

Pharma whales might gobble more small fish

Top 10 companies valued at 25 times their net profits in the past 12 months against industry median valuation of eight times

KRISHNA KANT
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Sun Pharma's acquisition of Ranbaxy could open the gates to more such deals with the yawning valuation gap in the drug industry.

The top 10 drug manufacturers (by market value) account for 80 per cent of the industry's market capitalisation, much higher than their revenue share of 58 per cent in 2013. There is a similar skew in profitability and revenue share for the big drug companies, raising the odds of their using market value as a currency to snap up smaller rivals.

The valuation gap was at play in the Sun-Ranbaxy deal. Sun was nearly six times more valuable than Ranbaxy, despite being only 40 per cent bigger in revenues when the deal was announced earlier this week (see table).

On average, the top listed drug companies are currently valued at around 4.5 times their revenues and 25 times their net profits in the past 12 months. In comparison, the industry's median valuation is 0.6 times revenues and eight times net profits.

The analysis is based on the 101 listed drug companies with net sales of ₹50 crore or

more during 2013.

The deal pushes Sun Pharma to the top of the market share league table at 8.6 per cent ahead of Abbott (6.7 per cent) and Cipla (4.9 per cent) during the 12 months ending January 2014, according to IMS Health TSA data.

On its own, Sun Pharma is the third largest player with a 4.7 per cent market share. Abbott had become the market leader when it acquired the former mutation business of Piramal Healthcare (now Piramal Enterprises) in early 2010.

"Consolidation is inevitable in the pharmaceutical industry. While there are hundreds of companies, the bulk of the industry's revenues and profitability is accounted for by the top manufacturers. Profitable growth will become even more difficult for smaller companies, given the rising cost of new product approvals and regulatory scrutiny. This gives larger

companies an opportunity to snap up their small rivals and scale up their domestic or export business," says Avinash Gupta, senior director and leader of financial advisory services at Deloitte India, a consulting firm.

Investment bankers agree. "We see more pharmaceutical companies willing to use acquisitions to scale up their operations. It will be driven by the top five or six companies that have the financial resources to invest and maintain their market position," says Ajay Saraf, head of investment banking at JGCI Bank.



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The other factor working for the big firms is the weak financial health of smaller companies. While the top drug companies are cash rich with little or no debt on their books, a majority of the small companies have funded their growth through borrowings that have put many in financial difficulty in the last

few quarters.

The top 10 drug companies account for over 60 per cent of the industry's combined net worth and over half of the assets. They accounted for only 43 per cent of the industry's borrowings in 2012-13 and 27 per cent of the industry's interest outgo during 2013.

"Setting aside the top companies, most of the mid- and small-cap pharmaceutical companies are trading at a discount to their revenues. This is an opportunity for bigger companies to scale up their operations by just spending a fraction of their current market value," says G Chokkalingam, founder of Equinomics Research & Advisory.

Other analysts, however, discount the possibility of a wave of mergers because of the differentiated nature of the pharmaceutical business. "(Drug) companies try to maximise their market share in a particular therapy or segment. This makes them extremely selective about acquisitions given the high upfront cost and the effort involved in post-acquisition integration," says Alok Datta, pharmaceutical analyst at Motilal Oswal Financial Services.



(in ₹ crore)	Market cap*	Net sales	PBID**	Interest	Net profit	Net worth***
Sun Pharma	1,30,029.9	15,032.3	4,569.1	47.4	4,770.1	14,989.7
Dr. Reddy's Labs	44,573.9	13,076.1	2,775.4	-63.3	2,240.5	6,369.1
Lupin	43,669.6	10,572.4	2,902.1	27.7	1,691.5	5,204.2
Cipla	32,116.0	8,747.0	2,285.9	120.3	1,379.3	9,009.7
GSK Pharma	21,539.6	2,520.2	749.2	0.0	484.4	1,989.7
Cadila Health	20,563.1	6,709.5	1,170.8	97.7	829.7	2,944.5
Ranbaxy Labs	19,790.5	10,632.9	-23.2	443.7	-399.7	4,079.4
DivisLab	18,041.4	2,418.8	1,091.5	1.8	780.5	2,500.6
Aurobindo Pharma	16,433.3	7,285.3	1,416.7	105.3	779.7	2,605.8
Glenmark Pharma	15,801.5	5,637.6	1,200.1	185.8	666.0	2,763.0
Top 10 Total	3,62,545.7	82,632.0	18,187.8	960.0	13,277.0	59,455.7
All companies	4,53,449.1	1,42,234.3	33,677.3	3,615.0	17,498.1	86,659.7

* Market cap (valuation as on April 9). ** PBID is profit before interest, depreciation and taxes. *** During FY13 on consolidated basis, after numbers during 12 months for four trailing quarters ending December 2013. Sources: Capitaline

Compiled by R. Research Bureau

Industry