

## 'Valtrex foam' no cover for weak base

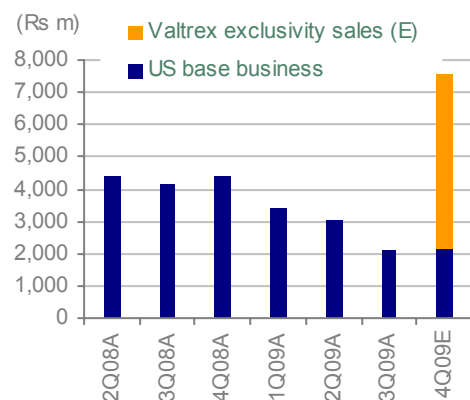
**Significant channel filling for generic valacyclovir (sold as Valtrex by innovator, GSK), launched in the US with exclusivity, helped Ranbaxy post better 4QCY09 numbers than our expectations. However, our analysis, supported by the company's weak guidance for CY10, indicates there has been no improvement in the base business across geographies. Assuming that the company's CY10 guidance factors in exclusivity sales coming up in the US—an assumption the management did not deny—we reckon that the base business will continue to be hardly profitable in CY10 as well. Resolution of FDA issues and resumption of normalised sales in the US will likely take at least a year, and more than US\$1bn of deeply out-of-money options are still on the balance sheet. We retain SELL with a target price of Rs225.**

**Valtrex generic helps beat 4QCY09 estimates:** Sales at Rs22.5bn and EBITDA at Rs4.1bn came 10% and 44% ahead of our estimates, respectively. Excluding our estimate of generic Valtrex sales, revenue and EBITDA were 9% and 70% below our estimates, respectively.

**No improvement in base business performance:** Domestic revenues grew only 6% YoY, CIS and Europe were broadly flat, Africa declined by 25% and Asia Pacific growth was a lacklustre 11%. We estimate US base business was down 50%. Base EBITDA margin remained low at an estimated 2%, though overall EBITDA margin jumped to 18% on the back of high-margin Valtrex sales.

**Valuation fundamentally unjustified:** Management's CY10 guidance implies continuing profitability issues in the base business; accordingly, we are cutting our core earnings estimates for CY10 and CY11 by almost 50%. Ranbaxy trades at 75x CY11ii core earnings, adjusted for one-off profits and exclusivity value per share.

### Valtrex bolsters a weak US business



### Financial Summary

Y/e 31 Dec	CY07A	CY08A	CY09A	CY10ii	CY11ii
Revenues (Rs m)	67,810	74,214	75,970	81,057	101,759
EBITDA Margins (%)	11%	8%	9%	12%	21%
Pre-Exceptional PAT (Rs m)	7,746	-9,512	2,965	5,259	14,128
Reported PAT (Rs m)	7,746	-9,512	2,965	5,259	14,128
EPS (Rs)	20.7	-22.6	7.0	12.4	33.4
Growth (%)		-209.1	-131.1	77.1	168.3
PER (x)	21.9	-20.1	64.6	36.5	13.6
ROE (%)	27.6	-22.1	6.5	10.3	22.5
Debt/Equity (x)	1.5	1.0	1.1	1.1	0.8
EV/EBITDA (x)	29.0	36.7	33.0	24.2	11.0
Price/Book (x)	6.1	4.4	4.2	3.7	3.1

Price as at close of business on 25 February 2010

**12-mth TP (Rs) 225 (-50%)**

**Market cap (US\$ m) 4117**

52Wk High/Low (Rs) 538/133

Diluted o/s shares (m) 421

Daily volume (US\$ m) 18

Dividend yield CY10ii (%) 1.1

Free float (%) 35.1

#### Shareholding pattern (%)

Promoters 63.9

FIIs 6.8

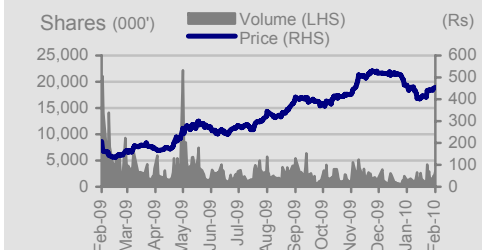
DIIs 11.8

Others 17.5

#### Price performance (%)

	1M	3M	1Y
Ranbaxy	-2.1	7.3	119.0
Rel. to Sensex	1.0	12.8	36.4
Sun Pharma	5.3	4.8	48.7
Dr Reddys	2.0	4.0	183.6
Cipla	-7.2	-6.9	62.3

#### Stock movement



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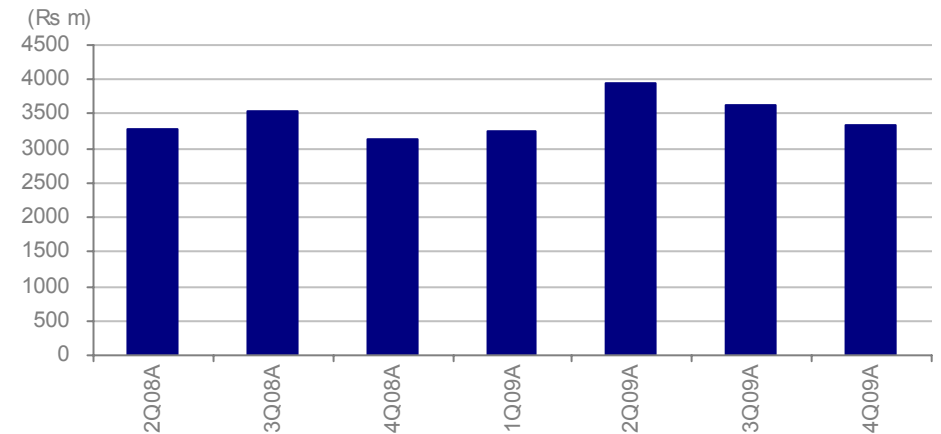
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**Figure 1: Base business remained weak in 4QCY09**

Rs m	4QCY08A	3QCY09A	4QCY09A	% YoY	%QoQ
Dosage forms - India	3,145	3,617	3,334	6.0	-7.8
Global consumer healthcare	576	563	726	26.0	29.0
Dosage forms - CIS	1,458	1,119	1,458	0.0	30.3
Dosage forms - Asia Pacific	1,174	1,275	1,308	11.4	2.6
Dosage forms - Europe	3,628	3,265	3,767	3.8	15.4
Dosage forms - Africa	1,678	1,758	1,282	-23.6	-27.1
Dosage forms - Latin America	912	1,038	997	9.3	-3.9
Dosage forms - US - base business	4,410	2,138	2,154	-51.2	0.8
Dosage forms - Canada	670	817	773	15.4	-5.4
Dosage forms - North America - base business	5,080	2,955	2,927	-42.4	-0.9
US exclusivities (estimate)	0	0	5,403	NA	NA
Total dosage forms	18,603	15,925	21,202	14.0	33.1
Total API	1,379	1,238	1,301	-5.7	5.1
Operating revenue excluding exclusivities	19,049	17,163	17,261	-9.4	0.6
Other Operating Revenue	933	1,695	-115	NA	NA
US Exclusivity sales	0	0	5,403	NA	NA
Total operating revenue	19,982	18,858	22,549	12.8	19.6
Total expenses	17,455	16,431	18,444	5.7	12.3
EBITDA	2,527	2,427	4,105	62.5	69.2
EBITDA Margin	12.6%	12.9%	18.2%	560 bps	530 bps
Depreciation	720	654	739	2.7	13.0
Operating profit	1,807	1,773	3,366	86.3	89.9
Operating margin	9.0%	9.4%	14.9%	590 bps	550 bps
Other income	-12829	-51	6,169	NA	NA
Interest cost	442	121	146	-66.9	21.0
PBT	-11464	1,601	9,389	NA	486.4
Total Provision for tax	-4666	435	6,769	NA	1,456.1
Tax rate	40.7%	27.2%	72.1%	3140 bps	4490 bps
Minority interest	24	17	102	317.6	486.4
Income from associate	24	-5	-30	NA	NA
Net profit	-6798	1,144	2,488	NA	117.6

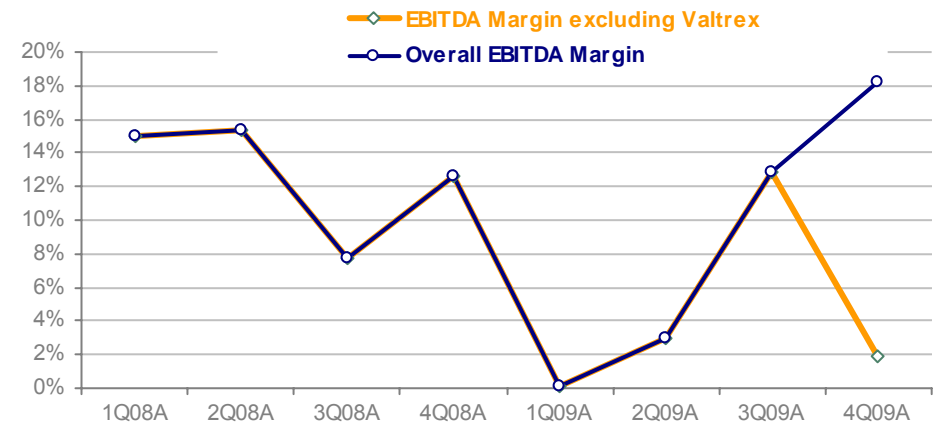
Source: Company, IIFL Research

**Figure 2: Stagnant domestic business**



Source: Company, IIFL Research

**Figure 3: Profitability continues to be weak**



Source: Company, IIFL Research

## Financial summary

### Income statement summary (Rs m)

Y/e 31 Dec	CY07A	CY08A	CY09A	CY10ii	CY11ii
Revenue	67,810	74,214	75,970	81,057	101,759
EBITDA	7,135	5,731	7,124	9,613	21,088
<b>EBIT</b>	<b>4,951</b>	<b>2,906</b>	<b>4,448</b>	<b>6,768</b>	<b>18,175</b>
Interest income	6,446	-15,852	6,360	800	800
Interest expense	1,412	2,055	710	684	821
<b>Profit before tax</b>	<b>9,985</b>	<b>-15,000</b>	<b>10,098</b>	<b>6,884</b>	<b>18,155</b>
Taxes	2,118	-5,651	6,991	1,546	3,812
Minorities and other	122	163	142	79	214
<b>Net profit</b>	<b>7,746</b>	<b>-9,512</b>	<b>2,965</b>	<b>5,259</b>	<b>14,128</b>

### Cashflow summary (Rs m)

Y/e 31 Dec	CY07A	CY08A	CY09A	CY10ii	CY11ii
Profit before tax	9,985	-15,000	10,098	6,884	18,155
Depr. & amortization	2,183	2,825	2,676	2,845	2,913
Tax paid	1,411	1,360	6,991	1,546	3,812
Working capital Δ	802	-2,388	-25,963	-1,990	-8,571
Other operating items	-1,336	14,373	-5,649	-116	21
Operating cashflow	10,223	-1,550	-25,829	6,077	8,705
Capital expenditure	-8,385	-7,224	-4,000	-4,000	-4,000
<b>Free cash flow</b>	<b>1,838</b>	<b>-8,774</b>	<b>-29,829</b>	<b>2,077</b>	<b>4,705</b>
Equity raised	92	36,146	0	0	0
Investments	0	-201	0	0	0
Debt financing/disposal	4,333	-4,497	5,635	5,452	-1,810
Dividends paid	-3,642	-2,620	0	0	-2,463
Other items	-1,199	-1,686	5,649	116	-21
<b>Net change in cash</b>	<b>1,424</b>	<b>18,368</b>	<b>-18,545</b>	<b>7,644</b>	<b>412</b>

Source: Company data, IIFL Research

### Balance sheet summary (Rs m)

Y/e 31 Dec	CY07A	CY08A	CY09A	CY10ii	CY11ii
Cash & equivalents	4,379	23,956	5,411	13,055	13,467
Sundry debtors	14,931	13,310	16,713	17,833	22,387
Inventories - trade	16,409	19,643	18,233	19,454	24,422
Other current assets	9,042	22,488	23,116	23,675	25,953
<b>Fixed assets</b>	<b>45,619</b>	<b>49,607</b>	<b>50,931</b>	<b>52,086</b>	<b>53,172</b>
Other term assets	2,403	5,432	5,432	5,432	5,432
<b>Total assets</b>	<b>92,782</b>	<b>134,437</b>	<b>119,836</b>	<b>131,534</b>	<b>144,833</b>
Sundry creditors	21,327	47,438	24,096	25,006	28,235
Long-term debt/CBs	41,416	43,114	48,749	54,201	52,391
Other long-term liabs	1,434	247	247	247	247
Minorities/other equity	571	675	816	895	1,109
<b>Net worth</b>	<b>28,034</b>	<b>42,962</b>	<b>45,927</b>	<b>51,186</b>	<b>62,852</b>
<b>Total liabs &amp; equity</b>	<b>92,782</b>	<b>134,437</b>	<b>119,836</b>	<b>131,534</b>	<b>144,833</b>

### Ratio Analysis

Y/e 31 Dec	CY07A	CY08A	CY09A	CY10ii	CY11ii
Revenue growth (%)	12.7	9.4	2.4	6.7	25.5
Op Ebitda growth (%)	-5.6	-19.7	24.3	34.9	119.4
Op Ebit growth (%)	-13.4	-41.3	53.1	52.1	168.6
Op Ebitda margin (%)	10.5	7.7	9.4	11.9	20.7
Op Ebit margin (%)	7.3	3.9	5.9	8.3	17.9
Net profit margin (%)	11.4	-12.8	3.9	6.5	13.9
Dividend payout (%)	40.9	0.0	0.0	40.0	29.8
Tax rate (%)	21.2	37.7	69.2	22.5	21.0
Net debt/equity (%)	132.1	44.6	106.1	105.9	83.4
Net debt/op Ebitda (x)	5.2	3.3	6.8	5.6	2.5
Return on equity (%)	27.6	-22.1	6.5	10.3	22.5
ROCE (%)	7.0	3.4	4.7	6.4	15.7
Return on assets (%)	8.3	-7.1	2.5	4.0	9.8

Source: Company data, IIFL Research



## Key to our recommendation structure

**BUY** - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.

**SELL** - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

**Add** - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.

**Reduce** - Stock expected to return less than the hurdle rate, ie return of less than 10%.

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