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Booster dose for Abbott's India plans

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Piramal Healthcare's decision to sell its domestic formulations business for an upfront payment of \$2.12 billion (about Rs 9,953 crore) to Abbott Laboratories Inc seems to have taken the market by surprise. The sale of this business, which made up roughly over 55 per cent of the company's consolidated FY10 revenues, also involves annual payments of \$400 million (about Rs 1,878 crore) to Piramal for the next four years beginning in 2011. The sale includes manufacturing, marketing, and selling of branded generic pharmaceutical products in India, Nepal, and Sri Lanka.

Deal valuations

The total consideration of \$3.72 billion (about Rs 17,400 crore, including the four annual payments over four years) values Piramal's Healthcare Solutions business at a whopping 8.7 times the segment's FY10 sales of about Rs 2,000 crore. While the business has charted an impressive growth over the recent years (20 per cent CAGR over the last three years), the premium still appears huge. Even if the domestic formulation business were to continue growing at a compounded growth rate of over 20 per cent over the next four years, the valuations still seem on the higher side. The company management in its last quarter analyst concall had only guided for a 15 per cent growth this year.

High demand for generic potion

So, why the high valuations? For one, it signals the increasing importance of a presence in the fast-growing Indian pharmaceutical market, at a time when global pharmaceutical companies are battling out drying R&D pipelines and increasing threat from genericisation. Earlier, inbound deals such as those between Ranbaxy-Daiichi, Orchid Chemicals-Hospira, or Shantha Biotech-Sanofi Aventis also happened at high valuations. Two, the deal would immediately vault Abbott to the top rank, giving it a market share of over 7 per cent (combined sales) in the Indian market, which otherwise would have taken it years to achieve. Three, the high valuations also signal the attractive growth potential of Piramal's formulations business. Its domestic formulations business had created a niche for itself, growing despite high competition driven primarily by its strong product portfolio in key therapeutic areas. The company had launched over 32 new products during the year and had ranked No. 1 in the Indian Pharmaceutical Industry in terms of sales from new products. Besides, the company boasts of having one of the largest field forces (over 4000) in the industry and had improved its presence in tier II and rural markets.

What's in it for Piramal?

The sweetheart deal offered by Abbott Laboratories appears to have been too good to resist for Piramal, for there otherwise seems to be no good reason to part with its growth engine.

Incidentally, it was the steady growth in its domestic formulation business that had helped the company record growth last year; CRAMs had lagged led by destocking by foreign pharmaceutical companies.

With the significant revenue spinner gone, the company would now be left with custom manufacturing, critical care (including inhalation anaesthetics), OTC consumer products, API, and diagnostic service businesses. While there has been improvement in demand prospects for CRAMs business, the segment's fate is largely dependent on the outsourcing orders by foreign players.

As for the remaining businesses, they aren't yet significant revenue contributors. This suggests that the growth void created by the deal may take a long time to be filled. Note that Piramal has also agreed not to make generic drugs to sell in India for a period of eight years as part of deal.

While there may not be any open offer for existing shareholders, the management has indicated at special one-time dividend.