

# RANBAXY LABORATORIES

INR 372



*Margin disappointment*

**ACCUMULATE**

Ranbaxy's Q1CY07 result was in line with our expectation, with Y-o-Y sales growth of 22.4%, EBITDA growth of 34.1%, and net profit growth of 78.7%. This net profit was boosted by Forex gain of INR 559 mn. Adjusting for this the profit would have been INR 885 mn (Which was below our expectations). The company has increased its guidance to 20% top-line growth in dollar terms (including small acquisitions) and maintained 16% EBITDA margin guidance. We believe this increase in guidance could be on the back of its expectation of some milestone revenues from GSK on account of its R&D deal. We are not changing our estimates of top-line growth of 12% primarily because there is little clarity on the progress of the molecule that is being developed by Ranbaxy for GSK. The EBITDA margins for the quarter at 12.2% were lower than our estimate but we do not give too much of weight to the quarterly aberrations and believe that Ranbaxy will be able to achieve 16.3% margins for the whole year.

The overall growth for Ranbaxy is expected to be modest in CY07E (with flat growth in US generics market). In addition to this there is still no clarity on the approval status for the Paonta Sahib facility. The issue of USFDA raid on Ranbaxy's US offices has also not been clarified yet. Till there is further clarity on these issues we believe the stock price could remain muted. We believe news flow related to acquisitions and USFDA issues could give some spurt to the stock price going forward. We thus believe the price performance will remain range bound with limited downside. At CMP of INR 370, the stock trades at a P/E of 21.5x on CY07E earnings. We maintain our 'ACCUMULATE' recommendation on the stock.

**\* US generics: growth likely to be flat in CY07**

Ranbaxy's US sales stood at USD 91 mn, registering 2% Y-o-Y growth. This was primarily on account of lack of launch of any big product during the quarter. The company has recently received approval for Pravastatin, triggering 180 days exclusivity for Ranbaxy on 80 mg strength. But we believe Ranbaxy will not be able to garner significant revenues from this opportunity as the market has already shifted to other strengths which have already gone off patent and hence are available at much lower price.

Ranbaxy received approval for 4 ANDA's in the quarter which included Zolpidem Tartrate, Sertraline Hydrochloride, Amoxicillin and Clavulanate Potassium Oral Susp. and Valacyclovir Tablets. The company now has 88 pending approvals with FDA of which 20 are FTF Para IVs. We do not expect any of these FTF opportunities to materialize in CY07E.

## Financials

Year to December	Q1CY07	Q1CY06	Growth (%)	Q4CY06	% change	CY06E	CY07E
Revenues (INR mn)	15,821	12,922	22.4	17,769	(11.0)	61,340	68,065
EBITDA (INR mn)	1,908	1,423	34.1	2,665	(28.4)	9,433	11,125
Net profit (INR mn)	1,276	714	78.7	1,833	(30.4)	5,151	6,851
EPS (INR)	3.2	1.8	78.7	4.6	(30.4)	12.9	17.2
PE (x)						28.7	21.5
EV/EBITDA (x)						17.5	14.4

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**Market Data**

52-week range (INR) : 530 / 301  
Share in issue (mn) : 372.5  
M cap (INR bn/USD mn) : 138.6 / 3,391.0  
Avg. Daily Vol. BSE/NSE ('000) : 1,522.8

**Share Holding Pattern (%)**

Promoters : 34.9  
MFs, Fls & Banks : 20.2  
Fls : 16.4  
Others : 28.6

Going forward, we believe growth in Ranbaxy's US business is likely to have a flat growth since in CY06 Ranbaxy had exclusivity revenues from Simvastatin and to add to this higher base, the 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)	Q1CY07	Q1CY06	Growth (%)	Q4CY06	Growth (%)
Dosage Forms	14,581	11,372	28.2	15,942	(8.5)
India	3,172	2,576	23.1	2,955	7.3
Europe (Incl Romania)	4,097	2,310	77.4		(2.4)
CIS, Russia	793	489	62.3		
Africa	1,057	844	25.3	6,090	
APAC & Middle east	1,057	800	32.2	1,075	(1.6)
Latam	396	400	(0.8)	716	(44.7)
USA	4,009	3,953	1.4	5,105	(21.5)
APIs	1,013	1,377	(26.4)	1,164	(13.0)
<b>Total Revenues</b>	<b>15,594</b>	<b>12,749</b>	<b>22.3</b>	<b>17,106</b>	<b>(8.8)</b>

Source: Company, Edelweiss research

**\* Europe: growth still impacted by stiff competition**

Europe registered sales of USD 93 mn, a 78% Y-o-Y growth. This quarter European revenues included USD 37 mn from Romania (majority from Terapia) which was not a part of Ranbaxy in 1QCY06. Adjusting for this the growth for the quarter was 7.6% on Y-o-Y basis. The key UK market had a growth of 77% primarily due to restructuring carried out in 2006 and several new product introductions. In the German market the company had 11% growth and 11 of its products were listed with AOK, Germany's largest health insurer. In France the company saw a de-growth of 25%. The company has guided that most of the European operations will turn profitable during this year which would help in margin expansion.

**\* India and other markets: Impressive growth continues**

Indian formulations business recorded revenues of USD 72 mn (Y-o-Y growth of 24%). This was primarily driven by 18 new product introductions. With its significant revenues coming from acute therapy areas (76%), we believe Ranbaxy is set to see good growth rate in Indian formulations going forward. We have estimated growth of 15% for Ranbaxy's domestic formulations business in CY07E and CY08E.

The CIS markets, showed an impressive growth rate of 61% with revenues of USD 18 mn. The revenues from Africa increased by 28% to USD 24 mn driven by revenues from ARVs. With Be-Tabs acquisition expected to be completed by May 2007, we expect the whole African region to contribute revenues of USD 131 mn. The Asia-Pac and Middle East region also recorded good growth rate of 34% for the quarter. We expect this momentum to continue going forward.

**\* Guidance**

The company has increased its top-line guidance from 15% to 20% for CY07E in dollar terms. We believe the company is focused on acquisitions and it is also expecting some milestone income from the R&D deal with GSK. As of now we are not changing our estimates but we may revise it as we get more clarity on the progress of the R&D deal with GSK. We believe the company will be able to meet its EBITDA guidance of 16%.

\* **R&D initiatives**

In this quarter Ranbaxy entered into collaboration with GSK according to which Ranbaxy will advance leads beyond candidate selection to completion of clinical proof of concept. GSK thereafter will conduct further clinical development for each program and take resulting products through the regulatory approval process to final commercialization. Ranbaxy has said that it could receive over USD 100 mn in potential milestone payments for a product developed by Ranbaxy and further double digit royalties on worldwide net sales. The joint team has recently approved the candidate selection of a compound for Respiratory Inflammation. Ranbaxy will take it forward to the pre-clinical stage. The company expects some milestone income from this candidate in this year. Though there is very little clarity on this development and as a result we have not factored any revenues from this deal for CY07E.

\* **Financials**

The company had a significant Forex gain in this quarter of INR 559 mn. The Net profit adjusted for the Forex gain the Net profit is INR 885 mn indicating a growth of 31.5% (against 78.7% reported growth) The EBITDA margins have improved by 101 bps on Y-o-Y basis primarily on account of better product mix. We believe these margins are set to improve over the year and end CY07E at EBITDA margin of 16.3%.

\* **Outlook and valuation**

With moderate growth of 12% in top-line expected for CY07E and no significant trigger in sight in near term, we believe stock performance will remain muted. However, any news related to acquisitions or approval for Paonta Sahib or further clarity on the USFDA raids will give some impetus to the stock price in short term. At CMP of INR 370, the stock trades at a P/E of 21.5x on CY07E. We believe the stock will remain range bound and thus maintain our '**ACCUMULATE**' recommendation.

Financial snapshot						(INR mn)	
Year to December	Q1CY07	Q1CY06	Growth (%)	Q4CY06	Growth (%)	CY07E	CY08E
Total operating income	15,821	12,922	22.4	17,769	(11.0)	68,065	77,736
Gross sales	15,644	12,753	22.7	17,077	(8.4)	68,065	77,736
Less: Excise duty	109	122	(10.7)	102	6.9	-	-
<i>Net sales</i>	15,535	12,631	23.0	16,975	(8.5)	68,065	77,736
Other operating income	286	291	(1.7)	794	(64.0)	-	-
Total expenses	13,913	11,499	21.0	15,104	(7.9)	56,940	63,439
Cost of goods sold	8,367	6,855	22.1	9,131	(8.4)	24,503	27,596
Raw material cost (including adj. to stock)	8,367	6,855	22.1	9,131	(8.4)	24,503	27,596
Gross profit	7,454	6,067	22.9	8,638	(13.7)	43,562	50,140
Other expenses	5,546	4,644	19.4	5,973	(7.1)	32,437	35,843
R&D	811	729	11.2	1,224	(33.7)	4,118	4,736
Selling, admin and general expenses	4,735	3,915	20.9	4,749	(0.3)	19,394	20,989
<b>EBITDA</b>	1,908	1,423	34.1	2,665	(28.4)	11,125	14,297
Other income	45	55	(18.2)	24	87.5	360	360
PBDIT	1,953	1,478	32.1	2,689	(27.4)	11,485	14,657
Depreciation	557	427	30.4	531	4.9	1,871	1,900
Interest	313	257	21.8	247	26.7	1,013	869
PBT	1,083	794	36.4	1,911	(43.3)	8,601	11,888
Extra ordinary items	(559)	(59)		(460)		-	-
Tax (including deferred tax)	355	135	163.0	512	(30.7)	1,720	2,378
PAT	1,287	718	79.2	1,859	(30.8)	6,881	9,510
Minority interest	11	4	175.0	26	(57.7)	30	30
Net profit	1,276	714	78.7	1,833	(30.4)	6,851	9,480
Equity capital (FV INR 5)	1,862	1,995		1,995		1,995	1,995
Dividend						2,729	2,729
Dividend per share (INR)						6	6
Number of shares (mn)	399	399		399		399	399
EPS (INR)	3.2	1.8	(44.0)	4.6		17.2	23.8
PE (x)						21.5x	15.6x
EV/EBITDA (x)						14.4x	10.8x
M. cap/Revenues (x)						2.2x	1.9x
<b>as % of net revenues</b>							
Other expenses	35.5	36.4		35.0		47.7	46.1
Other income	0.3	0.4		0.1		0.5	0.5
Total expenses	88.9	90.2		88.4		83.7	81.6
Depreciation	3.6	3.3		3.1		2.7	2.4
Gross profit	47.6	47.6		50.6		64.0	64.5
EBITDA	12.3	11.3		15.7		16.3	18.4
Net profit	8.2	5.7		10.8		10.1	12.2
Tax rate	32.8	17.0		26.8		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. Ranbaxy has invested in innovative R&D as well, but nothing significant has come out of it as yet.

## Investment Thesis

We believe that Ranbaxy will have steady growth without any significant upside because: (1) there are no significant product launches in the US generics market in the next year; (2) continued pricing pressure in the US to impact negatively; (2) emerging markets like India, Russia, and Brazil showing healthy growth; and (3) higher operating leverage puts pressure on margins, especially when the growth rate is tapering.

## Risks to the investment thesis

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 the new pharma policy.

## Financial Statements

<b>Income statement</b>					<b>(INR Mn)</b>
<b>Year to December</b>	<b>CY04</b>	<b>CY05</b>	<b>CY06</b>	<b>CY07E</b>	<b>CY08E</b>
Income from operations	54,321	52,816	61,340	68,065	77,736
Total operating expenses	44,507	49,705	51,907	56,940	63,439
Materials cost	19,090	22,213	23,435	24,503	27,596
Employee cost	6,382	6,786	6,985	7,474	8,595
R&D cost	3,376	4,925	3,870	4,118	4,736
Other expenses	15,659	15,781	17,617	20,844	22,512
EBITDA	9,814	3,111	9,433	11,125	14,297
Depreciation and amortisation	1,215	1,445	1,911	1,871	1,900
Interest	335	671	1,080	1,013	869
Other income	1,000	616	349	360	360
Extraordinary items [exp. /(gain)]	372	(333)	226	-	-
Profit before tax	8,892	1,945	6,565	8,601	11,888
Provision for tax	1,881	(698)	1,361	1,720	2,378
PAT( inc. exceptionals & pre minority int)	7,011	2,642	5,204	6,881	9,510
Minority interest & others	26	25	53	30	30
Pr. dividend, incl. tax thereon	-	-	-	-	-
PAT (inc. exceptionals) for equity shareholders	6,985	2,617	5,151	6,851	9,480

### Common size metrics- as % of net revenues

<b>Year to December</b>	<b>CY04</b>	<b>CY05</b>	<b>CY06</b>	<b>CY07E</b>	<b>CY08E</b>
Material cost	35.1	42.1	38.2	36.0	35.5
Employee cost	11.7	12.8	11.4	11.0	11.1
Other expenses	28.8	29.9	28.7	30.6	29.0
Depreciation	2.2	2.7	3.1	2.7	2.4
Interest expenditure	0.6	1.3	1.8	1.5	1.1
EBIDTA margins	18.1	5.9	15.4	16.3	18.4
Net profit margins	12.9	5.0	8.4	10.1	12.2

### Growth metrics (%)

<b>Year to December</b>	<b>CY04</b>	<b>CY05</b>	<b>CY06</b>	<b>CY07E</b>	<b>CY08E</b>
Revenues (%)	12.6	(2.8)	16.1	11.0	14.2
EBIDTA (%)	(8.9)	(68.3)	203.2	17.9	28.5
Net profit (%)	(7.9)	(62.5)	96.8	33.0	38.4
EPS (%)	(8.1)	(62.6)	83.7	33.0	38.4

### Cash flow statement

<b>Cash flow statement</b>					<b>(INR Mn)</b>
<b>Year to December</b>	<b>CY04</b>	<b>CY05</b>	<b>CY06</b>	<b>CY07E</b>	<b>CY08E</b>
Cash flow from operations	8,220	2,892	6,563	9,081	12,037
Cash for working capital	959	(951)	(3,651)	(1,793)	(2,774)
Net operating cash flow	9,180	1,940	2,912	7,288	9,263
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	(2,729)	(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	(4,429)	(5,229)
<b>Free cash flow</b>	<b>806</b>	<b>(6,370)</b>	<b>(16,819)</b>	<b>6,788</b>	<b>8,763</b>

<b>Balance sheet</b>		<b>(INR Mn)</b>				
<b>As on 31st December</b>	<b>CY04</b>	<b>CY05</b>	<b>CY06</b>	<b>CY07E</b>	<b>CY08E</b>	
Shareholders funds	25,077	24,467	46,690	50,812	57,563	
Capital	1,859	1,862	2,002	2,002	2,002	
Reserves & surplus	23,218	22,605	44,689	48,811	55,562	
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	67,002	69,424	73,675	
Gross block	23,132	29,920	31,420	31,920	32,420	
Depreciation	7,838	9,329	11,240	13,110	15,010	
Net block	15,294	20,591	20,180	18,810	17,410	
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	14,125	14,769	16,633	
Sundry debtors	11,357	11,404	15,125	16,783	19,168	
Cash and bank balances	1,339	2,430	2,165	4,524	8,058	
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	37,236	41,897	49,680	
Current liabilities	12,693	10,600	11,172	11,681	13,155	
Provisions	6,475	4,408	4,090	4,449	5,107	
Total current liabilities and provisions	19,168	15,008	15,262	16,131	18,262	
Net current assets	16,302	18,271	21,974	25,767	31,418	
Others						
Uses of funds	34,655	44,629	67,002	69,424	73,675	
Book value per share (INR)	67	66	117	127	144	

**Ratios**

<b>Year to December</b>	<b>CY04</b>	<b>CY05</b>	<b>CY06</b>	<b>CY07E</b>	<b>CY08E</b>
ROE (%)	27.9	10.7	11.0	13.5	16.5
ROCE (%)	26.6	5.9	11.4	13.8	17.3
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	2.4
Debt/equity	0.3	0.8	0.4	0.3	0.3

**Valuation parameters**

<b>Year to December</b>	<b>CY04</b>	<b>CY05</b>	<b>CY06</b>	<b>CY07E</b>	<b>CY08E</b>
EPS, post exceptionals (INR.)	18.8	7.0	12.9	17.2	23.8
<i>YoY growth (%)</i>	(8.1)	(62.6)	83.7	33.0	38.4
CEPS (INR)	22.1	10.9	17.7	21.9	28.5
PE (x)	20.8	55.5	28.7	21.5	15.6
Price/BV(x)	5.8	5.9	3.2	2.9	2.6
EV/Sales (x)	2.8	3.1	2.7	2.4	2.0
EV/EBITDA (x)	15.5	52.3	17.5	14.4	10.8

## Edelweiss Securities

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### SECTOR

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Niraj Mansingka - 2286 4304	Oil & Gas, Petrochemicals	Nirmal Ajmera - 2286 4258
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### RATING INTERPRETATION

<b>Buy</b>	Expected to appreciate more than 20% over a 12-month period	<b>Reduce</b>	Expected to depreciate up to 10% over a 12-month period
<b>Accumulate</b>	Expected to appreciate up to 20% over a 12-month period	<b>Sell</b>	Expected to depreciate more than 10% over a 12-month period
<b>Trading Buy</b>	Expected to appreciate more than 10% over a 45-day period	<b>Trading Sell</b>	Expected to depreciate more than 10% over a 45-day period

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