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A pharma giant in the making

Sun Pharma should be able to sort out Ranbaxy's problems and benefit from its otherwise strong business

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Despite healthy fundamentals, the stock of Sun Pharma underperformed BSE Healthcare Index since our recommendation in December 2013. This was on account of concerns over long-term growth. But the recent acquisition of Ranbaxy Labs has come as a shot in the arm for Sun Pharma. The stock has gained about 10 per cent since the announcement last Monday. While Ranbaxy's current $2 billion annual revenue will accrue to Sun, what will also help is the under-utilised potential in Ranbaxy's existing business.

Adding to Sun's muscle

Ranbaxy's strong brand portfolio and distribution network in India, niche product filings in the US and its business in other emerging markets should provide a leg up to Sun's revenues over the next three-five years. In the interim, revenues from the launch of exclusive products in the US should boost Sun's cash flows. Though Ranbaxy's issues with US drug regulator remain a concern, Sun's track record of turning around distressed companies it acquired such as Taro and URL Pharma raises hopes of an improvement in Ranbaxy's fortunes too.

If Sun Pharma is able to turn around Ranbaxy, it will translate into a big jump in the former's revenues and profit in the medium term.

Though the deal may not add to Sun's earnings materially in the first two years, the management expects accretion of $250 million to the revenues and operating profit in the third year. At the current price of ₹627, the Sun Pharma stock trades a little over 22 times its consolidated 2014-15 earnings, in line with its historical average. This is before

To good health The Ranbaxy acquisition gives Sun a broad-based presence across key therapy categories WAVEBREAK/SHUTTERSTOCK.COM

factoring in the upside from Ranbaxy deal. It may hence be an opportune time for investors with a two-to-three year horizon to buy the stock.

Biggest in India

After the deal, Sun Pharma will emerge as India's largest drug maker with a market share of around 9 per cent. Given the limited product overlap, the acquisition will strengthen Sun's position in therapies such as anti-infectives, dermatology, urology and orthopaedics. The combined entity will have 31 brands in the top 300 category in India. From being a largely chronic-focussed player, Sun Pharma will now have a broad-based presence across key therapy categories in the acute and chronic space.

The merger will strengthen Sun's institutional (hospitals) business and pave the way for its foray into the over-the-counter (OTC) segment.

Given the highly fragmented nature of the domestic market, building brands to a critical size is time-consuming. The acquisition of Ranbaxy with a vast range of brands will save Sun much time and effort.

Leg up to US sales

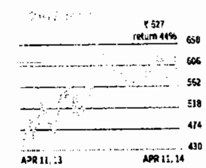
Also, Ranbaxy's portfolio of exclusive products such as Nexium, Diovan and Valcyte in the US market should boost Sun's cash flows in the next one to two years. Sun will also gain access to innovative drugs such as Absorica (for acne treatment) and other low-competition, niche drugs filed by Ranbaxy, making it the largest Indian generic company in the US.

Sun will also gain a foothold in other emerging markets, making it the fifth largest generic player globally. This will reduce the revenue concentration from the US market which contributes over 60 per cent of Sun's sales.

Ranbaxy appears to be a good fit for Sun Pharma. The buy has also been timed and priced right. At 2.2 times Ranbaxy's 2013 sales, the purchase price is just half the 5.5 times sales paid by Daiichi Sankyo in 2008.

BUY

- Ranbaxy acquisition a good fit
- Good long-term growth prospects
- Reasonable valuation



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