Sun Pharma acquires Ranbaxy: The Postmerger Blues

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Abstract

Sun Pharmaceutical Industries Ltd has become the world's fifth largest generics drugs maker after buying Ranbaxy Laboratories Ltd from Japan's Daiichi Sankyo Co. Ltd in an all-stock deal worth $3.2 billion (around Rs.19,200 crore). The company's founder and managing director Dilip Shanghvi is looking forward to realize synergies through the deal but he is facing big challenge in managing Ranbaxy part of the merged unit. He has to realize the synergies projected, find a solution of the problems being faced and ensure the growth of the merged unit.

Keywords: Acquisition, Post Merger, Integration, Pharmaceutical sector, Synergies

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"As a company, our most important focus will be to win the confidence of regulators", Shanghvi said in a press conference.[1] "We will do whatever it takes to win back the confidence of the regulators, so they trust what we do and they trust what we say." Post-acquisition of Ranbaxy Laboratories, Sun Pharma had become fifth in the world as a generic drug maker.[2] Apart from getting the plants updated as per USFDA requirements, post-merger integration issues were staring at the face of Sun Pharma[3]; though manufacturing of the newly formed entity now covered US, India, Asia, South Africa, CIS & Russia and Latin America with products sold in over 150 countries[4].

The deal had got nod from Competition Commission of India (CCI), Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) but the challenge lied ahead to achieve 100% compliance with manufacturing standards as prescribed by the regulators, achievement of the projected synergy of $250 million in 3 years and expansion of business with focus on R&D. Post deal, the Japanese company Daiichi Sankyo became the second largest shareholder in Sun Pharma and thus, would have a say in all strategic decisions. With phenomenal transformation at Ranbaxy through the deal, Sun Pharma had to prepare for well-defined post-merger integration at all levels.

The Indian Pharmaceutical Industry at a glance[5]

The Indian pharmaceuticals industry, as per the report by equity master, is third and thirteenth largest in terms of volume and value respectively around the globe. Branded generics with 70 to 80 percent share, dominate the market. India has achieved an eminent global position in pharma sector with huge pool of scientists and technologists working in this flourishing industry. The Union Cabinet has allowed Foreign Direct Investment (FDI) up to 100 per cent under the automatic route to manufacture medical devices in India.

Market Size

Among the manufacturing facilities registered with US FDA as on March 2014, Indian pharmaceutical was the highest at 523 in number outside US. The domestic pharma market grew at 12% Year on Year in Financial Year (FY) 2015-16 almost at par with average of 12.9% in FY15. Indian pharmaceutical firms aimed for acquisitions in Japan owing to aging populations and rising health costs, with aim to increase the penetration of generic drugs to sixty percent of the market by next year. Within the country, with 22.4% rate, Gujarat recorded the highest growth during November'14, which was more than the industry growth rate of 10.9%, as per AIOCD Pharma soft-tech AWACS. Biotechnology industry of India expected to achieve US $ 100 billion mark by end of 2025 with average growth rate of 30% a year. Major initiatives in the Indian pharma sector are as follows[6]:

Indian Government: Vision and Initiatives

The Addendum 2015 of the Indian Pharmacopoeia (IP) 2014 was published on behalf of the Ministry of Health & Family Welfare (GoI), with the ambition to improve the quality of medicines for better public health. 'Pharma Vision 2020' set by the government aimed to help India become a leader renowned globally for drug manufacture with quick processing time supplemented with new facilities to increase investments, simultaneously addressing the issue of affordability and availability of common drugs.

Steps initiated by the government are[7]:

- With the purpose to assess and benchmark the quality of Indian companies at par with Global players, data integrity guidelines are prepared by Indian Pharmaceutical Association (IPA).
- 'Make in India' programme launched by the government encourage manufacturing in country with reduction of imports.
- Venture capital fund of Rs. 1,000 crore (US $ 154 million) to support start-ups in R&D is set to be launched.
- Rs. 1,000 crore (US$ 146.72 million) planned to be invested in the pharmaceutical sector in Gujarat by Indian and Global companies.

Road Ahead

The generic drugs have made the medicines affordable by common man. Health programmes for rural India, lifesaving medicines and vaccines with preventive measures are positive indications for the pharma companies.[8] The Indian pharma market size is expected to grow to US $ 100 billion by 2020 due to increasing consumer spending, rapid urbanization, and raising healthcare insurance. With increase in consumer's affordability to spend with fast pace urbanization and awareness about the healthcare insurance, the vision 2020 appears achievable.

Sun Pharma and Ranbaxy are in a very competitive pharma industry. Listed below are the facts about Indian Pharmaceutical Industry to understand the competitive scenario:

Exports

Exports of Indian products increased at a CAGR of 26.1 per cent by value touching US $ 10.1 billion (Exhibit 1) during Financial Year2013.

Value of Market Segments

The largest share with 16 per cent in the Indian pharma market is held by anti-infective drugs. (Exhibit 2)

Revenue

With CAGR of 23.9 per cent, the Indian pharma industry aim to reach US $ 55 billion by 2020. (Exhibit 3)

Revenue share of sub-segments

Generic drugs hold the largest share of the pharmaceutical sector in India with 72% of the share (Exhibit 4).

About Sun Pharma[9]

Sun Pharmaceutical Industries Limited is a Mumbai, Maharashtra (India) based multinational pharmaceutical company. The company offers formulations in various therapeutic areas[10].

Mr. Dilip Shanghvi established the company in 1983 in Vapi, Gujarat with five products to diagnose psychiatry ailments.[11] It came up with its first research facility in 1991 which fueled its growth. Sun pharma went public in 1994 with issue over-subscribed 55 times. It was listing on the Bombay and the National Stock Exchange. In the past three decades, Sun Pharma has become one of the most profitable companies in the pharmaceutical sector around the globe through joint ventures and acquisitions in India and abroad[12]. It acquired Dadha Pharma to commence operations into oncology and gynecology. Other acquisitions include Gujarat Lyka Organic Ltd, and MJ Pharma in India and Taro Pharmaceutical and Caraco in the US.

Markets outside India contribute over 72% of the sales while 60% turnover comes from United States. Manufacturing facilities are located across 26 locations with plants in US, Canada, Brazil, Mexico and Israel.

The founding family holds the major stake in the company.[13]

The Indian pharma industry grew to $20 billion in 2015 compared to the turnover of $12 billion in 2014.[14] The timeline of Sun Pharma and its acquaree Ranbaxy is shown in Table 1.

Ranbaxy Laboratories Limited

Ranbaxy Laboratories Limited hold diverse range in generic medicines with presence in 23 globally leading markets.[15] Turnover was US$ 1.607 billion in 2007 with operations in 49 countries, manufacturing facilities in 11. It employed 12,000 people. Established in 1964, the timeline of Ranbaxy is shown in Table 2.

Ranbaxy was listed on the BSE, NSE and Luxembourg Stock Exchange. It had acquired Crosland Research Laboratories, Rima Pharmaceuticals and RPG Aventis among others to get a foothold in the European and US markets.[16]

In 2008, Daiichi Sankyo acquired a controlling stake in Ranbaxy. Following this deal, Ranbaxy had many quality control issues .[17] Ranbaxy's plants at Paonta Sahib and Dewas faced imports ban in 2008. In 2013 Ranbaxy gave out $500 million for felony charges because of the manufacture and distribution of adulterated drugs in India. In September 2013, its plant at Mohali and Toansa were banned from manufacturing pharmaceuticals for export to the US over quality issues.

Ranbaxy operated in 43 countries with 21 manufacturing facilities in 8 countries, and with products sold over 150 countries.

<u>The Deal</u>

Sun Pharmaceutical Industries Ltd. acquired Ranbaxy Laboratories Ltd. for 3.2billion USD from Japan's Daiichi Sankyo completely in stock with addition to 800 million USD of debt[18]. Daiichi owned 63.41 percent of the shares of Ranbaxy. The deal concluded on 6th April, 2014 after regulatory approvals. Thus, world's fifth biggest generic pharma company by revenue, and India's largest drug maker with local market share of 10% was created[19]. Post deal, the entity had Rs.30,000 crore (US $411million) as combined annual revenue and 2.5 trillion USD in market value. (Exhibit 5, 6, 7). Ranbaxy B.V., Netherlands, a 100% subsidiary of Ranbaxy also became a subsidiary of Sun Pharma. Series of deals by Sun pharma is enlisted in Table 3.

Shares of Ranbaxy Company Limited stopped trading on 6th April, 2014. The deal materialized after the clearance from CCI, NSE, Companies Act (1956) and regulatory authorities.[20] With this deal, shareholders of Ranbaxy received 0.8 of Sun Pharma shares for every Ranbaxy share.[21]

Daiichi had a stake of 9% in the company after the deal.[22] The public shareholders of Ranbaxy and Sun Pharma have 14% and 22% stake respectively after the deal.

The acquisition is expected to dilute the reported return on equity from 27.9% to 27.5% in FY 2016 because of low profitability of the acquired company.[23] Compared to its peers with ROE of 17-25%, it is placed at the higher end with operating ROE at around 41%. With profitable operations, expanded R&D capabilities and the global presence, the new entity is expected to create synergistic value creation of USD 250 million over three years; thereby creating USD 4.5 billion entity.

Issues : Sun Pharma received in return of the deal

Ranbaxy plants faced quality issues in its dedicated manufacturing units in Mohali, Dewas and Paonta Sahib[24]. The quality concern prompted US Food & drug Administration (FDA) which imposed a ban on drugs produced at these sites affecting the sales in US Market[25]. The Dewas and Paonta Sahib facilities were banned in 2008 and Mohali plant in 2013. Only Ohm Laboratories in New Jersey produced drugs for U.S. but the ban for other plants complicated the smooth functioning of the company[26]. Ranbaxy's problems were deepened with issues like wrong handling of data and inferior facilities of production, which led to $ 500 million payments in return for settlement with federal legislation. Adding to this, FDA further banned few generic drugs of Ranbaxy due to the manufacturing problems.

Regulatory Compliance:

Challenge here was to regain and restore the trust and confidence of the regulators. With the four of Ranbaxy plants being banned by USFDA, compliance with the regulatory authorities posed the biggest challenge for Sun Pharma post merger[27].

- Sun Pharma and Ranbaxy had obtained clearances from National and Bombay Stock Exchnage along with anti-competition authorities by August 2014[28].
- The CCI approved the acquisition on December 5, 2014 on the condition that the brands which were expected to contribute with less than 1% to the revenues of the new entity should be divested in order to prevent the negative impact on the competition existing in the domestic market[29].

The companies announced on February 2, 2015 that U.S.- F.T.C. had granted the early end of their waiting period.

Post deal challenges:

a. The Expected Synergies

Synergy benefits worth US$ 250 million were expected by third year since the deal closure[30]. Increased revenue, and cost management with supply chain efficiencies were the expected benefits.

The annual report of Sun Pharma for FY 2013-14 highlighted the significant points about the deal, and the opportunities as under:

- The formed entity was the **world's fifth largest** specialty-generic pharma company with sales of US $ 4.2 billion[31].
- The merged entity ranked number one and third in the generic and branded dermatology market respectively.
- With US FDA approval, the entity to have potential for developing complex drugs.
- The merger was to make Sun Pharma the largest pharma company in India with over 9% market share.
- Sun Pharma, through this deal, had to improve its global footprint in emerging pharma markets like Russia, Romania, Brazil, Malaysia and South Africa, for cross-selling and for building better brand.
- The merged entity to be indemnified by Daiichi Sankyo for costs incurred in course of settlement with US Department of Justice.

b. Integration

Post-merger challenges stand at a diverse range aiming from integration to regulatory compliance with the authorities[32]. Sun Pharma had the challenge to align its finance, technology and human resources to achieve the synergies projected.

The transaction created India's largest and world's fifth largest pharmaceutical company. One of the key integration was that of product portfolio, manufacturing and supply chain. Further, Sun Pharma was targeting US and European markets with cheaper copies of biotech drugs where it had to become more innovation oriented.

b1. Finance

The net worth of Ranbaxy had declined in 2011, which could be attributed to the following[33]:

a.) Payment of US$ 515 million to US-Department of Justice in 2013 on account of settlement of the charges of manipulation of data and poor facilities.
b.) Investments decreased with loss incurred on foreign currency derivatives.
c.) Deal took place at a crucial time when Ranbaxy was trying to improve its financial position, thereby possessing a challenge for Sun Pharma to restructure its finances.
d.) Considering the financial health and issues carried from past, synergies of US $250 million of the combined entity was to be worked under such fluid conditions.

Amidst all the concerns related to the deal, Sun Pharma had arrested the sharply declining trends in the financial year ending March 2016; the year on year change in sales was only 2%.

Moreover, the declining figures were attributed to the market response to the deal and adjustment to the changes. The adjusted net profit declined by 16% (YoY) in 2015 which showed positive growth in 2016 (13% YoY). The investment figures had also displayed bitterly negative change on Y-o-Y basis with -3% (2015) and -52% (2016). Sun Pharma, thus, was facing huge challenges in its finances (Table 4).

b2. Technology

Apart from the financial goals, the integration also had to focus on productivity and establishment of efficient supply chain[34]. The goals could be summarized as:

- "Concentrate on Global Business Growth," formed the priority[35].
- Expand the product portfolio.
- Focus on dermatology, oncology, controlled substances and ophthalmology.

- Perpetuate strong growth of talent; expand R&D capabilities
- Introduce innovative products to achieve strong revenue across the world.
- Implement best practices of Sun Pharma and Ranbaxy to minimize disruptions.

Manage diverse portfolio:

The merger gave Sun Pharma vastly diversified product and market portfolio having different regulations calling for higher level of management skills.

c. People

Integration Management Office (IMO) was responsible for the integration process. The merger had to focus on strengthening Sun Pharma's multi-cultural team of around 30000 people with as diverse as 50 global cultures. Integrating the two firms on work cultures, margin bonuses and bringing them on the common platform was the biggest operational challenge[36].

d. Leadership Team:

The team needed to draw the expertise and experience from both Sun Pharma and Ranbaxy. Though Ranbaxy was acquired, it was the oldest generic Indian drug brand with highest recall value and therefore the challenge was to restore employees' faith towards the cultural integration. Post deal, the loss of identity was adversely impacting the morale of Ranbaxy's employees. The big challenge before Sun Pharma was to retain required Ranbaxy employees and rebuild their morale.[37]

The Road Ahead

With dominant presence in U.S., India, Asia, Europe, South Africa, CIS & Russia and Latin America, the entity had vast presence in more than 150 nations. Skepticism in the minds of employees was hindering the complete turnaround .[38]

The company intended to invest more than $300 million in R&D and minimize jobs cut [39]. The integration challenges for Sun Pharma were the biggest to convert the deal into a successful venture. Despite this, the Company was open to further acquisitions[40].

Sun Pharma had devised a detailed turnaround strategy for Ranbaxy and prepared a wholesome approach to integrate supply chain and field force to boost efficient productivity[41]. To resolve regulatory issues and achieve higher growth due to synergy in domestic and emerging markets was Dilip Sanghvi's top priority. He estimated a three-four year period to engineer the turnaround of Ranbaxy[42]

In FY 2016, though the expected revenues of the merged entity were estimated at US $ 4.2 billion, 47% was to be delivered from U.S., 22% was to come from India and the rest of the world to contribute for 31%[43]. Besides the revenue from different markets, realizing the projected synergy had become a big challenge. The jury was out to see whether Sun Pharma realizes its projected synergy and when it achieves complete turnaround.[44]

Exhibits

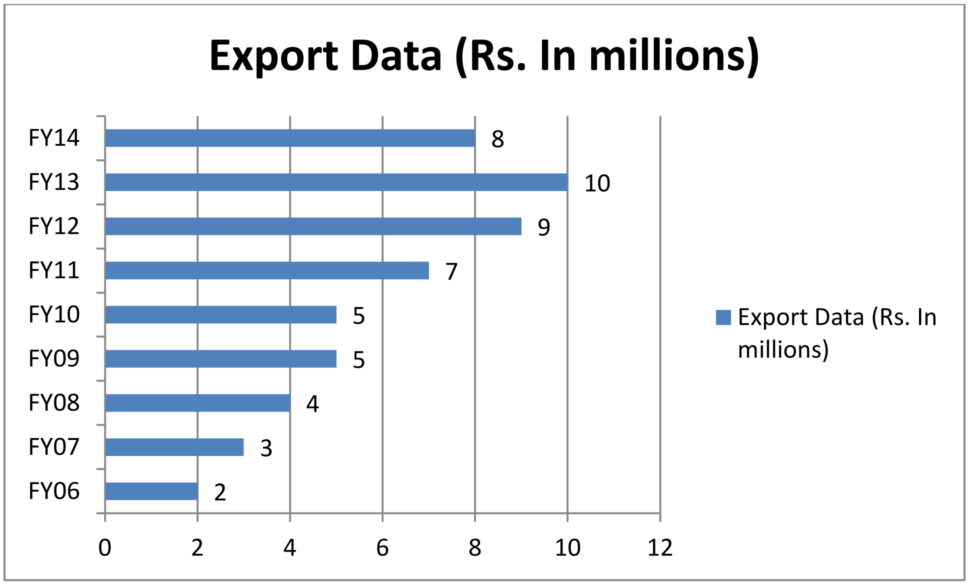

Exhibit 1

Source:Adopted data from Indian Brand Equity Foundation(www.ibef.org) accessed on May 15, 2016

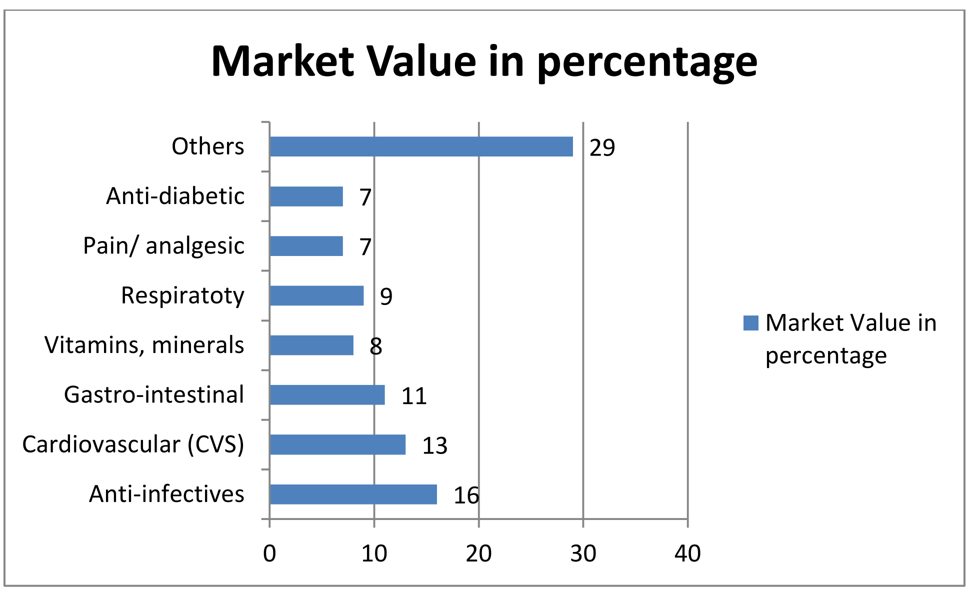

Exhibit 2

Source: Adopted data from Indian Brand Equity Foundation (www.ibef.org) accessed on May 15, 2016

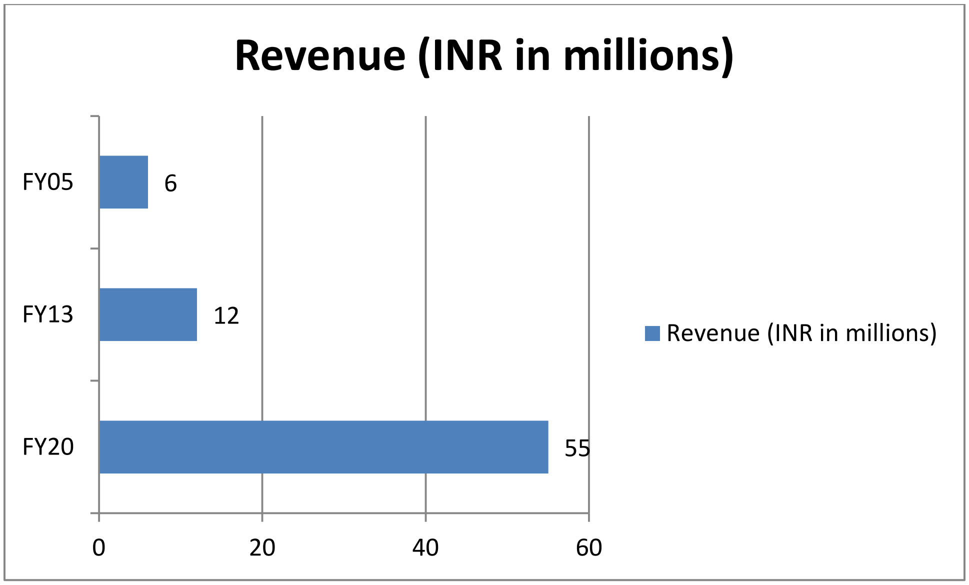

Exhibit 3

Source: Adopted data from Indian Brand Equity Foundation (www.ibef.org) accessed on May 15, 2016

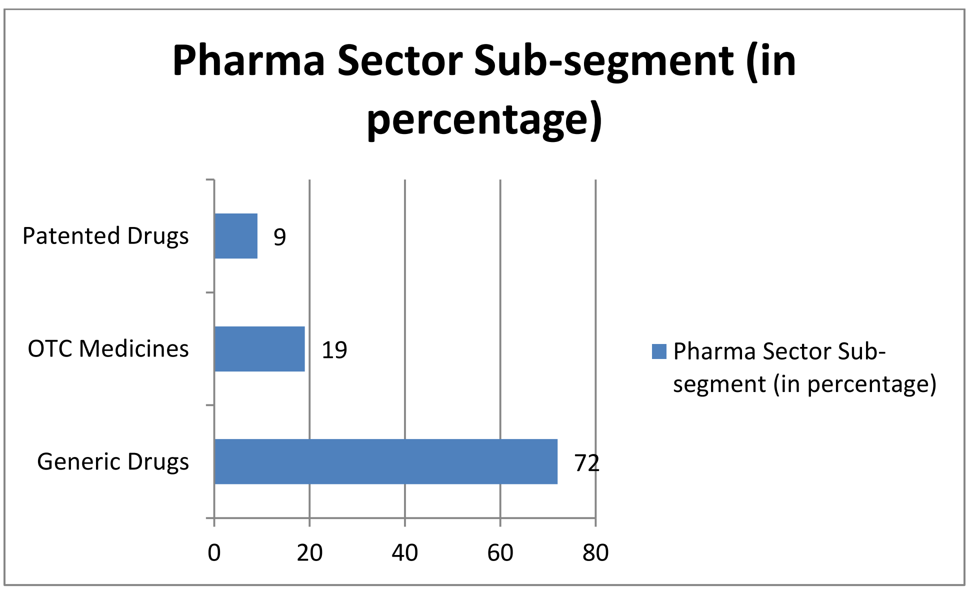

Exhibit 4

Source: Adopted data from Indian Brand Equity Foundation (www.ibef.org) accessed on May 15, 2016

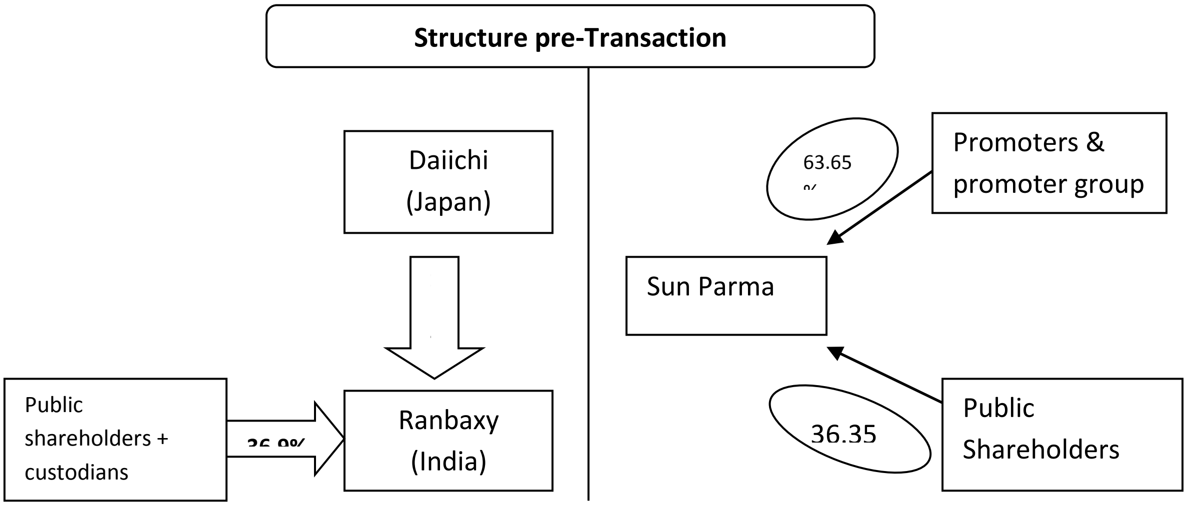

Exhibit 5

Source: Analyst

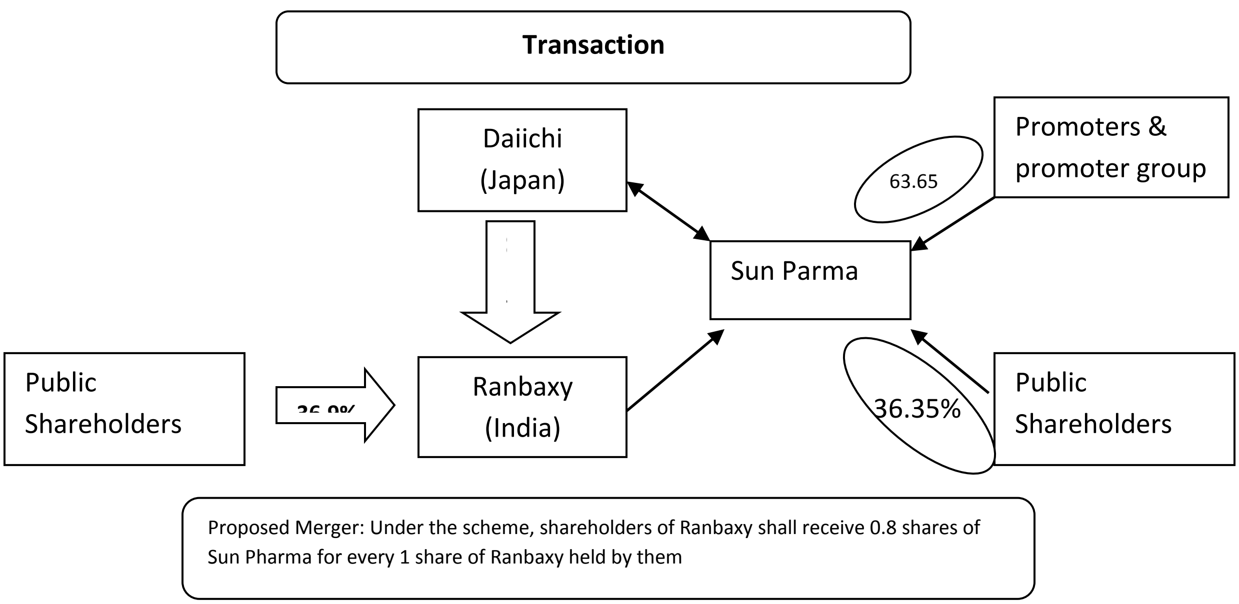

Exhibit 6

Source: Analyst

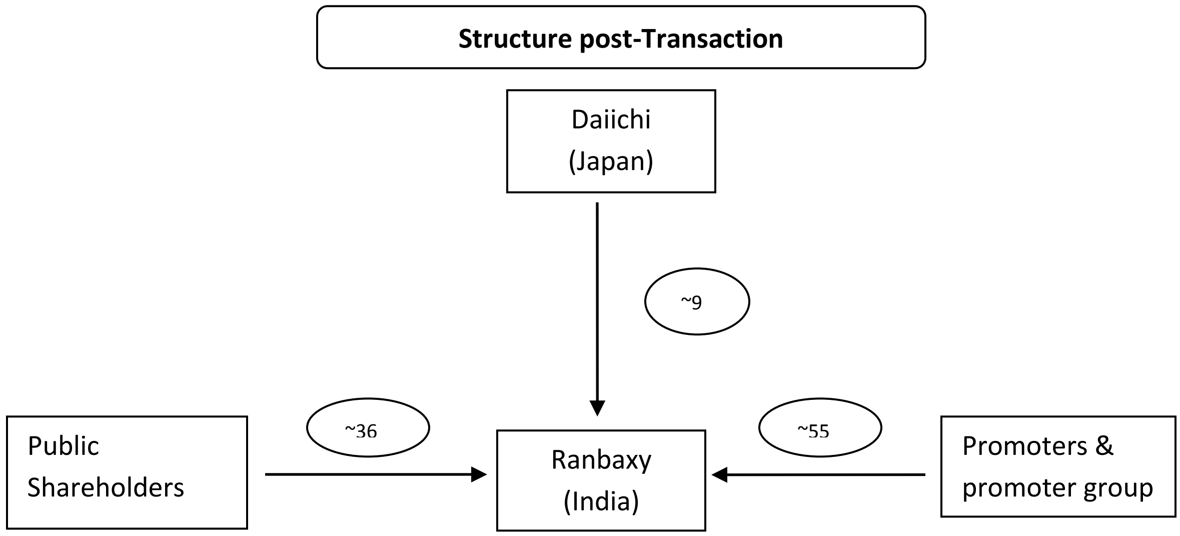

Exhibit 7

Source: Analyst

Table 1

Timeline: **Establishment & Growth**

Year	Details
1961	Ranbaxy was established
1973	IPO was launched by the company
1983	Marketing team of two people with five psychiatry products were established by Sun Pharma
1985	Ranbaxy Research Foundation was set-up by Ranbaxy
1994	IPO was launched by Sun Pharma
1996	Sales were covered across 24 countries
1997	Sales of Ranbaxy increased over INR 10,000 million marking the highest exports.
1998	The company entered United States with its own products. Ranbaxy has commenced to expand cross-borders.
2001	Ranbaxy progressed as the fast globally leading company with sales crossing US$ 100 million in U.S.
2003	Ranbaxy formed alliance with GSK was established with aim for new discoveries and development.
2004	Ranbaxy achieved higher milestone by becoming one of the billion dollar companies with sales reaching US$ 1 billion.
2004	With acquisition of RPG (Aventis), France became next destination for its operations.
2006	Largest FCCB of USD 440 million was announced by Ranbaxy in Indian Healthcare market
2007	Sun Pharma Advanced Research Company was demerged into a separate entity. The new comapny became the first “listed” research company ..
2008	The Japanese firm, Daiichi Sankyo Co. Ltd became a majority stakeholderand then the business model of Ranbaxy was revised.

2011	Ranbaxy became the global leading pharmaceutical company with global revenues crossing US$ 2 billion.

Source: Adopted data from the Sun Pharma disclosures (www.sunpharma.comhttp://www.sunpharma.com/about-us/milestones) accessed on June 19, 2016

Table 2

Timeline: History of Ranbaxy

Year	Details
1937	Ranjit Singh and Dr.Gurbax Singh founded Ranbaxy in 1937 in Amritsar . It was a distributor for a Japanese pharmaceutical company for vitamins and anti-tuberculosis drugs. Their brother, Mohan Singh later bought this company. **The name of the founders led the name "Ranbaxy".**
1951	The alliance with an Italian Company, Lapetit, helped Ranbaxy to expand its productline in India. .
1961	The alliance helped Ranbaxy with local manufacturing unit which helped it gain technical expertise.
1966	The association with Lapetit came to an end for Ranbaxy was determined to formulate more products on local grounds.
1969	With the problem of product shortage, Ranbaxy practised "reverse engineering" on Lapetit's products.
1970	"Patent Legislation" was introduced by the Indian Government which intended to protect only the processes with which drugs were produced. Imitation of the products was freely practised by the local producers while this became a big disadvantage to the MNCs.
1971	Drugs facility was established at Mohali, Punjab by Ranbaxy.
1973	The development was that by restrictions on the amount of equity MNCs could then hold in local companies. The amount of equity holding in local companies was restricted this yeart was a wave of development for local pharmaceutical companies . Ranbaxy went public in this year.

1975	Ranbaxy continued its investment in Indian Manufacturing operations which became an integral part of its core operations.
1980	The company transformed into an international company. The price controls extension in the Indian market, with investment encouragement from the government to invest abroad were the major contributing factors for the development.
1992	Joint ventures became the mode of expansion. JV with Eli Lilly helped manufacture products in India and market in South Asia.
1993	Ranbaxy expanded its operations in - India and Middle East; Europe CIS and Africa; Asia Pacific; and North and South America with headquarters in the US and UK.
1994	Lilly contracted with Ranbaxy to make generics for it because of the US healthcare reforms.
1997	The year marked with slow progress in the Indian economy, competition from Chinese products with focus on generic products and Ranbaxy also expanded through alliances and acquisitions.
1999	The year witnessed the demise of Parvinder Singh but the company continued progressing on the same pace.
2004	International activities were increased due to FDI movement from the country. M&A became an important strategy for growth, development and expansion. Accelerated further by FDI inflows, and reduction in constraints on the Indian companies which aimed at expanding cross borders.

Source: Adopted data from the Sun Pharma disclosures (www.sunpharma.com) accessed on June 19, 2016

Table 3

Timeline: **Series of Deals**

Year	Details
1997	First Joint venture entered in Lagos, Nigeria.
1992	Agreement signed with Eli Lilly & Co., USA to have a JV in India.
1993	Third agreement to set up joint venture in China. Third to follow was a joint venture in China.
1995	Ohm Laboratories, USA was acquired.
1996	API plant from Knoll Pharma at Ahmednagar(Maharastra, India) was acquired by Sun Pharma.
1997	Equity stake was purchased in TDPL and MJ Pharma.Acquisition of Caraco Pharmaceutical Laboratories, USA marked the first international acquisition by Sun Pharma.
1999	Milmet Labs and GujratLyka Organics, India were acquired.
2000	Acquired Pradeep Drug Company (India), also acquired Bayer's Generics (Germany)
2004	Acquired an Indian firm, Phlox Pharma.
2005	Sunpharma completes Buyout of manufacturing unit in Bryan, Ohio (US) was established by the company. ICN's business was also bought from Valeant Pharma. The assets, intellectual property, were purchased from Able Labs, US.
2006	The largest generic pharma company , Terapia, was acquired for USD 324 million. Also, the same year fifth largest drugmaker from South Africa, Be Tabs, was acquired for USD 70 million.
2008	Chattem Chemicals, USA was acquired.

2010	Acquired Taro Pharmaceuticals, Israel for its US stake to contribute for expansion of its US business.
2012	Dusa Pharmaceuticals and the generic business of URL Pharmaceuticals, USA were acquired..
2014	Sun Pharma acquired Ranbaxy for 4 million USD and became fifth largest generic drug maker in the world.

Source: Adopted data from the Sun Pharma disclosures (www.sunpharma.com) accessed on June 19, 2016

Table 4

Summarized Profit & Loss and Balance Sheet Statement of Sun Pharma (INR in millions)

	FY12	YoY	FY13	YoY	FY14	YoY	FY15*	YoY	FY16*	YoY
P&L Summary										
Net Sales	80,057	40%	1,12,389	40%	1,60,044	42%	2,72,451	70%	2,77,442	2%
Gross Profit	63,644	49%	91,592	44%	1,32,250	44%	2,05,059	55%	2,12,610	4%
EBITDA	32,507	67%	49,063	51%	71,141	45%	78,166	10%	79,561	2%
Net Profit	26,567	46%	29,830	12%	31,415	5%	45,394	44%	47,159	4%
Net Profit (Adjusted)	26,567	46%	35,666	34%	56,589	59%	47,771	-16%	54,011	13%
R&D Spend	4,449	34%	7,042	58%	10,418	48%	19,550	88%	23,025	18%
BS Summary	**Mar'12**	**YoY**	**Mar'13**	**YoY**	**Mar'14**	**YoY**	**Mar'15***	**YoY**	**Mar'16***	**YoY**
Shareholders Funds	1,22,358	29%	1,49,897	23%	1,85,250	24%	2,56,232	38%	3,16,939	24%
Loan Funds	2,650	-27%	1,982	-25%	24,890		75,963	205%	83,381	10%
Net Fixed Assets	32,742	19%	50,771	55%	58,242	15%	1,10,201	89%	1,33,606	21%
Investments	22,129	-1%	24,116	9%	27,860	16%	27,163	-3%	13,086	-52%
Cash & Bank balances	33,672	53%	40,587	21%	75,902	87%	1,09,980	45%	1,39,893	27%
Inventory	20,870	40%	25,778	24%	31,230	21%	56,680	81%	64,236	13%
Sundry Debtors	20,787	88%	24,122	16%	22,004	-9%	51,061	132%	67,959	33%
Sundry Creditors	9,927	54%	10,580	7%	13,283	26%	32,865	147%	34,896	6%

*All figures from FY11 to FY14 exclude Ranbaxy aqcuisition which is effective from 01 April 2014 * FY15 & FY16 numbers include the impact of Ranbaxy merger

Source: Adopted data from Financial public disclosures of Sun Pharma (www.sunpharma.com) accessed on June 19, 2016

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