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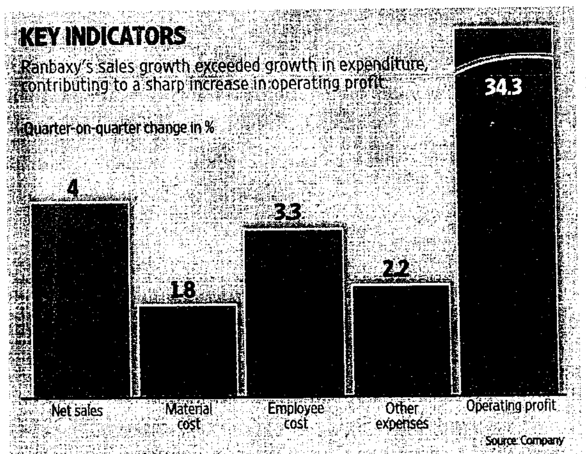
Relief for Ranbaxy Laboratories, but questions still remain

Ranbaxy Laboratories Ltd's shares made a comeback on Wednesday, after investors saw its December quarter earnings and heard the management's opinion on the import alert issued to one of its plants. The company's share gained 5.7% on Wednesday, after having lost 23% of its value since Ranbaxy announced the US food and drug administration's (FDA's) action against its Toansa drug ingredients plant in Punjab.

The company's management also clarified in a post-earnings conference call that products made using inputs from the Toansa plant account for only 15% of global sales. The immediate impact, of course, will be seen in the US market where the ban applies. Here too, the impact is limited to 10-12% of Ranbaxy's revenues in that market.



MARK TO MARKET

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This clarification does a few things. One, it puts a number on the impact that is material, but is not a massive setback. Two, Ranbaxy claimed it had maintained multiple ingredients sources to minimize business risk. If it can meet its requirements from these sources, it could still salvage the affected part of its US business. The impact on margins, too, may not be significant since its dependence was already low. Lastly, the management remains confident it can launch big-ticket products that are already in the US market pipeline even after the ban.

Ranbaxy's results give some more comfort. Sales rose by 7% to ₹2,859 crore in the December quarter over the year-ago period, and by 4% sequentially. In the US, sales rose by only 5%—mainly due to a high base effect—but the company said that its base business sales, excluding one-off opportunities, rose by 30%. In India, sales rose by 8% over a year ago and trade channel issues have been settled.

Operating profit margin improved to 9%, or a sequential improvement of two percentage points. Some of this was due to the product mix. The other expenses figure was stable as well, indicating that remediation costs relating to the consent decree may have stabilized. However, the Toansa episode did lead to an inventory write-off of ₹257 crore, which was responsible for a loss of ₹158.9 crore, after accounting for minority interest.

Now, investors' concern may have been assuaged to some extent after the management's comments. But the episode still raises questions on why, despite past instances and enough time to correct course, the company's facilities have tripped on FDA rules. If this relief is to sustain, Ranbaxy needs to resolve what appears to be a systemic flaw in its processes.

Company