An Interview with ICICI Securities: State of the Indian Pharmaceuticals M&A Market

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Lincoln International and ICICI Securities have a strategic alliance that builds upon both firms' key strengths to create unique opportunities for partnership between Western and Indian companies.

Ravi Talwar and Pranjal Srivastava, both Vice Presidents in the Investment Banking practice at ICICI Securities, recently shared their thoughts on the current Indian Pharmaceuticals M&A market with Lincoln International:

Q: How large is the Indian pharmaceuticals market and what is the current growth outlook?

The domestic formulations market is $6.2 billion and exports (bulk drugs and formulations) is $6.9 billion for 2007.

The domestic Indian pharma market is expected to grow to U.S. $11.4 billion by 2011-12, implying a projected CAGR of nearly 13% over the next five year period. Domestic demand is expected to be driven by both "mass" therapies (e.g. anti-infectives, gastro-intestinal, respiratory) and "specialty" therapeutic segments (e.g. CV, diabetes, obesity, hyper-cholesterol).

Q: What are some of the biggest challenges and opportunities facing Indian pharmaceutical chemicals firms these days?

A huge opportunity for Indian firms is going to come from regulated markets. Export opportunity is expected to dictate the pace of overall industry growth. Overall, pharma demand (including exports) is expected to exceed $33 billion by 2011-12 with the domestic opportunity being $11.4 billion and the export opportunity being $22.2 billion. Formulation exports, in the past, have largely been to semi-regulated markets and have now found numerous takers from the U.S., European and Japanese markets. With a host of patent expirations lined up over the next five years and the increasing penetration of Indian players in these markets through market authorizations and acquisitions, formulation exports to regulated markets are expected to soar by 34% per year over the next five years.

There is substantial growth potential in exports of bulk drugs over the next five years. This belief is strengthened by the escalating generics demand (especially in the U.S. and European markets), the growing number of contracts awarded to Indian pharmaceuticals players (for manufacturing bulk drugs for patented products) and the growing dominance of India in the number of overall DMF filings. India's cost advantage and expertise in custom synthesis (development of new non-infringing processes for manufacturing bulk drugs at lower costs) make this a win-win proposition for both Indian companies and outsourcers.

Contract research and manufacturing services (CRAMS) continues to be a high growth area for Indian pharma companies. Contract outsourcing services (CRO) particularly has seen explosive growth in recent years, and will continue to see substantial growth going forward given India's rapid patient/volunteer enrollment capability and highly qualified and cost effective scientific and medical staff.

Q: In recent years we have observed increased acquisition activity by Indian pharmaceutical chemicals firms into the U.S. and Europe. What is driving such activity? What sorts of acquisitions are Indian firms focusing on right now?

Acquisitions, in most cases, provide a ready-made client base, distribution network and product basket, which ultimately provides immediate access into target markets. India is still a small player in the U.S. $55 billion generic market with a share of only about 2%, and one of the strategies adopted by them to enhance presence is through acquisitions in the target market.

In the past few years, Indian pharma players have become increasingly aggressive and are gaining presence in export markets. Acquisitions are helping them to establish manufacturing facilities closer to the target market, increasing penetration and distribution reach. This enables them to gain higher confidence with buyers by virtue of their presence in the target markets.

Approximately 37 deals were initiated during 2006 and the first half of 2007, out of which around one-third were intended to gain entry into the European market. More and more Indian players are acquiring companies in Europe as European corporate entities are believed to be available at more attractive valuations than U.S. companies.

Additionally, European markets are heterogeneous and separate approvals must be sought to market a drug in each European country. Hence, acquisitions have been the best possible option for players who want to access European markets.

In terms of the nature of acquisitions, Indian companies are increasingly looking at acquiring companies in Europe and the U.S. with front end marketing and networks rather than manufacturing capacity.

Q: Is acquisition activity solely focused on generics? Will we see a wave of expansion into innovative pharma?

Acquisitions by Indian companies have been focused predominantly in the generics space. The recent acquisition of France-based Negma Laboratories by Wockhardt is perhaps is the first instance of an acquisition of a foreign research-based pharma company by an Indian company. Given the move by Indian companies in recent years to move up the value chain and enter into the proprietary drug space, it will not be surprising if more such acquisitions are seen in the future. However, we believe that Indian pharma still has some way to go before it makes a significant number of large ticket non-generics acquisitions.

Q: Lincoln has done some analysis which indicates that Indian pharma fine chemical firms are making fewer acquisitions of contract manufacturers in 2007. Do you have a view on whether this is really the case and what is behind the shift?

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We are not aware of any specific reasons why this may be the case. However, a reason could be that margins in a contract manufacturing business operating in a relatively higher cost jurisdiction may not be attractive to Indian players. Exceptions to this, however, could be contract manufacturers outside of India present in niche segments such as injectables—here the margins are relatively higher and manufacturing processes are more complicated and relatively difficult to replicate organically. Illustrative of this point is the acquisition of U.S.-based injectables contract manufacturer Hollister Stier by Indian CRAMS player Jubilant Organosys in April 2007.

Q: What kind of impact is the weakening U.S. dollar having on Indian firms? Does it impact their view toward acquisitions in the U.S.?

A weakening dollar vis-à-vis a strengthening rupee should have an impact on cross-border pharma activity of Indian firms. The U.S. is the world's largest pharma market and hence Indian firms have always fancied to have a strong foothold in U.S. markets. We expect increased U.S. acquisitions by Indian companies, especially by second tier Indian pharmaceutical companies.

Q: What is the Indian perspective on Chinese manufacturing? How much of a threat does it represent to Indian firms?

Like India, the Chinese pharma industry enjoys a cost advantage compared to the West. However, perceptions about outdated manufacturing technology and inferior quality of Chinese drugs mitigate an immediate threat to Indian companies.

Q: What are some key considerations a Western firm should take into account when considering an acquisition or strategic alliance with a firm in India?

Key considerations a Western firm should take into account are:

1. India is a rapidly growing pharma market which is expected to triple from approximately $6 billion currently to $20 billion in 2015. Moreover, patent protected products are likely to constitute 10% of the market by that time—this is very important from the standpoint of research-based Western pharma companies who would like to introduce patented products in India.
2. India has a great pool of talented professionals, which can be suitably leveraged.
3. India has some way to go in its labor reforms—an aspect that Western firms should be sensitive to.
4. Cultural differences vis-à-vis Western countries: any western firm venturing into India should study cultural aspects of Indian society very well. ■

Biographical Information

Ravi Talwar
Vice President
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Ravi Talwar heads the life sciences and healthcare practice at ICICI Securities, among his other responsibilities. He is responsible for originating and overseeing the execution of mandates in the life sciences and healthcare sector in the areas of M&A advisory and fund mobilization. Ravi has more than 12 years of experience in investment and corporate banking and previously worked with BNP Paribas Investment Banking, GE Capital and SBI Capital Markets.

Pranjal Srivastava
Vice President
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Pranjal Srivastava, CFA, focuses on originating cross-border acquisition opportunities for Indian companies. He heads the London office of ICICI Securities Inc., a subsidiary of ICICI Securities Limited, India's leading investment bank. Pranjal has been working for over 10 years with ICICI Securities, primarily advising Indian companies across various sectors on their fundraising plans. Pranjal has a deep understanding of the corporate finance requirements of Indian companies.

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