

Ranbaxy

On time delivery

In-line with our expectations, the US FDA approved Ranbaxy's Lipitor ANDA paving the way for a launch over the coming days from its Ohm Labs facility in the US. This was the most keenly awaited approval for Ranbaxy, and the company has maintained its track-record of monetizing all key Para-IV opportunities despite the substantial uncertainty involved with the ongoing FDA/DoJ issues. While this is very positive for Ranbaxy, we await further clarity on the comprehensive settlement that would entail a clearance of the Dewas and Paonta Sahib facility and is key to driving the operating leverage that is central to Ranbaxy's investment case. We also expect the market to now focus on its post launch execution of Lipitor and keenly await early market share trends. Re-iterate Neutral.

Ranbaxy monetizes Lipitor opportunity

In line with our expectations, the USFDA approved Ranbaxy's ANDA for Lipitor paving the way for a launch in the coming days. The approval was granted from Ranbaxy's Ohm Labs facility in New Jersey and follows Watson's launch of authorised generic earlier yesterday. Given the size of the opportunity (IMS sales: \$7.8bn), Lipitor generic was the most keenly awaited opportunity for Ranbaxy, and today's news is very positive for Ranbaxy, removing a big overhang on the stock. However, with the approval now in place, we expect the market to focus on its post-launch execution and comprehensive settlement involving Dewas and Paonta Sahib facilities.

All eyes set on market share gains...

We re-iterate our view that RBXY will struggle to gain significant market share in Lipitor post launch, and expect it to garner ~25-30% market share with ~50% price erosion during the six months, which would translate in ~Rs.28 EPS contribution.. This is so given PFE's aggressive contracting activity with PBMs and mail order chains, which account for ~40% of Lipitor prescriptions, and where RBXY has traditionally had a weak presence. Moreover, we believe that PFE is offering aggressive rebates to ensure that its branded drug remains at a similar or better co-pay tiers. Indeed, despite its certainty as an authorised generic, Watson now expects PFE to retain ~40% market share during the 180-day exclusivity.

...and comprehensive settlement keenly awaited

A comprehensive settlement with the FDA/DoJ now seems very likely in the coming days, and this now becomes the next critical catalyst as it would result in clearances of the Dewas and Paonta Sahib facilities. Ranbaxy's operating margin expansion story is predicated on operating leverage, which in-turn depends on the flow of future approvals in the US and its ability to quickly ramp up sales from Dewas and Paonta Sahib facilities. Given the extent of inquiry by the DoJ, it seems a near certainty that RBXY will be asked to pay financial penalties for its manufacturing issues. However, the quantum of penalties remains a guess for everyone. Our base case assumption is that Ranbaxy might have to pay ~\$300-400m as penalties and anything below ~\$100m will likely be the best case for the company. At its Q3 results earlier in November, management guided to ~\$100m quarterly run-rate for the best business post FDA resolution, which implies only ~20% increase from current levels.

Valuations reasonable - upside hinges on operating leverage

Following Q3 results and a more reasonable valuation, and going in the Lipitor launch catalyst, we turned Neutral on Ranbaxy on 11th Nov. At the current valuation, stripping out RBXY's Para-IV pipeline (valued at Rs.150 at 100% probability), RBXY now trades at 18.5x FY12 P/E. Our DCF valuation for core business points to a valuation of Rs. 300, which assumes Dewas returning back in FY11 (\$50m from new products every for each of FY12-14), FY11 steady state revenues of \$400m from US, includes contribution from Japan, sees operating margins expanding to 14% by FY15 and also includes the Valcyte and Primaxin opportunities. Our DCF-valuation of Rs.460 builds in upside from key Para-IVs including Lipitor, Caduet, Nexium, Actos, Provigil as well as Diovan (all 100% prob). We have now included Lipitor and Caduet opportunities in our financial forecasts, there is no change to our valuation as these were already included in our valuation (at 100% probability). Our FY12 and FY13 EPS stands upgraded by 47% and 96% to Rs.25.4 and Rs.58.7 respectively. We await further details on the comprehensive settlement before making changes to our model.

Accounting & corporate governance	Amber
Franchise Strength	Red
Earnings Momentum	Green

NEUTRAL

6% upside

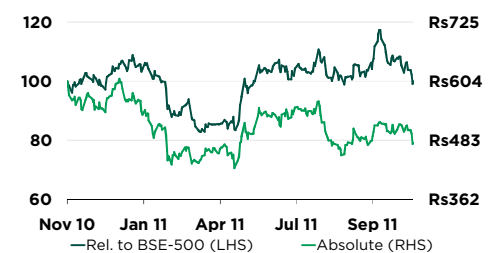
Fair Value (Rs) 460

Bloomberg Code	RBXY.IN
Share Price (Rs)	435
Market Cap	\$3.7bn/₹184bn
Free Float / FII holding	35%/7%
ADV (Rs m/ \$m)	\$9.5m/₹428m

₹m (unless stated) March YE	2010A	2011E	2012E	2013E
Sales	89,608	91,911	129,789	117,894
EBITDA	14,672	10,940	32,305	17,641
EBIT pre-ex	35.5	12.7	58.7	33.6
EPS reported	30.9	25.4	58.7	33.6
Dividend	5.0	2.5	5.9	5.0
FCF	17,378	222	20,444	13,051
Net Debt	(7,572)	(10,422)	5,550	14,475

X (unless stated)	2010A	2011E	2012E	2013E
EV/Sales	2.1	2.0	1.4	1.6
EV/EBITDA	10.0	13.1	5.2	8.7
P/E	12.2	34.2	7.4	12.9
ROCE	14.1	17.2	7.4	12.9
Dividend Yield (%)	1.1%	0.6%	1.3%	1.2%
FCF Yield (%)	9.5%	0.1%	11.1%	7.1%

Figure 1 Historical share price performance



Source: Bloomberg

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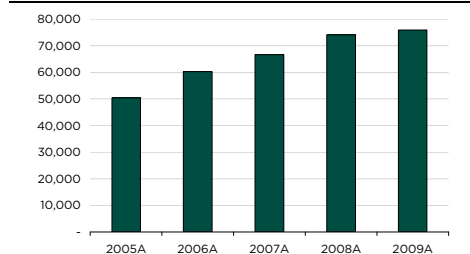
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Company snapshot

Ranbaxy is a global generics company with a broad presence across geographies, including India (20%), US (22%) including exclusivities, EU (18%), and other emerging markets (33%). Its core emerging markets include Romania, Russia and CIS, Africa and Latin America, while its key developed markets are US where its key focus areas are anti-infectives, statins and Para-IV litigation based opportunities.

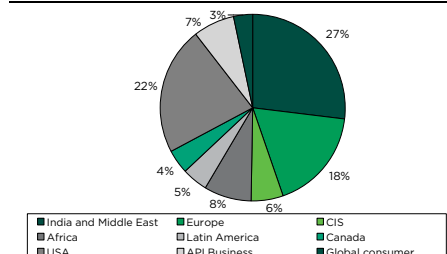
Ranbaxy is a global generics company with presence in 46 countries

Figure 2 Revenue trend (\$ m)



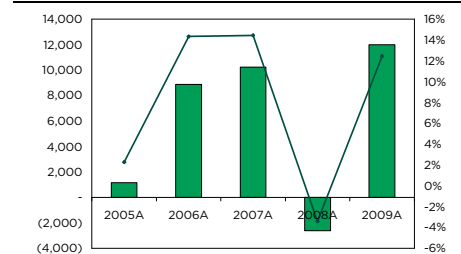
Source: Ranbaxy

Figure 3 FY09 revenue by division



Source: Ranbaxy

Figure 4 EBITDA margins v. growth



Source: Ranbaxy

Key risks and sensitivities

The biggest risk for Ranbaxy is the ongoing FDA import ban on Dewas and AIP (application integrity protocol) on the Paonta Sahib facility, which is critical to improving product flow and driving operation leverage. The key product risks for RBXY are: Diovan, Actos, Provigil in 2012 and Nexium in 2014. The risks to our call are earlier than anticipated resolution of FDA issues and alongside a quicker than anticipated market share ramp in the US. Positive catalyst momentum, particularly, for Para-IV opportunities is also a risk to our call.

Table 1 Key catalyst/events

Event	Impact	Date
FDA/DoJ resolution	V.High	2011
FDA inspection and clearance of Dewas facility	V.High	2011
Nexium formulations supply	Med	1Q'12

Source: Espirito Santo Investment Bank

	High case	Base case	Low case
DCF valuation	550	460	300
Upside/downside:	26% upside	6% upside	30% downside
FY 11/12/13 EPS	25/75/50	25/59/34	25/57/30
US generics base price/volume mix:	5% from FY12 onwards	10% for FY11-13 -5% thereafter	-8% from FY11 onwards
US new product assumptions	\$75m contribution from new products for FY11-13 each; \$50m each for FY13-15	\$75m contribution from new products for FY12-13 each, largely; \$50m each for FY13-15	\$20m contribution from new products for FY11-13 each, largely; \$30m each for FY13-15
Major launch assumptions in valuation:	Assuming all exclusivities and settlements are launched successfully	Assuming all exclusivities and settlements are launched successfully	Nexium API/formulation supplies at 100% probability; Lipitor, Nexium, Caduet, and Diovan at 100%; Diovan at 50% probability
India growth	FY11-15 growth at 15%	FY11-15 growth at 14%	FY11-15 growth at 13%
Japan contribution	\$80m in FY13 rising to peak of \$200m in FY15; gross margins: 40% for FY13-15	\$70m in FY13 rising to peak of \$110m in FY15; gross margins: 40% for FY13-15	\$50m in FY13 rising to peak of \$70m in FY15; gross margins: 25% for FY13-15
Europe (incl. Romania) growth:	Romania: 20% growth for FY11-13; Rest of EU: 8% growth for FY11-13	Romania: 20% growth for FY11-13; Rest of EU: 5% growth for FY11-13	Romania: 20% growth for FY11-13; Rest of EU: 5% growth for FY11-13
Africa, CIS and Latam growth:	Blended growth: 17.5% in FY11, 16% in FY12, 14% in FY13	Blended growth: 17.5% in FY11, 16% in FY12, 14% in FY13	Blended growth: 17.5% in FY11, 16% in FY12, 14% in FY13
SG&A and personnel costs:	SG&A costs at 23% of core revenues for FY11, 22% for FY12, and 20% for FY13	SG&A costs at 23% of core revenues for FY11, 22% for FY12, and 20% for FY13	SG&A costs at 23% of core revenues for FY11, 22% for FY12, and 20% for FY13
R&D costs:	6.5% of core revenues for FY11-15	6.5% of core revenues for FY11-15	6.5% of core revenues for FY11-15

Us versus consensus

The key source of divergence within consensus lies from FY11 onwards, given Lipitor 6-month exclusivity from Nov'11, and Diovan and Actos exclusivities in FY12. We now incorporate Lipitor and Caduet opportunities in our financials, but have factored in Diovan and Actos at 50% probability. However, for the purpose of valuation, we included rNPVs for each of these on top of our 3-stage DCF for the core business.

Table 2 Us versus Consensus

	Consensus	Us	% change
EBIT			
FY12	18,981	32,305	70%
FY13	13,924	17,641	27%
EPS			
FY12	37.8	58.7	55%
FY13	31.9	33.6	5%

Source: FactSet, Espirito Santo Investment Bank

SWOT analysis

Strengths

- Large product pipeline including a mix of commodity and Para-IV bodes well for US market
- Diversified exposure to various markets, including a mix of emerging markets and developed markets
- Ranbaxy has traditionally been strong in distribution in the US market, which is key to winning market share

Opportunities

- Step up capabilities in developing alternate formulations
- Monetise on biosimilars opportunity for developed markets through either own front-end or by partnering for supplies
- Monetise Japanese opportunity using Daiichi's front-end
- Launch Daiichi's products in other EMs
- Leverage scale to establish global leadership in specific areas

Source: Espirito Santo Investment Bank

Weaknesses

- US filings have virtually stalled since the FDA ban
- Most key markets continue to suffer from low profitability (single digit EBITDA margins), implying operational inefficiencies
- Its partnerships for niche product categories for US market have had limited success (Zenotech, Jupiter)

Threats

- Ranbaxy may find it difficult to win back lost base business in US
- FDA resolution could involve monetary penalties, or closure of penicillin unit at Dewas. Negative outcome of AIP on Para-IV's particularly Lipitor will erode business significantly
- Delay/loss of market exclusivity due to litigation for Para-IV products
- France continues to be loss-making, dragging down EU profitability

Ranbaxy

Recommendation:
Fair Value:

NEUTRAL
INR 460

Share Price:	435
Upside / Down side	6%
3 Month ADV (\$m)	\$9.5
Free Float	35%
52 Week High / Low	414-624

Bloomberg: RBXY IN
Model Published On: 01 December 2011

Shares In Issue (mm)	422
Market Cap (\$mm / Rs bn)	183,570
Net Debt	270
Enterprise Value (\$mm / Rs bn)	183,840

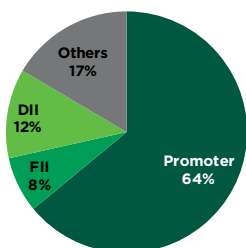
Forthcoming Catalysts

FDA/DoJ settlement	H2/CY11
Lipitor market share trends	Dec'11

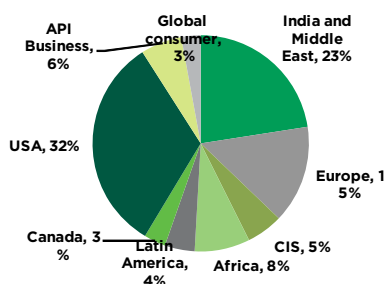
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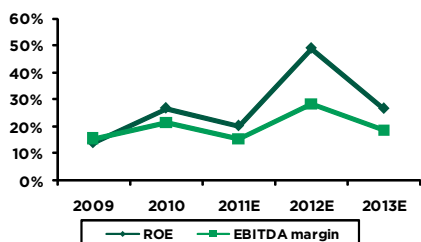
Shareholding Pattern



Operating Profit Breakdown



Margin Trends



Valuation Metrics	2009	2010	2011E	2012E	2013E
P/E (dil., reported)	65.8	12.2	34.2	7.4	12.9
P/S	2.4	2.2	2.0	1.5	1.6
P/B	4.2	3.1	2.9	2.1	1.9
EV/Sales	2.3	2.1	2.0	1.4	1.6
EV/EBITDA	18.3	10.0	13.1	5.2	8.7
FCF Yield	-3.7%	9.5%	0.1%	11.1%	7.1%
Dividend yield	0.0%	1.1%	0.6%	1.3%	1.2%

Key ratios	2009	2010	2011E	2012E	2013E
Gross margin	64.2%	68.0%	64.3%	65.6%	62.6%
EBITDA margin	15.8%	21.5%	15.6%	28.4%	18.6%
Op./EBIT margin	12.3%	14.0%	12.2%	25.7%	15.5%
Net margin	1.9%	15.3%	11.9%	19.7%	12.4%
ROE	14%	27%	20%	49%	27%

P&L Summary	2009	2010	2011E	2012E	2013E
Total Sales	75,970	85,355	89,668	125,789	113,894
Other income	2935	4253	2243	4000	4000
Total revenues	80,837	89,608	91,911	129,789	117,894
Gross profit	48757	58080	57649	82567	71287
Personnel expenses	(14,174)	(15,060)	(16,621)	(17,037)	(17,889)
Other SG&A expenses	(18,554)	(19,031)	(22,011)	(23,661)	(25,436)
R&D	(4,037)	(5,600)	(5,031)	(6,204)	(6,761)
EBITDA	11,991	18,389	13,987	35,665	21,201
Depreciation/amortisation	(2,676)	(3,717)	(3,046)	(3,361)	(3,561)
EBIT/Op. profit	9,315	14,672	10,940	32,305	17,641
Net Interest	(710)	2,181	2,154	82	407
Forex gains/(losses)	1,493	1,407	(6,512)	-	-
Other non-operating income/expenses	-	2,741	1,188	-	-
Profit before tax and minority interest	10,098	20,942	7,771	32,387	18,047
PBT adjusted	8,605	16,793	13,095	32,387	18,047
Tax	(6,991)	(5,849)	(2,286)	(7,536)	(3,752)
Minority interest	(141.8)	(125.6)	(125.6)	(125.6)	(125.6)
Net Income (reported)	2,965	14,968	5,359	24,725	14,170
Net Income (adjusted)	1,472	13,035	10,682	24,725	14,170
Weighted av shares	448	421	421	421	421
EPS reported (dil.)	6.6	35.5	12.7	58.7	33.6
EPS (adjusted)	3.3	30.9	25.4	58.7	33.6
DPS	-	5	3	6	5

Cash Flow Summary	2009	2010	2011E	2012E	2013E
PBT	10,098	23,462	12,476	21,055	21,781
Depreciation & amortisation	2,676	1,197	3,161	3,361	3,561
Working Capital	271	2,866	-6,028	-2,208	-3,712
Unrealised foreign exchange (gain)/loss	-10,785	0	0	0	0
Tax	-2,426	-5,849	-2,741	-4,718	-4,753
CF From Operations	-1,621	21,551	6,742	17,364	16,751
Capex (maintenance)	-5,221	-4,000	-3,000	-3,000	-3,000
FCF	-6,841	17,551	3,742	14,364	13,751
Capex (growth)	-1,000	-1,000	-2,000	-2,000	-2,000
Investments/disposals	4,531	0	0	0	0
CF From Investing	652	-5,000	-5,000	-5,000	-5,000
Dividends Paid	-6	-21	-1,922	-1,621	-2,535
Interest paid	-4,460	-770	-19,625	-3,000	-3,000
Change in Net Debt	-770	-3,000	-19,625	-3,000	-3,000
CF From Financing	-5,223	-3,021	-21,547	-4,621	-5,535
Inc./ Dec. in Cash & eq.	-6,078	13,530	-19,805	7,743	6,216

Balance Sheet Summary	2009	2010	2011E	2012E	2013E
Cash & equivalents	12,416	25,946	6,141	13,884	20,100
Debtors	18,399	15,176	19,149	21,769	24,307
Inventories	18,407	18,090	18,436	17,728	20,279
Current Assets	60,086	70,075	54,590	64,245	75,548
PPE	51,136	52,435	54,274	55,914	57,353
Deferred tax asset	4,906	4,906	4,906	4,906	4,906
Fixed Assets	61,449	62,748	64,588	67,227	67,667
Total Assets	121,535	132,824	119,178	130,472	143,215
Short Term Debt	(50)	(50)	(50)	(50)	(50)
Creditors	(14,393)	(13,718)	(12,010)	(11,714)	(13,090)
Other Current Liabilities	(26,670)	(26,670)	(26,670)	(26,670)	(26,670)
Current Liabilities	(41,112)	(40,438)	(38,729)	(38,433)	(39,809)
Long Term Debt	(36,295)	(33,295)	(13,670)	(10,670)	(7,670)
Other LT Liabilities	(161)	(161)	(161)	(161)	(161)
Long Term Liabilities	(36,456)	(33,456)	(13,831)	(10,831)	(7,831)
Total Liabilities	(77,568)	(73,893)	(52,560)	(49,264)	(47,640)
Shareholders' Equity	(43,967)	(61,434)	(69,121)	(83,712)	(98,079)
Total Liabilities & Sh. Eq.	(121,535)	(135,327)	(121,681)	(132,975)	(145,718)

Source: Ranbaxy, Espirito Santo Investment Bank Research estimates

Table 3 RBXY changes to estimates

	Revised estimates			Prior estimates			% change		
	FY11	FY12	FY13	FY11	FY12	FY13	FY11	FY12	FY13
Total Sales	91,911	129,789	117,894	84,040	103,018	110,140	9%	26%	7%
EBIT	10,940	32,305	17,641	6,764	16,110	15,490	62%	101%	14%
PBT (adj.)	13,095	32,387	18,047	8,919	16,132	15,593	47%	101%	16%
Net Income (adj.)	9,610	16,212	16,902	7,258	12,591	12,405	32%	29%	36%
EPS adjusted (dil.)	25	59	34	17.2	29.9	29.4	47%	96%	14%

Source: Espirito Santo Investment Bank

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12-MONTH RATING	DEFINITION
BUY	Analyst expects at least 10% upside potential to fair value, which should be realized in the next 12 months
NEUTRAL	Analyst expects upside/downside potential of between +10% and -10% to fair value, which should be realized in the next 12 months.
SELL	Analyst expects at least 10% downside potential to fair value, which should be realized in the next 12 months

SHORT TERM RATING	DEFINITION
ST POSITIVE	Analyst expects the stock price to appreciate in value within 3 months of the rating assignment because of a specifically identified catalyst(s) or event(s)
ST NEGATIVE	Analyst expects the stock price to decline in value within 3 months of the rating assignment because of a specifically identified catalyst(s) or event(s)

For further information on Rating System please see “Definitions and distribution of ratings” on: <http://www.espiritosantoib-research.com>.

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As at end September 2011	Total ESIB Research		Total Investment Banking Clients (IBC)		
	Recommendation	Count	% of Total	Count	% of IBC
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NEUTRAL	125	29.8%	12	25.5%	2.9%
SELL	68	16.2%	1	2.1%	0.2%
RESTRICTED	4	1.0%	1	2.1%	0.2%
TOTAL	420	100%	47	100%	

As at end September 2011	Total ESIB Research		Total Investment Banking Clients (IBC)		
	Recommendation	Count	% of Total	Count	% of IBC
SHORT TERM POSITIVE	0	0%	0	0%	0%
SHORT TERM NEGATIVE	0	0%	0	0%	0%
TOTAL	0	0%	0	0%	

Share Prices

Share prices are as at the close of business on the day preceding publication, unless otherwise specified.

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