Equities

2 December 2011 | 7 pages

Ranbaxy (RANB.BO)

■ Company Update

Alert: Lipitor Launch-Another Milestone on the Road to Recovery

- **Road to recovery** — The US FDA approval for generic Lipitor gives us more comfort on Ranbaxy's ability to recover lost ground in the US. Besides the material upside during the exclusivity period (we believe the disquiet over profit sharing to Teva is overdone) & reasonable recurring upside thereafter, it provides Ranbaxy leverage with the trade & should rub off favourably on its underlying biz. Moreover, approval for the ANDA, originally filed from Paonta Sahib, via a site transfer points to the progress made in the remediation process. Maintain Buy (1H).
- **Lipitor comes through as well** — Ranbaxy continued its near 100% track record of launching its FTF products, despite FDA issues at its plant - Flomax (also monetized) being the only exception. The Lipitor approval follows approvals for Imitrex (albeit delayed), Valtrex & Aricept - all through site transfers to its plant in New Jersey. However, the Lipitor approval is more encouraging, as we believe the original filing was made from the Paonta Sahib site that is subject to an AIP.
- **Our take on Teva's involvement** — Ranbaxy indicated that it would share some portion of profits on Lipitor with Teva, during the exclusivity period. Based on Teva's guidance, this appears to be cUS$100m at the higher end - i.e. cRs9-10/sh (one time) for Ranbaxy. We do not see this as very material in the overall context. We would have been concerned, had a tie-up involved Teva distributing the product - as that would mean it retains market share beyond exclusivity as well & Ranbaxy just gets a one time monetary upside (a la Flomax). However, in this case, Ranbaxy will be one of the leading players in generic Lipitor post exclusivity as well..
- **Our US analyst says** — (**Alert: TEVA: Teva Entitled to a Portion of Generic Lipitor Profit**) Terms of the agreement between the parties remain undisclosed; however, we believe it likely contained a range of scenarios incorporating different levels of service provided by Teva (e.g. API manufacturing, fill finish, distribution). We believe that Ranbaxy entered into an agreement with Teva as a contingency to accommodate the uncertainty created by its ANDA filing in order to ensure it fully monetized the Lipitor opportunity .We assume that the $0.10 referenced by Teva in its 3Q11 call implied that Teva provided a wider range of services to support Ranbaxy's generic Lipitor launch.
- **Financial Impact** — We understand that price discount for generic Lipitor is c50%. Assuming 30% market share, we calculate generic Lipitor could add cRs35 (cRs25 excluding payoff to Teva) to Ranbaxy's EPS during exclusivity. Post this period, we expect higher price erosion (c90-95%) & lower market share (c20%), potentially translating to recurring EPS upside of cRs2 (c12% of CY11E core EPS).
- **What's Next** — We believe investor focus will now shift towards Lipitor market share data (Ranbaxy to ramp up slower than Watson), reflection of Lipitor in earnings, closure to FDA/DoJ issues (potentially imminent), commencement of Nexium formulation sales to Astra and trends in core biz (expect margins to keep improving). Confidence in rest of the FTF pipeline (Actos, Valcyte, Nexium) should be higher.

Buy/High Risk	**1H**
Price (01 Dec 11)	Rs444.10
Target price	Rs700.00
Expected share price return	57.6%
Expected dividend yield	0.5%
Expected total return	**58.1%**
Market Cap	Rs187,410M
	US$3,595M

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

Prashant Nair, CFA
+91-22-6631-9855
prashant.nair@citi.com

Anshuman Gupta
+91-22-6631-9873
anshuman.gupta@citi.com

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Ranbaxy

Valuation

We have a target price of Rs700 for Ranbaxy, comprising Rs560 for the base generics business and Rs140 for its patent challenge pipeline. We use EV/Sales to value the core business as we believe Ranbaxy's current profitability is skewed by the unabsorbed overheads at Paonta Sahib & Dewas as well as the high legal & consultancy charges being incurred towards resolving the FDA issues at these plants. We value the core generics business (excluding exclusivity upsides) at 2.4x Jun '12E recurring sales, which is at a 10% discount to the median of the band in which it has traded over the past 8-9 years. We believe this discount is warranted given the uncertainties in its business. We value the company's patent challenge pipeline using a probability-adjusted NPV approach and applying a discount rate of 15%.

Risks

We rate Ranbaxy as High Risk. While there are signs of recovery in the business, we believe risk is still on the higher side due to the uncertainty related to its issues with the US FDA / DoJ. The key downside risks to our target price include: 1) Slower than expected resolution of the US FDA issues; 2) Setbacks on its already monetized patent challenge pipeline, in form of litigation wins by other generic companies or delay in approvals/launches; 3) Continued sluggish trend in India (18% of revenues) in the light of slower growth in the overall market.

Appendix A-1

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Ranbaxy (RANB.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Prashant Nair, CFA

	Date	Rating	Target Price	Closing Price
1	9-Dec-08	*2H	*241.00	213.05
2	26-Apr-09	*3H	*141.00	175.75
3	9-Jun-09	3H	*235.00	283.15
4	1-Dec-09	*1M	*620.00	469.10
5	11-Nov-10	1M	*700.00	584.85
6	7-Oct-11	Stock rating system changed		
7	7-Oct-11	*1H	700.00	517.50

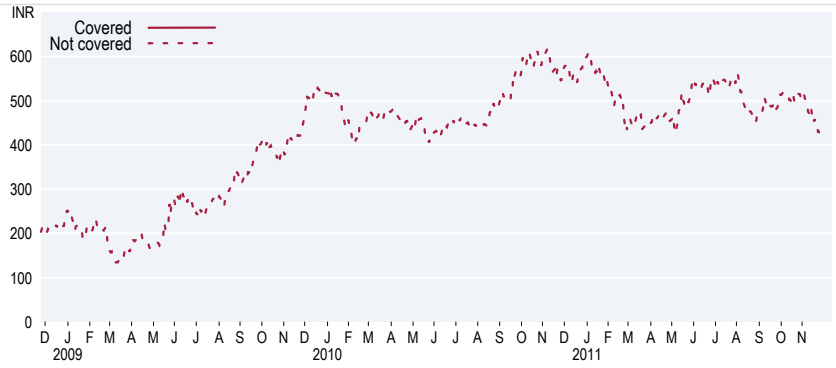
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Ranbaxy (RANB.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Prashant Nair, CFA



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Data current as of 10 Oct 2011	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
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