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Buying brands to the sound of cannons

EMERGING Indian businesses are experiencing a change in the rate of change: beginning with the facts -- Reckitt Benckiser has agreed to purchase Paras Pharmaceuticals for ₹3,260cr. which is a whopping price/sales multiple of over 8 times, an extra-ordinary premium compared to other precedent transactions not just in India but in other parts of the world too.

When you think about it, this whole phenomenon is baffling. Let us, for a moment, not look at these numbers as quantification often creates an illusion of precision. PE funds and strategic investors are often willing to pay premium to companies having proprietary products and processes, long-tenured management, growing market share and consistent returns on equity above 40% but it is not so easy to find such companies.

The "pace and pattern" of certain product categories in India like food services, beauty and wellness products and fashion products have deep historical roots and long evolution cycles and these companies do not take off, as if from nowhere. Companies like Lakme, Paras, McDonalds and many others have been building scale by steadily laying stone on stone, the process involves a lot of hard work. Savor this: it would have taken these firms 7-10 years to deliver a sales turnover of ₹500 crore if they were doing the same business in China as against 15-20 years in India.

Classical investors love to be hungry mosquitoes in a nudist camp where juicy targets are everywhere but, unfortunately, there are no such camps in India and hence the 'scarcity-premium' is driving up the valuations. Para's has clearly navigated this journey very well; they were rationally smart and reasonably long term in their thinking. They raised capital from a PE fund when most family run businesses were very skeptical of dealing with PE funds, which allowed them to focus relentlessly on product-innovation and distribution. Well done.

You must be wondering as to what is in it for Reckitt? MNCs understand that it is extremely tough to build distribution in India and even more difficult to create unique India-centric product categories, time-lines involved are long and process of build-up is often very frustrating. Not many MNCs are willing to wrestle with both the product development and the distribution and they are always on the look out for piggy-back opportunities. McDonalds was an exception, they decided to expand their consumer franchise through the affordability route, launched Aloo-Tikki burger at ₹20, sustained losses for almost five years. Aloo tikki burger is more than quarter of their business today and they are making good margins at ₹26 price point.

In 1993, Coca-Cola paid ₹180 crore to Parle to acquire iconic brands like Thums Up and most importantly, access to more than 5,00,000 retailers revenues and estimated 7.5 times PAT. Unilever acquired Lakme in late 90s by valuing the company at ₹280 crore (3.5 times FY 1995 revenues and 65 times PAT). Jubilant Foodworks took master franchise of Domino's for entire India in 1998 but generated sales of just over ₹200 crore in 2008 after 10 years of operations with net profit margins of less than 4%. However, come 2011, the company is all set to increase its revenues three time in three years with profit margins in excess of 10% as a result of having achieved the critical mass which is unique. Results are visible in the public market valuations which are giving multiples of over 6x revenues to the company and stock is up four times since IPO in less than a year.

Interestingly, in the case of the Paras transaction, neither Reckitt Benckiser nor Emami

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(which was reported to be the other lead contender for the deal), needed access to a distribution network as both are extremely well established in all the principal geographies in India for their existing portfolio of products (Dettol, Cherry Blossom, Disprin, Clearasil for Reckitt and brands such as Boroplus for Emami). Hence, clearly RB and Emami both felt that the brand equity associated with niche OTC brands such as Moov, D'Cold, Dermicool and Krack was sufficiently strong to justify the extraordinary valuation paid for the Company. Clearly, the buyers believe that these categories still have steam in them, or alternately, that there is opportunity for brand extensions in related product categories.

Another way of thinking about an acquirer's motivation is to analyse the distribution synergies and cross-sell opportunities between Reckitt's existing brand portfolio and the Paras portfolio. Needless to mention, translating this synergy into tangible economic benefits is linked to overcoming integration risks. The other possible driver of value would be the potential to grow the Paras' brands in the MENA region where Reckitt has a strong presence. However, this is more likely to translate into meaningful volumes only in the

Industry