins for the company to be in the range of 13.5-14% during CY10-12e.

Exhibit 11: Base margins to be range-bound



Source: Company, Antique

Lack of revival of base business to impact profitability

With the base business growth estimated at 4.3% in CY10-12e, higher operational costs, increased capex and higher interest cost are expected to adversely affect to overall profitability of the company in the coming years. We estimate net margins to be in the range of 9.0-9.5%. Our estimates do not include any income/profitability arising of exclusivity based products.

Valuation and outlook

We value Ranbaxy at INR385 per share based on15x CY12e base earnings of INR19.5 and INR103 per share for Para IV pipeline.

Initiate coverage with a SELL rating

At the CMP of INR455, the stock trades at a PER of 24.7x in CY11e and 23.3x in CY12e on base earnings. Resolution of FDA issue will be the key trigger for the stock, however we feel the upside could be capped depending on the penalty amount to be paid to the US FDA.

With the management taking a concerted view on shutting down one of the beleaguered sites of its subsidiary Ohm Labs, and new filings from the Mohali site to take time to gain approvals, we expect Ranbaxy to face significant amount of headwinds before any positives kick in.

We initiate coverage on the stock with a SELL rating and a target price of INR385 resulting in a downside of 15% from current levels.

Exhibit 12: SOTP valuation

	EPS (INR)	PER (x)	Value (INR)
Base business earnings	**19.5**	**15.0**	**292.4**
Para IV(FTF Ops)			
Lipitor	50.3	1	50.3
Caduet	2.3	1	2.3
Actos	18.0	1	18.0
Diovan	12.0	1	12.0
Provigil	3.3	1	3.3
Nexium	6.6	1	6.6
Total SOTP Valuation			**385**

Source: Antique

Financials

Profit and Loss Account (INRm)

Year ended 31st Dec	2008	2009	2010	2011e	2012e
Revenues	74,214	75,970	89,608	84,723	88,512
Expenses	68,482	68,694	70,496	73,116	76,032
Operating Profit	**5,732**	**7,277**	**19,112**	**11,607**	**12,480**
Other income	2,706	6,360	10,711	2,728	2,728
EBIDTA	**8,438**	**13,637**	**29,824**	**14,335**	**15,208**
Depreciation	2,825	2,676	5,533	4,564	4,915
Interest expense	2,055	710	614	800	776
Profit before tax	**3,558**	**10,250**	**23,677**	**8,971**	**9,516**
Taxes incl deferred taxation	(5,765)	6,955	5,849	1,077	1,142
Extra ordinary Items	18,558	(253)	1,697	-	-
Minority Interest	6	142	185	144	166
Profit after tax	**27,876**	**2,900**	**15,947**	**7,750**	**8,208**
Recurring EPS (INR)	**(22.4)**	**7.1**	**35.5**	**18.4**	**19.5**

Balance Sheet (INRm)

Year ended 31st Dec	2008	2009	2010E	2011e	2012e
Share capital	2,102	2,102	2,105	2,105	2,105
Reserves & surplus	40,861	41,331	53,942	60,805	68,074
Networth	**42,962**	**43,434**	**56,047**	**62,910**	**70,179**
Debt	43,114	36,295	43,348	40,848	38,348
Deferred tax liability	(12,229)	(4,746)	(227)	(227)	(227)
Minority Interest	675	533	647	792	958
Capital employed	**74,522**	**75,516**	**99,815**	**104,322**	**109,257**
Gross fixed assets	61,941	62,785	67,050	73,368	77,868
Accumulated depreciation	17,042	17,880	21,571	26,135	31,050
Net assets	**44,899**	**44,905**	**45,479**	**47,233**	**46,818**
Capital work in progress	4,708	6,231	3,818	2,000	2,000
Investments	5,432	5,407	4,985	4,985	4,985
Current assets, loans & advances					
Inventory	19,643	18,407	21,926	22,156	22,835
Debtors	13,310	18,399	16,052	16,713	16,732
Cash & bank balances	23,956	12,416	32,644	35,797	41,850
Loans & advances and others	7,729	9,065	12,338	12,338	12,338
Other current assets	2,283	1,798	3,971	3,971	3,971
Current liabilities & provisions					
Creditors	39,719	32,511	31,865	31,336	32,737
Other liabilities & provisions	7,720	8,602	9,534	9,534	9,534
Net current assets	**19,484**	**18,973**	**45,534**	**50,105**	**55,455**
Application of funds	**74,522**	**75,516**	**99,815**	**104,322**	**109,257**

Per share data

Year ended 31st Dec	2008	2009	2010	2011e	2012e
No. of shares (m)	420	420	421	421	421
BVPS (INR)	102.2	103.3	133.1	149.4	166.7
CEPS (INR)	73.0	13.3	51.0	29.2	31.2
DPS (INR)	8.6	-	2.3	2.1	2.2

Margins (%)

Year ended 31st Dec	2008	2009	2010	2011e	2012e
EBIDTA	7.7	9.6	21.3	13.7	14.1
EBIT	7.6	14.4	27.1	11.5	11.6
PAT	37.6	3.8	17.8	9.1	9.3

Source: Company, Antique

Cash flow statement (INRm)

Year ended 31st Dec	2008	2009	2010	2011e	2012e
PBT	**(15,000)**	**10,098**	**23,217**	**8,971**	**9,516**
Depreciation & amortisation	2,825	2,676	5,533	4,564	4,915
Interest expense	2,055	710	614	800	776
Interest / Dividend Recd	(1,083)	(1,116)	(1,677)	(2,728)	(2,728)
Other adjustments	12,968	(11,834)	(9,099)	-	-
(Inc)/Dec in working capital	(2,387)	271	2,987	(1,418)	703
Tax paid	(1,360)	(2,426)	(6,189)	(1,077)	(1,142)
CF from operating activities	**(1,982)**	**(1,621)**	**15,386**	**9,112**	**12,041**
Capital expenditure	(4,338)	(4,904)	(4,263)	(4,500)	(4,500)
(Purchase)/Sale of Investments	(3,548)	1,262	558	-	-
Income from investments	939	4,294	(18,002)	2,728	2,728
CF from investing activities	**(6,946)**	**652**	**(21,708)**	**(1,773)**	**(1,773)**
Inc/(Dec) in share capital	34,389	13	267	-	-
Inc/(Dec) in debt	(4,497)	(4,460)	8,248	(2,500)	(2,500)
Dividends & Interest paid	(4,294)	(776)	(607)	(1,687)	(1,716)
CF from financing activities	**25,598**	**(5,223)**	**7,908**	**(4,187)**	**(4,216)**
Net cash flow	**16,669**	**(6,192)**	**1,587**	**3,153**	**6,053**
Opening balance	3,876	22,244	16,052	17,639	20,791
Closing balance	**20,545**	**16,052**	**17,639**	**20,791**	**26,844**

Growth indicators (%)

Year ended 31st Dec	2008	2009	2010	2011e	2012e
Revenue	8.9	1.2	16.5	(2.5)	4.6
EBITDA	(19.7)	27.0	162.6	(39.3)	7.5
PAT	(217.4)	(132.9)	396.1	(47.7)	6.1
EPS	(207.7)	(131.5)	404.1	(48.2)	5.9

Valuation (x)

Year ended 31st Dec	2008	2009	2010	2011e	2012e
PE	(20.3)	64.4	12.8	24.7	23.3
P/BV	4.5	4.4	3.4	3.0	2.7
EV/EBITDA	35.3	27.8	10.6	17.4	16.2
EV/Sales	2.8	2.8	2.4	2.4	2.3

Financial ratios

Year ended 31st Dec	2008	2009	2010	2011e	2012e
RoE (%)	7.7	14.6	27.7	9.6	9.6
RoCE (%)	(26.6)	6.9	30.1	13.0	12.3
Debt/Equity (x)	1.0	0.8	0.8	0.6	0.5
EBIT/Interest (x)	1.4	6.5	22.1	8.8	9.7

Source: Company Antique

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