The chase begins

Strategic move or sell out, the Ranbaxy Laboratories-Daiichi Sankyo deal could mark the beginning of a new era in the Indian pharmaceutical market. As players realign themselves to their new role as prey rather than predators, ***Arshiya Khan*** *and* ***Suja Nair*** *analyse different options*

The surprise mid-June deal between the poster boy of Indian pharma, Ranbaxy Laboratories and Japan's second largest pharma company, Daiichi Sankyo, has shaken up the market. And rightly so, as Ranbaxy was often cited as an example of Indian pharma's growing confidence in global markets. It's acquisition of companies across the globe set a precedent for other Indian pharma companies, who followed suit by expanding their geographical footprints. With the Indian pharma market dominated by 'pharma families', could this deal trigger similar movements in other promoter-driven companies? Is the time right for promoters to exit?

Analysts feel that this one deal will not have such a great impact on the Indian pharma industry. "This deal was very specific to Ranbaxy's issues. We see that innovators would start looking at Indian companies, but we don't think this will trigger a significant number of deals in this space to happen immediately after this deal is concluded," says an analyst on condition of anonymity.

Sanjiv Kaul, Managing Director, Chrys Capital and an ex Ranbaxian opines, "Commercially, the Ranbaxy-Daiichi deal has been an excellent one for the Singh brothers. They have got a great outcome of Rs 737 per share. Moreover, it also is a bold directional shift for Ranbaxy in its strategic route-map. Ranbaxy has always been a pioneering company, thus, far and seen as a global India hero that other Indian companies wanted to emulate. But emotionally, I would have liked Ranbaxy to be the last man standing and not the first one to capitulate to an MNC."

On a professional note, Malvinder Mohan Singh, CEO and MD, Ranbaxy says, "I strongly felt that the time has arrived to make the next big leap to put the company in a new orbit and a higher growth trajectory. Being a leader, it was necessary to set the path to transform and create a new business model, combining the strengths of a big pharmaceutical company and a generics company."

Explaining the reasons behind the deal, Singh elaborates, "I explored various options keeping in mind the company's interest ahead of the family. As we progressed, our negotiations with Daiichi Sankyo, it became clear that this can be achieved only if my entire equity changed hands and Daiichi Sankyo gets a 50.1 percent stake. It was an emotional decision, but in the interest of the organisation and its long term sustainable growth, I had to take it."

Consolidation—a way of life

"Ranbaxy will continue to operate independently with full autonomy. I, as Chairman and CEO and MD, together with my existing team, will continue to drive the company to the next higher level in

Though both the companies, Ranbaxy and Daiichi Sankyo, will benefit and leverage on the opportunities that they mutually bring to each other, what can be the possible pain points? Kaul explains, consolidation is a way of life as far as pharma is concerned. The Daiichi Sankyo-Ranbaxy deal is a 'one of its kind' in global pharma. Hitherto, consolidation has taken place either amongst generic companies or amongst innovative research companies. In the generic space, Kaul highlights the

the global landscape. Pharma business is my passion and life and I am here to stay"

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CEO and MD
Ranbaxy Laboratories

example of Matrix getting acquired by Mylan, Ivax by Teva, and Hexal by Sandoz. And so, that's an acceptable kind of phenomena. Taking the thought further in the branded/innovative research space, Kaul mentions the deals wherein Glaxo acquired SmithKline Beecham, Sanofi acquired Aventis and Sandoz merged with Ciba.

He believes that the Ranbaxy-Daiichi Sankyo deal is unique only because Ranbaxy is a generic company and Daiichi Sankyo an innovative research company. And therefore, post acquisition, both these organisations would co exist as independent units under different managements reporting to the Daiichi Sankyo board. Daiichi Sankyo does not have the mindset to manage generic business on its own so they would obviously use Ranbaxy as a leveraging platform in this endeavour. Ranbaxy's foray in innovative research would be to access Daiichi Sankyo's considerable skill set here and provide the latter a low cost but skilled expertise/platform in India. "As long as that macro-perspective is kept in mind by both players, I don't see any conflict," says Kaul.

Sounding very positive about the deal, GV Prasad, Vice-Chairman and CEO, Dr Reddy's Laboratories, says, "The deal is a path breaking one, combining two very strong companies to create a new global force in the pharma industry. Ranbaxy adds international presence, generics pipeline and a strong India presence to Daiichi Sankyo. The India presence is vital to Daiichi Sankyo not only because it provided access to one of the fastest growing markets, but also a phenomenal advantage in terms of talent, infrastructure and low cost structure (from a global perspective). The combined company will have a very strong innovation as well as a leading non-proprietary portfolio. The strategic fit is very high and overlap is minimal."

As the industry recuperated from the surprise move, speculation took over with rumours that Nicholas Piramal India Limited (NPIL, now Piramal Healthcare), was planning to divest 10 percent stake in its research hive off, Piramal Life Sciences, and Torrent Pharma were looking to partially offload stakes to private equity (PE) investors. Pfizer (and to a lesser extent other MNCs like GSK), were reported to be launching a hostile bid for Ranbaxy.

But Ranbaxy managed to outsmart the market once again, by settling its five-year patent battle for Lipitor with an out-of-court settlement with Pfizer. This settled most of its Lipitor-related patent challenges with Pfizer. Obviously, Ranbaxy seems to be changing its stripes as it prepares for life as the Indian subsidiary of an innovator company.

Parting also a part of life?

Ironically, the deal with Daiichi Sankyo came in the wake of another high profile deal falling apart. Sun Pharma's proposed buyout of the Israeli Taro Pharma, was in line with its reputation of being a "turnover master" by identifying distressed companies, buying them out and turning them around. So what went wrong? And what could go wrong with the Ranbaxy-Daiichi Sankyo deal?

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Managing Director
Chrys Capital and ex Ranbaxian

When asked what strategy the company follows while planning its acquisitions, a Sun Pharma spokesperson says, "From a business standpoint, we try to look for businesses that would increase our product presence in the US, a ready revenue base that we can then build on. From a valuation perspective, we look at businesses that offer us a reasonable payback. Usually, such a combination is found only in businesses that are undervalued due to significant problems that these businesses face, but still have a significant potential that can be realised with the right management."

If this strategy worked for turnarounds that Sun has successfully achieved in the past (for example, its buyout in the US, Caraco, is today posting handsome returns) what went wrong with Taro? "Probably what did not work out in turning around Taro is that we are not running Taro, the current owners are. We are currently only the largest shareholder in Taro," clarifies the official spokesperson of Sun. Striking the same chord, Kaul echoes, "These things are pretty common in such transactions and part of an occupational hazard. Grandstanding, posturing for better gains is part of the process, and as they say, the show ain't over till the fat lady sings."

Not that the deal has turned sour irreversibly, discussions are going on and Sun still has a good case should it take Taro to court, according to legal experts. But it has to explore many options. Kaul believes, Sun should first exhaust all possible options based on a bilateral discussion with the current promoters. Only when that fails, should they resort to outside arbitration. And when that also fails, one can fall back on the judiciary system.

The next dose...

"Beyond financial due diligence, companies have to carry out business due diligence as well. It will provide valuation of tangible and intangible assets which companies have so far created and still has value in this changing climate"

- Dr R B Smarta
Managing Director Interlink Marketing Consultancy

Linking the two recent deals and catching the common trend, which chord will the other industry players strike? Will this strategy of 'hive offs' and 'exits' work in favour of Indian pharma companies? Will other Indian pharma companies, especially the promoter-driven ones follow suit? "There might be companies like Cipla or Aurobindo which might be targets for such deals, but we do not think this deal has sparked off this interest," says the analyst who does not wish to be named.

Kaul offers a broader perspective. The success or failure of the Sun-Taro deal is not going to materially affect the strategic direction of other Indian pharma companies. "Presently, it is also presumptive to assume that the deal has gone sour irretrievably. I believe the discussions are still on and letters are being exchanged back and forth between the two players. Even if it does not go through finally, this will not be a deterrent for future M&As," opines Kaul.

According to Ranjit Kapadia, Head Research (PCG), Prabhudas Lilladher, "Normally companies consider M&As if they stand to be complementary to the existing business. Secondly, the acquisition should lead to growth of both companies. If the acquiring company does not have a presence in the therapeutic segment, but if the target company has a presence, then the acquisition becomes complementary to each other. This makes the deal a two way advantage for both parties."

Screen the deal

The success of any venture between two companies hinges on the valuation.

An attractive valuation is the main reason that tempts promoters to dilute stakes and cash out. The Sun-Taro agreement provided for the acquisition of Taro by Sun for $ 7.75 per share and allowed either party to terminate the agreement after December 31, 2007. Sun had offered to raise the merger price to $10.25 per share, but Taro wanted more and this is considered to be the reason for the fallout. On this count, industry observers point out that the Ranbaxy promoters and shareholders, through the open offer announced subsequently, are receiving more than a fair valuation.

"The reasons for any deal to go sour can be if the conditions precedent are not met, or when the acquirer runs out of funds to complete the deal, or the deal does not continue to make any economic sense as there is no benefit from the deal to either the acquirer or the seller, or when the parties do not have healthy and cordial relations with each other"

- Dr Milind Antani
Head-Pharma LifeSciences Group

Nishith Desai Associates

There can be many more reasons for a deal going sour. Sometimes synergies do not match. To ensure that a buy out process becomes less risky, the parties are generally advised to complete the deal in three months. In the case of the Taro -Sun deal, procedures had dragged on for more than one year.

Secondly,s they have to take all shareholders (retail, institutional, major and minor) into confidence. In the Taro -Sun deal, right from the beginning, two key institutional investors, Franklin Advisers and Templeton Asset Management, part of Franklin Templeton, opposed the deal because they felt Sun was offering lower valuations. Though the promoters and PE firm Brandes initially sold their stakes, they later changed track. Explaining the parameters for due diligence process before investing in any company Dr R B Smarta, Managing Director, Interlink Marketing Consultancy says, "Beyond financial due diligence, companies have to carry out business due diligence as well. It will provide valuation of tangible and intangible assets which companies have so far created and still has value in this changing climate." Further, he says that the legal and contractual diligence is also equally important apart from de-risking stakes and collaborating with partners.

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Proper valuation is very essential for any deal to go safely. This is also a common problem that a company faces when it comes to M&As, How can a smaller company realise their money's worth from M&A? According to Kapadia, two or three different independent valuators do the valuation and submit a confidential report to the company which is discussed at the board level. And the final valuation is arrived at only after looking into the overall valuation. Deals take place only after that as these deals are billion dollar deals.

Legal tangle

Talking about legal remedies under the law, to ensure that both the parties are bound under agreement from backing out, Kartik Ganapathy, Head M&A Practice, Nishith Desai Associates, says, "Deals are based on agreements and contracts, which should contain clauses preventing parties from backing out. As far as the Taro -Sun deal is concerned, apart from the press release, they have not divulged much so we cannot speak to what happened. Provisions such as break-up fee clauses, exclusivity clauses etc., are important to keep parties in a deal. However, a deal falling apart under exigent circumstances including adverse diligence issues cannot be ruled out."

Kartik contends that apart from all the above mentioned measures, the company which is buying the target company should ensure that they are buying shares from shareholders at the correct (fair) price. Contracts can also have asset alienation restrictions, and conduct of business clauses, between signing and closing, in order to ensure that deals do not fall apart.

Further, he says, "Ultimately if the buyer has a well drafted agreement, with the majority shareholder/s agreeing to be bought and supporting the deal wholeheartedly, then essentially the deal should proceed smoothly."

The fulfilment of the conditions precedent is vital to the conclusion of a deal. Moreover, to safeguard the completion of any deal safely, it is necessary that the deal be completed as soon as possible. It is important to make sure that the interests of the minority stake holders have been taken care of to prevent any challenges from this quarter. On the same lines, Dr Milind Antani, Head -Pharma LifeSciences group,

"Almost all deals are contractual, that seals a person from backing out. As far as the Taro-Sun deal is concerned, apart from the press release, they have not divulged much so we cannot say much, but in order to ensure that the opposite party does not back out from the deal, we have certain provisions in the contract. As contractually we can bind a party by having breakup fees in case of any

Nishith Desai Associates says, "The reasons for any deal to go sour can be if the conditions precedent are not met, or when the acquirer runs out of funds to complete the deal, or the deal does not continue to make any economic sense as there is no benefit from the deal to either the acquirer or the seller, or when the parties do not have healthy and cordial relations with each other."

such back out in future"

- Kartik Ganapathy
Head-M&A Practice
Nishith Desai Associates

Failures in M&As are not uncommon, but in India these are not publicised too often. Some of the other recent famous failures that had happened in other industries include the Reliance-Mobile Telephone Networks (MTN)deal.

The last word

As the man at the centre of the storm Singh almost dares the naysayers, saying, "Ranbaxy will continue to operate independently with full autonomy. I as Chairman and CEO and MD, together with my existing team, will continue to drive the company to the next higher level in the global landscape. Pharma business is my passion and life and I am here to stay."

Crystal gazing into the future, Kaul elaborates. This indicates that Indian pharma companies are obviously now going to adjust to this new paradigm and factor this development in their strategic plans. There will be some who again may want to emulate Ranbaxy by selling at the right price. There will also be some who may still be averse to equity dilution and prefer retaining ownership. "How it will eventually pan out in the industry, only time will reveal. Nothing hereafter will be sacred anymore," he signs off.

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