Company Flash

25 April 2007 | 5 pages

Ranbaxy (RANB.BO)

Buy: Pravastatin Approval; Beyond the Numbers

- **Maintaining Buy (1M) rating** — While USFDA approval for pravastatin 80mg, with 180 days exclusivity, will likely have only a marginal impact on earnings, we think it puts some of the major concerns related to Ranbaxy's New Jersey facility to rest. It also highlights the progress of Ranbaxy's efforts to guard against slowing growth due to further delays in approval of its Paonta facility.

- **Putting some concerns to rest** — Pravastatin 80mg is the third approval Ranbaxy has received through its Ohm Labs facility in New Jersey after a surprise raid by the FDA-OCI in Feb 2007. While we expect the investigation to run its course, we expect the approvals to put worries that the inspection was triggered by a serious manufacturing- or compliance-related issue to rest.

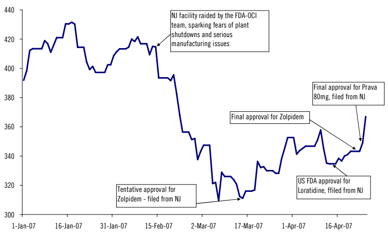
- **Getting around the Paonta impasse** — To this end, Ranbaxy has taken steps such as: a) re-filing products where approvals could get stalled from its other facilities (e.g. pravastatin), and b) tying up with other companies (such as Ipca) for certain products. Thus, while the Paonta approval remains important, we think any delay would not affect its US growth as much as previously thought.

- **Limited upside to estimates** — We estimate that the US$209m market for pravastatin 80mg has been significantly cannibalized by other dosage forms of pravastatin, and simvastatin, both of which are fully genericized.

- **Still a top pick** — As it is one of the few globally diversified & integrated generic companies, we believe Ranbaxy has sufficient room to cut costs further, which would provide leverage to improve profitability as sales continue to grow.

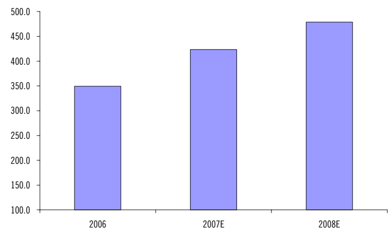
Buy/Medium Risk	**1M**
Price (25 Apr 07)	Rs349.50
Target price	Rs505.00
Expected share price return	44.5%
Expected dividend yield	1.4%
Expected total return	**45.9%**
Market Cap	Rs130,315M
	US$3,197M

Figure 1. Ranbaxy Stock Performance



Source: Citigroup Investment Research

Figure 2. Ranbaxy US sales (US$m)



Source: Citigroup Investment Research estimates

Prashant Nair, CFA[1]
+91-22-6631-9855
prashant.nair@citigroup.com

Chirag Dagli[1]
chirag.dagli@citigroup.com

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

[1]Citigroup Global Market India Private Limited

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 thesis

We rate Ranbaxy shares as Buy/Medium Risk (1M) with a target price of Rs505/share. We believe the stock price now factors in most negatives – vis-à-vis difficult global market dynamics, manufacturing-related issues with the FDA and a slowdown in product approvals. Moreover, we believe that these negatives and the declining stock price mask the positive steps that Ranbaxy has taken since the beginning of CY06 to effect a turnaround in its business. 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.

Valuation

We prefer to value Ranbaxy using EV/Sales methodology to reflect a much fairer value of its business today. We believe that the 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 high profitability in global generics. We believe this is being corrected now and the benefits of the aggressive cost reduction initiatives started coming through in the financials in CY06. With its presence across multiple geographies and a 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 applying a higher multiple. At 3x Sept 07 EV/Sales, our target price is Rs505.

Risks

We rate Ranbaxy shares as Medium Risk based on our quantitative risk-rating system. The key downside risks to our target price include: (1) intensifying pricing pressure in the US and European markets,; (2) the company paying high multiples to acquire more businesses in Europe and the USA, and (3) inability to resolve the manufacturing issues with the US FDA by the end of the current fiscal year. 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 (4) any new paragraph IV challenges.

Appendix A-1

Analyst Certification

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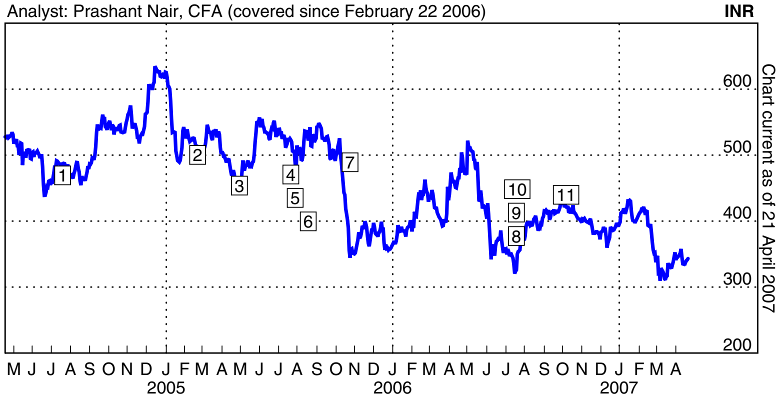
Ranbaxy (RANB.BO)

Ratings and Target Price History - Fundamental Research

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



Covered
Not covered

#	Date	Rating	Target Price	Closing Price
1:	20 Jul 04	*3M	1,025.00	486.90
2:	22 Feb 05	3M	*935.00	506.55
3:	29 Apr 05	3M	*845.00	456.42
4:	21 Jul 05	3M	*815.00	522.97
5:	28 Jul 05	3M	*407.50	NA
6:	18 Aug 05	3M	*385.00	522.05
7:	25 Oct 05	3M	*363.00	344.40
8:	19 Jul 06	*1M	*402.00	325.90
9:	19 Jul 06	1M	402.00	325.90
10:	20 Jul 06	1M	402.00	349.90
11:	6 Oct 06	1M	*505.00	422.35

*Indicates change.

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India -- Asia Pacific (130)	58%	14%	28%
% of companies in each rating category that are investment banking clients	42%	50%	42%

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Low to Medium Risk -- High Single A through High Triple B
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