

# RANBAXY LABORATORIES

INR 368

*Changing times*

BUY



We are upgrading our rating on Ranbaxy to 'BUY' from 'ACCUMULATE', as we foresee the branded generics segment's contribution to the company's revenues increasing significantly. Being a high margin business, branded generics business is a lucrative business area. Moreover, with the announcement of patent litigation settlement for *Valtrex*, we believe that the visibility on one-time opportunities has improved. With this, there is a higher possibility of similar announcement for monetising another Para IV opportunity in CY08E. Considering the increased visibility and the material significance of the likely one-time opportunities, it is appropriate to value the business using SOTP method. We value the base business at INR 418 per share and the opportunities for *Lipitor* and *Valtrex* at INR 40 and INR 18 per share respectively, which implies an upside of ~28% from the current levels. At a CMP of INR 368, the stock is trading at 17.6x CY08E earnings, excluding the one-time opportunities.

### \* Business shifting towards branded generics

The branded generics segment, which is likely to be Ranbaxy's key growth driver in the near term, is extremely lucrative in terms of margins. We expect almost 65% of the company's growth in CY08E to be driven by the branded generics business. With reduced dependence on the (plain vanilla) generics business (down to 23% in CY08E from ~29% in CY06), we believe Ranbaxy's profitability would improve significantly, going forward.

### \* One-time opportunities to provide additional upside

We believe that upsides from *Valtrex* and *Lipitor* opportunities in 2009-end and 2010, respectively, are extremely attractive, but have not been priced in the stock. Further, Ranbaxy has guided for another Para IV opportunity to be materialised in CY08E. The company has also signed its first authorised generic deal in Verapamil SR, following an agreement with FSC Labs, which has a market size of USD 122 mn. We believe that with such deals, the possibility of Ranbaxy monetising its ~20FTFs increases.

### \* All negatives priced in

Ranbaxy has underperformed the overall healthcare Index by more than 12% over the last one year. This underperformance was primarily driven by facility approval issues at Paonta Sahib and USFDA's raid on Ranbaxy's offices in the US. As a result of these negative sentiments, we believe all the adverse news is factored in the price and there is limited downside to the stock, going forward.

### Financials

Year to December	CY05	CY06	CY07E	CY08E
Revenues (INR mn)	52,816	61,434	66,826	78,327
Rev growth (%)	(2.8)	16.3	8.8	17.2
EBITDA (INR mn)	3,111	8,825	8,982	12,292
Net profit (INR mn)	2,617	5,103	6,854	8,346
Shares outstanding (mn)	372.4	372.7	399.0	399.0
EPS (INR)	7.0	13.7	17.2	20.9
EPS growth (%)	(62.6)	94.9	25.4	21.8
P/E (x)	55.5	26.9	21.4	17.6
EV/EBITDA (x)	52.3	17.5	17.8	12.7
ROE (%)	10.7	10.9	13.5	14.8

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**Amod Karanjikar**  
+91-22-2286 4429  
amod.karanjikar@edelcap.com

**Ranjan Varghese**  
+91-22-4019 4984  
ranjan.varghese@edelcap.com

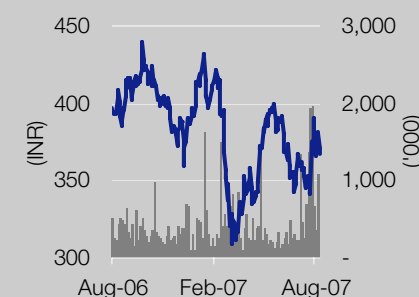
Reuters : RANB.BO  
Bloomberg : RBXY.IN

### Market Data

52-week range (INR) : 445 / 306  
Share in issue (mn) : 372.5  
M cap (INR bn/USD mn) : 137.0 / 3,382.9  
Avg. Daily Vol. BSE/NSE ('000) : 1,418.0

### Share Holding Pattern (%)

Promoters : 34.9  
MFs, Fls & Banks : 21.8  
Fls : 16.5  
Others : 26.8



\* **Valuations: Attractive**

At CMP of INR 368, the stock trades at 17.6x our CY08E base business earnings. We have used SOTP methodology to value the business, valuing the base business at INR 418 and the combined *Lipitor* and *Valtrex* opportunities at INR 58 per share. This implies a potential upside of ~28% from the current level. We, therefore, upgrade the stock to **'BUY'** from **'ACCUMULATE'**.

## Company Description

Ranbaxy is the largest generics player in the domestic market with a market share of more than ~4.7%. Exports contribute about 79% to its total revenues. The US generics market is the company's key market, contributing ~29% to its total revenues. The company has pursued inorganic growth opportunities in the past year, wherein 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 Theme

We believe that Ranbaxy will have steady growth in the coming quarters because of: (1) increased contribution of the branded generic segment to total revenues, (2) steady ~15% growth in India, and (3) increased visibility and material significance of one-time positive upsides from Valtrex and Lipitor.

## Key Risks

- Pricing pressure in the US market.
- Regulatory delays in the emerging markets.
- 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	61,434	66,826	78,327
Total operating expenses	44,507	49,705	52,609	57,844	66,035
Materials cost	19,090	22,213	23,733	26,730	28,981
Employee cost	6,382	6,786	7,955	8,353	9,188
R&D cost	3,376	4,925	3,955	4,010	4,411
Other expenses	15,659	15,781	16,966	18,751	23,455
EBITDA	9,814	3,111	8,825	8,982	12,292
Depreciation and amortisation	1,215	1,445	1,843	1,915	1,945
Interest	335	671	1,036	1,059	909
Other income	1,000	616	564	2,622	1,057
Extraor. items [exp./gain]	372	(333)	-	-	-
Profit before tax	8,892	1,945	6,510	8,630	10,496
Provision for tax	1,881	(698)	1,357	1,726	2,099
PAT (inc. excep. & pre min. int.)	7,011	2,642	5,153	6,904	8,396
Minority interest & others	26	25	50	50	50
Pref. dividend, incl. tax thereon	-	-	-	-	-
PAT (inc. excep.) for eq. sh.holders	6,985	2,617	5,103	6,854	8,346

### 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	38.6	40.0	37.0
Employee cost	11.7	12.8	12.9	12.5	11.7
Other expenses	28.8	29.9	27.6	28.1	29.9
Depreciation	2.2	2.7	3.0	2.9	2.5
Interest expenditure	0.6	1.3	1.7	1.6	1.2
EBIDTA margins	18.1	5.9	14.4	13.4	15.7
Net profit margins	12.9	5.0	8.3	10.3	10.7

### 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)	16.3	8.8	17.2
EBIDTA (%)	(8.9)	(68.3)	183.7	1.8	36.9
Net profit (%)	(7.9)	(62.5)	95.0	34.3	21.8
EPS (%)	(8.1)	(62.6)	94.9	25.4	21.8

Note: USD/INR exchange rate - 40.7 for CY07E and CY08E

<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	6,443	9,138	10,665
Cash for working capital	959	(951)	(3,712)	(1,707)	(3,119)
Net operating cash flow	9,180	1,940	2,731	7,431	7,545
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	(2,549)	(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	(4,249)	(5,229)
<b>Free cash flow</b>	<b>806</b>	<b>(6,370)</b>	<b>(17,000)</b>	<b>6,931</b>	<b>7,045</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	46,822	50,947	56,564
Capital	1,859	1,862	2,002	2,002	2,002
Reserves & surplus	23,218	22,605	44,821	48,945	54,562
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
<b>Sources of funds</b>	<b>34,655</b>	<b>44,629</b>	<b>67,134</b>	<b>69,558</b>	<b>72,675</b>
Gross block	23,132	29,920	31,420	31,920	32,420
Depreciation	7,838	9,329	11,172	13,087	15,032
Net block	15,294	20,591	20,249	18,833	17,388
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	14,305	16,111	17,468
Sundry debtors	11,357	11,404	15,148	16,478	19,313
Cash and bank balances	1,339	2,430	1,984	4,665	6,481
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	37,258	43,076	49,084
Current liabilities	12,693	10,600	11,314	12,743	13,816
Provisions	6,475	4,408	3,906	4,455	4,828
Total current liabilities and provisions	19,168	15,008	15,220	17,198	18,644
Net current assets	16,302	18,271	22,038	25,878	30,440
<b>Uses of funds</b>	<b>34,655</b>	<b>44,629</b>	<b>67,134</b>	<b>69,558</b>	<b>72,675</b>
Book value per share (INR)	67	66	126	128	142

**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	10.9	13.5	14.8
ROCE (%)	26.6	5.9	11.2	13.9	15.7
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	13.7	17.2	20.9
Y-o-Y growth (%)	(8.1)	(62.6)	94.9	25.4	21.8
CEPS (INR)	22.1	10.9	18.6	22.0	25.8
P/E (x)	20.8	55.5	26.9	21.4	17.6
Price/BV(x)	5.8	5.9	2.9	2.9	2.6
EV/Sales (x)	2.8	3.1	2.5	2.4	2.0
EV/EBITDA (x)	15.5	52.3	17.5	17.8	12.7

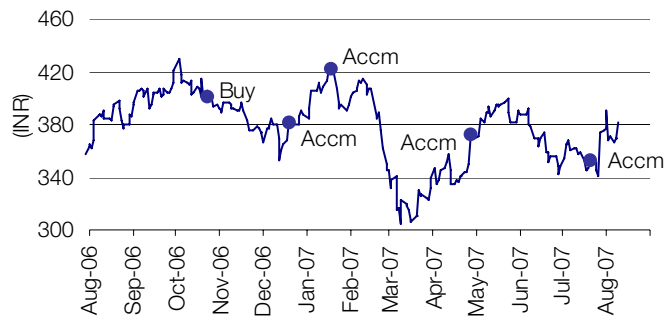
**Edelweiss Securities Limited**, 14<sup>th</sup> Floor, Express Towers, Nariman Point, Mumbai – 400 021, Board: (91-22) 2286 4400, Email: [research@edelcap.com](mailto:research@edelcap.com)

Naresh Kothari	Co-Head Institutional Equities	naresh.kothari@edelcap.com	+91 22 2286 4246
Vikas Khemani	Co-Head Institutional Equities	vikas.khemani@edelcap.com	+91 22 2286 4206
Shriram Iyer	Head Research	shriram.iyer@edelcap.com	+91 22 2286 4256

### Coverage group(s) of stocks by primary analyst(s): Pharmaceuticals:

Aurobindo Pharma, Cadila Healthcare, Cipla, Dishman Pharmaceuticals and Chemicals, Dr.Reddy's Laboratories, Glaxosmithkline Pharmaceuticals, Ipca Laboratories, Jubilant Organosys, Lupin, Nicholas Piramal India, Orchid Chemicals & Pharmaceuticals, Ranbaxy Laboratories, Shasun Chemicals and Drugs, Sun Pharmaceuticals Industries and Torrent Pharmaceuticals.

### Ranbaxy Laboratories



### Recent Research

Date	Company	Title	Price (INR)	Recos
1-Aug-07	<b>Cadila Healthcare</b>	In line; <i>Result Update</i>	355	Accum
1-Aug-07	<b>Aurobindo Pharma</b>	Weak quarter; <i>Result Update</i>	614	Buy
1-Aug-07	<b>Torrent Pharma.</b>	On tract; <i>Result Update</i>	217	Buy
31-Jul-07	<b>Dishman Pharma &amp; Che</b>	Soft quarter...; <i>Result Update</i>	315	Buy

### Distribution of Ratings / Market Cap

#### Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	95	40	24	6	175

\* 10 stocks under review / rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	76	67	32

### Rating Interpretation

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

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