

Sun Pharma to face challenges in rectifying quality control

31 products of the merged entity may be in the top 300 list

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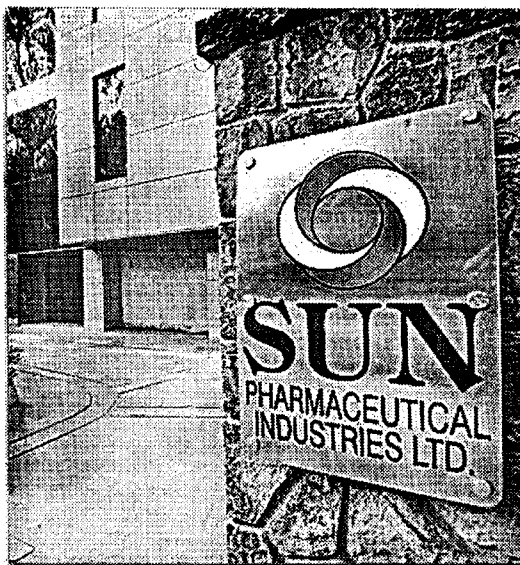
Mumbai

SUN Pharma management may face considerable challenges in rectifying a long history of quality control and regulatory problems plaguing Ranbaxy's recent performance, according to analysts. But given Sun Pharma's managing director Dilip Shanghvi's track record of breathing life into distressed companies, the blueprint for a turnaround may already be in place.

Sun Pharma has an impressive track record of successfully turning around distress assets. Founded in 1983 by Shanghvi, the company made some early acquisition between 1996-97 and 2000-01. The later acquisitions which include DUSA, URL, Caraco and Taro have all turned out favourably.

Ranjit Kapadia, a pharmaceutical analyst at Centrum Broking said, "There will be some challenges in case of Ranbaxy which they have to resolve once the merger gets completed. If they are able to work out right on the regulatory issues, there is an upside expected." For Shanghvi, the prime focus will be the "quality of business and its integration" as well as complying with regulatory standards.

Sun will acquire Ranbaxy in an all-equity transaction where each Ranbaxy shareholder will receive 0.8 shares of Sun, valuing the company at \$4 billion or 2.2 times its 2013 revenue, which is roughly half the price Daichi Sankyo paid to acquire a 64 per cent share of the firm in 2008.



FACING TROUBLE: Sun Pharma has an impressive track record of successfully turning around distress assets

"It looks like Sun got a good deal, but we think Sun's management will face considerable challenges to rectify a long history of quality control and regulatory problems plaguing Ranbaxy's recent performance," Suruchi Jain, equity research analyst of the research firm Morningstar India, said.

Expressing optimism, Shanghvi during a conference call on Monday, said, "Ranbaxy has a strong presence in markets where Sun Pharma doesn't... A large part of growth will come from emerging markets."

The \$3.2 billion all-stock deal with Daiichi Sankyo of Japan is one of the largest acquisitions in the Indian pharmaceutical industry. The deal also includes \$800 million debt that will

come to Sun Pharma's books.

Last year, Ranbaxy pleaded guilty to felony charges related to drug safety in the US and paid \$500 million in civil and criminal fines under the settlement agreement with the department of justice. In 2013 it also posted a revenue decline of 12 per cent and a net loss as operating costs have outpaced revenue growth.

At a time when Ranbaxy is also facing serious regulatory trouble from the US Food and Drug Administration over exports to the US, thanks to the import ban on its four manufacturing facilities in India along with a subpoena from US authorities seeking information on its API manufacturing facility in Toansa last month, it

is interesting to note what made India's largest drug maker by market value to look into acquiring struggling Ranbaxy.

"There are many positives behind Sun buying Ranbaxy. If we keep aside Ranbaxy's US business which contributes for about 29 per cent, the rest comes from its Indian business and the emerging markets. Ranbaxy's domestic business is doing quite well and it also has strong over-the-counter portfolio (OTC) products including Revital and Volini. Around 31 products of the merged entity will appear in the list of top 300 products. The merged entity will have the largest field force in the domestic market and will be able to penetrate rural areas through Ranbaxy's network. There will be a minimal overlap of brands between the two companies. Besides, going by the wholesale price index, the price of drugs which are under the price-control can be increased by 6.32 per cent and those outside price control can be increased by 10 per cent annually. This will also add to Sun's advantage in the domestic market," Kapadia said.

He also said the combined Sun Pharma-Ranbaxy will be undisputed leader in the domestic market with leadership position in 13 categories.

"Despite these mounting problems, we are fairly optimistic that Sun can eventually turnaround this business," said Jain.

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