MOTILAL OSWAL

Ranbaxy Laboratories

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,238	RBXY IN
	REUTERS CODE
S&P CNX: 2,809	RANB.BO

Equity Shares (m)	371.1
52-Week Range (Rs)	610/340
1,6,12 Rel. Perf. (%)	6/-52/-73
M.Cap. (Rs b)	142.5
M.Cap. (US$ b)	3.2

18 January 2006 — **Sell**

Previous Recommendation: Sell — Rs384

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
12/04A	54,220	7,279	19.6	-0.9	19.6	5.7	29.1	27.7	2.8	15.3
12/05E	53,238	2,263	6.1	-68.9	63.1	5.4	8.6	7.4	2.8	37.6
12/06E	58,508	4,270	11.5	88.7	33.4	5.0	15.0	13.9	2.6	21.5

4QCY05 results were much lower than our and consensus estimates, with sales and PAT declining by 1.2% and 96% respectively. Pricing pressure in regulated markets took a heavy toll on revenues and profitability.

- Net sales declined by 1.2% to Rs13.87b due to stiff pricing pressures in the US (down 27% to US$93m) and U.K (down 13% YoY to US$11m). Also, revenues from France declined 6% to US$19m due to regulatory changes. However, growth in Germany (up 31% to US$9m), rest of Europe (up 21% to US$16m) and Russia & Ukraine operations (up by 33% to US$20m) limited decline in total revenues to 1.2%.
- Continued pricing pressure in its key market, the US, resulted in decline of 10.8pp in EBITDA margins to 4.6%, translating into PBT of Rs34m. However, extraordinary net income of Rs285m (on account of sale of its Allied Business and a write-off for its US branded business) and a tax writeback of Rs377m cushioned net profit to Rs686m.
- During 4QCY05, the company filed 16 ANDAs taking cumulative ANDA filing to 170, of which 59 are awaiting approval including 19 Para-IVs.

At 33.4x CY06E and 27.1x CY07E (excluding upsides from patent challenges), valuations are stretched even after factoring in some premium for Ranbaxy's strong product pipeline and superior business model. Acquisitions have become imperative for Ranbaxy raising the risks for investors. We maintain **Sell.**

QUARTERLY PERFORMANCE (Rs Million)

Y/E DECEMBER	CY04				CY05				CY04	CY05E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Net Income	**13,470**	**12,992**	**13,614**	**14,341**	**11,835**	**13,642**	**13,470**	**14,291**	**54,291**	**53,238**
YoY Change (%)	*17.0*	*8.5*	*13.9*	*18.6*	*-12.1*	*5.0*	*-1.1*	*-0.3*	*21.9*	*-1.9*
EBITDA	**3,047**	**2,927**	**3,125**	**2,206**	**1,275**	**1,722**	**312**	**654**	**9,814**	**3,963**
Margins (%)	*22.6*	*22.5*	*23.0*	*15.4*	*10.8*	*12.6*	*2.3*	*4.6*	*18.1*	*7.4*
Depreciation	401	415	410	310	326	374	355	447	1,215	1,502
Interest	107	126	127	104	138	170	159	195	335	662
Other Income	55	275	66	34	31	85	48	22	1,000	186
PBT before EO Expense	**2,594**	**2,661**	**2,654**	**1,826**	**842**	**1,263**	**-154**	**34**	**9,264**	**1,985**
Extra-Ord Expense*	0	0	0	0	0	0	0	-285	372	-285
PBT after EO Expense	**2,594**	**2,661**	**2,654**	**1,826**	**842**	**1,263**	**-154**	**319**	**8,892**	**2,270**
Tax	615	624	520	224	131	247	-341	-377	1,574	-340
Deferred Tax	70	76	130	31	0	0	0	0	307	0
Rate (%)	*26.4*	*26.3*	*24.5*	*14.0*	*15.6*	*19.6*	*221.4*	*-118.2*	*21.2*	*-15.0*
Reported PAT	**1,909**	**1,961**	**2,004**	**1,571**	**711**	**1,016**	**187**	**696**	**7,011**	**2,610**
Minority Interest	3	3	3	6	3	3	3	10	25	19
Adj PAT after Minority Int.	**1,906**	**1,958**	**2,001**	**1,565**	**708**	**1,013**	**184**	**358**	**7,279**	**2,263**
YoY Change (%)	15.3	*-3.0*	*12.0*	*-3.8*	*-62.9*	*-48.3*	*-90.8*	*-77.1*	*-0.8*	*-68.9*
Margins (%)	*14.1*	*15.1*	*14.7*	*10.9*	*6.0*	*7.4*	*1.4*	*2.5*	*13.4*	*4.3*

*E: MOSt Estimates; * Audited CY04 numbers are different from earlier announced figures; hence quarterly numbers do not add up*

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Pricing pressure in the US continues to impact revenues

4QCY05 sales declined 1.2% YoY to Rs13.9b (US$ sales declined by 2.5% YoY), with sales in key market of US declining by 26% YoY. Unabated pricing pressure in the US and UK resulted in decline in revenues from these two regions by 26% YoY (to US$95m) and 13% (to US$11m) respectively. Also, revenues from France declined by 6% to US$19m due to certain regulatory changes in the market. However, growth in operations in Germany (up 31% to US$9m), Rest of the Europe (up 21% to US$16m), Russia & Ukraine (up by 33% to US$20m) and India (up by 13% to US$60m) restricted decline in total revenues to 1.2%.

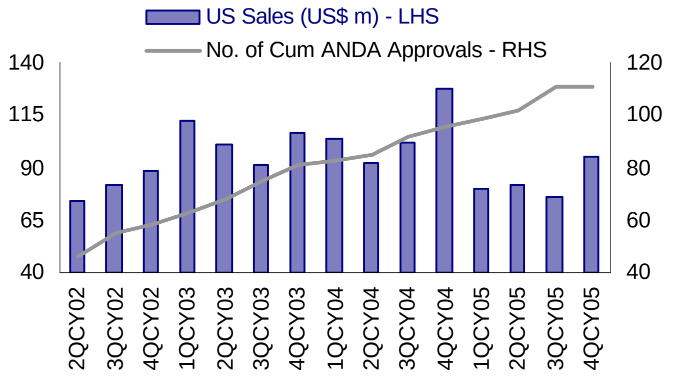
TREND IN MARKET MIX (US$M)

SALES BREAK UP	4QCY05	4QCY04	% CHG.	3QCY05	% CHG.
Dosage Forms	**276**	**289**	**-4.5**	**254**	**8.7**
India and Middle East	60	53	13.2	69	-13.0
Europe, CIS and Africa	92	81	13.6	82	12.2
Asia Pacific & Lat. Amer.	29	27	7.4	27	7.4
USA	95	128	-25.8	76	25.0
APIs	27	19	42.1	33	(18.2)
Allied Businesses	6	9	-33.3	10	-40.0
Net Sales	**309**	**317**	**-2.5**	**297**	**4.0**

Source: Company/Motilal Oswal Securities

Ranbaxy's US operations — its key growth engine in the past — were hit the most owing to a severe pricing pressure which took a heavy toll of most of the company's products. US sales have declined for the fourth consecutive quarter, despite having a higher number of cumulative product approvals.

RANBAXY'S US SALES – FOURTH CONSECUTIVE QUARTER OF YOY DECLINE



Source: Company/Motilal Oswal Securities

The fact that sales dropped by around 26%, despite 26% prescription growth for YTD November 2005 (v/s industry's prescription growth of 17%), highlights the magnitude of the prevalent pricing pressure in the US market.

Margins collapse … recurring PAT down 77% YoY

EBITDA margins declined to 4.6% compared with 15.4% in 4QCY04, owing to continued pricing pressure in the US and UK markets. This led to PBT of merely Rs34m. However, extraordinary net income of Rs285m (from sale of its Allied Business and a writeoff for its US branded business) and a tax write back of Rs377m cushioned net profit to Rs686m. Adjusted net profit was lower by 77% YoY to Rs358m.

Pricing pressure intensifies in US - only new launches can drive growth

Ranbaxy's US business declined by 26% to US$92m due to stiff pricing pressure and absence of new major product launches. We believe that given this severe price erosion, it will be difficult for companies like Ranbaxy to grow their existing portfolio (in fact the company will witness a decline).

The implication is that only those companies, which can introduce a large number of new products, will be able to show positive growth in the US market. New product launches are a function of a company's R&D capabilities (to develop the product) and the obtaining of timely US FDA approvals.

Ranbaxy currently has about 59 ANDAs pending approval — the second largest pipeline in the industry. Ranbaxy believes it has a strong product pipeline, which will begin to reflect positive performance from CY06 onward. Some of the larger opportunities are simvastatin and pravastatin with a combined market size of about US$6b at innovators' prices.

Para-IV pipeline

Ranbaxy's existing Para-IV pipeline for the US comprises 32 filings with 19 potential FTFs addressing a market size of US$16b. It has recently entered into an out-of-court settlement with Cephalon for modafinil patent challenge. It should be noted that while our estimates do not include upsides from these patent challenges, our sensitivity analysis indicates an upside of about Rs3.5 per share from the pravastatin FTF opportunity and about Rs7-Rs8 per share for the simvastatin FTF opportunity.

Specialty pipeline

Ranbaxy has plans to file about 18 NDDS-based ANDAs with the US FDA in 2005-07, which will bring in long-term benefits since competition for these products will not be as intense as in normal generics.

Looking at other markets for growth

Ranbaxy expects better performance in the UK and Germany in CY06E led mainly by new product launches. It expects its French operations to record a positive EBITDA, led by new launches and gradual shifting of product manufacturing to India. Ranbaxy is in the process of renewing its existing registrations in Brazil; while in China it is focusing on launching products with limited competition and is increasing its hospital coverage.

Acquisitions are imperative but generic assets are not cheap

We believe acquisitions are imperative if Ranbaxy must achieve its US$2b revenue target by CY07. The company is considering inorganic growth opportunities in Europe and the US. It is pertinent to note that many generic players (including most of the Indian companies) are looking at acquisitions to boost their generic businesses. The need to resort to inorganic growth has assumed relevance due to the recent consolidation in the global generics space with Teva and Sandoz announcing significantly large acquisitions. This implies that, in their quest for inorganic growth, generic players may end up acquiring expensive assets (resulting in extended paybacks). We do not rule out this possibility in Ranbaxy's case. The acquisitions made by both Teva and Sandoz have valued the acquired company at about 3-4x sales. We believe that such expensive acquisitions may extend the payback period for the acquirer.

Aggressive capex to boost product pipeline

Despite difficult market conditions, Ranbaxy has indicated that the US generics market presents attractive opportunities in the future and is gearing up to capitalize on them. The company incurred capex of US$150m in CY05 for expanding its manufacturing and R&D capacities. It plans to invest another US$100m in capex for each of the years CY06 and CY07. We believe that this is by far the largest investment by any Indian company in such a short time period and implies that the company expects strong product flow for the generics market in the coming years.

Loses US lipitor patent challenge

Ranbaxy Labs lost the lipitor (atorvastatin) patent challenge in the US District Court of Delaware. The court ruled that Ranbaxy infringes Pfizer's '893 patent and has failed to invalidate the '995 patent. This was the biggest patent challenge from any generic company since lipitor generates revenues of about US$8b for Pfizer in the US alone. The ruling will prevent Ranbaxy's launch till 2011 unless successfully challenged in the Appeals Court. Ranbaxy has indicated that it will be appealing against the lower court ruling. The Appeals Court is likely to take at least 12 months for ruling on this case.

While our earnings estimates for Ranbaxy remain unchanged, as we had not included upsides from generic lipitor, we do not rule out one-time write-offs for Ranbaxy related to lipitor although the company has not given any details regarding this.

Maintains guidance

The company maintained its guidance of revenue growth of 18%+ and EBITDA margins at 16%+ for CY06E. The company has included upsides from pravastatin 80mg exclusivity. The key driver for sales growth would be new launches (which were very few in CY05E) and upsides from FTF opportunities.

Ranbaxy is revisiting all the costs heads with specific focus on COGS, R&D, SG&A, Taxation and Supply Chain. It expects significant cost savings in CY06E which could positively impact EBITDA margins. The following table gives the expected savings in costs for CY06E:

CONTRIBUTORS TO EBITDA MARGIN	%
R&D (lower spend)	1.3
Cost saving initiative	0.7
Litigation (lower spend)	0.3
USA-Price erosion	-3.5
USA-New products	3.6
USA-Branded	1.0
RoW-New products/mix	1.5
COGS improvement	2.9
Incremental addition to EBITDA Margin	7.8

Source: Company

It should be noted that this margin expansion will be achieved on a very low base (EBITDA margin of 7.5% for CY05) and includes upsides from high-margin FTF opportunities like pravastatin 80mg exclusivity.

Valuation and outlook

We believe that despite the significant correction in Ranbaxy's stock price, valuations (based on core earnings excluding upsides from patent challenges) are rich. Hence, we believe that rather than the core fundamentals, the following events/news will be the drivers of the stock price in the short term

1) US ruling on exclusivities related to 80mg pravastatin and simvastatin
2) Acquisitions in the regulated generic markets
3) Any other patent challenge rulings.

Ranbaxy enjoys premium valuations since it is one of the leading global generic players. We believe that, given its strong product pipeline, Ranbaxy is well positioned to exploit the potential of regulated generic markets in the long-term with about US$40b-US$50b worth of drugs going offpatent over the next four years. However, at 33.4x CY06E and 27.1x CY07E earnings (excluding upsides from Para-IVs), valuations are rich. We believe that risks are increasing in the generics space for Ranbaxy. We maintain **Sell.**

Ranbaxy Laboratories: an investment profile

Company description

Ranbaxy is the largest pharmaceutical company and the ninth largest generic company in the world, with global revenues of over US$1b. It has a direct global presence in key markets of US, UK, Germany, France and Brazil with 50% revenues coming from the US and Europe.

Key investment arguments

- De-risked business model, with a wide-product basket and presence across different geographies
- Well placed to ride the generics wave on the sssssstrength of a strong distribution presence in key global markets and fully-integrated operations
- Successful scaling up of its branded portfolio and NCE/ NDDS efforts will sustain growth post patent expiries

Key investment risks

- Loss of the quinapril litigation v/s Pfizer could lead to substantial penalties
- Stiff competition from Indian players and aggressive counter strategies by innovators would continue to be challenging, depressing near-term earnings
- Intention to step up R&D to sales ratio by 100bp each year could hurt profitability if expected revenue growth does not come through

Recent developments

- Lost one of the key patent challenges for Lipitor in UK
- Entry in Pravastatin market in USA delayed due to Teva's exclusivity

Valuation and view

- Lack of near term catalysts, pressure on earnings to put pressure on valuations, despite the Atorvastatin opportunity
- Reward risk equation is unfavorable. We maintain **Sell**

Sector view

- Regulated markets would remain the key sales and profit drivers in the medium term. Europe is expected to emerge as the next growth driver, particularly for companies with a direct marketing presence
- FY06 is expected to be a year of consolidation in terms of profitability, as companies divert efficiency gains towards seeding their regulated markets and R&D initiatives
- We are overweight on companies that are towards the end of the investment phase, with benefits expected to start coming in from the next fiscal

COMPARATIVE VALUATIONS

		RANBAXY	DRL	CIPLA
P/E (x)	FY06E	63.1	37.9	27.7
	FY07E	33.4	30.8	19.8
P/BV (x)	FY06E	5.4	3.4	6.9
	FY07E	5.0	3.1	5.5
EV/Sales (x)	FY06E	2.8	3.3	4.8
	FY07E	2.6	2.7	3.8
EV/EBITDA (x)	FY06E	37.6	38.3	20.1
	FY07E	21.5	27.6	15.0

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEEC.04
Promoters	35.8	35.8	33.4
Domestic Institutions	14.6	14.4	15.1
FIIs/FDIs	29.1	31.4	33.9
Others	20.5	18.4	17.6

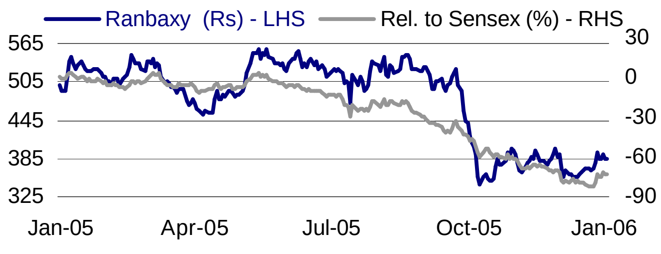
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
CY05	6.1	12.9	-52.7
CY06	11.5	20.4	-43.7

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
384	300	-21.9	Sell

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (Rs Million)

Y/E DECEMBER	2003	2004	2005	2006E	2007E
Net Sales	**44,553**	**52,351**	**51,099**	**56,701**	**64,593**
Change (%)	*23.0*	*17.5*	*-2.4*	*11.0*	*13.9*
Other Operating Income	3,447	1,870	2,139	1,806	1,540
Total Expenditure	37,404	44,407	49,275	51,504	57,487
EBITDA	**10,596**	**9,814**	**3,963**	**7,004**	**8,645**
Margin (%)	*22.1*	*18.1*	*7.4*	*12.0*	*13.1*
Depreciation	1,211	1,215	1,502	1,700	1,982
Int. and Finance Charges	252	335	662	794	694
Other Income - Rec.	662	1,000	186	204	197
PBT & EO Expense	**9,795**	**9,264**	**1,985**	**4,714**	**6,167**
Change (%)	*31.3*	*-5.4*	*-78.6*	*137.5*	*30.8*
Extra Ordinary Expense	-352	372	-285	0	0
PBT after EO Exp.	**10,147**	**8,892**	**2,270**	**4,714**	**6,167**
Tax	2,538	1,881	-340	424	863
Tax Rate (%)	*25.0*	*21.2*	*-15.0*	*9.0*	*14.0*
Reported PAT	**7,609**	**7,011**	**2,610**	**4,290**	**5,303**
Minority Interest	15	26	19	20	30
Adj PAT after Minority	**7,331**	**7,279**	**2,263**	**4,270**	**5,273**
Change (%)	*26.6*	*-0.7*	*-68.9*	*88.7*	*23.5*
Margin (%)	*16.5*	*13.9*	*4.4*	*7.5*	*8.2*

BALANCE SHEET (Rs Million)

Y/E DECEMBER	2003	2004	2005E	2006E	2007E
Equity Share Capital	1,855	1,859	1,859	1,859	1,859
Reserves	19,617	23,140	24,454	26,609	29,276
Revaluation Reserves	110	107	107	107	107
Net Worth	**21,582**	**25,106**	**26,420**	**28,575**	**31,242**
Minority Interest	166	180	199	219	249
Loans	5,850	8,527	8,250	10,000	8,500
Deferred liabilities	943	842	842	842	842
Capital Employed	**28,541**	**34,655**	**35,712**	**39,637**	**40,833**
Gross Block	16,533	23,132	27,582	32,032	33,532
Less: Accum. Deprn.	6,496	7,838	9,340	11,040	13,022
Net Fixed Assets	**10,037**	**15,294**	**18,242**	**20,992**	**20,510**
Capital WIP	1,005	2,876	1,000	1,000	750
Investments	168	184	184	184	184
Curr. Assets	**31,239**	**35,470**	**35,285**	**38,146**	**42,131**
Inventory	9,558	14,351	13,860	14,603	16,635
Account Receivables	7,511	11,357	11,388	12,314	14,014
Cash and Bank Balance	1,580	1,339	1,899	2,191	1,187
Others	12,590	8,423	8,139	9,038	10,295
Curr. Liability & Prov.	**13,909**	**19,168**	**19,000**	**20,685**	**22,742**
Account Payables	7,791	12,693	10,500	11,185	12,742
Provisions	6,118	6,475	8,500	9,500	10,000
Net Current Assets	**17,330**	**16,302**	**16,286**	**17,461**	**19,389**
Appl. of Funds	**28,541**	**34,655**	**35,712**	**39,637**	**40,833**

E: MOSt Estimates

RATIOS

Y/E DECEMBER	2003	2004	2005E	2006E	2007E
Basic (Rs)					
EPS	**19.8**	**19.6**	**6.1**	**11.5**	**14.2**
Cash EPS	23.0	22.8	10.1	16.1	19.5
BV/Share	57.9	67.2	70.8	76.6	83.7
DPS	8.5	8.5	3.1	5.0	6.2
Payout (%)	46.8	51.4	49.6	49.8	49.7
Valuation (x)					
P/E		19.6	63.1	33.4	27.1
PEG (x)		-27.7	-0.9	0.4	1.2
Cash P/E		16.8	37.9	23.9	19.7
P/BV		5.7	5.4	5.0	4.6
EV/Sales		2.8	2.8	2.6	2.3
EV/EBITDA		15.3	37.6	21.5	17.3
Dividend Yield (%)		2.2	0.8	1.3	1.6
Return Ratios (%)					
RoE	34.1	29.1	8.6	15.0	16.9
RoCE	35.2	27.7	7.4	13.9	16.8
Working Capital Ratios					
Asset Turnover (x)	1.6	1.5	1.4	1.4	1.6
Debtor (Days)	62	79	81	79	79
Inventory (Days)	78	100	99	94	94
Working Capital (Days)	129	104	103	98	103
Leverage Ratio (x)					
Current Ratio	2.2	1.9	1.9	1.8	1.9
Debt/Equity	0.3	0.3	0.3	0.3	0.3

CASH FLOW STATEMENT (Rs Million)

Y/E DECEMBER	2003	2004	2005E	2006E	2007E
Op. Profit/(Loss) before Tax	10,596	9,814	3,963	7,004	8,645
Interest/Dividends Recd.	662	1,000	186	204	197
Direct Taxes Paid	-2,436	-1,982	340	-424	-863
(Inc)/Dec in WC	-4,675	788	576	-883	-2,933
CF from Operations	**4,147**	**9,620**	**5,065**	**5,901**	**5,046**
EO Expense	-67	372	-285	0	0
CF from Oper. incl EO E	**4,214**	**9,248**	**5,350**	**5,901**	**5,046**
(Inc)/Dec in FA	-2,387	-8,342	-2,574	-4,450	-1,250
(Pur)/Sale of Investments	202	-16	0	0	0
CF from Investments	**-2,185**	**-8,358**	**-2,574**	**-4,450**	**-1,250**
Issue of Shares	0	116	0	0	0
(Inc)/Dec in Debt	1,871	2,691	-258	1,770	-1,470
Interest Paid	-252	-335	-662	-794	-694
Dividend Paid	-3,561	-3,603	-1,296	-2,135	-2,637
CF from Fin. Activity	**-1,942**	**-1,130**	**-2,216**	**-1,159**	**-4,800**
Inc/Dec of Cash	**86**	**-240**	**560**	**292**	**-1,004**
Add: Beginning Balance	1,494	1,580	1,339	1,899	2,191
Closing Balance	**1,580**	**1,339**	**1,899**	**2,191**	**1,187**

NOTES

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Disclosure of Interest Statement	Ranbaxy Laboratories
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No

MOSt is not engaged in providing investment-banking services.