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More big deals in generics space, predicts E&Y

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The global generics industry is witness- ing significant M&A activity, with 2004 and 2005 reporting a strong trend of consolidation. Through some of the highest transactions in history, Teva and Sandoz have emerged as generics leaders. This trend is likely to continue in the current year with some specific deals valued at $500 million, according to a special report, Health Quotient, released by global consultants, Ernst & Young on February 10, 2006.

The momentum in the consolidation activity in the global pharma generics sector is likely to continue into the future. A majority of the deals of global generic market leaders have been with an objective to expand into newer geographies. A relevant example here is Actavis which has executed 20 acquisitions (including those of local distributors) in the past six years. This strategy has helped Actavis make the successful transition from being a small Icelanding player to becoming an established global force with approximately $1.8 billion in market capitalization.

A few of the recent deals have also been executed with the specific intent of acquiring injectible capabilities. These are:

- Sandoz's acquisition of the Canadian firm Sabex Holdings in 2004, where Sabex had developed injectible generic drugs like vitamins, morphine and penicillin.
- Teva's acquisition of Sicor, a Nasdaq listed US firm in 2003. Sicor provided a platform for Teva in the lucrative US market for injectible generics. Additionally, Sicor also had attractive business in Active Pharmaceutical Ingredients (APIs) and biogenerics.
- With its acquisition of Israel-based Agis Industries in 2004, Perrigo inherited a strong topical portfolio of generics such as ointments and creams.

Vertical integration and India angle

Vertical integration into APIs is gathering steam. While most generic companies are seeing intense pressure on pricing and a sharp erosion in margins for finished dosage products, the comparative profitability for APIs is more sustainable. Leading generics players like Ranbaxy, Actavis, Richter Gedeon, Teva and Cipla, which also have API manufacturing capabililties, have demonstrated better resilience in their overall margins.

Increasingly, API suppliers are evolving into integrated players and posing direct competition to companies manufacturing finished form generics. A case in point is the recent acquisition by Matrix of Belgium-based Doc Pharma. It is expected that the interest of global generic majors in Indian companies would be driven by this factor. All large Indian companies are integrated with strong API cash flows and US Food and Drug Administration (FDA) approved assets. With more than 75 US FDA approved plants to its credit, India has the highest number of Drug Master Filings (DMF) and US FDA approved plants outside the US.

Exploring specialty pharma options

A different strategy being followed by generics companies is to use cash flows from generics to acquire proprietary drug development capabilities or evaluate investments in pharmaceuticals companies/business models which focus on one therapeutic segment. Endo Pharma, a $600-million US-based company, focuses largely on pain management.

Industry analysts estimate that generic deals have been done at an average EV/EBITDA multiples greater than 12. While several deals have been executed, interest in smaller deals continues. Several Indian companies continue to evaluate deal options in Europe with values ranging from $20-50 million.

Next wave of consolidation

India is set to be a key player in the next phase of consolidation. We expect several local players to be attractive targets for the following reasons:

- Indian pharma companies are emerging as strong, fully integrated players, holding their own in the global market, producing high quality products at " approved sites" in other regulated markets.
- According to some estimates, Indian companies have invested a combined capital expenditure of $1 billion between Financial Year 2003 and 2005, a majority of which is in FDA-approved assets. This would enhance India's attractiveness. India has a long tradition of manufacturing generics and knowledge of Good Manufacturing Practices (GMP).
- Almost all major Indian companies are integrated players, with profitable API businesses. Indian firms accounted for 35 percent of the DMF filings in 2004 with the US FDA. Global generics companies consider API integration factor as critical for long-term competitive advantage.

Post the Ivax deal , Teva has become the market leader with sales of over $7 billion, followed by Sandoz at $3 billion. All other players are currently in the $1.3 -1.6 billion range and would be looking to catapult to the big league.

A recent research report brings forth an interesting fact. Some of the larger Indian pharma companies make better margins from their operations in Russia as compared to the US or Europe. Also, several Indian pharma companies have a strong presence in different geographies. Thus, investment in these companies would also help to diversify the geographical risk of the global generic majors.

Major changes preceded Budget: E&Y

Finance minister P Chidambaram has successfully placed this year's Union budget without creating much political noise but his actions over last few months reveal it to be a continual process, industry experts said.

Rahul Roy, director of Ernst & Young India, said, "On its face, this year's budget might not be having any major announcement that might otherwise would have generated political noise. Closer study of moves taken by the Union government over the last few months shows that it has just been a continuous process."

"Steps have been taken allowing FDI in several areas during last few months, which could have been part of the Union budget, but then that would have led to political disturbance. The Budget was kept 'uneventful' in that way," explained Roy.

"A lot has already been done before the budget and so it should not be evaluated in isolation. The finance minister has already laid foundation stone and the success would depend on how efficiently the FM could continue with his objective without much of political noise," he added.

Referring to infrastructure bottlenecks, Roy said Indian ports needed to expand by 140 per cent to handle the growing traffic. Given the good monsoon, agriculture growth should have been higher than actually achieved, he pointed out.