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RANBAXY DEAL

Sun Pharma not to allow Ranbaxy minority investors a merger veto

Firm may walk away from the deal rather than keep Ranbaxy as a separate entity in case merger is nixed

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Buyout agreement: *Sun Pharma agreed to buy Ranbaxy for $3.2 billion in stock in addition to assuming $800 million of debt.*

Sun Pharmaceutical Industries Ltd will settle for nothing short of a full merger with **Ranbaxy Laboratories Ltd** although some minority investors want to maintain Ranbaxy as a separate unit and nurse it back to financial health before proceeding with the union.

The drug maker, which on 6 April agreed to buy Ranbaxy for $3.2 billion (around ₹19,200 crore) in stock in addition to assuming $800 million of debt, will walk away from the deal rather than keep Ranbaxy as a separate entity in case the merger, due to be completed by end-2014, is nixed, said three people including a senior Sun Pharma executive.

"The deal will cease to exist if the merger doesn't happen," said the executive, who didn't want to be identified.

The transaction, aimed at creating India's largest drug maker and the world's fifth largest maker of generic, or off-patent drugs, has come under scrutiny of the Securities and Exchange Board of India (Sebi) over allegations of insider trading in Ranbaxy shares in the run-up to the announcement of the deal.

"Any findings by Sebi that proves the insider trading of Ranbaxy shares would directly impact the merger," said a Mumbai-based corporate lawyer, who spoke on condition of anonymity.

For Sun Pharma, a merger of Ranbaxy's operations with its own is crucial. The acquisition will allow the company to expand in countries where it hasn't ventured so far and give it access to Ranbaxy's product pipeline in the US and the large distribution network in India. It will result in cost savings of $250 million for Sun Pharma.

Maintaining Ranbaxy, which has been battling regulatory issues with the US Food and Drug Administration (USFDA), as a separate entity would mean large overlaps of business and overheads.

"Given that the deal is beneficial for all shareholders of Sun as well as Ranbaxy, we expect the deal to be approved," a Sun Pharma spokesperson wrote in response to *Mint* queries.

Japan's **Daiichi Sankyo Co. Ltd** agreed to sell its stake in Ranbaxy to Sun Pharma at ₹457 per share; it had bought the stake five years ago paying 61% more.

Ranbaxy and Daiichi declined to comment for this story.

The transaction requires approvals from the audit committee, shareholders including minority investors and the boards of directors.

The transaction will need approval by a majority, representing 75% in value of the shares present and voting at the shareholder meetings of Sun Pharma and Ranbaxy.

The deal hit a roadblock within days of it being signed after two minority shareholders challenged the merger in the Andhra Pradesh high court, alleging insider trading in Ranbaxy shares.

The shareholders cited a sharp rise in the share price of Ranbaxy prior to the announcement of the acquisition. The high court first ordered an interim stay on the merger, asking Sebi to withhold approval for the union, but later vacated the stay and asked the market regulator to investigate the allegations.

Experts say the merger process could face other obstacles.

The Companies Act, 2013 and listing norms of Sebi under the related-party transaction clause also makes a special resolution by minority shareholders mandatory for approving mergers and acquisition deals between two companies.

In the Sun-Ranbaxy case, according to experts, there are two grounds which could probably be invoked to prove a relationship between the parties involved. First is the equity that Silverstreet Developers Llp, a wholly owned subsidiary of Sun Pharma, holds in Ranbaxy.

Silverstreet Developers currently holds close to 2% in Ranbaxy. Silverstreet bought a 1.64% stake in Ranbaxy in December and March quarters, according to a shareholding disclosure by Ranbaxy to the stock exchanges. Sun Pharma previously said Silverstreet had bought these shares as an investment.

Close relatives of Sudhir Valia, Sun Pharma's wholetime director and brother-in-law of Sun Pharma promoter and managing director Dilip Shangvi, are directors of Silverstreet Developers.

A second ground is a binding agreement between Daiichi and Sun Pharma under which the Japanese company Daiichi indemnified Sun Pharma against the potential risk of imposition of penalties by USFDA on account of compliance issue at its Toansa plant.

"If Daiichi's indemnity agreement with Sun Pharma attracts the applicability of related-party transaction under the newly amended Companies Act, it would require a special resolution by the (Ranbaxy) minority shareholders for the merger," said a senior executive associated with a London-based foreign institutional investor, who didn't want to be identified.

"As a minority shareholder in Ranbaxy, we are concerned about many of the crucial details of the deal such as the understanding between the key stakeholders, valuation, Sun Pharma's alternative option if the merger doesn't take place etc., which are still not public," he said.

To be sure, the indemnity agreement was not part of the acquisition deal, which was exclusively between Ranbaxy and Sun Pharma; Daiichi is not a direct party to the agreement although it is the ultimate beneficiary in the deal.

The Sun Pharma spokesperson said the company was not a related party either with Ranbaxy or Daiichi. "The indemnity is valid only for the post-merger combined entity and there is no benefit that Sun Pharma is deriving from this indemnification at the moment," the spokesperson said. Minority investors in Ranbaxy are arguing that they will benefit if they continue as shareholders in the company while Sun turns it around. They cite the example of Israel-based **Taro Pharmaceutical Industries Ltd**, which Sun Pharma had as long ago as 2007 and wanted to acquire and eventually merge with itself.

Sun Pharma's management helped Taro turn around from a sick company into a profit-making one, boosting its share price, but gave up the merger plan last year after Taro shareholders demanded a higher price.

Analysts and minority shareholders of Ranbaxy are also concerned about recent compliance issues at Sun Pharma cited by the USFDA, which could take its toll on the latter's share price. In its latest letter to Sun Pharma in May on its Karkhadi factory in Gujarat, the USFDA has pointed to data integrity issues similar to those that plagued Ranbaxy.

"Sun's ability to navigate its own internal regulatory issues as well as integration of Ranbaxy's struggling operations presents a significant challenge for the management team over the coming quarters," said Suruchi Jain, an equity research analyst at **Morningstar India Pvt. Ltd**, the Indian arm of US financial advisory firm **Morningstar Inc.**

USFDA's warning letter issued to Sun in May over discrepancies in data gathering during batch-testing of drugs is a red flag, Jain wrote in a report released on 2 June, likening it to Ranbaxy's regulatory problems. "We are more concerned about Ranbaxy's merger with Sun Pharma at present as USFDA issues are looming large with Sun Pharma too after the USFDA issued a warning letter to one of its plants charging (it with) serious violations," said a Ranbaxy shareholder in Mumbai.

"The magnitude of the issue with Sun Pharma may get enlarged if the company's other plants are also coming under such scrutiny," said this investor, who didn't want to be identified.

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