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Striding Ahead

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STRIDING AHEAD

Strides Arcolab's bet on specialities has worked. Can it maintain its advantage?

by Venkatesha Babu

A DIFFERENT PATH: Arun Kumar, managing director and vice-chairman of Strides Arcolabs, is reaping the fruits of focusing on specialities

IN December 2010, Bangalore-based mid-size pharmaceutical firm Strides Arcolabs (SAL) increased its stake in Ascent Pharmaceuticals, its subsidiary with generic pharmaceutical operations in Australia and South-east Asia, from 58 per cent to 94 per cent. It paid a 51 per cent premium (A$0.40 per share) over the then prevalent market price.

To an external observer this may have looked like another parent company exercising greater control over a subsidiary. But market watchers and analysts were left flummoxed by the premium paid, which effectively valued Ascent at A$100 million. A year later, SAL sold Ascent to Watson Pharma for an enterprise value of A$393 million (about Rs 1,980 crore). This "flipping" quadrupled Ascent's value in just one year and helped Strides make a killing. It used Rs 1,860 crore to lower its debt-equity ratio from a high of 3.01 in 2008 to just 0.67 in 2011.

The result: markets sat up and took note. In the past six months, the SAL scrip has shot up 62.5 per cent whereas the Sensex has essentially remained flat with a return of 4.5 per cent.

For Arun Kumar, managing director and vice-chairman of SAL, it is vindication of the strategy he adopted about four years ago — to focus on the specialities business and growth led by intellectual property (IP) when everyone else was riding the generics export bandwagon.

But can he maintain and build on the lead?

Missing The Generics Boom

Indian pharmaceutical players' ability to innovate and engineer generic drugs and active pharmaceutical ingredients (APIs) cost-effec-

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HIGH QUALITY: There has been a significant ramp-up in SAL's FDA-approved manufacturing facilities

tively has made them global competitors. A number of Indian companies such as Cipla, Dr. Reddy's Laboratories, Ranbaxy and Lupin have built businesses by reverse engineering off-patent drugs, manufacturing them to high standards and supplying them cheap to global markets. Some of these became so large and attractive that several multinational pharmaceutical companies looking to bolster their generic product pipeline bought them out.

SAL, founded by Kumar in 1990, was an early starter but missed out on the generics-led export boom. By 2005, it seemed to lack a vision and strategy. Its merger with Matrix Labs did not fructify due to many reasons, notably who would have the final say in the new entity. "Yes, we did miss out on the generics boom," admits Kumar.

In 2007, the company lost Rs 51 crore on a revenue of Rs 865 crore. With promoters' shareholding falling to 11 per cent, it was being written off. That is when SAL, which had a small specialities business ('steriles' in industry parlance) in injectable drugs, decided to differentiate itself. But making a splash in the specialities business requires big investment, and the technology, regulatory, manufacturing and distribution barriers are high. The legacy businesses of pharma and branded generics are needed to fund the scaling up of the specialities business.

Cutting The ATM Cord

In SAL's case, its pharma and branded formulations business was mainly dependant on anti-retrovirals, tuberculosis and malaria drugs — the ATM category. Strides, like other players, supplied ATM drugs for programmes funded by international donor agencies. While business was steady, margins were slim.

To focus more on specialties, SAL spun this business into a subsidiary, Agila. For funding, it got into joint ventures or global partnerships to supply generic products. It tied up with the likes of Pfizer, GSK, Sandoz, Teva, Novartis, Aspen, Sagent and Martindale, where the marketing and distribution would be taken care of by the partner while SAL looked after the backend.

The fact that it had one of the largest manufacturing facilities in the world for soft gelatin capsules also helped, along with it being a leading supplier of ATM drugs to regulated markets. This meant it had stable revenue streams to fund the specialties business.

From a high of about 25 per cent, ATMs today form less than 10 per cent of SAL's revenues. But Kumar says the pharma and branded generics business will continue to be key contributors. "We have long-term customer contracts, which provide a stable revenue stream. We have many product filings completed and this business can grow with limited capex requirements."

Reliance Securities, in its research note of February 2012, says the pharmaceutical segment, which formed 60 per cent of SAL's revenues and 46 per cent of its pretax profits, would continue to grow even after Ascent's sale.

Venkat Iyer, CEO of Agila, says the company has several strengths, including eight manufacturing units. "We have one of the largest

INJECTING GROWTH

Strides' revenues have grown over 24 per cent in five years

Figures in Rs crore
Source: Company

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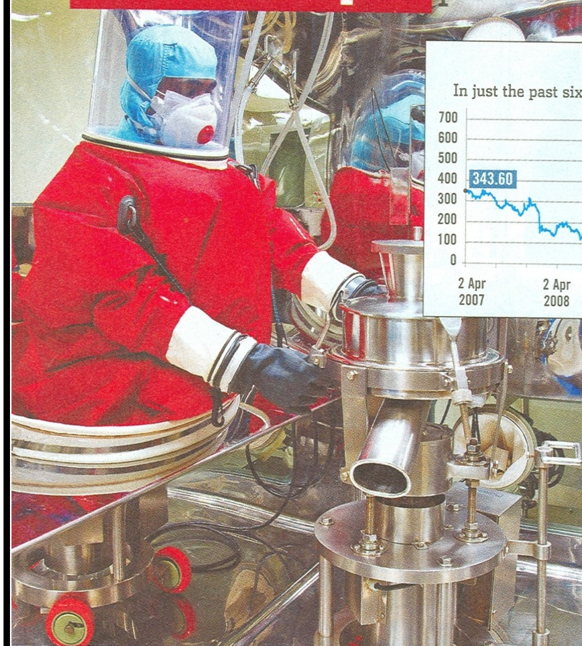

THE BACK-UP PLAN: Branded generics fund the scaling up of the specialities business

Source:BSE

lyophilisation (freeze drying) capacities in the world. We are a full-service player with a diversified portfolio and we have long-term joint ventures with leading players."

Playing To Its Strengths

Strides has also been quick to capitalise on drug shortages in the US as some of the largest players there have either had compliance issues with USFDA, or have discontinued or suspended production. Besides, the injectables business involves process complexity and a relatively long manufacturing lead time. There are only a limited number of players in this segment. "Over 82 per cent of the shortage is in injectables (in the US), which is our core strength. This provides us pricing flexibility," says Iyer.

Apart from oncology, it intends to focus on ophthalmic therapeutic drugs. Brokerage house Motilal Oswal, in a February 2012 report, said it expects the specialties business to contribute 75 per cent of Strides' revenue by 2013, up from just 28 per cent in 2009. While SAL attributes serendipity as well as strategy for helping it attain its position in the injectables market, it is not taking its foot off the accelerator: it is betting big on an IP-led growth to retain its edge.

A few years ago, most large Indian pharmaceutical firms were spinning off their R&D units into separate subsidiaries. But the 350 scientists at Strides are key to its future, avers Kumar. On an average, the company has been filing about 40 ANDAs a year (an abbreviated new drug application is an application for US approval of an existing licensed medication). "(It is) much higher than some of our larger peers," claims Kumar. "We will not get into basic research or say we will launch a new molecule... We want to focus on delivering value to the stakeholders."

That the strategy has worked is borne out by the tenfold growth in licensing income in the past five years — from Rs 50.5 crore to Rs 527.7 crore. The company is also foraying into biosimilars. It made a small move by acquiring biotech firm Inbiopro. With \$59 billion worth of biologics set to lose patent protection by 2015, the company wants to have an active play in this segment. "Biologics will grow at a CAGR of 8-10 per cent over the next five years against the 4-6 per cent for the total pharmaceuticals market. We want to be early movers to take advantage of this growth," reasons Kumar.

His optimism is tempered by the vice-president of a leading biotech company, who says: "There were a number of circumstances, including shortage of injectables, in the crucial US market that helped Strides. But once capacities ramp up as they inevitably will, and competition gets its act together, it remains to be seen whether they will have the same degree of pricing flexibility and profits as at present."

But Kumar is confident. "With high ANDA filings, a significant ramp-up in FDA-approved manufacturing facilities, foray into new areas, global partnerships and a strong balance sheet, we are poised to move into the next phase." It seems the company is taking giant strides.

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GIANT STRIDES

Arcolab's licensing income has grown more than 19 times in the past six years

Figures in Rs crore
Source: Company

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