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Interview: Indian family-owned firms becoming more open to sell-off option

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Selling off the family jewels, or even a discussion on the issue, was considered unthinkable in closely-held, family-owned Indian pharmaceutical firms even just a few years ago.

Not any more, according to industry veteran Dr Brian Tempest. He told *Scrip* that post two mega deals - Abbott's purchase of Piramal Healthcare's domestic formulations business some weeks ago, and Daiichi Sankyo's acquisition of Ranbaxy Laboratories in 2008 - family-owned Indian businesses were becoming "more objective" about divesting, and that more big deals were likely soon.

"My sense is that we will see some more of these kinds of deals in the near future. There is a widely-held perception in big pharma boardrooms that they need to be more focused on their India businesses than they have been till now. And the easiest and sure shot way to increase presence in the Indian market is to have access to the established Indian platforms," he said.



Dr Tempest is an ex-CEO of Ranbaxy and currently an advisor to MAPE, an Indian boutique bank, and UNCTAD, the United Nations Conference on Trade and Development, among other positions. He said that, with hindsight, many Indian promoters could now see the commonsense and opportunity of such a strategic move, referring to the exit of the Singh family, Ranbaxy's founders.

"As a consequence of this deal many promoter families are involved in such conversations. What is the best way of distributing the family wealth? With the positive economic dynamics in India one can see the multitude of opportunities if there is a pile of cash available. This is what the Singh family divestment has now let loose in India," he said in a recent article, "A structural change in the global pharmaceutical marketplace", published in the *Journal of Generic Medicines* (JGM).

Dr Tempest believes that fears of price increases following such takeovers are misplaced. While big pharma is expected to expand strongly in Asia and the developing world, and to present a "pharmerging face" to the world alongside its mature markets face, he also envisions a new global deal on intellectual property (IP). This could be cut with two different levels of IP protection for the mature and the pharmerging markets.

expensive deals?

Dr Tempest, who has been one of the few Westerners to head an Indian blue chip firm with global operations, also distances himself from the chorus that Abbott paid too much for Piramal's business.

"The picture looks vastly different if you examine the deal structure closely," he said. He explained that some analysis demonstrated that, adjusted for the time value of the phased payment in the purchase consideration (some 40% of the deal value will be paid over the next five years), and the tax gains involved for the buyer, the Ranbaxy and Piramal deals had comparable valuation metrics.

"Two deals are now setting a norm for the value of major Indian pharmaceutical assets," he observed.

Abbott acquired Piramal's local formulations business for \$3.7 billion, including an upfront payment of \$2.12 billion and additional annual payments of \$400 million for the next four years starting in 2011 (scripnews.com, 21 May 2010).

The deal valued Piramal's business at about eight times sales and 30 times EBITDA (earnings before interest, taxes, depreciation and amortisation), compared with the Ranbaxy valuation of about four times sales and 22 times EBIDTA.

Dr Abhishek Sharma, vice-president and head of life sciences at MAPE, said that there were two main structural differences about the Piramal deal. First, more than 40% of the deal value would be paid over the next five years, leading to a net present value discount of close to half a billion dollars.

Second, the Piramal deal was an asset sale, and there was a huge taxation difference for both the buyer and seller in an asset deal as opposed to a share deal.

"Abbott will get a tax depreciation cover on almost the full purchase amount. Theoretically, taxes saved for Abbott will add up to close to Rs50 billion (\$1.06 billion) and the issue will be more about whether Abbott will earn enough to fully avail the tax credits. We estimate that the realisable cash value of the tax breaks will be at least half a billion dollars. Factor in these and we are probably looking at the Piramal deal value being 5.5x sales and 18-20x EBITDA, comparable with Ranbaxy metrics," Dr Sharma said.

The Piramal family would also end up paying close to 40% as income tax (immediate loss of 22% for gains on asset sale and 15% loss on distribution of dividends) before the cash reaches the shareholder's pocket, unlike Ranbaxy's founders, which sold their publicly-listed shareholding with zero or little tax incidence.

"Abbott seems to have compensated the seller for their tax losses by sharing some of the tax upsides they will enjoy under this structure. Besides, Daiichi ended up buying the whole kitchen

sink, while Abbott is walking away with just the prized Indian branded generics piece," Dr Sharma told *Scrip*.

Dr Tempest also brushed aside the general perception that Abbott will need several years (said to be as many as 18 by some analysts) to recover its investment in Piramal. "Once you look at this as 'an incredible strategic platform' as the Abbott management publicly said, you can then perhaps better appreciate that they will be staying up at night after this deal, but not worrying about the downside but about how to maximise this opportunity," he said.

Abbott, which rocketed to top position with a 7% market share in India through the deal, will now have 7,000 medical representatives. "This will be keeping a number of Indian company executives awake at night. Abbott is probably not far off the mark when it said it sees its Indian business growing to \$2.5 billion in the next one decade. From an Indian perspective, current financial numbers and current stock market metrics are perhaps clouding the view; but once you see the strategic big pharma perspective, the view is completely different," Dr Tempest claimed.

price hikes

The takeover of Indian firms by multinationals need not necessarily mean higher drug prices on the domestic market, according to Dr Tempest.

"There are valid historical reasons why such a situation is unlikely. India is a net exporter of cheap medicines to the world today compared to the seventies when it was a small, import-reliant industry," he said. He added that the Indian market was probably the "most competitive" in the world, with almost all key molecules having more than 10 brands each.

With little innovation having happened in the last decade anywhere, most of the products available were generic already, and the market would continue to be predominantly so, he said.

However, Dr Tempest said that, while new drugs would demand a premium, differential pricing was increasingly being used by big pharma.

"Pfizer tried introducing drugs in India at US prices and didn't succeed. On the other hand, Merck [& Co] has successfully launched its antidiabetes drug by pricing it at a fifth of the US price. Western companies are now developing two price regimes - one for OECD and a lower price for the emerging world," he explained. That made the market price-competitive, where no single group could come to dominate it.

Besides, many physicians in the rural markets of India were still untapped, and it was mostly Indian companies that were aggressively venturing into the huge mass market, he said. "I believe that the expected growth will continue to come from expanding reach rather than price increases."

An estimated 70% of India's population resides in rural areas, while accounting for less than 20% of consumption of medicines in the country.

IP issues

Dr Tempest believes that with a new generation of global CEOs with "young open minds", a new global deal on IP will be cut, with two different levels of protection for the mature markets and the pharmerging markets.

"I see a TRIPS-plus regime in OECD and a simple TRIPS-compliant IP in the emerging world. I also see the least developed countries' deal with the WTO [World Trade Organization] where they have IP relief being extended further. The current leadership of big pharma is more realistic than the past," Dr Tempest said.

The dual pricing policy used by some big pharma companies in Africa and Southeast Asia was one such sign of the impending change, he had suggested in the *JGM* article.