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Wockhardt crisis, an eye opener for biotech sector

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A spree of back to back acquisitions along with indiscriminate raising of FCCBs have cost Wockhardt dearly but this should be an eye opener for biotech companies that are already reeling under financial crunches and going for large scale borrowings.

The saga of Wockhardt, India's sixth largest pharmaceutical giant, is a lesson for biotech companies that are aspiring to follow the track of "aggressive" asset building. Indiscriminate costly borrowings and going in for huge Foreign Currency Convertible Bonds (FCCBs) based on pure speculation, have led Wockhardt to its present crisis with a net debt standing at over Rs 3,000 crore as of December 31, 2008.

Wockhardt announced that it has approached the Corporate Debt Restructuring (CDR) cell to restructure its burgeoning debts and liabilities. Habil Khorakiwala has stepped down as the managing director of the company and he handed over the reins to his son Murtaza Khorakiwala. Habil Khorakiwala retained his position as the chairman of the company. In a press statement to the Bombay Stock Exchange (BSE) dated on March 31, 2009, Wockhardt announced that "In view of the adverse market conditions, liquidity constraints and debt burden the board has decided to make a reference to CDR through ICICI Bank Limited for financial restructuring debts of the company"

Wockhardt was due to come out with its audited results in March 2009. However in a statement to the BSE, Wockhardt announced that on account of potential restructuring of businesses of the company and its subsidiaries, which the company is currently evaluating the audits could not be completed.

Not only Wockhardt but few other biotech companies are also affected by the credit crunch. Biotech companies, perpetually reeling under credit crunches and hiccups will be badly hit if the inertia and lack of understanding of market dynamics continues. Without evaluating the consequences, these biotech companies are forced to approach banks and private equity (PE) firms to fund their projects. Industry pundits are of the opinion that the companies are opting for a buyout or selling part of their stakes, because under the burden of debt, biotech companies cannot sustain on their own for a long time. This situation is a classic example of survival of the fittest. The big fish survives while the smaller fish gets eaten up.

Stuck between the devil and the deep sea

Much has been spoken about its mounting debt burden, but Wockhardt has been hit by its indiscriminate raising of FCCBs to the tune of Rs 547 crore based on market speculation that investors would inevitability convert them into shares which could have been a good revenue churner for the company. Wockhardt raised FCCBs at a convertible share price of more than Rs 400 which was not agreeable to investors considering the present volatile market dynamics and the dropping share prices of Wockhardt to less than Rs 80. The company's forex predicament of last four quarters further added to the net debt burden of Rs 3,400 crore. According to analysts, the company is in such a tight situation that even if it wishes to sell off all its assets it would be difficult to redeem their debts because even its acquired companies have not been doing well, and prospective buyers have put a freeze on investments.

The promoters of the company have pledged 43 percent of their total 74 percent stake in the company but analysts predict that even this might not be enough to repay all its debt.

An analyst opined that there was a combination of three factors which contributed to Wockhardt's woes. Wockhardt raised FCCBs, redemption of which will happen in September 2009 at a 30 percent premium which is Rs 721 crore. Financing its acquisitions happened through external commercial borrowings (ECBs). In addition to this Wockhardt had bought a lot of market instruments to hedge itself against the dollar when it was moving down. Now the dollar is moving in another direction and Wockhardt's mark-to-market is coming at Rs 300 crore. The global recession and pressure on generic prices in developed markets have compounded the matters.

Immediately after the announcement of its adversity, Wockhardt share prices fell by 11.1 percent despite the sensex moving up. Rating agency, Credit Rating Information Services of India Limited (CRISIL), downgraded Wockhardt's rating under rating watch with negative implications in the event of shortfalls and delays from the company's side to repay its loans. CRISIL downgraded its rating on pass through certificates (PTCs) from P4 to P5. Reports are that SBI has given a funding of Rs 100 crore and Fortis Healthcare is about to buy Wockhardt's healthcare division and its 100 percent subsidiary, Wockhardt Hospitals. There have been talks doing the rounds of a deal closing in between the two groups wherein Fortis promoters will get to acquire up to 74 percent stake in the Wockhardt Hospitals.

Biotech blues

Biotech sales and revenues constitute a minuscule share of Wockhardt's total revenues, as its core business has always been pharmaceuticals, especially generics. The company earlier had ambitious plans to foray into the biosimilars market and currently sells three biotech products in the Indian market—Biovac-B (hepatitis B vaccine), Wepox (anaemia) and Wosulin (insulin).

Moreover industry experts said that Wockhardt's insulin product, Wosulin, has not been doing well in the market due to quality issues and now the liquidity crisis can make matters worse. "For a product like Wosulin, which is an expensive and high-end product, the company can approach only a high-end doctor who will need a lot of convincing to buy the product. Marketing of such a product requires a huge investment that will not happen when the company is in financial crisis," commented the same expert.

"In addition to this, there are other biotech products which are in the pipeline that includes Glaritus, which was launched recently. Now with its cash tight situation, chances are that the success rate of these products can be very low because we will see a major drop in its investments," commented an analyst. Wockhardt recently launched Glaritus, a recombinant human insulin that works slowly for over 24 hours. As an expert rightly put it, "The fate of its biotech division depends on just six products. Wockhardt has gone into such deep debt that it has no other choice but to either divest its biotech division or look out for a possible sellout or a strategic partner."

Pfizer and French drug company, Sanofi Aventis, are reportedly doing due diligence to pick up stake in Wockhardt's biotechnology business. Both these companies have been eyeing the biotech market for a long time. Pfizer has already bought out Wyeth as a first step to enter the biotech arena. According to reports, the value of the deal could be about Rs 250 crore. The deal would be more in the nature of a strategic business tie-up rather than a complete sell out. Wockhardt established a biotech park in Aurangabad, Maharashtra, in 2004, which has six manufacturing facilities. Wockhardt reportedly claims that the complex has the capacity to cater up to 15 percent of global biopharmaceuticals demand that could be worth Rs 497,300 crore by 2010.

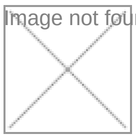
Biotech counterparts to follow the same path

Despite the biotech industry growing between 15-20 percent, the problem of running into a liquidity crisis haunts every Indian biotech company. Experts are optimistic about the biotech sector in India, but unfortunately the Indian biotech companies are constantly reeling under pressures of funding for their larger-than-life plans which might force them to go into indiscriminate borrowings. While the smaller companies die out, the bigger ones look out for a strategic partner or selling out stakes to a cash-rich company.

The lack of financial backing is hindering the expansion of Indian biotech firms and a very few venture capitalists are eagerto invest in the biotech sector. Economic slowdown has made things worse for Indian biotech companies. Biotech companies like Avesthagen have shelved out their plans to go in for an initial public offering (IPO).

Bangalore-based Avesthagen is another company which is reportedly running under debt issues. Dr Villo Morawala-Patell, founder of Avesthagen, told that they have put on hold many projects and they were looking at raising funds from banks (ICICI venture being one of them) and postponed their IPO plans. An internal source from the company revealed that the company is under serious debt and is looking for funds from external agencies. There were reports that many people were laid off but Dr Patell said that these people resigned on their own will. Reports are that the debt arises mainly from the complex business model the company follows. The company wanted to raise around Rs 600 crore from stocks last year but even that was shelved out. Reports are that it will now raise Rs 150 crore through private equity investment.

Now, biotech companies need to consider the feasibilities of their ambitious projects, many of them either being shelved or delayed. The government intervention, both at the state and central level, is the need of the hour and this coupled with awareness among venture capital investment firms is also needed. Experts are of the opinion that companies of the size as that of Wockhardt should be judicious as far as their investments are concerned. “Wockhardt went on an indiscriminate acquisition spree without being cautious. But biotech companies need to be very careful especially when it comes to acquisitions, because many a time acquisition might not reap much benefits. It is high time that Indian companies learn to be judicious in their spending especially now in this period of global recession,” advised a renowned auditor.



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