

## Indian Pharmaceutical: Ripe For Consolidation

- India's Pharmaceutical Sector Growing Fast Both In Domestic And Exports Markets
- Up To 50% Lower Costs Make India An Attractive Production Hub
- A Highly Fragmented Domestic Market Calls For Consolidation In The Industry

The Indian pharmaceutical industry is characterised by the twin benefit of strong domestic consumption growth on the one hand and robust export opportunities on the other. At the same time, the intense competition in a highly fragmented market is posing a great challenge too. The stage is set for the next phase of growth accompanied by consolidation. This stage will see traction owing to the global meltdown of equity markets that has brought the valuations at very attractive levels.

With the increasing need of capital for sustaining the growth momentum or even sustaining in the business due to the highly competitive environment and limitations on the ability to introduce new drugs due to the new patent regime, a number of Indian pharmaceutical companies will find it difficult to pursue the growth path on their own. Such companies will be ideal candidates to join hands with strong multinational companies. The acquisition of India's largest drug-maker Ranbaxy Laboratories by Daiichi Sankyo Company Limited, one of the largest pharmaceuticals companies of Japan last year is an apt example in this context.

The foreign pharma companies already operating in the Indian market are also trying to increase their stakes in the domestic subsidiaries, which indicates the growing importance of this market for them. In the last week of March, Swiss firm Novartis International AG and Pittsburgh-headquartered Mylan Inc announced plans to significantly hike equity stakes in their Indian subsidiaries. The leading multinational pharmaceutical companies are increasing their focus on emerging markets such as India and China in their growth plans, as pointed out by a global survey of top 15 pharmaceutical companies conducted by Ernst & Young, one of the largest professional services firms.

### Export Becoming Major Growth Driver

Pharmaceutical industry in India is showing a good resilience in the current phase of slowdown both in the domestic and export markets. But export has become an important growth driver for this industry in the recent years with more than 50% of the revenues coming from overseas markets, particularly the U.S. and Europe. The Global recession has impacted India's drug exports only marginally, which is estimated to reach at \$8.25 billion in the financial year 2008-09 against the earlier estimate of \$8.97 billion, according to the Pharmaceutical Export Council of India - an organisation set up by the Government of India. The growth rate of pharma exports in 2008-09 was estimated at 23%. The industry, however, is expected to have slightly lower growth in exports as revealed in a survey by the Federation of Indian Chambers of Commerce and Industry (FICCI), one of the oldest industry chambers in the country with a nationwide membership of more 1,500 corporates and 500 chambers of commerce and business associations.. The FICCI survey has predicted a 16% increase in India's pharmaceutical exports, while most of the other industrial sectors expect a negligible growth or contraction during 2009-10.

Exponential growth for Indian pharma exporters is expected as many blockbuster drugs are going off-patent. It's estimated that over the next five years, the global pharmaceutical companies are set to lose about \$100 billion in sales due to blockbuster drugs going off-patent. Indian companies are well poised to take advantage of this situation, owing to the competitive advantage in generic drugs business. Basic production cost of drugs in India is up to 50% lower compared with the established markets such as the U.S. and the costs of U.S. Food and Drug Administration (FDA or USFDA) approved plants in India are 30%-50% lower.

Indian companies are continuously increasing their presence in the U.S., a \$440 billion market that constitutes around 47% of the global pharmaceutical market. In February 2009 alone, the Indian companies (along with their subsidiaries) large and mid-sized, together have secured approvals for 15 Abbreviated New Drug Applications (ANDAs).

Global rating agency Fitch Ratings Ltd., recently commented that the exports of low-cost Indian generics are going to benefit due to the weak global economic environment and the weaker rupee. Similar factors will also generate greater demand for low-cost contract research and manufacturing activities (CRAMS) of the Indian firms.

### Strong Domestic Growth

Drug sales to retail consumers in India grew by 9.8% to \$6.98 billion (Rs.34,000 crore) in the calendar year 2008, according to research firm ORG IMS Research, a joint venture of AC Nielsen ORG-Marg and the U.K.-based IMS Health. The growth rate in 2008 was lower than 13.4% registered in 2007, due to a dip in the second half of 2008. These figures are compiled from the data collected from wholesalers and don't include the drug sales through hospitals estimated at about \$1.4 billion (Rs.7000 crore) per annum. After a decline of 1.2% in October 2008, the monthly retail drug sales has improved significantly in the following months with the growth rate of 6.8% in November 2008, 13.3% in December 2008, 14.4% in January 2009 and 13.3% in February 2009, respectively.

The domestic market of Indian pharmaceutical industry is likely to register 12%-13% growth in 2009, only marginally lower than the earlier projections of 15% as an impact of macroeconomic conditions, according to ORG IMS Research. The impact of macroeconomic factors is much less on the Indian companies compared to the global peers. In the next 4-5 years, this industry is expected to continue to grow at more than 10% to touch the \$30 billion mark by 2020. In the long term, the domestic consumption is expected to keep growing at a healthy pace, because currently India's healthcare spending is only 5.6% of the country's gross domestic product (GDP), which is among the lowest globally.

The domestic consumption of drugs is bound to increase as the necessity of drugs will increase with time and they will become more affordable for a larger population. The necessity will increase with the rising population and lifestyle disorders making people more vulnerable to ailments such as cardiovascular diseases and diabetes. Secondly, medicines will become more affordable to a larger number of people as the size of India's 300 million middle class is rapidly increasing and the income levels are also going up.

### Highly Fragmented

The domestic pharmaceutical market is quite fragmented with the top five companies commanding only 22% market share. Cipla Ltd, has become the largest and the fastest growing company among the top five companies, outclassing Ranbaxy Laboratories Ltd. Even the top 20 companies have a total market share of about 57% only in contrast to the global drug market dominated by the 10 largest companies that account for about 40% of global sales.

India's Domestic Pharmaceutical Market (12 Months Ended January 2009)			
Company	Size ( \$ Billion)	Market Share (%)	Growth Rate (%)
Total Pharma Market	6.9	100.0	9.9
Cipla	.36	5.3	13.4
Ranbaxy	.34	5.0	11.5
Glaxo Smithkline	.29	4.3	-1.2
Piramal Healthcare	.27	3.9	11.7
Zydus Cadila	.24	3.6	6.8
Total of Top 5	1.53	22.1	--
Source: ORG IMS			

## An Active Sector For M&A And Private Equity Deals

Pharmaceutical, Healthcare & Biotechnology was one of the busiest sectors on the deal street of India in 2008. It was second in terms of total value with \$5.57 billion, marginally below the Telecommunication sector which had total transactions worth \$5.78 billion, according to a report of consulting firm Grant Thornton. In terms of volume, the Pharma sector had 57 deals, second to 102 deals in Information Technology & IT-enabled Services sector. The \$4.60 billion acquisition of Ranbaxy Laboratory, India's largest drug-maker, by Japanese firm Daiichi Sankyo Co., Ltd was on the top of the table of India's largest deals in 2008. Out of the total 57 M&A deals in the sector, 17 deals were domestic.

Private Equity (PE) firms have also been active in the pharma sector in 2008 with total 22 PE deals worth \$337.41 million. The average PE deal size for the sector in 2008 was estimated at \$15.34 million, 20% higher than \$12.82 million in 2007. Narayana Hrudayalaya, one of the world's largest pediatric heart hospitals, which received a funding of \$100 million, was on the top of PE deals chart of 2008 for the sector.