

Company Flash

19 February 2008 | 6 pages

Ranbaxy (RANB.BO)

Buy: R&D Demerger Scheme Approved

- R&D de-merger scheme approved** — Ranbaxy's board has approved the de-merger of the New Drug Discovery Research Unit of the company into a subsidiary, Ranbaxy Life Science Research Ltd. (RLSRL). Under this scheme shareholders of Ranbaxy will be issued one equity share (FV:Re1) of RLSRL for every four equity shares (FV: Rs5) held in Ranbaxy.
- Post de-merger structure** — Ranbaxy will hold a 19.8% stake in RLSRL and 4.9% will be held by RLSRL Employee Welfare Fund Trust. The rest (75.3%) of the 126m equity shares would be held by Ranbaxy shareholders. Ranbaxy has also subscribed to redeemable preference shares worth Rs2bn in RLSRL, as initial funding to RLSRL. RLSRL's shares would be listed on the NSE and BSE while the GDRs would be listed on the Luxembourg Stock Exchange. We believe it could take around 6-8 months for all formalities to be completed.
- Significant cost savings** — After the de-merger all the assets, liabilities, employees and pipeline related to the New Drug Discovery Research Unit will be transferred to RLSRL. The company expects annual savings of approximately US\$25m consequent to the de-merger. We believe this implies an accretion of c7% (net of tax) to our CY08E EPS (pre de-merger).
- Maintain Buy (1M)** — Adjusted for NPVs of Valtrex, Tamsulosin & Lipitor exclusivities, Ranbaxy trades at 16.8x CY08E FDEPS, which is very attractive in our view. The listing of the R&D company would unlock some additional value for shareholders as well.

Buy/Medium Risk	1M
Price (19 Feb 08)	Rs415.40
Target price	Rs505.00
Expected share price return	21.6%
Expected dividend yield	1.2%
Expected total return	22.8%
Market Cap	Rs155,008M
	US\$3,913M

Price Performance (RIC: RANB.BO, BB: RBXY IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Dec	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2005A	2,617	7.03	-62.6	59.1	6.3	10.6	1.4
2006A	5,103	12.76	81.7	32.5	6.4	20.3	2.0
2007E	7,863	19.67	54.1	21.1	5.5	28.1	2.0
2008E	8,704	21.77	10.7	19.1	4.7	26.7	2.2
2009E	11,228	28.08	29.0	14.8	4.0	29.2	2.4

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Ranbaxy

Company description

Ranbaxy is a leading domestic pharmaceutical company with a strong export business complementing the domestic business. It has a vision of becoming a leading generics pharmaceutical company in the global market and, in the long term, a research-led pharmaceutical company. The company already has a presence in several countries, and has developed a complex business model, perhaps the first of its kind from a developing country. Over the past few years, Ranbaxy has grown rapidly and established itself firmly as a leading generics company globally. While the core pharmaceutical business is growing, the company has also invested in R&D. The company also has a strong chemicals and animal healthcare business in India.

Investment strategy

We rate Ranbaxy Buy (1M) with a target price of Rs505/share. We believe the stock price now factors in most negatives - viz. difficult global market dynamics, manufacturing related issues with the FDA, slowdown in product approvals, and loss of the Pravastatin 80mg opportunity. Moreover, we believe that these negatives and the declining stock price mask the positive steps that Ranbaxy has been taking since the beginning of CY06 to effect a turnaround in its fortunes. Benefits of its restructuring initiatives were visible in 1QCY06 operating profit margins, the EU foray has gained momentum with a series of acquisitions and revenues should scale up faster once the manufacturing issues are resolved. In the interim, we expect strong earnings momentum driven by exclusivity launch of Simvastatin 80mg to provide support to stock valuations and restrict downside.

Valuation

We prefer to value Ranbaxy using EV/Sales methodology to reflect a much fairer value of Ranbaxy's business today. We believe that Ranbaxy's current cost structure and profitability are not normalized. Its cost structure is highly fixed-cost oriented and is a legacy of the heady days of very high profitability in global generics. We believe this is being corrected now, and the benefits of the aggressive cost reduction initiatives have started coming through in the financials in CY06. With its presence across multiple geographies and wide basket of products, we believe the business is not fairly valued at 2.5x sales - this is primarily on account of profitability being under par. A large part of the costs are discretionary and related to pipeline building measures for future growth, which do not contribute to revenues in the near term. Our fair value multiple of 3x Sept 07 EV/Sales is at a discount to its peers such as Cipla and Sun and towards the lower end of the company's EV/Sales range of 2-4.6x over the past five years. Because the company is still emerging from a period of poor sales growth and sub-optimal profitability, we will wait for growth to return before considering applying a higher multiple. At 3x Sept 07 EV/Sales, our target price is Rs505.

Risks

We rate Ranbaxy Medium Risk based on our quantitative risk-rating system. The key upside risks to our target price include: (1) New ANDA approvals above the expected three to four per quarter; (2) Upside from simvastatin 80mg being higher than we expected (3) News on the NCE development program; and (5) Any new paragraph IV challenges. The key downside risks that could impede the stock from reaching our target price: (1) Intensifying pricing pressure in the US and European markets; (2) The company paying high multiples to acquire more businesses in Europe and USA; and (3) Inability to resolve the manufacturing issues with the US FDA by the end of the current fiscal.

Appendix A-1

Analyst Certification

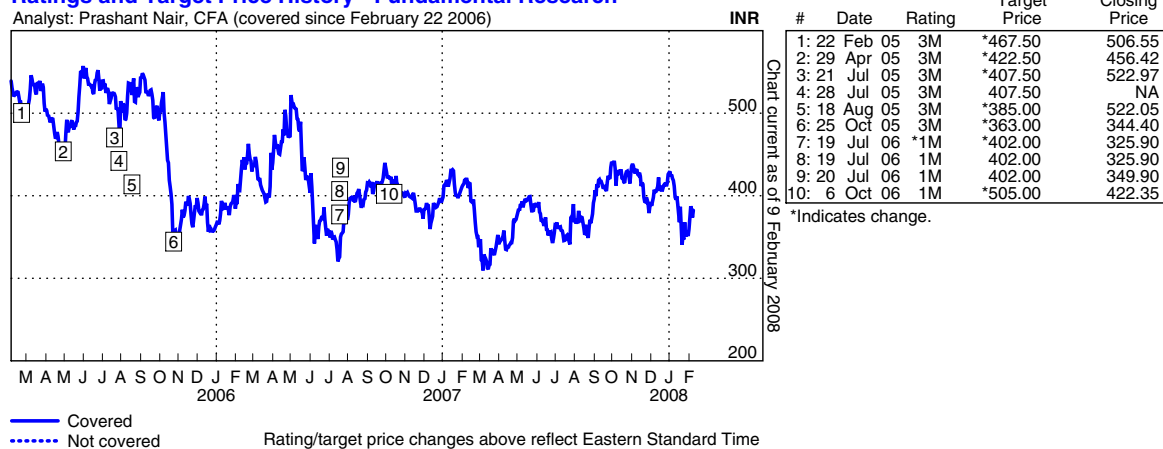
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Ranbaxy (RANB.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Prashant Nair, CFA (covered since February 22 2006)



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