

Ranbaxy Laboratories Limited ----- Maintain NEUTRAL
Disappointing margins; increase in revenue guidance a positive, but not meaningful
EPS: ▲ TP: ◀▶

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- 1Q07 results were slightly weaker than expected, as weaker margins offset stronger revenues. EBITDA missed by 10%. Non-operating gains (incl. forex) resulted in EPS being in-line.
- As expected, Romania (Terapia) revenues grew 50% y/y: addition of Ranbaxy products to Terapia distribution is helping share gains. Growth should revert to market growth (~18-20%) in 2 quarters.
- Weak margins should disappoint investors expecting a margin pick-up as revenue mix shifts to the higher margin developing markets. Despite the addition of Romania and good growth in India, cost of sales as % of revenues remained flat y/y at 54%.
- We believe low-margin revenues from Germany (insurance contracts), UK, Africa (growth mainly from ARVs) and continuing price declines in the US (company said 15-20% y/y) are to blame.
- Increase in revenue guidance to 20% y/y in US\$ is explainable by pravastatin, and possible back conversion of Indian and European revenues to US\$. Current USDINR is 10% lower than average-06.
- We make minor changes to base estimates, and include Pravastatin 80mg (FY07E increases by 5%). Maintain NEUTRAL.

Ranbaxy's 1Q07 results were slightly weaker than expected, as weaker margins offset the higher than expected revenues. EBITDA missed our estimates by 10% – clearly forex had a role to play. Non-operating forex gains due to hedging compensated, and the company met our net profit expectations.

Seeking top line; Terapia doing spectacularly well

Comparing the geographical breakdown of revenues, we conclude the company seeks revenue growth at the expense of margins. Revenue growth was better than expected in the UK, Germany (company is targeting bulk insurance contracts), Africa (mainly ARVs – tender business). This is consistent with company strategy of gaining scale.

For the first time, the company broke out Romania (Terapia) revenues – at US\$37mn, they grew 50% y/y. In the past we have highlighted the four quarter revenue surge that Ranbaxy should benefit from as Ranbaxy's products (30-40 launches expected this year) start selling via erstwhile Terapia's distribution. The company has also expanded its field force, and should be accelerating its product launches. We currently estimate US\$160mn in revenues from Romania in FY07E.

The company is also expanding its sales force in India, targeting new divisions. It expects to add 200 people more to its current base of ~200 field reps.

Margins a source of concern; R&D pushed out again

Despite the addition of Romania (a 60%-plus gross margin market, in our view) and in India, cost of sales as % of revenues remained flat y/y at 54%. This reflects not just the 15-20% price declines in the US market, but also higher contributions from bulk contracts in Germany and in Africa (on ARVs). This validates our theory that despite product mix shifting away from the US over the next two years, margin improvement may remain muted.

R&D expenses increased 11% y/y, but fell 33% q/q, as the company is again balancing out its R&D spend to align with revenues – which pick up over the course of the year.

Guidance upped in US\$ terms, no impact to our estimates

Revenue guidance was increased to "20% y/y in US\$" from "15%-plus" indicated three months back. The forex rates used to assess the base for Europe and India are not clear. But if we assumed Mar-30 as the base rate, we find a US\$14mn increase in Indian revenues (4.4% lower rupee on average in 2006), and a US\$23mn increase in European revenues from forex. Together with the US\$19mn upside from Pravastatin 80mg, this explains most of the US\$67mn increase in guidance. We therefore do not consider the increase significant.

Minor change to estimates: adjusting for Pravastatin

We have made some minor changes to our estimates. The base business numbers remain unchanged – higher revenues from Germany and ARVs get balanced by lower margins. We now include Pravastatin exclusivity in our model – FY07E EPS goes up by 5%. We maintain NEUTRAL with T/P Rs380.

Bbg/RIC	RBXY IN / RANB.BO	Price (27 Apr 07, Rs)	369.95		
Rating (prev. rating)	N (N)	TP (Rs) (prev. TP)	380 (380)		
Shares outstanding (mn)	372.86	Est. pot. % chg. to TP	3		
Daily trad vol-6m avg (mn)		52-wk range (Rs)	522.00 - 309.50		
Daily trad val-6m avg (US\$ mn)		Mkt cap (Rs/US\$ bn)	137.9/ 3.1		
Free float (%)		Performance	1M 3M 12M		
Major shareholders	Promoters: 34%	Absolute	12.7 (6.9) (21.4)		
		Relative	4.0 (6.5) (34.6)		
Year	12/04A	12/05A	12/06E	12/07E	12/08E
Revenues (Rs mn)	54,030	52,269	60,216	65,812	70,520
EBITDA (Rs mn)	9,523	2,564	9,193	10,082	11,447
Net profit (Rs mn)	7,383.0	2,309.3	5,204.7	6,573.5	7,393.0
EPS (Rs)	19.9	6.2	14.0	16.5	18.6
- Change from prev. EPS (%)	n.a.	n.a.	0	5	0
- Consensus EPS (Rs)	n.a.	n.a.	13.8	17.6	21.3
EPS growth (%)	1.5	(68.8)	125.2	18.1	12.5
P/E (x)	18.6	59.6	26.5	22.4	19.9
Dividend yield (%)	2.3	2.3	1.6	2.0	2.3
EV/EBITDA (x)	15.4	61.7	18.8	17.0	14.8
P/B (x)	5.5	5.6	5.1	4.4	3.9
ROE (%)	29.2	9.4	19.0	21.0	20.8
Net debt/equity (%)	29	72	119	100	81

Note 1: Ord/ADR=1. Note 2: Ranbaxy is the leading Indian Pharmaceutical Company. Note 3: Ranbaxy is a leading Indian Pharmaceutical company, with a significant % of revenues coming from generics.

Figure 1: Estimates vs. Actuals and YoY comparison

Rs Mn	1Q07A	1Q07E	Diff (%)	1Q06A	Y/Y %
Net Sales	15,535	14,997	4%	12,631	23%
Other Income	286	0		405	-29%
Total Expenses	13,627	13,505	1%	11,499	19%
Cost of Goods Sold	8,367	7,701	9%	6,855	22%
SG&A	4,735	4,742	0%	3,915	21%
Operating Expense R&D	811	1,062	-24%	729	11%
EBITDA	1,908	2,115	-10%	1,538	24%
EBITDA Margin (%)	12%	14%	-1.8%	12%	0%
Total Non-Oper. Income (Loss)	530	103	417%	-257	NA
Net Income	1,287	1,260	2%	719	79%

Source: Company data, Credit Suisse estimates.

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Companies Mentioned (Price as of 27 Apr 07)

Ranbaxy Laboratories Limited (RANB.BO, Rs372.15, NEUTRAL, TP Rs380.00)

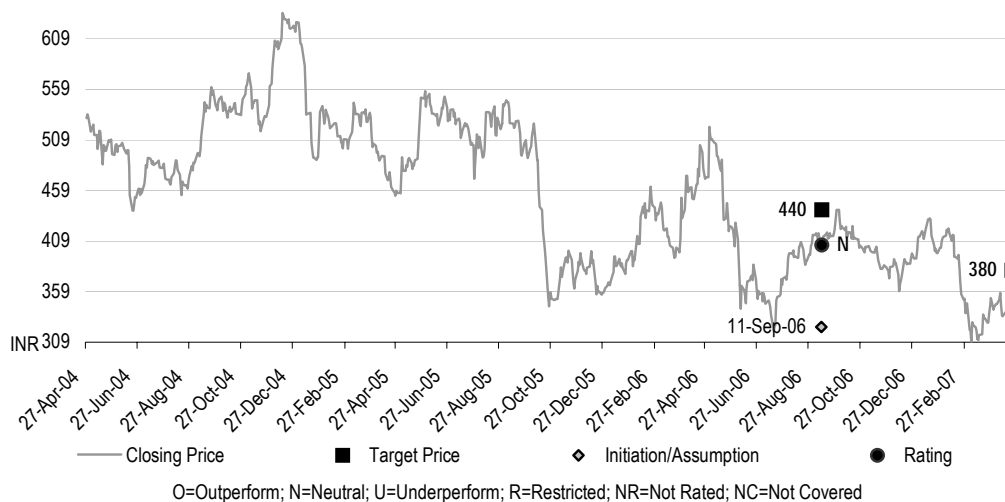
Disclosure Appendix

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3-Year Price, Target Price and Rating Change History Chart for RANB.BO



RANB.BO Date	Closing Price Price (INR)	Target Price Price (INR)	Rating	Initiation/Assumption
11-Sep-06				X
12-Sep-06	405.15	440	NEUTRAL	
24-Apr-07	349.15	380		

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Price Target: (12 months) for (RANB.BO)

Method: Our Target price for Ranbaxy is Rs380 (21x FY09E EPS of Rs21). The stock has historically traded within a narrow band of 20-24x 12 month forward EPS (ex-ante), and closely tracks consensus estimates. Therefore, 9-12 months from now, the stock should trade on FY09E multiple. We do not expect consensus earnings to go up by much, and set the target price in the middle of the trading range, i.e. 21x.

Risks: Risk to our Rs380 target price for Ranbaxy are: 1) we are ascribing zero value to the NCE pipeline – if the company were to out-license in early stages, there could be upside to earnings, and 2) there are several Paragraph IV challenges under litigation – any success on those could provide a positive surprise; downside risks: 1) Paonta Sahib approval could be delayed beyond mid-07, which would delay new product launches in the US, 2) integration risk on Terapia and 3) continuing price declines in the US generics market could hurt margin recovery.

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