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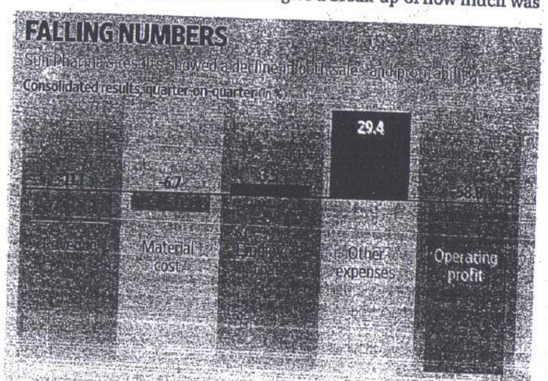
Sun Pharma-Ranbaxy: honeymoon over, now to make it work

The first financial results of **Sun Pharmaceutical Industries Ltd** and Ranbaxy Laboratories Ltd after they became one is likely to leave the market puzzled.

The initial period after the merger of the two large companies can be expected to be volatile. Post-merger, investors typically expect combined sales to increase, since the merged company's sales get added, and profitability to improve due to scale and integration benefits.

In Sun-Ranbaxy's case, however, Sun Pharma's results show a sequential decline in sales by 11.2% to ₹6,157 crore. Year-on-year comparisons are not relevant because of the merger. The management said that sales in the US market have been affected by supply disruptions and price cuts in many products. This has affected both sales and profits, as the US market is a large contributor to the sales and profitability of the company.

Also, charges relating to the Ranbaxy merger and harmonization of policies led to lower profits. The total impact was about 10% on the sales, but Sun Pharma did not give a break-up of how much was due to the merger and how much to supply disruption and price erosion.



Source: Company, Mint research

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MARK TO MARKET

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The current quarter's results show a significant decline in operating profit compared with the merged entity's December pro-forma numbers.

So what does an investor do when faced with such results: a decline in sales and a 59% decline in operating profit over the preceding quarter?

Sun Pharma is not making it any easier—it has not given more clarity on what to expect and has also refrained from giving guidance, citing uncertainties.

Right now, wait-and-watch seems the right thing to do. It will take a few more results to get some clarity on Sun Pharma's financial performance, such as the new sales figure that can be taken as a base figure, and the level at which its operating profit margin will settle. And it could take much longer for the merger's benefits to start showing results.

Meanwhile, investors would do better to focus on other, more important, things. Is the price erosion in the US market and supply disruptions tapering? Will Sun Pharma manage to get US Food and Drug Administration (FDA) compliance for its Halol facility? Any US FDA approvals for new generic products with a large market size will be a help, as it will take care of price erosion in the company's base business.

Knowing the quality of Sun Pharma's management and its success in handling acquisitions, reading too much into the current numbers could lead to the wrong conclusions.

Sure, the share can be expected to lose ground—it fell by 9% on Monday—as investors are likely to be unprepared for this result. But that may just be another addition to the background noise created by this quarter's results.

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