

## ***Hiving off pharma R&D units - the key to lower risk and better valuation?***

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As the industry becomes more and more competitive, Indian pharmaceutical companies are aggressively planning strategies to de-risk their business and are resorting to hiving off their R&D units. This is meant to reduce risk in the core generics business and to focus on improved and innovative investment in R&D, serving the dual purpose of achieving faster growth in the new chemical entity (NCE) business and value addition in the core generics business.

Dr. Reddy's Labs and Sun Pharma were the pioneers of this trend in the Indian market. Nicholas Piramal, Wockhardt and Ranbaxy are also planning similar moves in an attempt to reduce the risk in the parent company. The R&D firms can then focus on basic research and raise funds through PE funds, VCs or by way of an independent listing. This way, the interests of shareholders who may be risk-averse are protected, while options are provided to those with a larger risk appetite.

The fact that India has still not launched its first NCE has led many industry experts to be skeptical of the trend of hiving off R&D units. Some like Glenmark Pharma have hived off the generics business instead, and retained the R&D business, expecting better valuations for a generics business.

There are no clear-cut solutions, but Poonam Bhana, analyst at ValueNotes believes that hiving off R&D units is a judicious decision. It gives shareholders of the existing company an option to exit the risky R&D business while unlocking value of the R&D pipeline in the new company and also attracting investors that are prepared for a long wait before revenues flow in.

To minimize risk in the R&D companies, most firms are opting for collaborative R&D, for instance, Ranbaxy with GSK, Nicholas Piramal with Eli Lilly and Glenmark with Merck. Revenues in collaborative R&D business may flow in the form of royalty and/or milestone payments.

ValueNotes has published a report on Pharmaceutical Outsourcing in Drug Discovery and Development in April 2007. Subsequent updates have focused on key trends in the space such as partnerships and alliances, increasing role of bioinformatics in R&D, integrated offerings of vendors.

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