

NOVEMBER 11, 2010

#### RESULT

Coverage view: **Attractive**

Price (Rs): **584**

Target price (Rs): **340**

BSE-30: **20,589**

**Lame quarter.** Ranbaxy continues to disappoint with core performance especially on the margin front. Gains from extended Valtrex sales in the US (post-exclusivity) and strong Indian formulation sales growth (up 18% yoy) were offset by weak performance in Europe, Africa, ROW and API segments. Excluding exceptional gains, PAT falls short of our estimates by 11%. We therefore retain our SELL rating on the stock.

#### Company data and valuation summary

Ranbaxy Laboratories

##### Stock data

52-week range (Rs) (high,low)	624-364
Market Cap. (Rs bn)	258.5

##### Shareholding pattern (%)

Promoters	63.9
FIs	9.1
MFs	2.9

##### Price performance (%)

	1M	3M	12M
Absolute	0.6	34.9	44.8
Rel. to BSE-30	(2.4)	17.7	14.0

##### Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	7.2	24.0	14.6
EPS growth (%)	(128.9)	234.8	(39.4)
P/E (X)	84.0	25.1	41.4
Sales (Rs bn)	73.3	82.8	82.6
Net profits (Rs bn)	3.0	10.2	6.2
EBITDA (Rs bn)	12.4	16.1	11.2
EV/EBITDA (X)	22.3	16.4	23.3
ROE (%)	7.0	20.1	10.4
Div. Yield (%)	0.0	0.7	0.7

#### Valtrex and Indian operations provide cushion

In line sales on account of (1) continuation of Valtrex sales post exclusivity, (2) Operation Virat led Indian formulation sales growth. The strength in Indian formulation (up 18%) and US formulation business (up 70%) yoy was offset by (1) Europe down 15%, (2) Africa down 7%, and (3) RoW down 12% and API down 13%. Base business EBITDA margins continue to be weak at 8% which include US\$10 mn provisions –excluding which EBITDA would have been 10.1%. EBITDA margin disappointment came on account of sustained R&D expenditure despite Daichi Sankyo funding its NDDR research.

#### No respite from the one-offs

Exceptionally high other income, driven by forex gains was the highlight of the quarter. The exceptional items for the quarter consisted of (1) MTM loan gains of US\$24 mn, (2) US\$33 mn gain on derivatives, (3) US\$4 mn provision product settlement with Roche, (4) US\$10 mn provision on Simvastatin recall, and (5) US\$2 mn non-compete fee from Daichi. Net of these exceptional items, PAT falls short of our estimates by 11%.

#### FDA/DOJ issues – status quo

In a departure from its earlier stated position, the management refused to guide for any timelines on a final FDA/DOJ resolution. Key exclusivity opportunities like Lipitor and Aricpet have been filed from the facilities under the regulatory scanner. The roadmap for monetizing these opportunities remains uncertain pending a final settlement with regulators. We don't share the Street optimism (and that of the management) regarding a quick resolution and believe there's a binary risk to successful monetization of the FTF opportunities. We maintain our SELL rating with a target price of Rs340 and retain our base business EPS at Rs14.6.

#### QUICK NUMBERS

- Sales at US\$405 mn were helped by Valtrex in the U.S and 18% growth in Indian formulation business
- Adjusted for the impact of exceptional items, the net profit was lower than our estimates by 11%
- No incremental progress on FDA/DOJ issues
- Maintain Sell and Price Target of Rs 340

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**Rich Valuations, Binary Risks: Maintain Estimates and reiterate sell**

We retain our base business EPS at Rs14.8 as we are building in (1) complete recovery in the India business at 15% sales growth and (2) savings of US\$20 mn in total annual R&D spend of US\$100 mn post hive-off of NDDR division to Daichi. At current levels, the stock is completely discounting regulatory risks from the pending DOJ/FDA issues and valuing non-recurring opportunities on a recurring basis. At 40X FY2012 earnings, the stock trades at a 100% premium to other frontline peers. We reiterate Sell and a price target of Rs340.

**Other miscellaneous takeaways from the call**

- ▶ Valtrex market share for the quarter was 36%
- ▶ 7 ANDAs were filed for the quarter from the Ohm facility
- ▶ The weakness in Europe business was on account of a loss of wholesaler
- ▶ US\$4 mn provision-product settled with Roche—certainty of launch in March 13, Ranbaxy has taken this provision in the quarter

**SOTP breakdown for price target of Rs337**

	<b>Valuation (Rs mn)</b>
	<b>2011E</b>
Base business EPS (Rs)	14.6
Base business Value per share (Rs)	234
Value of patent challenge pipeline (Rs)	69
Value of Nexium deal (Rs)	34
Cash per share	
<b>Share price target (Rs)</b>	<b>337</b>

Source: Kotak Institutional Equities estimates, Company

**Breakup of profits (Rs mn)**

	2009	2010E	2011E		2009	2010E	2011E
<b>Sales</b>				<b>PAT before excep. (Rs)</b>			
Base	68,219	69,113	82,610	Base	1,698	3,340	6,241
Valtrex	5,274	13,863		Valtrex	1,320	6,862	
<b>Total</b>	<b>73,494</b>	<b>82,976</b>	<b>82,610</b>	<b>Total</b>	<b>3,019</b>	<b>10,202</b>	<b>6,241</b>
<b>EBITDA pre R&amp;D</b>				<b>EPS before excep. (Rs)</b>			
Base	5,572	9,141	12,921	Base	4.0	7.8	14.6
Valtrex	4,220	10,719		Valtrex	3.1	16.3	
<b>Total</b>	<b>9,791</b>	<b>19,860</b>	<b>12,921</b>	<b>Total</b>	<b>7.1</b>	<b>24.1</b>	<b>14.6</b>
<b>EBITDA, %</b>				<b>P/E (X) (adjusted for FTF value)</b>			
Base	8.2	13.2	15.6	Base	147.6	75.0	40.2
Valtrex	80.0	77.3		<b>Total</b>	<b>82.3</b>	<b>24.3</b>	<b>40.2</b>
<b>Total</b>	<b>13.3</b>	<b>23.9</b>	<b>15.6</b>				

Source: Kotak Institutional Equities estimates, Company

## Interim results - Ranbaxy , December fiscal year-ends (Rs mn)

	3QCY10	3QCY10E	3QCY09	2QCY10	% change		
					3QCY10E	3QCY09	1QCY10
<b>Net sales</b>	<b>18,838</b>	<b>19,303</b>	<b>17,163</b>	<b>20,987</b>	<b>(2)</b>	<b>10</b>	<b>(10)</b>
Income from operations	509	500	1,695	517	2	(70)	(2)
Cost of sales	11,461	11,099	10,503	11,475	3	9	(0)
SG&A	5,053	5,500	4,653	4,491	(8)	9	13
R&D expenses	1,447	399	1,569	1,370	263	(8)	6
Expenses	17,960	16,998	16,725	17,336	6	7	4
<b>EBITDA as defined by management</b>	<b>1,387</b>	<b>2,805</b>	<b>2,133</b>	<b>4,167</b>	<b>(51)</b>	<b>(35)</b>	<b>(67)</b>
<b>EBITDA - (adjusted)</b>	<b>2,324</b>	<b>2,704</b>	<b>2,007</b>	<b>5,020</b>	<b>(14)</b>	<b>16</b>	<b>(54)</b>
Depreciation/amortisation	987	700	654	695	41	51	42
Interest - exp/(inc)	110	200	121	111	(45)	(9)	(1)
Other income	932	700	163	1,273	33	472	(27)
Fx gain/(loss)	1,097	—	(8)	(1,158)	NM	NM	NM
<b>PBT</b>	<b>2,319</b>	<b>2,605</b>	<b>1,513</b>	<b>3,476</b>	<b>(11)</b>	<b>53</b>	<b>(33)</b>
Tax	290	339	435	(3)	(14)	(33)	NM
<b>PAT</b>	<b>2,028</b>	<b>2,267</b>	<b>1,078</b>	<b>3,478</b>	<b>(11)</b>	<b>88</b>	<b>(42)</b>
Extra ordinary income post tax	1,100	—	88	(159)	NM	1,153	NM
Minority interests	49	40	21	63	22	135	(23)
<b>Profit for shareholders</b>	<b>3,079</b>	<b>2,227</b>	<b>1,145</b>	<b>3,256</b>	<b>38</b>	<b>169</b>	<b>(5)</b>
Dosage - India	4,930	4,015	4,178	4,487	23	18	10
Dosage - Europe	2,769	3,635	2,900	3,195	(24)	(5)	(13)
Dosage - CIS	1,209	1,291	1,089	927	(6)	11	30
Dosage - Africa	1,644	2,062	1,758	1,774	(20)	(6)	(7)
Dosage - ROW	2,326	2,917	3,095	2,072	(20)	(25)	12
Dosage -North America	4,912	3,988	2,955	7,376	23	66	(33)
API	1,082	1,394	1,230	1,197	(22)	(12)	(10)
<b>Total</b>	<b>18,872</b>	<b>19,303</b>	<b>17,205</b>	<b>21,028</b>	<b>(2)</b>	<b>10</b>	<b>(10)</b>

Source: Kotak Institutional Equities estimates, Company

## Profit and loss statement, December fiscal year-ends, 2006-2011E

	2,006	2,007	2,008	2009	2010E	2011E
<b>Net sales</b>	<b>60,183</b>	<b>67,440</b>	<b>72,245</b>	<b>73,347</b>	<b>82,831</b>	<b>82,610</b>
<b>Operating expenses</b>						
Materials	(23,733)	(27,217)	(31,831)	(32,080)	(29,358)	(30,152)
Selling and administration	(17,822)	(21,187)	(23,844)	(22,591)	(25,137)	(25,352)
Employee cost	(7,955)	(8,918)	(12,626)	(13,537)	(15,568)	(17,903)
Others	(3,099)	(3,353)	0	(637)	0	0
<b>Total expenditure</b>	<b>(52,608)</b>	<b>(60,675)</b>	<b>(68,301)</b>	<b>(68,845)</b>	<b>(70,063)</b>	<b>(73,407)</b>
<b>EBITDA</b>	<b>7,574</b>	<b>6,765</b>	<b>3,944</b>	<b>4,502</b>	<b>12,768</b>	<b>9,203</b>
Depreciation and amortisation	(1,843)	(2,183)	(2,825)	(2,676)	(3,513)	(3,450)
<b>EBIT</b>	<b>5,731</b>	<b>4,581</b>	<b>1,119</b>	<b>1,826</b>	<b>9,256</b>	<b>5,753</b>
Net finance cost	(1,036)	(1,412)	(2,055)	(710)	(669)	(800)
Other income	1,815	7,776	(14,064)	9,036	6,821	3,200
<b>Pretax profits before extra-ordin:</b>	<b>6,510</b>	<b>10,946</b>	<b>(15,000)</b>	<b>10,152</b>	<b>15,408</b>	<b>8,153</b>
Current tax	(535)	(1,056)	(860)	(1,103)	(4,529)	(1,112)
Deferred tax	(822)	(1,063)	6,510	(5,888)	(500)	(600)
<b>Reported net profit</b>	<b>5,153</b>	<b>8,827</b>	<b>(9,350)</b>	<b>3,161</b>	<b>10,379</b>	<b>6,441</b>
Minority Interests	50	122	162	142	177	200
<b>Reported net profit after minorit:</b>	<b>5,103</b>	<b>8,705</b>	<b>(9,512)</b>	<b>3,019</b>	<b>10,202</b>	<b>6,241</b>
Exceptional items	0	0	0	0	6,415	0
<b>Reported net profit after minorit:</b>	<b>5,103</b>	<b>8,705</b>	<b>(9,512)</b>	<b>3,019</b>	<b>16,617</b>	<b>6,241</b>

Source: Kotak Institutional Equities estimates, Company

## Balance sheet, cash model, December fiscal year-ends, 2006-2011E

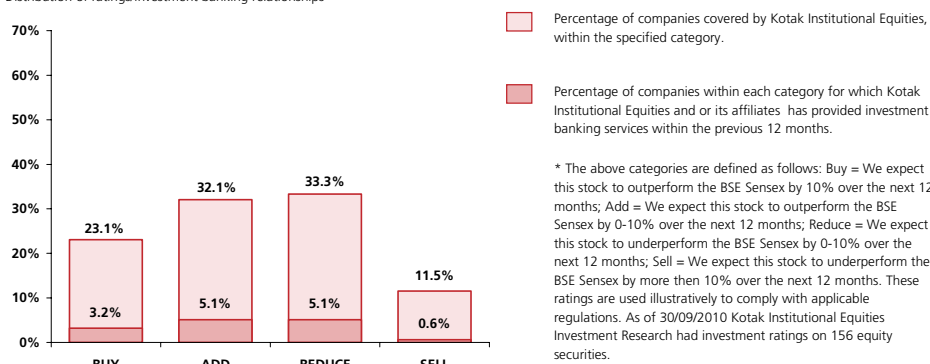
	2006	2007	2008	2009	2010E	2011E
<b>Balance sheet</b>						
Total equity	25,859	28,034	42,962	43,434	58,105	62,341
Total debt	39,556	41,416	42,848	36,295	35,371	18,472
Current liabilities	17,597	21,327	45,883	41,112	45,992	42,361
Minority Interests	334	571	675	533	710	910
Deferred tax liabilities	654	1,434	(12,229)	(4,745)	(4,245)	(3,645)
<b>Total equity and liabilities</b>	<b>84,001</b>	<b>92,782</b>	<b>120,139</b>	<b>116,629</b>	<b>135,934</b>	<b>120,440</b>
Cash and cash equivalents	2,951	4,379	23,957	12,416	25,744	10,000
Current assets	38,153	40,381	41,144	47,670	54,391	55,331
<b>Net fixed assets</b>	<b>19,587</b>	<b>19,909</b>	<b>21,365</b>	<b>21,393</b>	<b>21,249</b>	<b>21,209</b>
Intangible assets	19,366	22,136	23,535	23,512	22,912	22,262
Capital -WIP	3,581	3,574	4,707	6,231	6,231	6,231
Investments	362	2,403	5,431	5,407	5,407	5,407
<b>Total assets</b>	<b>84,001</b>	<b>92,782</b>	<b>120,139</b>	<b>116,629</b>	<b>135,934</b>	<b>120,440</b>
<b>Free cash flow</b>						
Operating cash flow, excl. work	7,021	11,170	(5,900)	5,147	11,361	8,925
Working capital	(4,403)	1,119	26,413	(11,297)	(3,826)	(4,590)
Capital expenditure	(19,239)	(4,509)	(7,385)	(2,368)	(2,169)	(2,110)
Investments	—	—	—	—	—	—
<b>Free cash flow</b>	<b>(16,621)</b>	<b>7,780</b>	<b>13,127</b>	<b>(8,518)</b>	<b>5,365</b>	<b>2,225</b>

Source: Kotak Institutional Equities estimates, Company

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As of September 30, 2010

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