

Risk/Reward attractive; Up to Buy

Recommendation upgraded to Buy from Neutral

We upgrade Ranbaxy Laboratories to a Buy from Neutral with PO of Rs492/share (28% upside potential). Our upgrade is driven by robust 27% EPS CAGR (CY06-08E) given higher visibility in scale-up of international operations and US products/R&D milestone upsides. Our PO includes Rs30/sh for Lipitor early entry into US.

27% EPS CAGR(CY06-08E) discounts risks but not upsides

We are tweaking CY07E EPS by 3% (24% growth) and estimate 32% EPS growth in CY08E (Rs21.5), slightly ahead of consensus which factors known risks like US pricing pressure / FDA issues. However, this does not factor a potential 37% EPS upside in CY08E from (a) generic Lipitor launch in Canada (b) generic Valtrex (herpes) exclusivity and (c) R&D milestones from GSK plc.

Bull-Bear analysis: risk vs. reward highly attractive

In a bull case scenario, we estimate 37% EPS upside from various product/R&D upsides which would result in potential PO of Rs634/sh (65% upside) whereas in a bear-case scenario (higher than expected pricing pressure, prolonged FDA issues, no product upsides), we estimate 14% EPS upside would result in potential PO of Rs333/sh (13% downside)

Significant stock underperformance prices in FDA issues

In our view, the stock's significant 40%+ relative underperformance in the past years on back of FDA issues and lack of big product visibility is now nearing an end. This is due to the robust earnings outlook, likely upsides from products like Lipitor (Canada), Valtrex, and impact of de-risking through collaborations.

Estimates (Dec)

(Rs)	2005A	2006A	2007E	2008E	2009
Net Income (Adjusted - mn)	2,284	5,320	6,510	8,557	NA
EPS	6.13	13.33	16.32	21.45	NA
EPS Change (YoY)	-69.0%	117.4%	22.4%	31.5%	NA
Dividend / Share	4.50	9.00	9.00	9.00	NA
Free Cash Flow / Share	(20.95)	9.49	13.19	15.29	NA
GDR EPS (US\$)	0.139	0.295	0.399	0.525	NA
GDR Dividend / Share (US\$)	0.102	0.199	0.220	0.220	NA

Valuation (Dec)

	2005A	2006A	2007E	2008E	2009
P/E	62.29x	28.65x	23.41x	17.81x	NA
Dividend Yield	1.18%	2.36%	2.36%	2.36%	NA
EV / EBITDA*	62.26x	17.71x	14.75x	11.92x	NA
Free Cash Flow Yield*	-5.12%	2.48%	3.45%	4.00%	NA
EV / Sales	3.05x	2.60x	2.27x	1.94x	NA

* For full definitions of *iQmethod*SM measures, see page 16.

Equity | India | Pharmaceuticals
07 May 2007



Merrill Lynch

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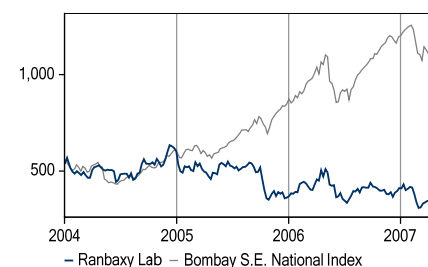
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Stock Data

Price (Common / GDR)	Rs381.95 / US\$7.58
Price Objective	Rs492.00 / NA
Date Established	7-May-2007 / NA
Investment Opinion (Common)	C-2-7 to C-1-7
Investment Opinion (GDR)	C-2-7 to C-1-7
Volatility Risk	HIGH / HIGH
52-Week Range	Rs305.50-Rs519.80
Market Value (mn)	US\$3,730
Shares Outstanding (mn)	399.0 / 399.0
Average Daily Volume	367,152
ML Symbol / Exchange	XANBF / BSE
ML Symbol / Exchange	RBXZF / NAS
Bloomberg / Reuters	RBXY IN / RANB.BO
ROE (2007E)	23.5%
Net Dbt to Eqty (Dec-2006A)	139.7%
Est. 5-Yr EPS / DPS Growth	17.0% / 10.0%
Free Float	64.2%



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Refer to important disclosures on page 17 to 18. Analyst Certification on page 15. Price Objective Basis/Risk on page 15.

07 May 2007

*iQprofile*SM Ranbaxy Laboratories

Key Income Statement Data (Dec)	2005A	2006A	2007E	2008E	2009
(Rs Millions)					
Sales	52,269	61,349	70,196	82,425	NA
Gross Profit	20,721	27,407	31,532	37,605	NA
Sell General & Admin Expense	(13,232)	(14,441)	(16,507)	(19,385)	NA
Operating Profit	1,119	7,168	8,741	11,164	NA
Net Interest & Other Income	492	(387)	(538)	(531)	NA
Associates	NA	NA	NA	NA	NA
Pretax Income	1,612	6,781	8,203	10,633	NA
Tax (expense) / Benefit	698	(1,411)	(1,641)	(2,020)	NA
Net Income (Adjusted)	2,284	5,320	6,510	8,557	NA
Average Fully Diluted Shares Outstanding	372	399	399	399	NA

Key Cash Flow Statement Data

Net Income (Reported)	2,284	5,320	6,510	8,557	NA
Depreciation & Amortization	1,445	1,843	2,084	2,226	NA
Change in Working Capital	(878)	(4,584)	(3,585)	(4,874)	NA
Deferred Taxation Charge	0	0	0	0	NA
Other Adjustments, Net	(1,144)	1,412	1,753	2,084	NA
Cash Flow from Operations	1,706	3,991	6,762	7,993	NA
Capital Expenditure	(9,508)	(205)	(1,500)	(1,890)	NA
(Acquisition) / Disposal of Investments	NA	(17,196)	NA	NA	NA
Other Cash Inflow / (Outflow)	12	(408)	(572)	72	NA
Cash Flow from Investing	(9,496)	(17,809)	(2,072)	(1,818)	NA
Shares Issue / (Repurchase)	3	0	0	0	NA
Cost of Dividends Paid	(3,167)	(3,591)	(3,591)	(3,591)	NA
Cash Flow from Financing	8,880	14,212	(4,667)	(5,679)	NA
Free Cash Flow	(7,802)	3,786	5,262	6,103	NA
Net Debt	17,613	36,822	37,901	37,869	NA
Change in Net Debt	10,425	19,210	1,079	(32)	NA

Key Balance Sheet Data

Property, Plant & Equipment	26,187	24,935	24,776	24,908	NA
Other Non-Current Assets	221	17,825	18,397	18,325	NA
Trade Receivables	11,404	15,703	18,036	21,174	NA
Cash & Equivalents	2,430	2,825	2,848	3,343	NA
Other Current Assets	19,445	22,101	25,250	29,643	NA
Total Assets	59,686	83,388	89,307	97,393	NA
Long-Term Debt	20,043	39,647	40,749	41,212	NA
Other Non-Current Liabilities	0	0	0	0	NA
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	15,008	17,379	19,277	21,933	NA
Total Liabilities	35,051	57,026	60,026	63,146	NA
Total Equity	24,636	26,362	29,281	34,247	NA
Total Equity & Liabilities	59,686	83,388	89,307	97,393	NA

*iQmethod*SM - Bus Performance*

Return On Capital Employed	5.2%	11.2%	11.4%	13.5%	NA
Return On Equity	9.2%	21.0%	23.5%	27.1%	NA
Operating Margin	2.1%	11.7%	12.5%	13.5%	NA
EBITDA Margin	4.9%	14.7%	15.4%	16.2%	NA

*iQmethod*SM - Quality of Earnings*

Cash Realization Ratio	0.7x	0.8x	1.0x	0.9x	NA
Asset Replacement Ratio	8.7x	0.1x	0.9x	1.1x	NA
Tax Rate (Reported)	NM	20.8%	20.0%	19.0%	NA
Net Debt-to-Equity Ratio	71.5%	139.7%	129.4%	110.6%	NA
Interest Cover	1.7x	6.9x	6.0x	7.3x	NA

Key Metrics

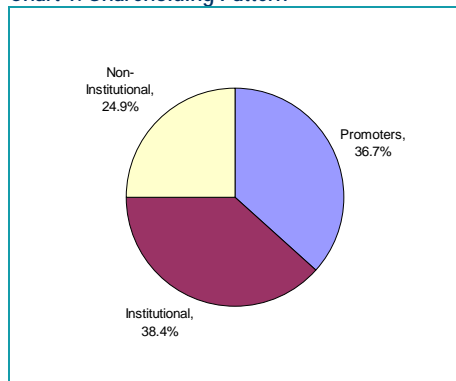
Sales Growth (YoY)	-3.3%	17.4%	14.4%	17.4%	NA
EBITDA Growth (YoY)	-73.1%	251.5%	20.1%	23.7%	NA
Net Income Growth (YoY)	-69.0%	132.9%	22.4%	31.5%	NA
Net Profit Margin	4.4%	8.7%	9.3%	10.4%	NA

* For full definitions of *iQmethod*SM measures, see page 16.

Company Description

Ranbaxy is India's largest pharmaceutical company (by revenue). It sells products in more than 125 countries, has an expanding international portfolio of affiliates, JVs & alliances, ground operations in 49 countries and mfg operations in 9 countries. The US and Europe contribute more than 45% of revenues with the rest mainly from BRICS markets. It has targeted revenues of US\$5bn by 2012. The Singh family owns a majority stake.

Chart 1: Shareholding Pattern



Source: BSE website

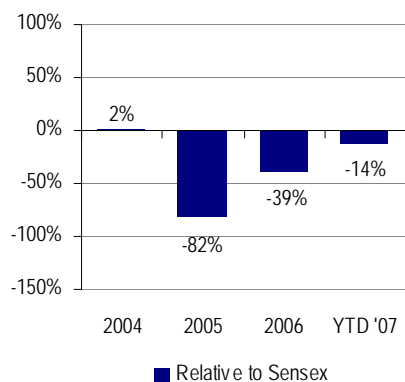
Stock Data

Shares / GDR	1.00
Price to Book Value	5.2x
Market Cap (US\$ mn)	3,730

Table 1: Ranbaxy Performance

	Absolute Returns	Relative to Sensex
1 Month	2.04%	-7.33%
3 Month	-17.19%	-15.18%
6 Month	-16.78%	-26.10%
YTD '07	-13.86%	-13.53%
1 Year	-27.46%	-42.82%

Source: Bloomberg

Chart 2: Ranbaxy Relative Performance


Source: Merrill Lynch Estimates

Upgrade to Buy; PO of Rs492/share

We are upgrading Ranbaxy to Buy from Neutral primarily on strong 30% earnings growth expectation as well as our expectation of potential litigation/R&D related product upsides. Our upgrade is predicated on the following factors –

Robust 27% EPS CAGR (CY06-08E)

Our 27% EPS CAGR (CY06-08E) is driven by 16% revenue CAGR and 150bp increase in EBITDA margin (16.2% from 14.7). This is driven by (a) generic pravastatin exclusivity in CY07E (Rs 0.8 EPS) (b) R&D savings (c) Scale-up of BRICS/ E. Europe market revenues to 55% of revenues by CY08E vs. current 48% (d) impact of Be-Tabs (S. Africa) and Terapia (Romania) acquisitions.

Table 2: Incremental earning drivers in CY07E (Rs)

EPS drivers	CY07E
Generic Pravastatin (US)	0.76
Be-Tabs & Terapia acquisition	0.93
R&D cost savings	0.6
Higher margin in Western Europe	0.12
Others	0.59
Overall EPS rise (Rs16.3 from Rs13.3)	3.0

Source: Merrill Lynch Research

Lipitor /other product upsides could add 37% to FY08E EPS

Over the next 12months we estimate Ranbaxy to benefit from launch of Lipitor generic in Canada (favorable lower Court ruling; appeals ruling awaited), generic Valtrex exclusivity (tentative approval received) and milestone from US\$100mn R&D deal with GSK. We estimate these to add about 37% to CY08E EPS.

Bull-Bear analysis: risk vs. reward highly attractive

In a bull case scenario we estimate the 37% EPS upside from various product/R&D upsides to result in potential PO of Rs634/sh (65% upside) whereas in a bear-case scenario (higher than expected pricing pressure, prolonged FDA issues, no product upsides) we estimate 14% EPS upside which results in potential PO of Rs333/sh (13% downside).

Significant stock underperformance price in FDA issues

Within the Indian pharmaceutical space, Ranbaxy has been among the worst performing stock for a long time which is largely on the back of earnings disappointments, FDA issues, low visibility on big ticket product upsides. In our view, this phase of prolonged underperformance is nearing an end noting robust earnings outlook, likely upsides from products like Lipitor (Canada), Valtrex, R&D milestones and the company's de-risking strategy through collaborations.

PO of Rs492/sh includes Rs30 for Lipitor early entry in US

We value Ranbaxy's base business at Rs462/sh based on 21.5x on CY08E EPS, nearly in-line to the stock's current P/E valuation and at a discount to its historical average. Further, we value Ranbaxy's potential 15 month early entry into US with generic Lipitor (in 2010) at Rs30/share.

Valuations at discount to historical average

Ranbaxy trades at 22.4x CY07E and 17.3x CY08E earnings, which is a discount to its 2-year historical average on CY08E EPS. Ranbaxy's CY08E earnings growth of 27% is higher than the sector average EPS growth of 24%.

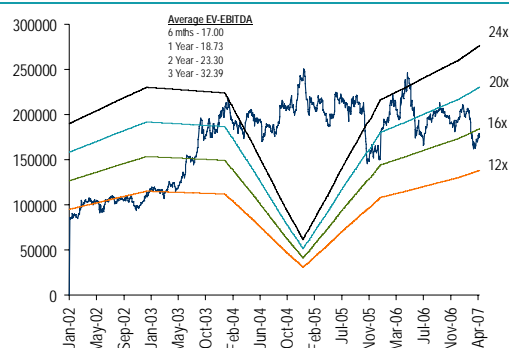
Ranbaxy's current valuations are also at par to the Indian pharma universe as well as its US generic peer average which trade at 22.7 x and 17.3x on CY07E and CY08E EPS respectively.

Table 3: Ranbaxy: Valuations comps with Indian/US/EU generic universe average

	P/E (x)		EV/EBITDA (x)		EV/Sales (x)	
	CY07E	CY08E	CY07E	CY08E	CY07E	CY08E
Ranbaxy	23.6	17.9	14.9	12.2	2.5	2.1
Indian Pharma average	21.3	17.6	12.6	10.7	3.1	2.7
US generic average	22.7	17.3	11.8	10.1	3.1	2.7
EU generic average	19.0	16.2	11.0	9.7	2.8	2.4

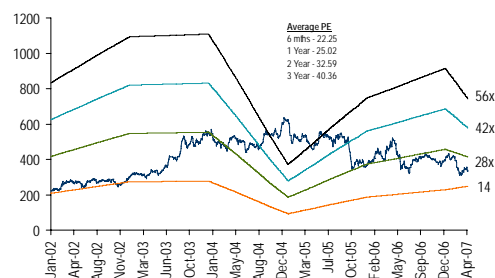
Source: Merrill Lynch Research

Chart 3: Ranbaxy EV-EBITDA bands



Source: Source: Merrill Lynch Estimates

Chart 4: Ranbaxy PE bands



Source: Merrill Lynch Estimates

Ranbaxy: Bull-Bear EPS/PO scenarios

Our Bull/Bear scenario analysis provides Ranbaxy's EPS sensitivity to five key events which could provide an upside/downside to our base estimates. In a bull scenario we estimate about 37% upside to base CY08E EPS while in a bear scenario, we estimate a 14% downside to base CY08E EPS.

Five key EPS sensitivity factors

- FDA manufacturing issue at Poanta Sahib manufacturing facility been delayed since June'06
- Lipitor launch in Canada (US\$800mn) in early 2008 where Ranbaxy already has a favorable lower Court ruling and the Appeals decision is expected in 2007
- Generic Valtrex (US\$1bn; herpes) marketing exclusivity where the trial could take place in 2007
- R&D milestones from GSK Plc as part of the US\$100mn R&D deal with GSK
- US generic pricing pressure

Table 4: Ranbaxy Laboratories EPS sensitivity - Bull-Bear Scenarios

Key parameters	CY08E		
	Base case	Bear case	Bull case
Lipitor launch in Canada (A)	Loses litigation	loses litigation	Launch in early 2008 and 50% market share
Generic Valtrex marketing exclusivity (B)	loses litigation	loses litigation	Wins litigation; 50% market share
R&D milestones from GSK Plc ©	No milestone	No milestone	US\$10mn milestone
US generic pricing pressure (D)	10% erosion in base business	20%+ price erosion in base generics	5-7% erosion in base business
FDA manufacturing issue (Poanta Sahib facility) (E)	FDA issue gets resolved in 2007	FDA issue continues for another year	FDA issue gets resolved in next few months
Sensitivity to CY08E EPS and PO			
Base EPS	21.5	21.5	21.5
Generic Lipitor (A)	0	0	5
R&D milestone from GSK (B)	0	0	1.00
Generic Valtrex exclusivity (C)	0	0	1.5
US generic pricing pressure & FDA manufacturing issue (D & E)	0	-3	0.5
Total EPS	21.5	18.5	29.5
% EPS upside/downside	0.0	-14.0	37.2
Fully diluted shares (mn)	399	399	399
Current Price (Rs)	384	384	384
Current P/E	17.86	20.76	13.02
Target P/E multiple	21.5	18	21.5
Base business Price target (Rs)	462	333	634
% upside/downside	20.4	-13.3	65.2

Source: Merrill Lynch Research

Table 5: Ranbaxy's revenue mix in North America (US\$mn)

Year to Dec	CY03	CY04	CY05	CY06	CY07E	CY08E
Base generic revenues	411	426	333	392	341	323
New launches - CY07 & CY08E					75	169
Generic Pravastatin					20	
Total Sales (e)	411	426	333	392	436	492
Growth (%)	38.9	3.6	(21.9)	17.7	11.4	12.8

Source: Merrill Lynch Research

Robust top line from key markets

We expect Ranbaxy's overall revenues to grow 22% and 17% in CY07E and CY08E respectively in dollar terms (14% and 17% in rupee terms) on back of strong 26% growth in BRICS & E. Europe markets as well as mid-teens growth in international generics markets (US, W. Europe).

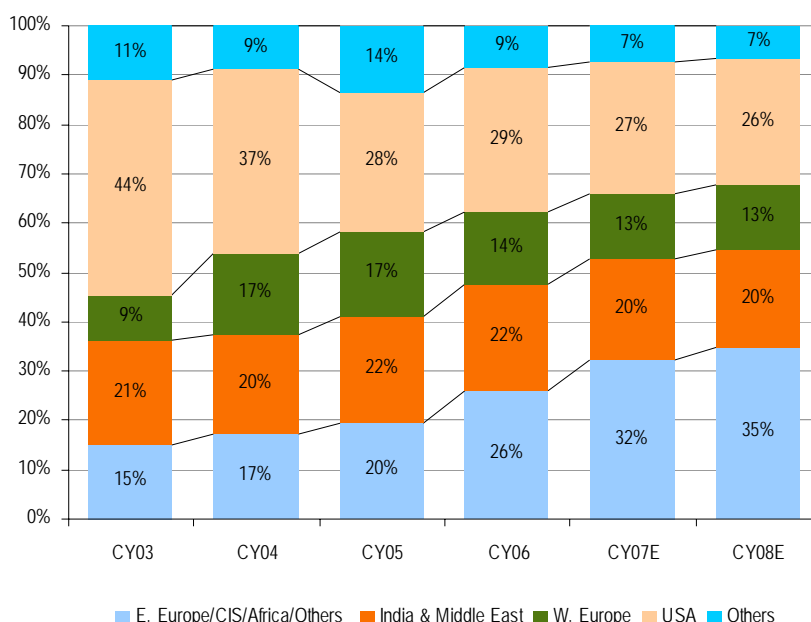
India growth momentum likely to sustain

We expect Ranbaxy's India business (20.5% of CY06 revenues) to grow at 14% CAGR (CY06-08E) driven by greater contribution from chronic and NDDS (Novel drug delivery systems) products, new launches and in-licensed products. Chronic and NDDS portfolio currently contribute about 35% of Ranbaxy's India business.

BRICS/E. Europe - likely 55% revenue contribution (CY08E)

Driven by impact of Terapia acquisition (Romania, Russia), Be-Tabs acquisition (South Africa) as well as strong 20%+ organic growth in most AsiaPac markets, we expect the BRICS markets to grow at 26% CAGR (CY06-08E). We estimate near 55% revenue contribution from BRICS markets vs. current 48%.

Chart 5: Increased revenues from BRICS/E as evident from Geographical split of Revenues



Source: Merrill Lynch Research, Company data

W. Europe: growth turnaround in Germany & other markets

Within the W. Europe markets, we estimate Ranbaxy's flat growth trend in the last three years will likely see a turnaround driven by (a) double digit growth trend in Germany where the company has tied-up with the largest insurer, AOK for 11 generics (b) growth and profitability turnaround in UK driven by new launches and (c) strong growth in smaller markets like Spain and Poland. Overall, we estimate 15% revenue CAGR (CY06-08E) in the W. Europe markets.

US generics - FDA issue clearance could provide upside

Within US generics, our estimate of 12% revenue CAGR (CY06-08E) does not

build any contribution from potential Para IV wins except generic Pravastatin which was launched in Apr'07 (likely US\$20mn revenues and about US\$10mn profits). We estimate 13% price erosion in base generics business in CY07E and likely 15 new launches (5 already launched). Possible early resolution of Poanta sahib FDA issue could provide an upside to new launches and overall revenues.

As of date, Ranbaxy' has 88 ANDA's pending approval with the US FDA. These products at an innovator market size are valued at US\$56bn and comprise a well-balanced mix of plain vanilla generics, niche & potential first to file (FTF) products. Ranbaxy's FTF status on approximately 20 Para IV ANDA filings, represent an innovator market size in excess of US\$25bn. Ranbaxy's current pending filing tally of 88 represent the second largest in the global generics industry (after Teva).

Table 6: Pharmaceutical sales: Region-wise break-up of revenues (US\$ mn)

Region	CY03	CY04	CY05	CY06	CY07E	CY08E	CAGR (%) (CY06-08E)
Dosage forms							
India & Middle East	201	230	254	293	334	378	13.6
W. Europe	89	192	199	193	214	253	14.6
E. Europe, CIS, Africa	70	104	136	227	380	481	45.5
AsiaPacific & Latin America	70	93	94	120	150	188	25.1
USA	411	426	333	392	436	492	12.0
Total Dosage Forms	841	1,045	1,016	1,225	1,514	1,792	20.9
Active Pharmaceutical Ingredients	76	70	126	115	121	127	5.0
Allied Businesses	27	33	34	-	-	-	
Net Sales (US\$mn)	944	1,148	1,176	1,340	1,634	1,919	19.7
<i>Growth (%)</i>	<i>27.7</i>	<i>21.6</i>	<i>2.4</i>	<i>13.9</i>	<i>22.0</i>	<i>17.4</i>	
<i>INR : USD rate</i>	<i>48.0</i>	<i>46.5</i>	<i>44.1</i>	<i>45.3</i>	<i>42</i>	<i>42</i>	
Net Sales (Rs mn)	45,301	53,333	51,880	60,652	69,296	81,352	15.8
<i>Growth (%)</i>	<i>22.0</i>	<i>17.7</i>	<i>(2.7)</i>	<i>16.9</i>	<i>14.3</i>	<i>17.4</i>	

Source: Merrill Lynch Research, Company Reports

Improving EBITDA margin trend

We forecast Ranbaxy's EBITDA margin to increase to 16.2% in CY08E (vs 14.2% in CY06), vs. management guidance of 16% EBITDA margin in CY07E itself. Key drivers -

- Within US generics, we estimate generic pravastatin marketing exclusivity and 15-17 new launches to help maintain margins despite continuing 10%+ pricing erosion in base generics.
- Within the Europe/CIS and Africa geographies, the Terapia and Be-tabs acquisitions which together account for nearly US\$100mn incremental revenues in the region will likely deliver 25%+ EBITDA margin, significantly higher than overall company margin.
- We forecast a modest 6% increase in R&D spend (US\$100mn) in CY07E, in-line with management guidance.
- We model SG&A spend to be maintained at 23.5% of although there appears a scope to rationalize SG&A spend given impact of various cost rationalization measures implemented a year ago.

Table 7: Pharmaceutical sales: Regionwise break-up of revenues (US\$ mn)

Region	CY03	CY04	CY05	CY06	CY07E	CY08E	CAGR (%) (CY06-08E)
Total operating income (US\$mn)	980	1163	1185	1355	1656	1944	
Region-wise EBITDA (US\$mn)							
India & Middle East	30	30	36	47	54	60	13.6
% margin	15%	13%	14%	16%	16%	16%	
Europe, CIS and Africa	8	13	7	35	66	96	65.9
% margin	5%	4%	2%	8%	11%	13%	
AsiaPacific & Latin America	14	19	11	22	27	38	31.9
% margin	20%	20%	12%	18%	18%	20%	
USA	144	128	-10	84	96	109	13.8
% margin	35%	30%	-3%	22%	22%	22%	
Total dosage forms	186	189	44	188	243	303	
% margin	22	18	4	15.3	16	17	5.1
Active Pharmaceutical ingredients	12	7	13	12	12	13	
% margin	16	10	10	10	10	10	-
Allied businesses	2	5	2	0	0	0	
% margin	7	15	5				
Total EBITDA (US\$mn)	200	201	58	199	255	316	26.0
Total EBITDA (Rsmn)	9592	9331	2564	9011	10824	13390	
Overall EBITDA margin (%)	20.4	17.3	4.9	14.7	15.4	16.2	

Source: Merrill Lynch Research

Impact of Rupee appreciation on Ranbaxy would be marginally positive

Export revenue exposure of Rs24.9bn effectively hedged by corresponding dollar-costs of Rs8.1bn and FCCB outstanding (US\$440mn) worth Rs18.4bn leading to the net positive impact.

Table 8: EPS Sensitivity to rupee appreciation

Rupee Sensitivity for Ranbaxy	Rs mn	With 5% appreciation Impact per share	Impact on EPS
Export Revenues	24964	-3.13	-19.2%
Dollar Costs	8098	1.01	6.2%
Dollar denominated debt (US\$60mn @Rs42)	18480	2.32	14.2%
Net Exposure	-1614	0.20	1.2%

Source: Merrill Lynch Estimates

Early US Lipitor entry: Rs30 NPV

Possible 15 month early generic Lipitor launch

Last year, The U.S. Court of Appeals for the Federal Circuit reversed a district court decision and ruled that Pfizer's '995 patent on Lipitor (expires on June 28, 2011) is invalid on technical grounds. In light of the appeals court ruling, Ranbaxy's generic Lipitor could enter the market in March 2010, 15 months earlier than previously expected. The appeals court did uphold the '893 patent and the patent term extension. This means Lipitor will have market exclusivity until March 24, 2010.

NPV of 15-month gain about Rs30 per share

Our NPV calculation assumes that the market exclusivity of Lipitor is pushed earlier from June 2011 to March 2010. We note that Ranbaxy has the 6-month Hatch-Waxman market exclusivity and expect an authorized generic Lipitor to co-exist during the 6 month period after March 2010. Assuming a 70% price discount and 50% market share for Ranbaxy during 2010, we estimate that Ranbaxy could generate about US\$600mn revenues and about US\$300mn profits during the 6-month period. Discounting it back to the current year at a 10% rate, the NPV impact is about Rs30 per share.

Pfizer seeking to correct the '995 patent

Pfizer has stated that it hopes to correct the technical defects in the '995 patent with the U.S Patent and Trademark Office (USPTO). It is unclear how long the USPTO will take to complete its process. We note that ML Pfizer analyst has assumed Lipitor genericisation from 2010 onwards.

Several pipeline catalysts ahead

Of the various pipeline catalysts, we highlight five key newsflow that could help improve stock momentum, some of which could likely deliver further earnings upside-

1. Resolution of FDA manufacturing issue at Poanta sahib in 2007
2. Market share build-up for generic Pravachol launched in Apr'07
3. Appeals decision of Lipitor litigation in Canada
4. R&D milestone from GSK Plc
5. Progress on other patent challenges like Avelox, Flomax and Tricor.

Table 9: Ranbaxy Laboratories: Key newsflow

Timeline	Event/ Milestone	Details & potential impact
2Q 2007	Resolution of FDA related manufacturing issue at Poanta Sahib facility; more clarity on FDA investigation in US	Positive for sentiment; overhang on new launch delays may be removed; potential upside to base earnings
2Q 2007	Market share build-up for Pravachol 80mg dose (cholesterol lowering) and marketing exclusivity	Incorporated in MLe; launched in April'07; about Re1 impact on CY07E EPS
2Q 2007	Patent expiry of Lipitor in Canada in May'07 (US\$800mn; cholesterol lowering); likely appeals court ruling	Canadian Federal Court has ruled that Pfizer's Canadian atorvastatin patent CA 2,021,546 is invalid; Ranbaxy is awaiting the Appeals Court ruling (likely in 3Q); approval not yet received; favorable ruling could result in atleast 10% upside to CY07E EPS and significant upside to CY08E EPS.
2Q 2007	Progress on Clarinex/Clarinex-D patent litigation vs. Schering (US\$325mn; desloratidine; allergy)	Ranbaxy has a Para IV challenge; however FTF status is unknown; Other Para IV filers include Belcher, Perrigo, Mylan, Watson, Sandoz, Glenmark, Lupin, Sun, Dr. Reddy's, Cadila. Possible settlement.
3Q 2007	Litigation update on generic Valtrex (US\$1.08bn, Valacyclovir, herpes; Ranbaxy vs. GSK patent litigation)	Ranbaxy is FTF for Valtrex (Valacyclovir); 30-month stay has expired; trial date not yet set; tentative approval received; if successful in trial then launch possible in early 2008 (Rs1.5 EPS impact).
4Q 2007	Trial on Tricor (US\$1.08bn; Fenofibrate, cholesterol lowering drug) anti-trust lawsuit by Teva	Teva and Ranbaxy have FTF; Teva has sued Abbott for having converted the market into new strength; trial scheduled for Nov'07
4Q 2007	Summary Judgment decision on Flomax patent challenge (tamsulosin; US\$800mn; benign prostatic hyperplasia; Ranbaxy vs. Boehringer)	Ranbaxy is FTF and has not been sued; Ranbaxy filed a motion for SJ of invalidity of '063 patent for double patenting. All other proceedings stayed pending decision on SJ which can be expected in 2007; 30-month stay expires in Oct'07
4Q 2007	Likely lower Court ruling on Avelox patent challenge (moxifloxacin); acute bacterial sinusitis; US\$271mn; Bayer)	DRL is FTF; Ranbaxy has not been sued; 30-month stay expires on 21st Oct'07; Lower court decision expected in 2007
2007	Likely launch of generic Lipitor in various European markets	To date, Ranbaxy has successfully invalidated Pfizer's Lipitor patents in UK, Austria & Netherlands
2007	Appeals ruling on patent litigation trial on Actos vs. Takeda (US\$2.2bn; diabetes)	Possible shared exclusivity between Mylan, Watson, and Ranbaxy. Watson and Ranbaxy are not challenging the '777 patent (compound) which was ruled against Mylan; possible appeals ruling in 2007
2007	Progress on Nexium patent litigation vs. AZN (US\$4.3bn; esomeprazole; ulcer)	Ranbaxy and Teva are Para IV challengers; Ranbaxy is FTF
2007	Likely news flow on further acquisitions in Europe/US	Likely dilutive impact on earnings
2007	Focus on price erosion in base generics business	10% price erosion in base generics assumed in MLe

Source: Merrill Lynch Research

Financial Summary

Table 10: Pharmaceutical sales: Regionwise break-up of revenues (US\$ mn)

Region	2004	2005	2006	2007E	2008E	CAGR (%)
Dosage forms						
India & Middle East	230	254	293	334	378	13.6
India	217	238	275	314	354	13.5
Middle East	13	16	18	21	24	15.0
Europe, CIS & Africa	296	335	420	593	734	32.2
<i>Ranbaxy UK Ltd (RUKL)</i>	<i>50</i>	<i>44</i>	<i>35</i>	<i>37</i>	<i>40</i>	<i>7.5</i>
<i>Basics GMBH (Germany)</i>	<i>26</i>	<i>31</i>	<i>30</i>	<i>33</i>	<i>40</i>	<i>14.9</i>
<i>Ranbaxy France (RPG)</i>	<i>73</i>	<i>74</i>	<i>67</i>	<i>74</i>	<i>90</i>	<i>15.8</i>
<i>Poland</i>	<i>11</i>	<i>11</i>	<i>15</i>	<i>20</i>	<i>27</i>	<i>34.9</i>
<i>Laboratorios Ranbaxy SL (Spain)</i>	<i>5</i>	<i>4</i>	<i>9</i>	<i>12</i>	<i>13</i>	<i>22.3</i>
<i>Rest of W. Europe</i>	<i>27</i>	<i>35</i>	<i>37</i>	<i>39</i>	<i>43</i>	<i>7.5</i>
<i>Russia</i>	<i>25</i>	<i>33</i>	<i>40</i>	<i>50</i>	<i>60</i>	<i>22.5</i>
<i>Ukraine Belt</i>	<i>20</i>	<i>22</i>	<i>25</i>	<i>30</i>	<i>36</i>	<i>20.0</i>
<i>ranbaxy Romania (Terapia)</i>		<i>13</i>	<i>72</i>	<i>140</i>	<i>175</i>	<i>55.9</i>
<i>Ranbaxy Nigeria Ltd</i>	<i>16</i>	<i>20</i>	<i>24</i>	<i>30</i>	<i>38</i>	<i>25.0</i>
<i>Ranbaxy South Africa</i>	<i>13</i>	<i>24</i>	<i>24</i>	<i>75</i>	<i>101</i>	<i>105.4</i>
<i>Rest of Africa</i>	<i>30</i>	<i>24</i>	<i>42</i>	<i>55</i>	<i>71</i>	<i>30.0</i>
AsiaPacific & Latin America	93	94	120	150	188	25.1
Ranbaxy Farmaceutica (Brazil)	32	22	26	33	41	25.0
Ranbaxy Malaysia	14	14	20	25	31	25.0
Thailand	7	8	10	13	17	30.0
China	12	15	13	16	19	22.0
Rest of AsiaPacific & Latam	28	35	51	64	80	25.0
USA	426	333	392	436	492	12.0
Total Dosage Forms	1,045	1,016	1,225	1,514	1,792	20.9
Active Pharmaceutical Ingredients	70	126	115	121	127	5.0
Allied Businesses	33	34	-	-	-	-
Net Sales (US\$mn)	1,148	1,176	1,340	1,634	1,919	19.7
<i>Growth (%)</i>	<i>21.6</i>	<i>2.4</i>	<i>13.9</i>	<i>22.0</i>	<i>17.4</i>	
<i>INR : USD rate</i>	<i>46.5</i>	<i>44.1</i>	<i>45.3</i>	<i>42</i>	<i>42</i>	
Net Sales (Rs mn)	53,333	51,880	60,652	69,296	81,352	15.8
<i>Growth (%)</i>	<i>17.7</i>	<i>(2.7)</i>	<i>16.9</i>	<i>14.3</i>	<i>17.4</i>	

EBITDA Build-up	CY04	CY05	CY06	CY07E	CY08E	CAGR (%)
Total operating income (US\$mn)	1163	1185	1355	1656	1944	
Region-wise EBITDA (US\$mn)						
India & Middle East	30	36	47	54	60	13.6
% margin	13%	14%	16%	16%	16%	
Europe, CIS and Africa	13	7	35	66	96	65.9
% margin	4%	2%	8%	11%	13%	
AsiaPacific & Latin America	19	11	22	27	38	31.9
% margin	20%	12%	18%	18%	20%	
USA	128	-10	84	96	109	13.8
% margin	30%	-3%	22%	22%	22%	
Total dosage forms	189	44	188	243	303	
% margin	18	4	15.3	16	17	5.1
Active Pharmaceutical ingredients	7	13	12	12	13	
% margin	10	10	10	10	10	-
Allied businesses	5	2	0	0	0	
% margin	15	5				
Total	201	58	199	255	316	26.0
Total EBITDA (Rsmn)	9331	2564	9011	10824	13390	
overall EBITDA margin (%)	17.3	4.9	14.7	15.4	16.2	
Total EBITDA	201	58	199	255	316	
Overall EBITDA (%)	17.3	4.9	14.7	15.4	16.2	
Conversion rate	46	44	45	42	42	
EBITDA (Rs mn)	9331	2564	9011	10824	13390	21.9
Overall EBITDA margin	17.5	4.9	14.9	15.6	16.5	

Source: Company data, Merrill Lynch Estimates

Table 11: Profit Model, December Yearends, 2004-2008E

Year to Dec (Rs mn)	2004	2005	2006	2007E	2008E
Gross sales	53,130	51,880	60,652	69,296	81,352
Less: Excise duty	679	861	482	515	582
Net sales	52,451	51,019	60,170	68,781	80,771
Other operating income	1,387	1,249	1,179	1,415	1,654
Total operating income	53,838	52,269	61,349	70,196	82,425
Materials	19,090	22,213	23,797	27,375	32,147
Manufacturing	2,267	2,549	3,009	3,439	4,039
Personnel	6,382	6,786	7,136	7,850	8,635
Cost of goods sold	27,739	31,548	33,942	38,664	44,820
Gross profit	26,099	20,721	27,407	31,532	37,605
SG&A expense	13,392	13,232	14,441	16,507	19,385
R&D expense	3,376	4,925	3,955	4,200	4,830
EBITDA	9,331	2,564	9,011	10,824	13,390
Technology licensing income	191	-	-	-	-
Non-operating income	1,291	1,164	649	931	989
Interest expense	(335)	(671)	(1,036)	(1,469)	(1,520)
Depreciation/Amortization	(1,215)	(1,445)	(1,843)	(2,084)	(2,226)
Pretax profit	9,264	1,612	6,781	8,203	10,633
Extra-ordinary items	(372)	333	(270)	-	-
PBT after extra-ordinary items	8,892	1,945	6,511	8,203	10,633
Current tax	(1,983)	698	(1,357)	(1,641)	(2,020)
Minority interest	26	25	50	53	55
Reported net profit	6,986	2,617	5,104	6,510	8,557
Adjusted net profit	7,358	2,471	5,320	6,510	8,557

Key Parameters

DPS (Rs)	8.5	4.5	9.0	9.0	9.0
Fully-diluted shares (mn) - Rs 5 FV	371.8	372.4	399.0	399.0	399.0
EPS - fully diluted (Rs)	19.8	6.6	13.3	16.3	21.4
CEPS-fully diluted (Rs)	22.1	9.6	17.0	20.5	25.9

Margins (%)

EBITDA Margin	17.3	4.9	14.7	15.4	16.2
Gross Profit Margin	48.5	39.6	44.7	44.9	45.6
Net Profit Margin	13.7	4.7	8.7	9.3	10.4

Growth (% YoY)

Gross revenues	17.3	(2.4)	16.9	14.3	17.4
Total net revenues	14.4	(2.9)	17.4	14.4	17.4
Operating Profit	(2.7)	(72.5)	251.5	20.1	23.7
Gross Profit	14.8	(20.6)	32.3	15.1	19.3
Net Profit	1.6	(66.4)	115.3	22.4	31.5
EPS	1.4	(66.5)	101.0	22.4	31.5

Source: Company data, Merrill Lynch Estimates

Table 12: Balance Sheet, December Year-end, 2004-2008E

Year to Dec (Rs mn)	2004	2005	2006	2007E	2008E
Equity Capital	1,859	1,862	1,862	1,862	1,862
Reserves and Surplus	23,247	22,605	24,334	27,253	32,219
Shareholders funds	25,106	24,467	26,196	29,115	34,082
Minority interests	180	166	166	166	166
Deferred tax liability (net)	842	(49)	(49)	(49)	(49)
Loan Funds	8,527	20,043	22,047	23,149	23,612
Loan from FCCB issue	-	-	17,600	17,600	17,600
Total loans	8,527	20,043	39,647	40,749	41,212
Total capital	34,655	44,627	65,960	69,981	75,411
Gross block	23,132	29,920	32,120	34,220	36,110
Less: accu. depreciation	7,838	9,329	10,785	12,444	14,202
Net block	15,294	20,591	21,335	21,776	21,908
Capital WIP	2,876	5,595	3,600	3,000	3,000
Net Fixed assets	18,170	26,187	24,935	24,776	24,908
Goodwill-Terapia/Be-Tabs acquisition	-	-	17,196	17,196	17,196
Investments	184	172	580	1,152	1,079
Inventories	14,351	13,624	15,952	18,226	21,397
Sundry debtors	11,357	11,404	15,703	18,036	21,174
Cash and bank balances	1,339	2,430	2,825	2,848	3,343
Other current assets	844	1,250	831	949	1,114
Loans and advances	7,579	4,571	5,317	6,075	7,132
Current assets, loans/advances	35,470	33,279	40,629	46,134	54,161
Current Liabilities	12,693	10,600	11,997	13,625	15,999
Provisions	6,475	4,408	5,382	5,652	5,934
Current liabilities and provisions	19,168	15,008	17,379	19,277	21,933
Net current assets	16,302	18,271	23,249	26,857	32,227
Total assets	34,655	44,629	65,960	69,981	75,411

Source: Company data, Merrill Lynch Estimates

Table 13: Cash Flow, December Yearends, 2004-2008E

Year to Dec (Rs mn)	2004	2005	2006E	2007E	2008E
Operating					
Operating profits (a)	9,523	2,564	9,011	10,824	13,390
Changes in working capital (b)	(4,372)	(878)	(4,584)	(3,585)	(4,874)
Other operating	102	21	(436)	(478)	(523)
Total operating	5,253	1,706	3,991	6,762	7,993
Investing					
Capex (c)	(8,470)	(9,508)	(205)	(1,500)	(1,890)
Goodwill (Terapia, Be-Tabs acquisition)	-	-	(17,196)	-	-
Other investing	5,144	12	(408)	(572)	72
Total investing	(3,325)	(9,496)	(17,809)	(2,072)	(1,818)
Financing					
Dividends paid (d)	(3,163)	(3,167)	(3,591)	(3,591)	(3,591)
Share capital	3	3	-	-	-
Premium/reserves	(287)	(995)	(54)	-	-
Borrowings	2,677	11,515	19,604	1,102	463
Other income	1,291	1,164	649	931	989
Net extraordinary income	(372)	333	(3)	-	-
Finance cost	(335)	(671)	(1,036)	(1,469)	(1,520)
Tax paid (e)	(1,983)	698	(1,357)	(1,641)	(2,020)
Total financing	(2,168)	8,880	14,212	(4,667)	(5,679)
Net change in cash	(240)	1,091	395	23	495
Net cash at beginning	1,580	1,339	2,430	2,825	2,848
Net cash at end	1,339	2,430	2,825	2,848	3,343
Gross cash flow (a+e)	7,540	3,261	7,654	9,184	11,369
Free cash flow (a+b+c+e)	(5,302)	(7,125)	2,866	4,099	4,605
Disc. cash flow (a+b+c+d+e)	(8,465)	(10,292)	(725)	508	1,014
Free cash flow per share (Rs)wtd	(14.3)	(19.1)	7.2	10.3	11.5

Source: Company data, Merrill Lynch Estimates

Table 14: Valuation summary, December yearends, 2004-2008E

Year to Dec (Rs mn)	2004	2005	2006	2007E	2008E
ROE DUPONT ANALYSIS					
Net Profit	7,358	2,471	5,320	6,510	8,557
Year-end Equity	23,320	24,772	25,332	27,656	31,598
Return on Equity (%)	31.6	10.0	21.0	23.5	27.1
Dupont Analysis					
EBIT margin (EBIT/sales) (%)	17.8	4.4	12.7	13.8	14.7
Asset turnover (sales/assets) (x)	1.7	1.3	1.1	1.0	1.1
Financial leverage (assets/equity) (x)	1.4	1.6	2.2	2.5	2.3
Interest burden (pretax/EBIT) (x)	96.5	70.6	86.7	84.8	87.5
Tax burden (net/pretax) (%)	79.4	153.3	78.5	79.4	80.5
Return on equity (%)	31.6	10.0	21.0	23.5	27.1
Ratios					
Debt/Equity (x)	0.34	0.71	1.51	1.40	1.21
ROE (%)	31.6	10.0	21.0	23.5	27.1
ROCE (%)	21.8	4.2	11.4	11.7	13.6
Valuation parameters					
EPS (Rs) YE	19.8	6.6	13.3	16.3	21.4
CEPS (Rs) YE	22.1	9.6	17.0	20.5	25.9
Growth (%)					
Net revenues	14.4	-2.9	17.4	14.4	17.4
EPS	1.4	-66.5	101.0	22.4	31.5
Valuation metrics					
Price (Rs)	385	385	385	385	385
Fully-diluted shares (mn)-Rs 5 FV	371.8	372.4	399.0	399.0	399.0
P/E	19.5	58.0	28.9	23.6	18.0
EV/EBITDA	14.1	43.2	17.8	14.7	12.0
EV/Sales	2.8	3.1	2.8	2.5	2.1

Source: Company data, Merrill Lynch Estimates

Price Objective Basis & Risk

We upgrade Ranbaxy Laboratories to a Buy from Neutral with PO of Rs492/share (28% upside potential). Our upgrade is driven by robust 27% EPS CAGR (CY06-08E) given higher visibility in scale-up of international operations and US products/R&D milestone upsides. Our PO includes Rs30/sh for Lipitor early entry into US.

The stock currently trades at 22.4x CY07E earnings and 17.25x CY08E earnings estimate.

Risks to our PO: Regulatory delays in product launches, Litigation risks, higher than expected US generic pricing pressure, prolonged FDA manufacturing issues and EU healthcare reform pressure.

Analyst Certification

I, Visalakshi Chandramouli, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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07 May 2007

*iQmethod*SM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

*iQmethod*SM is the set of Merrill Lynch standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of *iQmethod* are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

iQdatabase[®] is our real-time global research database that is sourced directly from our equity analysts' earnings models and includes forecasted as well as historical data for income statements, balance sheets, and cash flow statements for companies covered by Merrill Lynch.

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Important Disclosures

XANBF Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of April 30, 2007 or such later date as indicated.

RBXZF Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of April 30, 2007 or such later date as indicated.

Investment Rating Distribution: Health Care Group (as of 31 Mar 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	97	46.86%	Buy	25	27.78%
Neutral	100	48.31%	Neutral	32	34.41%
Sell	10	4.83%	Sell	3	33.33%

Investment Rating Distribution: Global Group (as of 31 Mar 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1562	45.16%	Buy	415	30.09%
Neutral	1615	46.69%	Neutral	446	30.65%
Sell	282	8.15%	Sell	49	19.76%

* Companies in respect of which MLPS&S or an affiliate has received compensation for investment banking services within the past 12 months.

FUNDAMENTAL EQUITY OPINION KEY: Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. **VOLATILITY RISK RATINGS**, indicators of potential price fluctuation, are: A - Low, B - Medium, and C - High. **INVESTMENT RATINGS**, indicators of expected total return (price appreciation plus yield) within the 12-month period from the date of the initial rating, are: 1 - Buy (10% or more for Low and Medium Volatility Risk Securities - 20% or more for High Volatility Risk securities); 2 - Neutral (0-10% for Low and Medium Volatility Risk securities - 0-20% for High Volatility Risk securities); 3 - Sell (negative return); and 6 - No Rating. **INCOME RATINGS**, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure); 8 - same/lower (dividend not considered to be secure); and 9 - pays no cash dividend.

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