

April 15, 2008

Rating	Outperformer
Price	Rs444
Target Price	Rs576
Implied Upside	27%
Sensex	15,808

(Prices as on April 11, 2008)

Trading Data

Market Cap. (Rs bn)	165.61
Shares o/s (m)	373
Free Float	65.2%
Avg. Daily Vol ('000)	1,847.8
Avg. Daily Value (Rs m)	766.7

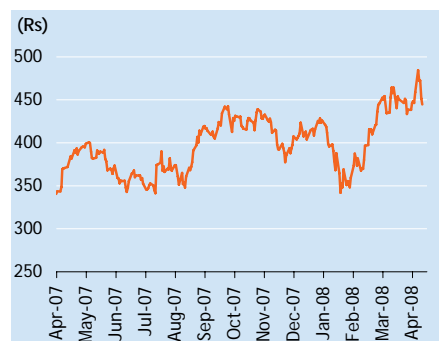
Major Shareholders

Promoters	34.8%
Foreign	14.0%
Domestic Inst.	25.2%
Public & Others	26.0%

Stock Performance

(%)	1M	6M	12M
Absolute	(1.4)	6.6	37.7
Relative	(1.9)	20.5	19.3

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



Source: Bloomberg

Ranbaxy Laboratories

Upsides from FTF opportunities

We recently met Mr. Malvinder Singh, CEO and Managing Director of Ranbaxy Laboratories (RLL) and came back with a positive note. RLL is likely to benefit from the three First-to-File (FTF) opportunities: de-merger of NCE, related R&D and cost control.

- **FTF opportunities:** We have estimated FTF sales opportunity for three generics of Imitrex (GSK), Valtrex (GSK) and Flomax (Boehringer Ingelheim) aggregating to \$US21m, Rs208m and Rs424m in CY08, CY09 and CY10 respectively, for which RLL has already settled litigations with the patent holders. For generic Lipitor and Nexium, we have not factored the FTF upsides in view of the on-going litigations.
- **R&D demerger:** RLL has announced the demerger of its R&D relating to Drug Delivery Research (DDR) for enhancing shareholder value. The company currently has eight molecules in different stages of development. This would result in reduction of R&D cost by over Rs1.0bn for RLL and hence will improve profitability.
- **Margin improvement:** We expect RLL's EBIDTA margin to improve from 14.5% in CY07 to 19.9% in CY10 due to cost control measures and high margin FTF opportunities.
- **Valuation:** We expect the company to report EPS of Rs20.5, Rs32.0 and Rs42.9 for CY08, CY09 and CY10 respectively, including FTF opportunities. The stock currently trades at 21.6x, 13.9x and 10.4x based on CY08E, CY09E and CY10E earnings. We rate RLL an Outperformer with a price target of Rs566, a 27% upside over CMP. A detailed report will follow in due course.

Key financials (Y/e Dec)	CY07 A/E	CY08E	CY09E	CY10E
Net sales (Rs m)	69,520	81,912	103,240	127,209
Growth (%)	13.4	17.8	26.0	23.2
EBITDA (Rs m)	10,058	14,249	19,892	25,270
PAT before EO (Rs m)	6068	8095	12622	16910
Growth (%)	17.8	33.4	55.9	34.0
EPS (Rs)	15.4	20.5	32.0	42.9
Net DPS (Rs)	8.5	10.0	11.0	12.0

Source: Company Data; PL Research

Profitability & valuation	CY07 A/E	CY08E	CY09E	CY10E
EBITDA margin (%)	14.5	17.4	19.3	19.9
RoE (%)	25.7	24.3	22.3	24.6
RoCE (%)	10.6	12.6	17.0	20.4
EV / sales (x)	2.9	2.5	1.9	1.5
EV / EBITDA (x)	20.0	14.4	9.7	7.4
PE (x)	28.8	21.6	13.9	10.4
P / BV (x)	5.4	4.8	3.0	2.5
Net dividend yield (%)	1.9	2.3	2.5	2.7

Source: Company Data; PL Research

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FTF opportunities

RLL has 18 Para IV FTF opportunities with an innovator market size of over US\$27bn (Rs1,080bn) over the next few years. The company has a robust product flow with assured visibility on FTF products from CY08 to CY10. It has plans to launch at least one potential FTF every year from CY08 to CY13. The company has settled the patent litigations with the three patented products namely: Imitrax, Valtrex and Flomax, with innovator companies and is confident of launching the generic version of these products over CY08 to CY10. RLL has not disclosed the terms of the settlement. These three products have market size of US\$3.5bn (Rs140bn) at the innovator's price. The launch of Nexium and Lipitor is subjected to the outcome of court cases and hence we have not factored them into our projections. Details of revenue and profits from three FTF products are shown in the following table:

FTF opportunities

Products (in \$ m)	2008	2009	2010	Assumptions
Sumatriptan	20.83	104.17		Mkt. size US\$1.0bn, MS 50%, price erosion 60%, expected sales US\$125m (1m+5m)
Valcyclovir		104.00	208.00	Mkt. size US\$1.3bn, MS 80%, price erosion 40%, expected sales US\$312m (2m+4m)
Tamsulosin			216.00	Mkt. size US\$1.2bn, MS 60%, price erosion 40%, expected sales US\$216m (6m)
Total	20.83	208.17	424.00	
Conversion rate	40.90	40.50	40.20	
Total sales	852.1	8,430.8	17,044.8	
PBT @ 60%	511.3	5,058.5	10,226.9	
Tax rate @ 25%	127.8	1,264.6	2,556.7	
PAT	383.4	3,793.8	7,670.2	
Equity shares (diluted)	394	394	394	
EPS (Rs)	1.0	9.6	19.5	

Source: Company data

The above table indicates that the three FTF opportunities are likely to generate revenue of Rs852m, Rs8,431m and Rs1,7045m in CY08, CY09 and CY10 respectively. Considering PBT at 60% of sales and tax rate of 25%, this would result in net profit of Rs383m, Rs3,794m and Rs7,670m respectively during the same period.

Moreover, RLL is likely to have an upside from generic version of Nexium (market size US\$5.5bn) and generic Lipitor (market size US\$8.0bn). The company has obtained tentative approval for generic Nexium and is waiting



for the final approval. For generic Lipitor, RLL has won '995' patent. The litigation for both these products are continuing in the US Courts and the management believes that they have a strong case.

Demerger of R&D

RLL has announced the demerger of its NCE related R&D. This is likely to result in savings of over Rs1.0bn in CY08 and improve return ratios. RLL has currently eight NCE (one in phase II, two in phase I and five in pre-clinical) in the pipeline. The demerger would give an exit option for the shareholders, who do not wish to continue in the high-risk, high-return business. The shares of the demerged company are likely to be listed in June 2008. RLL has plans to rope a strategic investor in the R&D company.

Under the demerger scheme, RLL shareholders will receive free of cost one share of FV of Rs1 each for every four shares of FV of Rs5 of RLL. The company is likely to declare the details of R&D pipeline shortly.

Cost optimisation

RLL has taken several measures to control cost. This is likely to improve its EBIDTA margin from 14.5% in CY07 to 19.9% in CY10. The improvement is likely to come from the reduction in material cost, R&D expenses and personnel costs. The company has achieved 3% improvement in working capital in CY07 and the same is likely to continue.

The management has indicated that the litigation cost is likely to be maintained at the current level of around Rs2.0bn per annum.

Entry into new areas and markets

RLL has plans to enter into new therapeutic areas to widen its product basket and higher coverage of doctors. RLL has improved its share in emerging market from 44% in CY05 to 54% in CY07. The emerging market business has higher margins and the same are sustainable. The promising markets are Romania (21% growth), Germany (69%), UK (36%), Italy (50%), Portugal (50%) and Spain (12%).

RLL has received an approval to launch generic Amlodipine Besylate in Japan. It is the first company to receive such an approval.



Forex gains

The company has consistently made gains from forex transactions in the past. It has not entered into cross currency or speculative forex transactions but has carried out only business related transactions in CY07. The net forex gain from FCCB and translation charges was Rs1,812m in CY07. It has US\$440m FCCB, which is likely to be converted at Rs716.32 per share before March 2011.

Strong presence in the domestic market

RLL derives around 20% of its revenue from the domestic market and has achieved 23% growth in CY07. The company has leadership in NDDS platform, which constitutes 9% of its domestic sales. RLL has 9 brands in top 100 and 18 brands in top 300 products. Its major OTC product Revital has sales of over Rs800m and is growing around 25% per annum.

Strategic alliances

RLL has the following strategic alliances in the domestic market: Kreb's Biochemicals (about 15% stake) for fermentation products, Jupiter Biosciences (about 15% stake) for peptides and Zenotech (45% stake) for biotech, oncology and injectibles.

Acquisition of Orchid Chemicals

The management has said that they do not wish to comment on this issue. RLL is not likely to do any hostile takeovers.

Financials

We expect RLL to report 22% CAGR in sales over next three years from CY07-CY10 due to strong growth in emerging markets and revenue from FTF opportunities. We expect its EBIDTA margin to improve from 14.5% in CY07 to 19.9% in CY10 due to expected reduction in material cost, personnel cost and R&D expenses. We expect RLL's net profit before EO items to improve at CAGR of 41% over next three years.

We expect RLL's RoCE to improve from 10.6% in CY07 to 20.4% in CY10. However, its RoE is likely to decline from 25.7% in CY07 to 24.6% in CY10 due to FCCB conversion.

EPS from the core business and from FTF opportunities is shown in the following table:

EPS core and FTF opportunities

Particulars	CY08E	CY09E	CY10E
Total sales (Rs m)	852.1	8,430.8	17,044.8
	511.3	5,058.5	10,226.9
Tax rate 25%	127.8	1,264.6	2,556.7
PAT	383.4	3,793.8	7,670.2
Equity shares (diluted)	394	394	394
EPS (Rs)	1.0	9.6	19.5

Source: Company data

As seen from the above table, FTF opportunities are likely to generate EPS of Rs1.0, Rs9.6 and Rs19.5 in CY08, CY09 and CY10 respectively.

Valuation

At the CMP of Rs444, the stock trades at 21.6x, 13.9x and 10.4x CY08E EPS of Rs20.5, CY09E EPS of Rs32.0 and CY10E EPS of Rs42.9 respectively (inclusive of FTF gains). P/E on the basis of core and core+FTF business is indicated in the following table:

Core and Core+FTF based P/E

Particulars	CY08E	CY09E	CY10E
Net profit before EO items	8,095	12,622	16,910
Net profit after EO items & minority interest	8,369	12,882	17,090
Equity capital (fully diluted)	1,971	1,971	1,971
EPS (Rs)	20.5	32.0	42.9
EPS from FTF products (Rs)	1.0	9.6	19.5
EPS from the core business (Rs)	19.6	22.4	23.4
CMP (Rs)	444	444	444
P/E on core EPS	22.7	19.8	19.0
PE on core+FTF EPS	21.6	13.9	10.4

Source: Company data

On the basis of only core business EPS, the scrip is trading at 22.7x CY08, 19.8x CY09 and 19.0x CY10 earnings, without taking into consideration the upsides from generic Nexium and Lipitor.

We expect RLL to be Outperformer with target price of Rs566 based on 20x earnings of base business (Rs468) and 5x earnings of FTF business(Rs98) in CY10.



Profit & loss account (consolidated)

(Rs m)

Y/e Dec	CY07A/E	CY08E	CY09E	CY10E
Net sales	69,520	81,912	103,240	127,209
Operating expenses	59,462	67,662	83,348	101,939
Material cost	24,212	28,245	35,300	43,250
Manufacturing	3,364	3,902	4,840	5,840
Personnel	8,171	9,565	11,735	14,420
Selling, general and admin.	19,476	22,650	27,680	33,950
Research & development	4,239	3,300	3,793	4,479
Other income	1,299	401	473	541
EBIDTA	11,357	14,650	20,365	25,811
<i>EBIDTA margin</i>	<i>16.3</i>	<i>17.9</i>	<i>19.7</i>	<i>20.3</i>
Depreciation	2,153	2,331	2,429	2,601
Avg. gross block	52,441	54,919	57,411	59,987
<i>Amortisation rate</i>	<i>4.1</i>	<i>4.2</i>	<i>4.2</i>	<i>4.3</i>
EBIT	9,204	12,320	17,937	23,210
<i>EBIT margin</i>	<i>13.2</i>	<i>15.0</i>	<i>17.4</i>	<i>18.2</i>
Interest	1,443	1,525	1,115	550
Avg. Debt	37,385	37,784	28,678	14,575
<i>Av. Int. rate</i>	<i>3.9</i>	<i>4.0</i>	<i>3.9</i>	<i>3.8</i>
Profit before tax	7,761	10,795	16,822	22,660
Tax provision	1,693	2,700	4,200	5,750
<i>Effective tax rate</i>	<i>21.8</i>	<i>25.0</i>	<i>25.0</i>	<i>25.4</i>
- Current tax	896	1,500	2,400	4,000
- Deferred tax	797	1,250	1,800	2,020
Profit after tax before EO	6,068	8,095	12,622	16,910
Extraordinary items	1,812	344	340	270
Minority interest	60	70	80	90
Net profit	7,820	8,369	12,882	17,090
Net margin	11.2%	10.2%	12.5%	13.4%
Equity capital	1,863	1,863	1,971	1,971
Face value	5	5	5	5
Equity shares	373	373	394	394
CEPS	25.3	27.1	38.8	49.9
Payout ratio	0.6	0.5	0.3	0.3
Dividend yield (%)	1.9	2.3	2.5	2.7



Balance sheet (consolidated)

(Rs m)

Particulars	CY07A/E	CY08E	CY09E	CY10E
Sources of funds				
Equity share capital	1,863	1,863	1,971	1,971
Share application money pending allotment	9	9	9	9
Reserves & surplus	28,085	32,172	55,343	66,863
Minority interest	440	464	445	697
Networth	30,397	34,508	57,768	69,540
Avg. networth	30,397	34,508	57,768	69,540
Secured loans	2,550	2,950	1500	1,650
Unsecured loans	32,664	37,405	15,500	10,500
Total debt	35,214	40,355	17,000	12,150
Avg. debt	37,385	37,784	28,678	14,575
Deferred tax liability	2,433	3,683	5,483	7,503
Capital employed	68,043	78,546	80,251	89,193
Avg. capital employed	67,714	73,295	79,399	84,722
Application of funds				
Gross block	53,709	56,128	58,693	61,281
Avg. gross block	52,441	54,919	57,411	59,987
Less: accum. depreciation	14,533	16,864	19,292	21,894
Net block	39,176	39,264	39,401	39,387
Capital work-in-progress	4,100	5,650	6,200	6,900
Investments	719	719	719	719
Deferred tax asset	1,855	1,856	1,801	1,963
Current assets, loans & advances				
Inventories	17,405	21,700	26,080	30,300
Sundry debtors	14,700	20,850	22,350	29,135
Cash and bank balance	5,041	8,385	9,627	12,003
Other current assets	1,080	1,043	1,062	1,118
Loans and advances	5,350	5,203	5,165	5,327
Less: current liab. & prov.				
Current liabilities	13,845	17,005	21,565	24,967
Provisions	7,537	9,118	10,587	12,691
Net current assets	22,194	31,058	32,132	40,225
Capital deployed	68,043	78,546	80,252	89,193



Ratios

Particulars	CY07A/E	CY08E	CY09E	CY10E
Valuation (x)				
P/E	28.8	21.6	13.9	10.4
P/BV	5.4	4.8	3.0	2.5
Market cap/sales	2.4	2.0	1.7	1.4
EV/operating profit	20.0	14.4	9.7	7.4
EV/sales	2.9	2.5	1.9	1.5
Profitability (%)				
Operating margin	14.5	17.4	19.3	19.9
EBIDTA margin	16.3	17.9	19.7	20.3
EBIT margin	13.2	15.0	17.4	18.2
PBT margin	11.2	13.2	16.3	17.8
Net margin	11.2	10.2	12.5	13.4
RoE	25.7	24.3	22.3	24.6
RoCE	10.6	12.6	17.0	20.4
Growth (%)				
Revenue	13.36	17.82	26.04	23.22
Operating profit	15.4	41.7	39.6	27.0
EBIDTA	21.0	29.0	39.0	26.7
Net profit	53.2	7.0	53.9	32.7
EPS	17.8	33.4	55.9	34.0
CEPS	43.6	7.3	43.1	28.6
Efficiency ratios				
Working capital (days)	119.97	118.65	111.70	103.81
Inventory (days)	88.00	87.13	84.46	80.89
Debtors (days)	79.85	79.21	76.37	73.86
Creditors (days)	79.85	79.21	76.37	73.86
Net fixed assets (x)	1.78	2.09	2.62	3.23



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PL's Recommendation Nomenclature

Buy	: > 15% Outperformance to BSE Sensex	Out Performer (OP)	: 5 to 15% Outperformance to Sensex
Market Performer (MP)	: -5 to 5% of Sensex Movement	Under Performer (UP)	: -5 to -15% of Underperformance to Sensex
Sell	: <-15% Relative to Sensex		
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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