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MERGERS AND ACQUISITIONS IN INDIAN PHARMACEUTICAL INDUSTRY: A CASE STUDY ON MATRIX LAB**DR. SURESH CHANDRA DAS****ASST. PROFESSOR****MAHENDRA INSTITUTE OF MANAGEMENT & TECHNICAL STUDIES****BHUBANESWAR****POOJA PATTANAYAK****STUDENT****MAHENDRA INSTITUTE OF MANAGEMENT & TECHNICAL STUDIES****BHUBANESWAR****BHAGYASHREE PATNAIK****RESEARCH SCHOLAR****MAHENDRA INSTITUTE OF MANAGEMENT AND TECHNICAL STUDIES****BHUBANESWAR****ABSTRACT**

Foreign multinational companies along with Indian pharma companies are partnering together to tap opportunities in the fast growing emerging economies (BRIC nations) and the larger established markets in the West and Far East (Japan). Acquisitions, alliances and partnerships are some of the tools used to penetrate and capture a larger share of the potential opportunity in these markets. These developments bode well for the pharma industry and society as a whole who stand to benefit from such alliances and partnerships through reduced costs and streamlined supply chains. The paper describes the recent merger and acquisition which has happened in Indian Pharmaceutical industry. The paper describes the case of acquisition of Matrix Lab by Mylan Laboratories. The paper narrates the rationale and benefits of this acquisition.

KEYWORDS

Mergers and Acquisitions, Cost arbitrage.

JEL CLASSIFICATION

C23, C25, L65, G34.

INTRODUCTION

The Indian Pharma industry is on the threshold of becoming a major global market by 2020. Many experts believe that the Industry has the potential to grow at an accelerated 15 to 20% CAGR for the next 10 years to reach between US\$49 billion to US\$74 billion in 2020. The Indian pharmaceuticals market is witnessing dynamic changing trends such as large acquisitions by multinational companies in India, increasing investment by domestic and international players in India, deeper penetration into the rural markets, growth and availability of healthcare and incentives for setting up special economic zones (SEZ's). Indian Pharma companies are already major outsourcing partners of global Pharma companies. Research & Development in India is getting more innovative. Domestic companies have strengthened their position in the world for supplying solutions across the pharmaceutical value chain. They are likely to become a competitor of global Pharma in the areas of manufacturing and R&D, and a potential partner in others.

The social, demographic and economic context in which the global pharmaceutical industry operates is rapidly changing. Globally, pharma companies are facing pressure from governments and taxpayers alike for reducing prices of drugs and initiating outcome-based pricing. Simultaneously, there is a vast decline in R&D productivity, diminished pipeline for new drugs, increased drug discovery costs as well as increased regulatory measures that companies need to contend with. The Indian pharma industry is showing signs of robust growth. The domestic pharma market is expected to grow at a CAGR of 15% to 20% to reach a value anywhere between US\$ 50 billion and US\$74 billion by 2020.

INDIAN PHARMACEUTICAL INDUSTRY: AN OVERVIEW

The domestic Indian pharmaceutical industry consists of both domestic companies and subsidiaries of MNCs. India's pharmaceutical firms can be well differentiated by size, annual sales, export markets, and R&D capabilities. The largest 250 companies control nearly 70 percent of the domestic market with the top 10 controlling approximately 40 percent (Greene, 2007). In January 2005, India amended its patent laws governing pharmaceuticals, bringing them into conformance with the WTO TRIPs agreement. Under the new patent law, Indian drug makers can no longer manufacture and market reverse engineered drugs patented by foreign pharmaceutical firms. This law forced Indian firms to change their business strategies and they focus on the generics market in Europe and the USA, invest more in innovative R&D and target contract manufacturing market. Firms started performing more mergers and acquisitions deals, and form other alliances with domestic and foreign pharmaceutical firms. Nearly 97 percent of India's drug market consists of second-and-third generation drugs no longer subject to patent protection in the developed countries (Kale, 2007). Multinational pharmaceutical firms have entered India after 2005 and using the same resource base as that of Indian firms to compete in the Indian domestic market. This forced Indian firms to make several strategic changes in order to remain competitive in domestic and global market as well as to sustain increasing pressure on profit margins.

SWOT ANALYSIS OF INDIAN PHARMACEUTICAL INDUSTRY

TABLE 1

<p>STRENGTHS</p> <ol style="list-style-type: none"> 1.Higher GDP growth leading to increased disposable income in the hands of general public and their positive attitude towards spending on healthcare 2.Cost Competitiveness 3. Low-cost, highly skilled set of English speaking labour force 4. Growing treatment naive patient population 	<p>WEAKNESSES</p> <ol style="list-style-type: none"> 1. Poor all-round infrastructure is a major challenge 2. Stringent price controls 3. Lack of data protection 4. Poor health insurance coverage
<p>OPPORTUNITIES</p> <ol style="list-style-type: none"> 1.Global demand for generics rising 2. Rapid OTC and generic market growth 3. Increased penetration in the non - metro markets 4. Large demand for quality diagnostic services 5. Increase in healthcare insurance coverage 6. Significant investment from MNCs 7. Public-Private Partnerships for strengthening infrastructure 	<p>THREATS</p> <ol style="list-style-type: none"> 1. Labour shortage 2. Wage inflation 3. Government expanding the umbrella of the Drugs Price Control Order (DPCO) 4. Considerable counterfeiting threat 5. Competition from other emerging economies

MERGERS AND ACQUISITIONS IN INDIAN PHARMACEUTICAL INDUSTRY

Liberalization facilitated Indian firms to market generics drugs to the US and other Western European countries. Indian drug manufacturers currently export their products to more than 65 countries worldwide; the US being the largest customer. However, Indian firms face some challenges such as non tariff barriers, decreasing profits in the generics market, competitive threats from big pharmaceutical MNEs, fierce competition from Chinese and Eastern European manufacturers. Indian firms are aiming to move up the value chain by developing capabilities to produce super generics² and branded generics³. Indian companies have realized that to compete with the global pharmaceutical companies, even domestically; will involve new strategies and more innovation. But India, with advantages of having a large domestic market and having the highest number of US FDA approved plants outside the US which offer a low cost manufacturing base is trying to capture the opportunity through strategic alliances and M&A. Identifying domestic and foreign demand most Indian pharmaceutical companies aimed at expanding their manufacturing capacities mostly by means of M&A. At the same time, Indian companies with the aim to gain competitive advantages have been increasing their R&D expenditure and focusing on building a product pipeline.

M&A activities by Indian Pharmaceutical industries are being concluded with the objective of complimenting the strengths of two entities to get market access, new technologies as well as new products. Drive to enhance the size and thereby attaining higher economies of scale could be considered as key motivations for M&A in pharmaceutical sector. According to (KPMG, 2006), it could be mentioned that Indian pharmaceutical firms are pursuing foreign acquisitions with the goals of improve global competitiveness, move up the value chain, Creation and entry to new markets, Increase their product portfolio, Acquire assets (including research and contract manufacturing firms, in order to boost their outsourcing capabilities) and new products, Consolidate their market shares, Compensate for continued sluggishness in their home market.

In Indian pharmaceutical industry 322 M&A deals has been undertaken in the given time period of 2001-2013. Out of the total deals number of mergers is 125 (38.82 percent) and number of acquisitions is 197 (61.12percent). Share of pharmaceutical industry is also highest among all the other industries participating in M&A in manufacturing sector during this period.

RATIONALE BEHIND M&A IN PHARMACEUTICAL SECTOR

M&A are becoming an important strategy of corporate functioning. This phenomenon existed and was well studied since long in developed countries like the US and those of Europe. A significant amount of literature is dedicated for understanding the post merger performance and consequences. But before finding the impact of M&A it is required to study the motives behind M&A and the factors which facilitate this corporate activity. M&A are driven by different and complex pattern of motives and no single approach can explain them completely.

The decision to undertake M&A depends on the various firm’s characteristics. Following subsections give an insight of several studies that explain how different firm characteristics affect decision to make M&A investments. The size of the firm affects firm’s decision to invest as well as its performance in many ways. Large firms possess diverse capabilities which provide them the opportunity to exploit economies of scale as well as scope (Majumdar, 1997). Moeller et al. (2004) tried to find relation between firm size and gains from acquisitions and found that small firms perform significantly better when they make acquisition announcement and at the same time large firms have substantial wealth lose when they announce acquisition. They also did not confirm any nonlinear shaped relationship between size and gains of acquisition.

Danzon et al. (2007) explained in the case of pharmaceutical industries that firms with foreign affiliation are more likely to merge in order to access foreign markets and these firms are less likely to be acquired than domestic firms. Beena (2008) argued that foreign affiliation of firms also impact their M&A decision as well as performance. R&D intensity and Export intensity performance was slightly better for domestic industry as compared to those of MNE affiliated.

Duflos and Pfister (2008) find in their result that acquiring and target firms in pharmaceutical industry are younger than sample average. Young firms want to grow faster and M&A provide this opportunity to them. Lin et al. (2010) find in the study that patent stock of the firm is associated to business age and more the patent therefore lower incentives to innovate and M&A fill in this void.

The above section clarifies that empirical studies have used various firm characteristics to determine the factors affecting M&A decision. In the present study also firm characteristics like age, size, profit, and leverage are included as lacuna in a way that not many studies have been undertaken in developing economies which tries to find out the firm specific determining factors of a strategic corporate activity like M&A. The limited literature available in developing countries for M&A activity is largely based on post acquisition firm performance. Therefore the current study tries to understand the determinants of M&A in an emerging economy with special reference to pharmaceutical industry.

SOME OF THE IMPORTANT M&A ACTIVITIES IN PHARMACEUTICAL SECTOR IN INDIA

TABLE 2

Year	Indian player	MNC	Nature of deal
2011	Wockhardt	Danone	Acquisition for US\$ 350 million
2010	Paras Pharma	Reckitt Benckiser	Acquisition for US\$ 726 million
2010	Piramal Healthcare	Abbott	Acquisition of domestic formulations business for US\$ 3.7 billion
2008	Dabur	Fresenius	Acquisition of 73.3% stake for Euro 139 million
2008	Ranbaxy	Daiichi Sankyo	Acquisition for US\$ 4.6 billion

Source: Industry reports, PwC analysis

THE CASE STUDY OF MATRIX LAB: A WORTHY ACQUISITION BY MYLAN LAB

Mylan Laboratories Inc. is a leading pharmaceutical company with three principal subsidiaries: Mylan Pharmaceuticals Inc., Mylan Technologies Inc. and UDL Laboratories Inc. Mylan develops, licenses, manufactures, markets and distributes an extensive line of generic and proprietary products.

Matrix Laboratories Limited is a public limited company listed on BSE and NSE, and is engaged in the manufacture of Active Pharmaceutical Ingredients (APIs) and Solid Oral Dosage Forms. Matrix is one of the fastest growing API manufacturers in India and focuses on regulated markets such as U.S. and EU. The company has a wide range of products in CNS, anti-bacterial, anti-AIDS, anti-asthmatic, cardiovascular, gastrointestinal, anti-fungal, pain management and life style related therapeutic segments. Six API manufacturing facilities of the Matrix Group are approved by the U.S. FDA. The combined FDA approved capacity of the company is one of the largest in the country. The company's Finished Dosage Forms (FDF) manufacturing facility has a capacity to manufacture 2 billion tablets and 300 million capsules on two-shift basis. With about 2,300 employees, including over 300 R&D scientists, Matrix focuses on developing APIs with non-infringing processes to partner with generic players in regulated markets for their early formulation entry. It has recently acquired Docpharma, Belgium, for a front-end presence in Belgium, the Netherlands and Luxembourg. In addition Matrix has a controlling stake in Mchem (China) and Concord Biotech India. Newbridge Capital/TPG Ventures, U.S., and Temasek Holdings, Singapore, are the strategic investors in Matrix with combined holding of about 40 percent.

TRANSACTION DETAILS

Under terms of the transaction, approved by Mylan's Board of Directors, Mylan will acquire up to 71.5% of Matrix's shares outstanding.

Mylan will acquire approximately 51.5% of Matrix's shares outstanding for Rs. 306 per share in cash pursuant to an agreement with certain selling shareholders. Mylan will acquire all Matrix shares currently owned by (i) Temasek (Mauritius) Pte. Limited (an investment vehicle of Singapore Government-owned Temasek Holdings), (ii) entities controlled by Newbridge Capital (a joint venture between Texas Pacific Group and Blum Capital Partners), and (iii) Spandana Foundation. As part of the same agreement with these shareholders, Mylan will acquire shares from Matrix's Chairman, N. Prasad. After the transaction, N. Prasad will continue to own 5% of Matrix's shares outstanding.

In addition, Mylan will make an open offer to Matrix's remaining shareholders to acquire up to 20% of Matrix's shares outstanding at the same Rs. 306 per share price in cash. The open offer will take place in accordance with the relevant regulations and procedures of the Securities and Exchange Board of India (SEBI).

The transaction will be funded using Mylan's existing revolving credit facility and cash on hand. A portion of the funds received by Newbridge, Temasek and N. Prasad will be used to purchase newly issued shares of Mylan common stock. Newbridge has agreed to invest approximately \$93 million, Temasek has agreed to invest approximately \$46 million, and N. Prasad has agreed to invest \$25 million, each at a price per Mylan share of \$20.85 (the average of Mylan closing share prices for the ten trading days prior to the announcement of the transaction), subject to certain regulatory approvals.

Mylan expects the transaction to be moderately accretive to management's internal earnings estimates in fiscal 2008, the first full fiscal year following the anticipated closing of the transaction, and significantly accretive thereafter, excluding synergies, charges related to the transaction and the impact of amortization of intangible assets ("Cash EPS"). Mylan is re-affirming its adjusted EPS guidance (excluding stock option expense and transaction related costs) for fiscal 2007 of \$1.35 to \$1.55 per diluted share. In addition to reporting U.S. GAAP earnings per diluted share, upon closing, Mylan intends to provide Cash EPS.

Following the transaction, Mylan will continue to maintain a strong balance sheet, consistent with Mylan's commitment to preserving a flexible capital structure. The transaction, expected to close in the calendar fourth quarter of 2006, is subject to satisfaction of all conditions to the purchase agreement with the selling shareholders, the closing of the open offer, and certain other customary closing conditions.

STRATEGIC RATIONALE

Mylan and Matrix together will have approximately 5,100 employees in 10 countries. Matrix will provide Mylan with a significant presence in important emerging pharmaceutical markets, including India, China, and Africa, as well as a European footprint and distribution network through Matrix's Docpharma subsidiary. By combining Matrix's active pharmaceutical ingredient (API) and drug development business with Mylan's expertise in finished dosage forms (FDFs), this transaction also will allow Mylan to capture incremental pieces of the value chain through backward vertical integration. Additionally, Matrix will expand Mylan's capabilities in a number of key areas including products with higher barriers to entry and long-term growth opportunities, and allow the company to pursue a broader portfolio of new products at lower costs. As part of the Mylan organization, Matrix will benefit from a strong U.S. presence, expanded production capabilities and manufacturing capacity, and industry-leading expertise in product development and process optimization. Matrix is the world's second largest API player with respect to the number of drug master files (DMFs), with over 165 APIs in the market or under development, and 10 API and pharmaceutical intermediate manufacturing facilities, six of which are FDA approved. Matrix has diverse API capabilities, knowledge of the API patent landscape, capability in early API development, a low cost structure and strong scientific capabilities. Matrix's API manufacturing platform will provide Mylan with significant cost savings and enable first in-last out product lifecycles. Their finished dosage form pipeline will expand Mylan's forms and therapeutic categories and allow Mylan to pursue a broader portfolio of product opportunities more economically.

Matrix's presence in Asia and Africa provides Mylan with access to multiple, under-penetrated and growing new markets. In addition, Matrix's strong development capabilities and access to India's highly skilled, scientific talent pool will allow Mylan to increase its number of ANDA submissions. Matrix's additional manufacturing capabilities will provide Mylan with maximum manufacturing flexibility, allowing it to better manage industry cycles, while optimizing market share and gross margins. Matrix's Docpharma subsidiary is a leading marketer of branded generics in Belgium, the Netherlands and Luxembourg, and provides Mylan with a platform for building a larger European presence. This transaction will allow Mylan to distribute products from its broad portfolio into these markets, creating substantial additional distribution opportunities for Mylan's products, extending their growth cycle, and allowing Mylan to capture incremental revenues. Mylan resources and products will accelerate Docpharma's expansion into existing markets, as well as support expansion into multiple new European markets through both organic growth and acquisitions. Mylan also plans to pursue the distribution of Docpharma's novel, existing products and development pipeline in the U.S. in areas such as female health and oncology.

Matrix also expands Mylan's high-barrier-to-entry product capabilities, particularly in the area of anti-virals. Matrix is currently the world's largest supplier of generic anti-retroviral (ARV) APIs. Through its ARV franchise, Mylan and Matrix intend to partner with international programs to bring lower-cost treatment solutions to patients in regions of the world most affected by HIV. For Mylan, Matrix is the entry vehicle for achieving global presence. Matrix has opened the gates for Mylan to high-value markets like Europe and under-served markets like Asia and Africa, besides the cost arbitrage. This is an extremely complementary transaction that accomplishes a number of Mylan's key objectives. Mylan is executing on its commitment to establish a global platform and expand its dosage forms and therapeutic categories. Additionally, this acquisition deepens Mylan's vertical integration and enhances its supply chain capabilities. The transaction will allow Mylan and Matrix to strengthen and expand their core businesses and competencies, while creating significant opportunities for global expansion and growth. Mylan, a proven industry leader, is an ideal partner for Matrix. Our strategic vision remains unchanged and this transaction creates greater growth opportunities for Matrix. This transaction also offers significant benefits for customers of Matrix. Together, these companies will be able to compete more effectively, while delivering cost savings to customers. The additional financial resources Mylan brings also will allow to further enhance Matrix's capabilities in manufacturing and product development.

MATRIX LAB PERFORMANCE AFTER ACQUISITION BY MYLAN LABORATORIES**TABLE 3**

Ratios	2007	2008	2009	2010	2011
Current Ratio	1.56	1.51	2.17	1.81	2.04
Debt-Equity Ratio	0.23	0.64	0.73	0.53	0.51
Operating Profit Ratio	51.59	10.15	19.16	26.60	33.67
Return on Equity	0.42	0.14	0.32	0.43	0.59
Total Asset Turnover	0.51	0.68	0.79	0.81	0.91

Source: Calculated from the annual report of Mylan Laboratories

Current ratio defines the relationship between current assets and current liabilities. The current ratio has been increasing from 2007 to 2011, it indicates that the firm has the liquidity and ability to pay its current obligations. Debt-Equity ratio measures the relative claims of outsiders and the owners against the firm's assets. The Debt-Equity ratio has increased substantially from 2007 to 2009 but in 2011 it has again gone down. This is a good indication for the company because higher Debt-Equity ratio may be unfavorable for the company.

The operating profit ratio has been highest in 2007 but it slid down to 10.15% in the next year. But it has slowly improved and by 2011 it has touched the level of 33.67%. Return on equity has increased from 0.14 in 2008 to 0.59 in 2011. This is a favorable indication for investors. The total asset turnover is also having growth trend.

CONCLUSION

There is a scope to improve the present analysis by looking into the role of cross border M&A deals as well as the impact of type of mergers in determining the factors driving M&A in this particular industry. At the same time it would be interesting to find out impact of new product patent regime on M&A, as this particular development can enhance innovation and restrict competition in pharmaceutical market. Pharma MNCs have acquired Indian companies to maximise their capabilities in serving the global market. The acquisition of Matrix Laboratories by Mylan in 2006 is one of the earliest examples of this trend. Pharma MNCs collaborating with Indian companies bring to the table new products, latest technology, higher investments, quality systems and the knowledge of regulatory processes. On their part, Indian companies provide local market knowledge, cost advantage and local scientific talent. Such alliances have the potential to bring significant benefits to both parties and add value to society as a whole. Such partnerships bring in new drugs and therapies to the market and increase patient's awareness about diseases and wider treatment choices available.

The current paper describes the case of acquisition of Matrix Lab by Mylan Laboratories. The acquisition has helped Matrix to launch new products in domestic market. After the acquisition the financial soundness of both the companies has increased.

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