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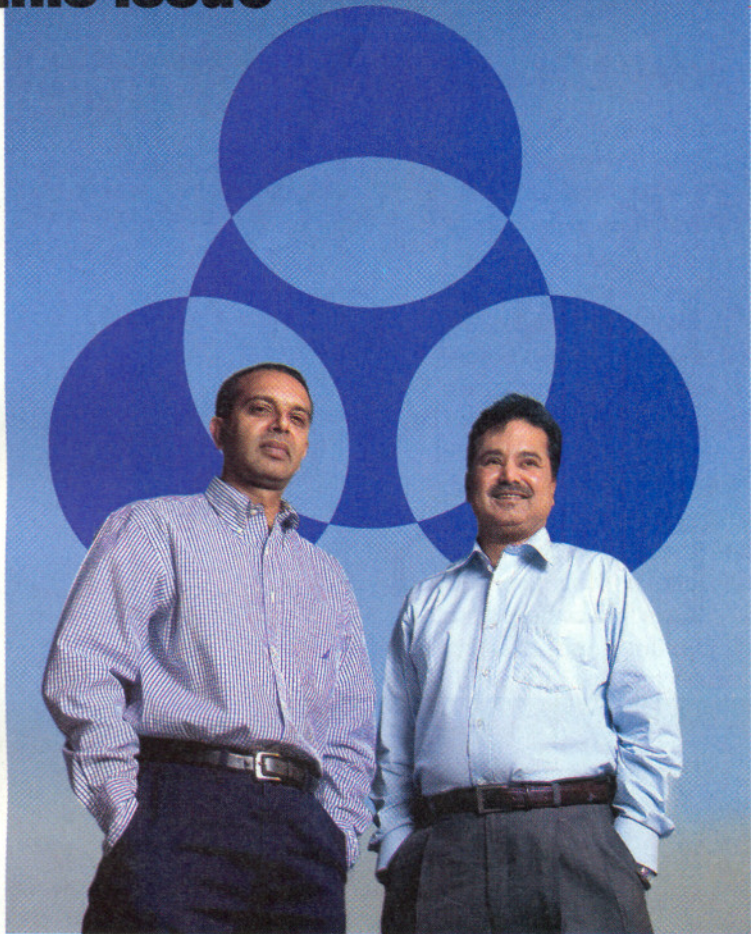
# Achtung!

Dr. Reddy's moves deep into Europe by buying betapharm, Germany's fourth-largest generic firm, for \$570 million

Satish Reddy and G.V. Prasad



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**COVER STORY 34**

# Europe Ahoy!

Dr. Reddy's Laboratories acquires betapharm, Germany's fourth-largest generic company, for \$570 million, in one of the biggest overseas acquisitions by an Indian company. With \$11.8 billion worth products going off patent by 2011, Europe is firmly on the radar of leading generic companies. This acquisition gives Dr. Reddy's the arsenal to move deep into Europe and exploit that opportunity.

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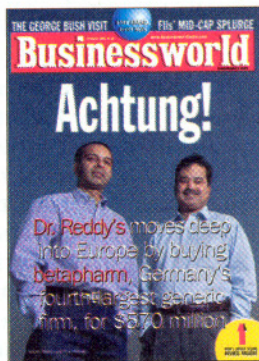
# The discovery of the world

**I**NDIA'S businessmen have begun to treat the world as their stage. Dr. Reddy's buyout of German generics firm betapharm for \$570 million may be the biggest overseas deal struck by an Indian company so far, but it has to be seen as part of a series of bold moves by Indian businesses to create bigger footprints around the world. There is no big Indian business group today that does not have significant global ambitions and all of them use global benchmarks to assess how well or badly they are doing.

Many would see Dr. Reddy's move as highly risky and, perhaps, unnecessary, but the company has always been known for making difficult bets and winning most of them. "This acquisition will take Dr. Reddy's closer to its ambition of becoming a middle-level global pharma company," says special correspondent Gina S. Krishnan who has been following the ups and downs of the industry for years. One hopes that the acquisition will not result in the company putting less emphasis on R&D — the big payoffs can come only from there and Dr. Reddy's is better positioned than others to make breakthroughs in R&D.

It is no coincidence that the broadening global vision of Indian business has gone hand in hand with the widening strategic ambition of India itself. Each trend feeds on the other. Look at the way Lakshmi N. Mittal's bid for European steel major Arcelor has drawn in India's political and diplomatic establishment, who are fighting Mittal's battles in European capitals. Or how the United States' re-evaluation of India was caused mostly by the on-going economic transformation of this country.

This issue of *Businessworld* is a good indicator of India's rapidly expanding engagement with the world. The cover, of course, is on Dr. Reddy's German buyout. Another story is on how foreign institutional investors are discovering stars among small- and mid-cap companies. Despite their fears about low liquidity, they have substantially increased their exposure to smaller companies. Then there is the piece on how China is reacting to the American president's Indian visit. The real story, I think, is not about the world re-discovering the opportunities India presents; it is about Indians discovering the opportunities the world presents.



*Tony Joseph*

TONY JOSEPH, EDITOR

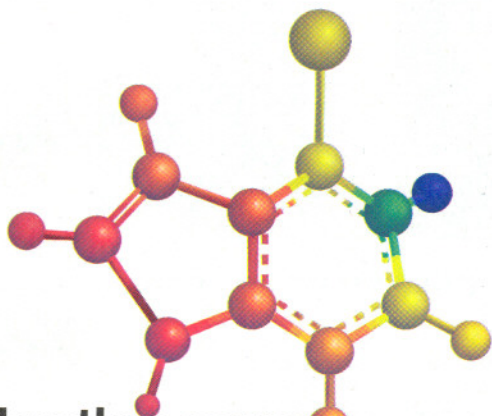
# DRL'S

## What DRL went and bought

Company	Acquired in	Cost (\$million)	What Dr. Reddy's got
TRIGENESIS (US)	May 2004	11	Dermatology R&D
ROCHE (Mexico)	December 2005	59	Custom pharmaceutical services
BETAPHARM (Germany)	March 2006	570	Market and regulatory access

Source: BW research

On 15 February 2006, Dr. Reddy's bought German generic firm betapharm for \$570 million. What the deal means for DRL.  
By Gina S. Krishnan



## How they compare

Key elements	Dr. Reddy's	betapharm
Turnover (2004-05)	Rs 1,629.04 cr	euro 174 million
Profits (2004-05)	Rs 65.46 cr	euro 40 million
Employees	6,500	360
Products	105	146
Pipeline	36	60
Therapeutic segments	CVD, diabetes, pain, gastro-intestinal tract, oncology, dentistry, dermatology	CVD, gastro-intestinal, CNS, anti-infectives, musculoskeletal

Source: BW research

In February 1999, when Tata Tea bought UK-based tea giant Tetley for £260 million (around \$420 million or Rs 1,800 crore then), it was one of the biggest overseas acquisitions ever made by an Indian company. Adjusted for inflation, that deal would be worth around \$470 million or Rs 2,070 crore if done today. More important than the size, it catapulted Tata Tea to the upper echelons of global branded tea companies.

The intervening six years have seen a plethora of cross-border deals, but nothing of the scale of the Tata-Tetley tango (outside the oil and gas sector).

Until 15 February 2006, that is.

In the wee hours that Wednesday, Hyderabad-based Dr. Reddy's Laboratories (DRL) bought betapharm, the fourth-largest generic company in Germany, for euro 480 million (around \$570 million or Rs 2,500 crore). For DRL, which had a turnover of Rs 1,629 crore (around \$370 million) in 2004-05, it was certainly a significant buy.

Opinion is divided on whether DRL paid too much — but it is equally true that its peer in India and the country's largest pharma company, Ranbaxy Laboratories, is reported to have bid even higher (euro 500 million). Although he doesn't comment on the amount, CEO and managing director Malvinder Mohan Singh does admit to having "bid aggressively". He adds: "Although we have a presence in Germany, an acquisition would have given us leadership position in the market."

It took DRL 85 days to clinch the deal but, perhaps fittingly for such a milestone deal, it came with its share of drama. London-based venture capital firm 3i, which had 80 per cent share in the company, and founder Peter Walter, first evinced

# D-D Day

interest in selling off betapharm in 2005. Initially, Israel-based Teva (the world's largest generic company), Switzerland-based Sandoz, a few European companies, and Indian companies like Wockhardt, Nicholas Piramal and Cadila bid to buy betapharm. The bids were to be opened in end January, but had to be pushed back as more companies, including Dr Reddy's and Ranbaxy, showed interest.

In the end, despite not having made the highest bid, DRL walked away with the deal on the strength of the promoters' perception that the two made for a perfect business fit, besides having deep cultural affinity. Wolfgang Niedermaier, CEO of betapharm, commented after the deal was finalised: "DRL's impressive pipeline of generic and innovative products, and its high quality standards combined with competitive manufacturing costs will help further develop our position in the German market and offer an entry platform for the European market."

## Europe: The Next Generic Frontier

Why this tug-of-war over betapharm? The issues involved are more than just about buying a company to add market share or shore up bottom lines.

The US is the biggest pharma market, accounting for \$245 billion of the \$500-billion global market. With products worth \$82 billion going off patent by 2008, it's a natural target for generic companies.

That, and the fact that the generic business has been booming on the back of increasing demand for cheaper drugs, had been giving Big Pharma the jitters. But Big Pharma is fighting back with a vengeance. First-to-file Para IV filings (which result in 180 days of exclusive marketing rights for the generic company along with the patent-holding company) are being contested tooth-and-nail in US courts, with Big Pharma clearly coming out better. (DRL's loss of amlodipine maleate to Pfizer sort of signalled the Big Pharma fight-back, but more on that later).

They are also hitting back on another

**GOTCHA! G.V. Prasad (L)  
and Satish Reddy**

# THE EUROPEAN

## Europe is high on generics

Region	Generic market size
GERMANY	4.8
UK	2.8
FRANCE	1.6
NETHERLANDS	0.6
SPAIN	0.6
ITALY	0.5

Figures in euro billion  
Source: Merrill Lynch Research

## Patents are expiring\*

Calendar year	Value (euro billion)
2006	1.5
2007	1.7
2008	1.8
2009	2.0
2010	1.7
2011	3.1

\*euro 11.8 billion worth patent expirations are to happen in the four key generic markets by 2011; all values are estimates; Source: Merrill Lynch Research

## Generics is growing

Region	Generics growth
UK	38
FRANCE	35
ITALY	24
SPAIN	24
GERMANY	13

Figures in per cent  
Source: IMS Health

front: by appointing authorised generics, or generic companies who they authorise to sell generic versions of their NCEs (new chemical entities or original drugs) after their patents expire. For instance, Merck has authorised DRL to sell generic copies of Proscar, thereby cutting into the revenues that a first-to-file Para IV filer is likely to get.

So, generic companies have been forced to look at Europe. According to Merrill Lynch Research, by 2011, euro 11.8 billion worth patent expirations will happen in the four key generic markets of Europe (UK, France, Italy and Germany). (See 'The European Generic Opportunity'). The market, at \$14.2 billion, is fairly large; generics are growing faster than brands; and the rate of growth is almost equal to that of the US. So, Europe is increasingly being seen as an attractive hedge against the US.

Also, in Europe, there is no provision for marketing exclusivity (akin to Para IV), so generic companies are on a level playing field. While Europe doesn't offer the windfalls that accompany a successful Para IV challenge, the generics opportunity is far more predictable.

To get ahead in Europe, generic companies have to get in early. Acquiring a local European company makes better sense than starting from scratch, because a lot of time is needed to establish oneself with doctors and pharmacists. With product patents beginning to expire, buying a company that has a network and brand equity improves the chances of bettering the competition.

Within Europe, Germany is the largest generic market, at euro 4.8 billion. It is also growing at a reasonable 13 per cent. With not too many German generic companies up for grabs, the dash for betapharm was hardly surprising.

betapharm is the fourth-largest generic pharma company in Germany. The top three — Ratiopharm (turnover: euro 1.08 billion), Hexal (euro 1.07 billion) and Stada (euro 302 million) — together have 50 per cent marketshare (betapharm has 3.5). The owner of Ratiopharm, Adolf Merckle, and CEO Claudio Albercht have ruled out sale of their company. Swiss multinational Novartis bought Hexal last year. Stada is valued at around euro 2.6 billion (according to a pharma expert with the bank WestLB), and is out of reach of most generic companies. But Stada is still a takeover target for larger companies as almost 95 per cent of its shares are in diversified holdings. And the fifth- and sixth-largest generic players taken together are smaller than betapharm.

### DRL's betapharm Gamble

As this article was being written, the entire top brass of DRL were in Germany to complete the formalities of the deal. The fact that DRL managed to stave off such stiff competition augurs well for its prospects in Europe, provided it carries out the integration and pooling of synergies of the two companies effectively.

However, questions remain. First, does it make sense to pay \$200 million

more than DRL's 2004-05 turnover for betapharm? After all, for a company that is just beginning to come out of a bad patch, a deal like this not producing results could do a lot of damage.

Even three weeks after betapharm was won, not too many details are available. Understandably, analysts are playing it safe. Says Mahesh Sawant, manager (healthcare practice), Frost & Sullivan: "We cannot comment on the fairness of the valuation, but on preliminary look it appears to be an expensive deal. However, it can be looked upon as a long-term goal to grab a larger share of the European generics market."

The management of DRL, however, is confident of having got it right. Says V.S. Vasudevan, president and CFO: "We are not putting our balance sheet under pressure. Now we can leverage financial resources in different ways. There are different structures available and we will use them."

Adds G.V. Prasad, executive vice-chairman and managing director: "This year we have done some inorganic moves — all of them earnings accretive — and the experience has been positive so far." Of the euro 480 million that betapharm has been valued at, euro 80 million will come from DRL's internal accruals. The remaining euro 400 million will be lent by Citibank (see 'How betapharm Materialised').

Second, could DRL have done something better with the money? It

# GENERIC OPPORTUNITY

## faster than brands

Brands growth

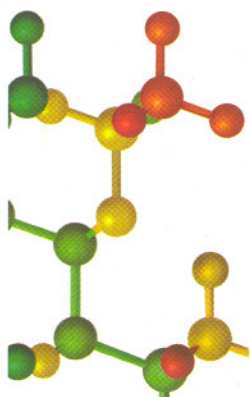
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5



was, after all, founded by (founder chairman) Anji Reddy to be an innovator company. And while that strategy has come under criticism, it hasn't been abandoned. Given how Big Pharma is coming out all guns blazing, it isn't entirely out of place to argue that DRL could have perhaps gone for a smallish drug research company, with a pipeline. And while that may not have given DRL size (an important determinant in the generics game), in the long term it may have brought in significant revenues.

And third, what does such an expensive deal actually give the company? In an internal communiqué sent by Satish Reddy, managing director and COO, to the staff of DRL, he says the acquisition takes the company closer to its goal of being a billion-dollar company by 2008.

Such lofty goals aside, betapharm also gives DRL several benefits. Most important, it provides a deeper foothold in Europe. Says Prasad: "The German market is significant because of its size, for its brand, pricing is better and profits are sustainable over a longer period."

## And it's growing almost as quickly as the Americas

Market	Generics growth*
<b>N. AMERICA</b>	<b>22.4</b>
<b>TOP 5 EUROPE</b>	<b>21.6</b>
<b>KEY 7 MARKETS</b>	<b>22.1</b>

\* Compounded annual growth rate in per cent  
Top 5 Europe include UK, Germany, Spain, France and Italy; Key 7 markets include USA, Japan, Germany, UK, France, Italy, Spain Source: IMS Health

There are other benefits too. One, betapharm does not have manufacturing or product development overloads. That will mean no retrenchments and, therefore, easier integration. While today betapharm outsources its manufacturing entirely, it is expected that gradually, betapharm's manufacturing will shift to India. DRL's facilities are already European regulation compliant.

Two, it has a rich pipeline of 146 registered products that are already selling in Europe, with 60 more coming up in the next five years. DRL can add its own products and take the pipeline all over Europe (through mutual recognition procedures, which all European countries are expected to sign) and other markets. Says Prasad: "There may be a bit of duplication in the products that we sell but not much."

Three, betapharm is strong in areas like cardiovascular, central nervous system, gastro intestinal, etc. All these belong to the chronic care category, which means high levels of prescription over a long period of time.

Four, having been around for 13 years, and with a 250-strong sales force, betapharm has built strong relationships and brand equity, a key element to success in Germany. The German market is similar to the Indian one, where doctors, chemists, medical salesmen and insurance companies form a mutually-beneficial motley. That's unlike the US where sales are driven through large distributors and insurance companies.

Five, betapharm has a strong IP and regulatory infrastructure, which gives faster access to European markets. Expectedly, DRL plans to use its regulatory infrastructure for future filings in Germany and Europe.

Six, at 25 per cent growth, betapharm has been the fastest-growing generic company in Germany (among the top 10) for the last five years, so DRL doesn't have to worry about turning it around.

That, however, is only one part of the story. The other is about reviving a company that was down in the dumps after a couple of body blows. betapharm is a key element of DRL's strategy to climb back from the abyss, and battle on to realise its vision.

### The Long And Winding Road Back

One reason why pharma-watchers have doubts about the soundness of the betapharm deal is that DRL has just begun to recover from a couple of serious setbacks. It was a situation partly brought about by its focus on research for NCEs.

Anji Reddy's vision is to take DRL into the top 10 of global pharma. And that could be done by only one way: original molecule research. That goal was dealt a body blow when Ragagli-tazar, an insulin sensitiser molecule that DRL had out-licensed to Novo Nordisk in 1998, showed up adverse side effects in clinical trials. Subsequently, Novo abandoned research on the molecule in 2002, and returned another one, Balaglitazone (indicated for diabetes) in 2004, without putting it through trials.

That was the first setback. The second was in March 2004, when DRL lost its Para IV filing for specialty chemical (sort of a dry run before an NCE launch) amlodipine maleate (AmVaz), a variation of Pfizer's amlodipine besylate (Norvasc), in a higher court after a

## Back from the dumps



Figures are BSE closing prices in Rs  
Source: BSE

## Dr. Reddy's: Key financials

Head	2002-03	2003-04	2004-05
<b>REVENUES</b>	<b>1,665.02</b>	<b>1,742.37</b>	<b>1,629.04</b>
<b>OPERATING PROFIT</b>	<b>431.16</b>	<b>303.34</b>	<b>44.36</b>
<b>NET PROFIT</b>	<b>392.09</b>	<b>283.20</b>	<b>65.46</b>

All figures are Indian GAAP standalone numbers in Rs crore  
Source: Company

## 'betapharm was perfect'

G.V. Prasad, executive vice-chairman and managing director, Dr. Reddy's, spoke to *BW's* Gina S. Krishnan after the betapharm deal was concluded. Excerpts:

- *How important was an acquisition in Germany?*  
 ■ It was very significant. We do not have any formulations in Germany, though we do supply some APIs. Germany is the second largest generic market in the world and we had been looking at it for more than two years. We felt betapharm was perfect.
- *What will the integration with betapharm mean?*  
 ■ Since we do not have any presence in Germany today, betapharm will be a bolt-on acquisition and will not need extensive integration. betapharm is well set for the near term in terms of pipeline and we do not believe any rationalisation is necessary.
- *Is the goal of Dr Reddy's \$1 billion by 2008?*  
 ■ Our long term vision is to become a discovery-led global pharmaceutical company and in the medium term, we want to build a global generics (both branded and unbranded) business. It is our estimate that we will get to the \$1-billion mark by 2008.
- *What next after betapharm?*  
 ■ We have three priorities:  
 1. We will need to scale up our US generics business. We also need to build critical mass in the UK. Beyond this we are focused on geographic expansion into other countries in Europe, Turkey, Mexico and Canada. Scale and reach is important to the global generics business.  
 2. We are exploring ways to accelerate the launch of our dermatology business in the US through various initiatives. Right now, the internal pipeline is probably at least two years away and we are exploring other options to expedite the launch of this business.  
 3. The third priority is to develop ways to accelerate the launch of NCEs through our own sales organisations as well as through licensing arrangements.

Photograph: SANJIT KUNDU



lower court had ruled in its favour. A favourable ruling would have brought in an estimated \$200 million in sales for DRL, but that was not to be.

One of the most strongly-contested pharma litigations in the US, Pfizer's victory served as a wake-up call for Big Pharma and signalled the beginning of their aggressive fightback against generic companies.

The twin shocks put DRL on the mat. Sales plummeted, so did profits. Its net profit crashed from Rs 340 crore in 2003 to Rs 247.4 crore in 2004.

Of the two setbacks, the failure of Raglitazar probably hit DRL harder, and analysts went for the jugular on its discovery foray. They said it was foolhardy for a global minnow like DRL to attempt drug discovery, and they should stick to safer areas like generic marketing and API (active pharmaceutical ingredient) manufacturing instead.

But the company did not flinch. *BW* did a cover story on DRL in August 2004 (see 'Against All Sceptics', *BW*, 16 August 2004), and even then Anji Reddy had reiterated his commitment to research. His logic was simple: "If you see the statistics, the No. 1 generic company is the 26th in the world pecking order. So, do you want to remain 26th in the world even after 100 years? There is no way you will become the 10th pharma company in the world without drug discovery."

Similar sentiments were expressed by Prasad and Satish Reddy. The way to go forward, then, was to mitigate the risks of drug discovery in some way.

In 2004, DRL bought Trigenesis, a US-based specialty player, for \$11 million. This gave it access to some niche dermatology products. In November 2005, it bought Roche's API plant in New Mexico for \$59 million. Roche's plant has multi year contracts in manufacture and sale of APIs including intermediates to Roche and other innovator companies that run through 2009.

Then, in March 2005, DRL signed a landmark deal with ICICI Venture to raise \$56 million for the launch of generic drugs in the US. ICICI Venture will give \$22.5 million in the first phase and a possible (additional) \$33.5 million in the second. ICICI Venture will fund the development, registration and legal costs, and DRL will pay it royalty on net sales for a period of five years.

## How betapharm materialised



THE euro 480-million (\$570-million) deal was done based on two balance sheets. Fifty per cent was lent against the betapharm balance sheet, and the remaining 50 per cent was lent against Dr Reddy's. In all, Citibank came forward and lent Dr Reddy's euro 400 million, and the remaining euro 80 million came in from Dr Reddy's internal accruals. Though Dr Reddy's has taken shareholder's approval to raise capital from the markets, it does not have any immediate plans of doing so. Says V.S. Vasudevan, president and CFO: "There is no question of putting Dr. Reddy's balance sheet under any pressure since there are many different financial structures available and we will use them." Significantly, Dr. Reddy's does not rule out further acquisitions.

Then came the biggest windfall, funding for drug research. ICICI Venture, Citigroup Venture and DRL formed an integrated drug development company, Perlecan Pharma, with equity capital commitment of \$52.5 million. The VCs were to cough up \$22.5 million each, with the remaining \$7.5 million coming from DRL, which has already transferred four NCE assets to the company in the area of cardiovascular and metabolic diseases. This meant that the risk of discovery of these four NCEs was spread across the three partners. Also, DRL's main balance sheet would not entirely have to bear the vagaries of an innovation-led strategy, one of the main reasons why DRL's stock was battered.

To de-risk drug discovery further, DRL is getting into collaborative research. It tied up with UK-based Argenta Discovery for development and commercialisation of a novel approach to the treatment of chronic obstructive pulmonary disease (COPD). Both companies have agreed to fund the joint collaboration up to proof-of-concept.

Another such example is Balaglitzone (the one that was returned by Novo Nordisk without putting through trials), with Denmark-based Rheoscience. The molecule will be completing carcinogenic studies and may enter phase III clinical trials as early as September.

As if on cue, the results and the stockmarkets are back to being positive.

In the third quarter of 2005-06, DRL posted net adjusted profits at Rs 62.8 crore compared to Rs 4 crore in Q3 last year. Its stock too has moved North substantially (see "Back From The Dumps").

Things are looking up on other fronts as well. Recent product launches like glimepride, citalopram and ciprofloxacin are doing well; Merck selected DRL as its authorised generic for Proscar (finestride) and Zocor (simvastatin); and it has 45 ANDA filings lined up, with 29 expected to be first-to-file Para IV.

So, has betapharm changed the DNA of the company from a discovery-led one to a generic-led one? Not quite. DRL's core focus is still research, and it has smartly built a defence mechanism to minimise losses. Even during the bad days, the company put in 14 per cent of its revenues into R&D.

For DRL to make it to the top 10 in global pharma, scale is key. Says Prasad: "Scale is important to leverage the infrastructure and capabilities we have created." That can be achieved through acquisitions of generic companies such as betapharm. CFO Vasudevan indicates that more acquisitions are in the offing.

If successful, betapharm and other generic acquisitions that may happen have the potential to oil the wheels of DRL's original strategy: use revenues from generics to fuel drug discovery.

But if betapharm fails, it could be another long haul. ■