



*cutting through complexity*

# Healthcare & life sciences in China – Towards growing collaboration

KPMG Healthcare and Life Sciences

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# Introduction

Healthcare and life sciences industry is a broad one and involves a wide range of disciplines. In this report, we mainly focus on three sub-sectors in China — pharmaceuticals, medical devices and drug distribution. Developments in these three segments have the potential to impact global trends and enhance the quality of life of China's citizens.

Healthcare and life sciences in China is in the midst of hyper growth. The industry has transformed itself from a loose grouping of inward looking domestic companies into an aggressive player with a global impact. Fueled by the government's ambitious healthcare targets and policy backing, domestic and multinational companies are enthusiastically positioning themselves as vital links in the global life science supply chain.

As the pace and volume of activity picks up, enterprises are behaving in a more mature and far-sighted manner. Healthcare & life sciences sub sectors are characterised by rapidly expanding sales in pharmaceuticals and medical devices and an evolving distribution system eager to reach remote markets and achieve economies of scale.

More exciting developments are happening at the back end — research and development is undergoing systemic change due to greater collaboration between foreign and domestic entities, investors are making smarter choices and, most significantly, mergers and acquisitions, which were dipping, are set to enter a new period of growth.

Industry players — both Chinese enterprises and multinational companies (MNCs") — are changing their business models to suit their long-term targets. Until recently, companies operated within their specific areas of strength, avoiding any overlapping of market segments. While Chinese entities focused on the mass market, providing basic products for people with low purchasing power, foreign multinationals aimed for the high-value segment serving the wealthier urban centres.

Now, healthcare and life sciences in China is poised for a significant paradigm shift, with foreign and domestic companies eyeing each other's territories. In future, it is possible that both will compete in similar markets, but, despite intensified competition, there will also be a greater degree of collaboration and consolidation.

Foreign enterprises are determined to harness the vast potential of smaller cities, towns and grassroots markets and to penetrate the lower-end segment. To jumpstart this process, they need to collaborate with local companies who have strong market penetration and formidable regional networks.

Chinese enterprises, on the other hand, are keen to expand their portfolio of low-cost goods and move towards products that bring them higher margins. Financing for these next generation launches is relatively easy to acquire. Backed by funding from previous operational profits, the capital market, private equity houses and venture capital, companies are now able to spend more on R&D to launch more lucrative products. Smarter Chinese firms are also forging partnerships with foreign companies, looking for domestic joint ventures and going overseas in search of technical upgrades.

This document is intended to provide a pathway to changes that are already occurring and will likely affect the healthcare and life sciences industry in China in the coming years. As the industry is maturing and offering a more level playing ground, we anticipate an increasing number of the healthcare and life sciences firms in China working to achieve faster and smarter, embracing exciting opportunities and challenges.



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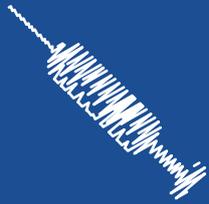
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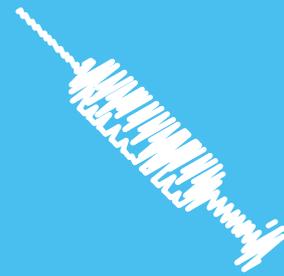


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# Healthcare & life sciences: Changing landscape



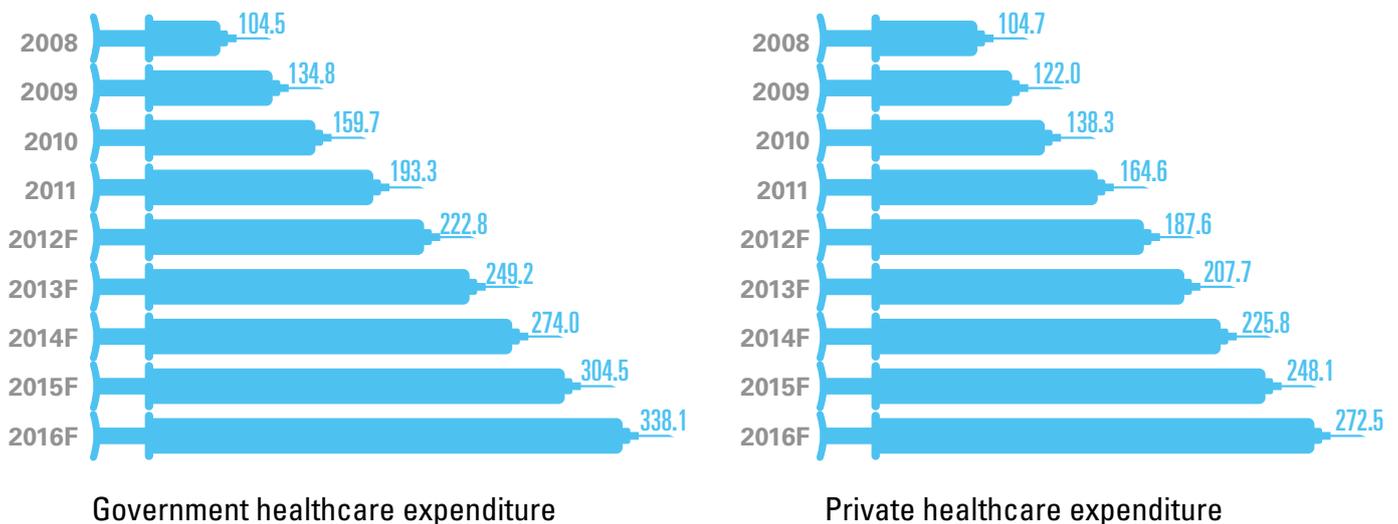
# 1. Boom in healthcare and life sciences

China is set to become a crucial player in the healthcare and life sciences industry and, within a decade, is expected to be a global leader in drug discovery and innovation. According to the Ministry of Health, the country will generate healthcare opportunities worth over USD 500bn by 2014-2015. Along with the rest of the economy, China's healthcare & life sciences market has grown dramatically, now accounting for 5.6 percent of the global market.<sup>1</sup>

Healthcare spending — including pharmaceuticals, medical devices, distribution, hospital, pharmacies and insurance — currently accounts for less than six percent of GDP, but the figure is expected to increase to almost 10 percent within 4 years. This remains low compared to nearly 18 percent in the United States and nearly 12 percent in Western Europe, but provides ample scope for high rates of growth in the future.<sup>2</sup>

“Looking forward, we assume there will be 18 to 20 percent annual growth in Chinese drug spending through 2015,” said Norbert Meyring, head of KPMG Life Science in China and Asia Pacific, “healthcare & life sciences sector in China will maintain a scorching pace due to demand generated by robust economic growth and a rising middle class.” Other reasons, including government support, urbanisation pressures and changing lifestyles, as well as an ageing population and increasing awareness of the need for quality healthcare, are also key drivers of the industry boom.

**Government/Private Healthcare Expenditure (US\$ bn)**



Source: BMI Report, December 2012; China Life science 2012: From Local to Global; EIU; Press Articles

<sup>1</sup> China Life Sciences Industry 2012, Adroit People

<sup>2</sup> America's stunningly overpriced healthcare system, 2nd Dec 2012, Business Insider



## Reasons for the healthcare & life sciences boom

### High growth and vast middle class

- GDP is forecasted to grow at around 8 percent in 2013; projected to be world's largest by 2016.<sup>3</sup>
- Middle class to reach 700mn by 2020, indicating high potential for upgraded healthcare demand.<sup>4</sup>

### Government support for universal healthcare

- The primary mega force driving healthcare & life sciences is the government's determination to provide quality healthcare for all citizens, which led to the sweeping health reforms of 2009.
- The 12th Five Year Plan is another important booster, triggering increased opportunities and investment for all healthcare & life sciences players. This has led to a new era of consolidation and M&A as a means of coping with complex healthcare demands.

### Urbanisation pressures and changing lifestyles

- China's urban population will hit the 1bn mark by 2030. By 2025, China will have more than 220 cities with 1mn-plus inhabitants.

- The creation of mega-cities with populations in excess of 20mn is leading to enormous healthcare challenges. The prevention of disease is crucial in such high-density environments, and there is a growing need to tackle ailments arising out of sedentary lifestyles and changing diets.

### Aging population and increasing awareness of healthcare

- China's ageing population is a significant factor. At least 185mn people are now over the age of 60 (13.7 percent of the population). A substantial increase in spending on pensions and social security will result in a relatively wealthy segment of elderly consumers.
- In urban centers, there is a growing awareness of healthcare needs. Strong economic growth will finance such awareness, by triggering a rise in per capita health expenditure. This is currently very low in China at USD 186, compared with USD 8,000 in the United States and USD 870 in Brazil.<sup>5</sup>

<sup>3</sup> China 2013 GDP growth forecast at 8.4 percent, 28th Jan 2013, CCTV

<sup>4</sup> Snapshot: China Life Sciences Industry, Woodward Partners, 2012

<sup>5</sup> Health spending per capita update, 2012, The World Bank ;

# Landmark Policies Enabling the Healthcare and Life sciences Boom

## 12th Five Year Plan (FYP) (2011-2015):

Blueprint providing clear strategies for healthcare allocation and build-up of healthcare infrastructure.

### Pharmaceutical manufacturing

- Develop five or more large pharmaceutical manufacturers with annual sales above RMB 50bn, and 100 or more with annual sales above RMB 10bn
- Ensure that the annual sales of the top 100 pharmaceutical manufacturers represent 50 percent or more of the total annual sales of all pharmaceutical manufacturers
- Encourage leading companies to conduct mergers and acquisitions via vertical integration and horizontal consolidation so as to optimise the value chain, reallocate resources and improve efficiency
- Encourage leading companies to go abroad, i.e. to build manufacturing sites and R&D centres. Increase the number of such companies to 50
- Emphasise the development of specific types of medicine, such as biological medicines, innovative chemical medicines, modern variants of traditional Chinese medicine (TCM), etc., as well as medicines for specific diseases i.e. cancer, cardiovascular disorders and diabetes

### Pharmaceutical distribution

- Develop one to three large national pharmaceutical distribution groups with annual sales above RMB 100bn, and 20 regional pharmaceutical distributors with annual sales above CNY10bn
- Ensure that the annual sales of the top 100 pharmaceutical wholesalers represent 85 percent or more of the total annual sales of all pharmaceutical wholesalers, and that the annual sales of the top 100 pharmaceutical retailers represent 60 percent or more of the total annual sales of all pharmaceutical retailers
- Increase the proportion of pharmacy chains in the total retail pharmacy stores to two thirds or more and build a stronger pharmaceutical distribution network at county level and below
- Enhance the comprehensive strength of key enterprises to the level of leading international rivals and encourage pharmaceutical distributors to grow bigger and stronger via acquisitions, mergers, trusteeships, equity participation/control, economies of scale, process intensification, and globalisation of their businesses

## Medical devices

- Develop 8–10 large medical device groups with annual sales above CNY 5bn
- Strongly support 10–15 medical device groups, assist 40–50 innovative high-tech corporations, and set up 8–10 manufacturing bases, as well as 10 country-level demonstration bases, for innovative medical devices
- Emphasise research and development of products suitable for grassroots markets and substitute imported mid-to-high-end products with locally made ones

## Implementation Plan of Deepening the Healthcare Reform (2009-2011):

The goal of the Plan is to provide safe, effective and affordable health services to all urban and rural residents by 2020. CNY 850bn was earmarked in 2009 for the first phase of a three-year health service upgrade. The Plan focuses on five broad areas:

- Comprehensive medical insurance coverage for the entire population: Over 90 percent of the population is covered by one of the three main medical insurance programmes, which handle urban employees, urban non-working residents and the rural population. Medical subsidies to the covered population have risen to CNY 200 per capita. This broader coverage enables vast numbers of people to afford drugs and is opening up the grassroots market
- Improvement of pharmaceutical supply system: This covers the entire supply system for pharmaceutical products — from production, circulation and procurement through to dispatching. The most important aspects are the Essential Drug List (EDL) and the National Reimbursement Drug Lists (NRDLs).
- From an initial list of 300 plus generic drugs, the size of the EDL, under which the prices of drugs are controlled, has grown since it was first introduced in 2009. A revised and expanded edition of NEDL was issued in March 2013. This list includes 520 kinds of drugs, of which 317 are chemical and biopharmaceutical and the rest are Chinese patented drugs. Some exclusive TCMs have also been included. Nearly 200 of the 520 listed medicines are meant for children, including vaccines listed in the national immunization scheme. The list includes more drugs for cardiovascular and chronic diseases, as well as anti-cancer medication. The National Development and Reform Commissions (“NDRC”) will issue the ceiling price of the drugs later on.

- The effect of these lists on pharmaceutical companies is profound. Inclusion can bring access to vast markets, but may also force companies to operate on wafer-thin margins.
- Strengthening and equalisation of the public healthcare service: These government programmes cover disease prevention and control for the entire population. More new public healthcare resources will be granted to Mid and West China. The focus of such programs on making prevention a priority will ensure a vast market for vaccines.
- Improvement of grassroots healthcare services: This includes strengthening the infrastructures and networks of grassroots hospitals and clinics. Three-hundred plus county-level hospitals, 1,000 plus town-level health centers and 13,000 plus village-level clinics will be set up. Due to the reforms, the grassroots market will become an intensely competitive area. Penetration into this market is expected to lead to more opportunities.
- Reform of public healthcare infrastructure and hospital system, and modernisation of hospital standards, processes and practices: Medical institutions will undergo substantial changes as a result of this reform. There will be a vast increase in demand for medical devices, software systems and IT in healthcare. A greater number of social funds will be encouraged to invest in hospitals and other medical institutions in order to enhance efficiency.



**Characteristics & trends of the healthcare and life sciences market**

China’s healthcare and life sciences industry, be it pharmaceuticals, medical devices or distribution, is characterised by a highly fragmented structure. The top players in each subsector occupy only a small share of the pie, indicating that the market is still in the early stages of development. There is also a high degree of regional differentiation and segregation, with very minor players operating in their own small markets. Also, large parts of this layered market continue to be flooded with low priced, low quality products.

The market, however, is undergoing major changes and becoming more mature. Two reasons are driving these changes — first, a new regulatory system is forcing companies to focus on quality and safety; second, companies themselves are becoming more sophisticated and gearing up to meet the stringent regulatory requirements. Together, the two forces are driving a fundamental maturing of the life science industry.

Regulation, which undoubtedly is the most crucial force, is getting more streamlined and targeted at ensuring quality, affordability and accessibility. A new GMP (Good Manufacturing Practice) rule is now in force to improve overall manufacturing conditions and ensure better product quality. Price ceilings on essential drugs, together with restrictions

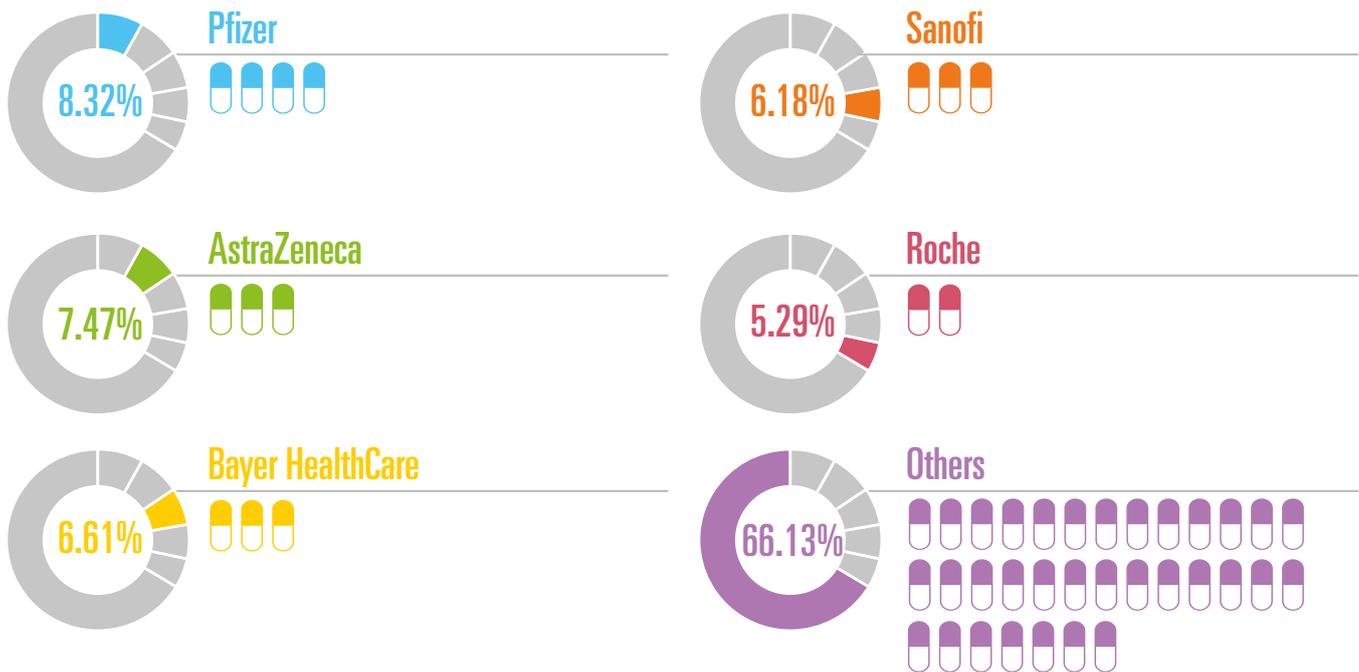
on markup of drug prices during the distribution phase, are intended to curb unnecessarily high retail prices, making products more affordable.

Other measures, such as crackdowns on fake products and restraints on excessive advertising of OTC drugs, are designed to ensure a positive business environment and a more level playing field for all companies, as well as better compliance.

On another level, players themselves are becoming more sophisticated, both actively and passively, as they learn valuable lessons from the intense competition and the demands of the market. Previous price wars between domestic companies have bottomed out and the focus is now on better quality products and more efficient manufacturing processes that can ensure higher margins.

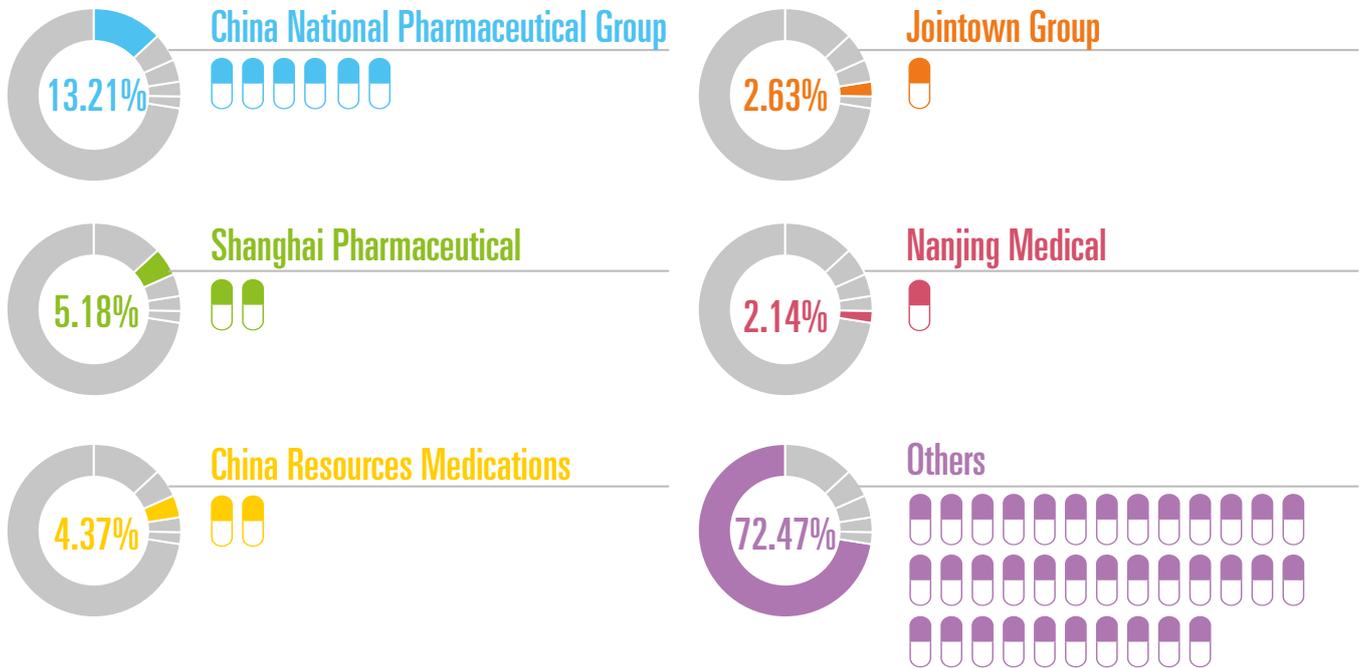
The excessive returns traditionally enjoyed by multinationals from patented drugs are now being curbed, pushing these companies to explore a broader market. Expansion aimed at realising economies of scale is being seriously pursued at all levels. Redundant layers of distribution and uncompetitive market players will be phased out during this drive towards maturity. There will be more focus on research, especially from Chinese companies, and increasing collaboration between the industry and academia.

**Top 5 multinational MNCs in China in Q1 2011**



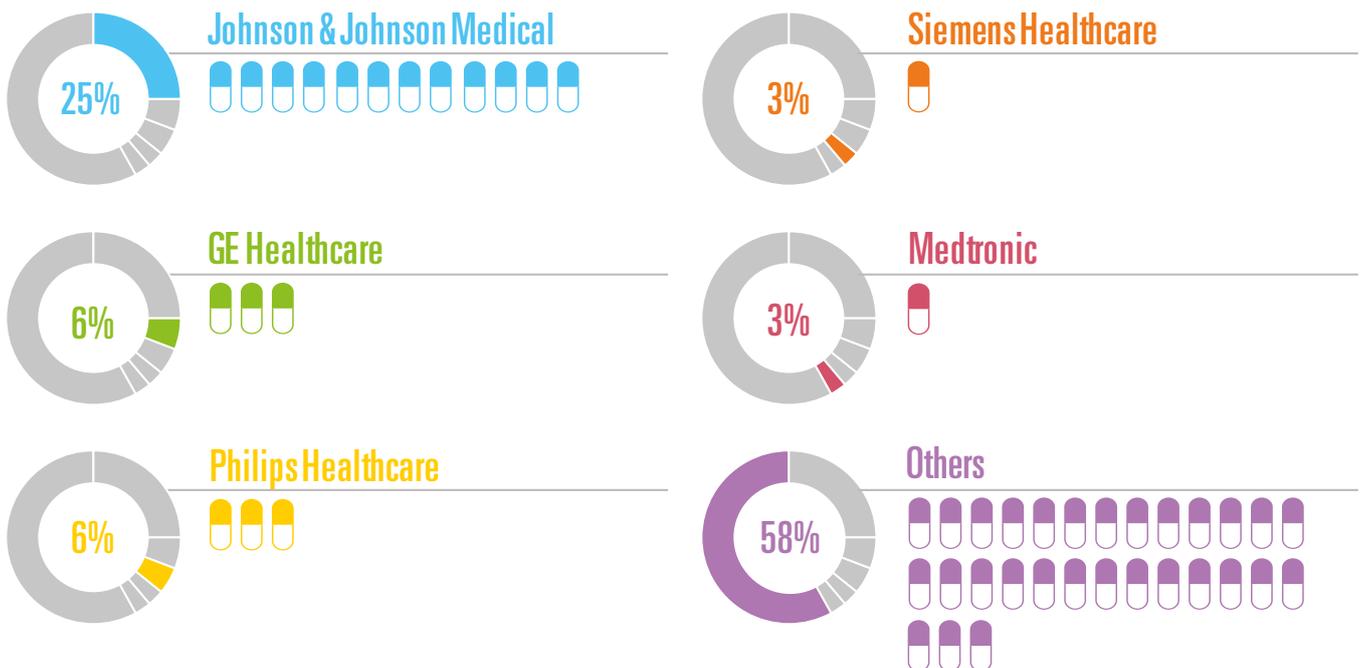
Source: China’s pharmaceutical industry – Poised for the giant leap. KPMG, May 2011

Top-10 Pharma Distributors in China for 2011



Source: JP Morgan broker report dated December 03, 2012

International companies with prominent market share in China



Source: Medical Devices in China, New Zealand Trade and Tourism, July 2012

Broadly, three major trends can be seen developing in this market. First, the legacy of overproduction of cheap, basic products is now giving way to a new hunger for quality. Companies are strengthening their efforts to guarantee a quality product in order to meet the upgraded demands of a prosperous middle class. Many are planning higher-than-ever expenditures on R&D, while others may take shortcuts through the acquisition of pipelines or by making in-license arrangements overseas. Lower margins and a shrinking market for cheap products are driving agile local companies to shift to higher-priced, branded products.

The second characteristic revolves around the new marketing strategies adopted by many players. Companies eager to share a larger slice of the high-growth grassroots market are accelerating their footprint in lower-tier cities and rural areas. Expansion into these regions not only requires a strong and experienced sales force, but also tailor-made products able to meet the unique health challenges of people in diverse Chinese provinces. Both foreign and local companies are working on strengthening their long-term presence in these broader regions through smart sales strategies and niche products, enabling more suburban and rural people to easily access affordable products.

The third visible trend is cost control at all levels, from manufacturing to marketing, with companies taking serious action to slash unnecessary expenses. Manufacturing is becoming more rational and the aggressive capacity expansion seen in the past is no longer considered desirable. Companies are selecting their manufacturing sites more carefully and foreign enterprises are executing capacity plans with localisation in mind. Marketing activities are also more targeted. Tie-ups throughout the chain — whether involving vertical/horizontal acquisitions or collaborations — are part of a nation-wide effort to squeeze out unnecessary spending and maintain previous profit levels.

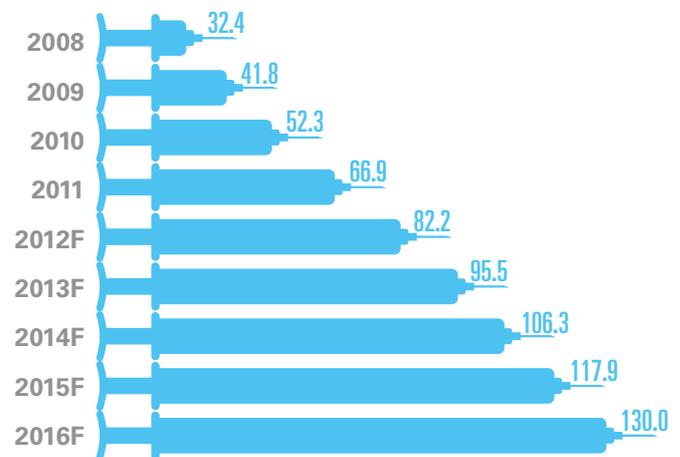
In this swiftly changing era, the majority of healthcare and life sciences companies will be forced into a struggle for survival. However, looking ahead, the overall outlook is positive, offering survivors a chance for healthy competition and a platform for collaboration. Increasing interaction and tie-ups will ensure optimisation for companies, with better delivery of products and services. Most importantly, Chinese consumers will be the main beneficiaries of this optimisation process — which is in fact the long-term goal of healthcare and life sciences.

Within the healthcare and life sciences industry, we will focus on three subsectors that are growing and developing at a sensational pace — pharmaceuticals, medical devices and pharmaceutical distribution.

### Pharmaceuticals: Staying ahead of the curve

China is already the third largest pharmaceutical market and is comparable to Japan in terms of absolute drug market size, but the country still lags behind when it comes to per capita healthcare spending and the maturity of its healthcare system. Between 2008 and 2012, China's pharmaceuticals market achieved an average annual growth rate of 26.2 percent. Contrast that with global pharmaceutical growth, which only saw annual rates of 4 to 6 percent during the same period.<sup>6</sup> According to the same report, the pharmaceutical market will expand more slowly over the next 4 years, but will still hit an average annual growth rate of 11 percent.

#### Pharmaceutical Industry in China (by sales in US\$ bn)



Source: BMI Report, December 2012

The future performance of the sector may well be characterised by sustained high revenue growth, but at lower profit margins due to cost containment policies. Competition will become more intense as a result of dealing with these challenges, with companies formulating a basket of strategies. These will include expanding the application of current drugs, accelerating R&D on new drugs and attempting to add new pipelines through M&A, along with rationalisation of capacity building.

**Gains from the patent cliff:** In 2012, major companies lost exclusive rights to manybn-dollar-selling drugs. More than 40 brand-name drugs — collectively worth USD 35bn in total annual sales — lost their patent protection. Generic companies received permission to make their own lower-priced versions of well-known drugs like Plavix, Lexapro and Seroquel and to claim a share of the profits that had previously belonged exclusively to Big Pharma.

Global and Chinese companies have reacted differently to the patent cliff, formulating various long-term solutions to deal with the problem. Top multinationals, faced with the loss of patents in 2012, have redefined themselves, whether by specialising in hard-to-make drugs, R&D and patenting of new drugs or through making large acquisitions.

<sup>6</sup> Source: BMI report, Dec 2012

Simultaneously, they are working to expand the application of drugs whose patents are about to expire — or have already expired — and are distributing them in emerging markets, especially those with large grassroots markets such as China, in order to prevent swift declines in revenues.

Interestingly, local companies have been unwitting beneficiaries of this patent cliff. Riding on this tide, many domestic makers are contemplating either licensing-in the drugs or manufacturing generics. They are expecting to do this by leveraging their cost advantage, and by exploiting deeper and wider distribution channels.

Reaction to the patent cliff from both parties has created potential opportunities for collaboration. The most recent headline-grabbing example is the joint venture between Pfizer and Zhengjiang Hisun. By collaborating with a strong local partner, multinationals are able to achieve better coverage and penetration than in the past, while still mainly focusing on growing their proprietary products. Domestic companies, meanwhile, are able to gain access to valuable advanced products and management expertise.

**Price controls make a deep impact:** China's complicated pricing mechanism will continue to dictate the future plans of all drug companies. The regime is likely to implement price controls for the next five years, at the minimum, in an effort to contain expenditure. Pharmaceutical companies thus have little option but to work around this complex landscape.

Early in 2013, the National Development and Reform Commission (NDRC) dealt another blow and announced that 20 categories, or more than 400 varieties, of drugs will have their maximum retail prices adjusted as of February 2013, with average price cuts of 15 percent. High-end drugs will see price cuts of 20 percent.<sup>4</sup> In the case of imported drugs, authorities will adopt new methods, including international price comparisons, to regulate cost.<sup>5</sup> The impact of price control is severe. Prices of mature products are under intense pressure and experience frequent reductions, even as manufacturing and marketing costs and other expenses are going up.

Two major approaches have been adopted to cut costs. One is economies of scale — by way of either horizontal or vertical consolidation. Sichuan Kelun is the forerunner in this regard, having already completed its antibiotics value chain. The other approach is to localise manufacturing. A good example is Denmark's Lundbeck. As the world's No. 1 in neurological pharmaceuticals, the company chose to set up its first Asian factory in Tianjin in 2012 after selling drugs in China for 16 years.

As an alternative, many companies are seeking to develop new products which are not subject to price controls. Innovative drugs and first generics are able to enjoy exclusive pricing rights, guaranteeing high profit margins. China's State Food & Drug Administration, or SFDA, and NDRC

recently drafted a new regulation stating that first generic drugs will be able to enjoy sole pricing rights, granting the pharmaceutical manufacturer a premium of up to 30 percent above the uniform price.

In a similar fashion to the patent cliff, price control will also lead to a surge in collaborations, with foreign companies endeavoring to cut costs with the help of their Chinese partners and local enterprises attempting to expand their portfolio to include higher-priced drugs.

**Quality comes first:** In 2012, several scandals regarding pharmaceutical quality clouded the industry and raised nationwide concerns. Toxic capsules and excessive lead content, for example, led to a severe crisis of trust towards market players and supervising authorities.

In response to these scandals, and with the aim of guiding the industry toward healthy development, the government imposed harsh penalties on the companies involved. Stricter regulations and requirements are being issued to supervise quality, such as New GMP norms and consistency between the patented drugs and their generics. Under these circumstances, companies are encouraged to improve compliance, and to shift from a cost-oriented to a quality-oriented approach.

Furthermore, innovative pharmaceuticals are being increasingly encouraged through favorable policies and market feedback. Although the transition period will be difficult — with higher expenditure on quality management and portfolio upgrades — the outcome will eventually be beneficial.

On the other hand, strict government regulation is forcing market players to upgrade manufacturing, distribution and service quality. Many drug companies are also trying to bring in consistency between generics and branded products by leveraging their R&D. This upgrading process will take time, but companies have begun to see the need for adopting self-compliance. They are waking up to the fact that improvements in quality will lead to more customers, stronger reputations and, in the long run, higher profit margins.

It is likely that the impact of the three parameters — patent cliff, price control and quality regulations — on the pharmaceutical sector will be long-lasting. The urgency to step up quality and reach much wider markets will encourage collaboration between Chinese companies and multinationals. Both players will take advantage of each other's strengths as they go through a process of both organic and inorganic growth. The trend in the pharmaceutical sector will broadly move from fragmentation to industry concentration, accelerated through a process of alliances, JVs and mergers. Of course, such far-reaching changes will take time to achieve.

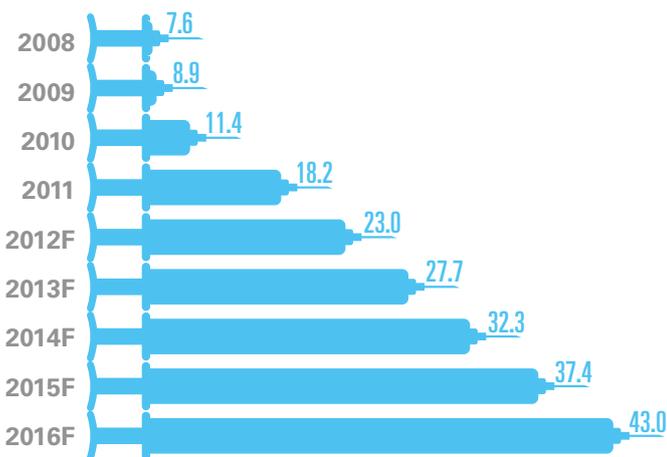
<sup>7</sup> China to lower drug prices by 15 percent in Feb, 8th Jan 2013, China Daily

<sup>8</sup> Price cut for 20 types of drugs, 8th Jan 2013, China Daily

### Medical devices: Foreign and domestic players eyeing on each others' territories

China's medical device market is the third largest in the world. It reached USD 18.2bn in 2011 and is expected to grow at 15.7 percent CAGR from 2012 to 2016 as health infrastructure continues to boom.<sup>9</sup> With this double-digit growth, China's medical device market is expected to become the world's second largest by 2015.

Medical devices in China (by sales in US\$ bn)



Source: BMI Report, December 2012

As such, the devices segment has been, and will remain, a high performer. Both foreign and domestic enterprises have aggressive expansion plans and are strategising heavily to reap market opportunities. Their focus, however, differs greatly.

Multinationals are the main players in the advanced equipment sector and foreign-made products dominate the high-end market. GE Healthcare, Siemens Healthcare and Philips Healthcare together account for a large proportion of China's high-end medical device market. As mega cities are saturated to an extent and offer limited growth potential, foreign manufacturers are turning their attention to second and third tier cities and even villages to address the needs of the lower-tier market, which requires more affordable products, in-depth channels and specialised sales forces. Two routes are open to companies hoping to achieve this — either an organic 'do-it-yourself' ("DIY") approach or inorganic growth through M&A.

GE Healthcare is a pioneer in the DIY model. The company is developing primary care products for smaller basic care providers. It is also reaching out to grassroots medical institutions, including village clinics, county or township hospitals, and community health clinics, by training medical personnel to use its advanced devices. GE is tailoring 70 percent of its new products in China to grassroots healthcare needs. The company plans to increase its sales in the rural market from less than 20 percent of the company's total to more than 50 percent in the next three to five years.<sup>10</sup>

Medtronic, on the other hand, is a good example of 'inorganic' growth. The company is following the 'inland strategy' and has purchased Kanghui Holdings, a China device company with well-established sales connections in smaller cities and rural areas.

Chinese medical device companies, which are mainly low-end product providers, are seeking to upgrade and offer better quality products for the large domestic and even overseas markets, for the purposes of securing higher profits. Moreover, the product portfolio is extending beyond its original limits. Leading Chinese companies are no longer satisfied with their long-established rule over the niche market for a single type of product. Instead they are hungry for more territories. These companies conduct R&D, collaborate with MNCs or purchase stakes to realise their ambitions by taking advantage of government backing or social funding.

A typical example of a development route for Chinese companies is Microport Scientific, which is a leading stent provider but also stretches its footprint to other areas. Established in 1998, the company started as a provider of PTCA balloon dilatation catheters. The company then offered stents, ranging from bare metals to more advanced drug eluting, and was able to make rapid progress in this niche market while receiving both funding and policy support from the government. Since 2003, the company's products have been sold worldwide, and its domestic market share has remained at over 30 percent.

Microport, however, continues to be hungry. In 2008, it acquired a diabetic medical device provider, Beijing Pangerui, indicating its readiness to expand into other areas. Since its listing on the Hong Kong stock exchange in 2010, Microport's pace of expansion has quickened, with the company completing three acquisitions shortly afterwards.

Now, with foreign and domestic players eyeing each other's territories, there will be fierce competition, pushing top players in the current niche market to look for a wider customer base. Obviously, those who can offer better quality and lower priced products will thrive. Diversification of product offerings, introduction of hi-tech devices and an ability to cover more ground in an extensive market ahead of industry peers, will be the keys to long-term success. The complex challenges of the market will force companies to once again consolidate and collaborate through various kinds of tie-ups and pacts.

### Pharmaceutical distribution: Sector consolidation and integration is the top priority

The pharmaceutical distribution sector has developed rapidly over the past 10 years, along with the overall healthcare and life sciences industry. According to the China Drug Distribution Industry Report, 2012-2015, total sales of pharmaceutical distribution are expected to reach CNY 1.42tn by 2015.<sup>11</sup> In 2011, sales of the segment totaled USD 150bn, attaining a year-on-year rise of 21 percent. In 2012, the figure grew 20 percent year-on-year to CNY 1.8bn.

<sup>9</sup> BMI report, Dec 2012

<sup>10</sup> US medical device makers turn attention to 2nd and 3rd Tier cities, 28th Oct 2012, China Biotech In Review

<sup>11</sup> China Drug Distribution Industry Report, 2012-2015, Sept 2012, Sino Market Insight

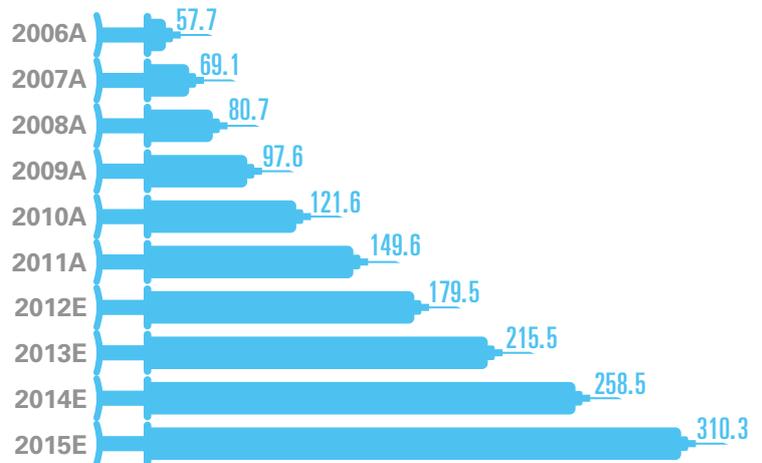
Despite its size, the sector remains fragmented, complex and inefficient. Fragmentation is a serious issue, rendering the distribution industry immature by international standards. The United States, with 40 percent of worldwide drug sales, has only 75 wholesalers, of which the top three have a market share of 85 percent. In contrast, China's top three players just about manage to cling on to a market share of around 23 percent, while there are more than 13,000 pharmaceutical distributors out in the field, most providing access to only a local market or even just one or two hospitals.

This complex and inefficient distribution system severely limits the growth of the pharmaceutical industry and results in unnecessary costs. China's prescription and OTC drugs, 95 percent of which flow through distributors, typically pass from a national distributor to multiple distributors in each province, city, and town before reaching hospitals or pharmacies.<sup>12</sup> Thus, distribution costs in China are much higher than those in developed countries as it often takes between two to six intermediaries to get products from the manufacturer to the dispenser.

Consolidation and integration are therefore inevitable. As mandated by the 12th Five-Year Plan, the sector is required to consolidate and establish one to three national distributors with sales over CNY 100bn and 20 regional distributors with sales over CNY 10bn. The government also wants to attract foreign investment in pharmaceutical distribution and retail and participate in the restructuring and acquisitions of distributors to further develop the industry.

The process has already started and is being led by large state-owned enterprises and big private Chinese companies. The current market leaders –Sinopharm, Shanghai Pharma, Jointown and China Resources - have grown rapidly since 2009 by consolidating smaller regional players and staking claims in new markets.

**Pharmaceutical distribution in China (by sales in US\$ bn)**



Source: JP Morgan broker report dated Dec 03, 2012

Supply chain capabilities are also growing. For instance, Sinopharm conducts its business in state-of-the-art warehouses across its distribution network. It has invested more than USD 15.8mn in its Shanghai distribution centre, which includes sortation conveyor belts and automated storage and retrieval systems. It has also implemented warehouse management systems that will improve order picking, optimise operating flows, and measure performance.

Foreign investors are also keen to become stakeholders in pharmaceutical distribution. International giants such as Alliance Boots and Cardinal Health have already started to participate in this market through acquisitions or joint ventures. The sector is sure to benefit substantially from foreign participation in terms of enhanced management expertise and a rational industry structure.

<sup>12</sup> China's Pharmaceutical Distribution: Poised for Change / AT Kearney



## 2. High growth through collaboration

To cope with high growth, the future trend of healthcare and life sciences in China will be towards collaboration – a broad network of alliances that includes joint ventures, research pacts, in-licensing and mergers & acquisitions.

The maturing industry, although generating plenty of opportunities, imposes unprecedented pressures and demands on its players. Facing multiple challenges of maintaining product quality and extending markets and technology, both multinational and domestic companies have little option but to ‘grow up’.

Apart from engaging in greater competition, both can seek more room for consolidation and collaboration. Funding mechanisms too are opening up to them through private equity, venture capital and the capital markets.

### China eager for more tie-ups

China managed to buck the global downturn in M&A in 2012. Throughout the year, M&A activity across the globe remained muted — including in the pharmaceuticals sector — as the volume of acquisitions by drug companies fell 35 percent year on year.<sup>13</sup> Emerging markets, however, were able to avoid this trend and pharmaceutical companies are now spending record amounts on acquisitions in these markets, with China being the most attractive target.

Overall expenditure by both overseas and Chinese pharmaceutical companies in emerging markets reached USD 20bn in 2012. Spending by overseas acquirers alone in key growth markets is running at USD 3.5bn, an increase of 95 percent over 2011.<sup>14</sup>

This indicates that the consolidation-collaboration trend is becoming entrenched in the healthcare and life sciences market, with both foreign and Chinese companies becoming unusually active. Big multinationals as well as leading domestic players are adopting M&A and joint ventures as a short-cut to rapid development — in fact, they seem to be rushing headlong to tap China’s booming life science industry.

For multinationals, acquisitions in China are crucial for advancing their globalisation strategy and also to entrench their local presence in this vast market. Big Pharma, including Pfizer and Bristol-Myers Squibb, have spent the last few years digesting earlier acquisitions. Now, there is an expectation that they are ready to start buying again.

Led by Pfizer and Merck, five of the largest drug-makers active in China — also including Johnson & Johnson, Abbott Laboratories and Sanofi — had more than USD 70bn in cash, near cash and short-term investments at the end of the third quarter of 2012.<sup>15</sup> Some have also announced their ambitions to grow in the Chinese economic wonderland through M&A.

Joint venture agreements have also proved to be a good way for multinationals to grow their capabilities. These international giants, which mainly operate in urban and semi-urban areas, are desperate to penetrate the hinterland. This is much more feasible through collaboration with established Chinese companies, which can help achieve deeper penetration and greater cost savings. Furthermore, such collaboration is mutually beneficial. Through joint ventures, domestic companies are beginning to access higher quality products, wider sales coverage, better technology and advanced management and corporate governance.

The story does not end there though — Chinese companies want to take things even further. Local enterprises, especially the leading ones, now have sufficient reasons to be active acquirers or investors in the domestic market. These range from consolidating market share to accessing more customers.

For instance in 2012, Shanghai Pharmaceuticals, one of China’s biggest drug makers and distributors, bought a 70 percent stake in Changzhou Kony Pharma, allowing it to broaden its product portfolio and strengthen its manufacturing of special active pharmaceutical ingredients (APIs). The chairman of Shanghai Pharmaceuticals has further indicated in the press that the company intends to continue seeking M&A deals that facilitate development and enhance their nationwide presence.<sup>16</sup>

Overseas expansions by Chinese producers have begun to flourish and the number has increased rapidly in recent years. Many have gone into developing markets, such as Southeast Asia and Eastern Europe, but more and more are eyeing the mature Western market for its high-paying customers, high-end technology and potential image benefits. For example, there are currently more than 40 Chinese pharmaceutical companies setting up manufacturing or R&D facilities in the United States, including Hengrui, Hisun, Huahai and Tasly.<sup>17</sup> Others are entering the overseas markets via licenses, authorised sales or even acquisitions.

<sup>13</sup> Pharma M&A takes nosedive, except in China, 12th Dec 2012, Fierce Pharma

<sup>14</sup> China top target for record pharma emerging market M&A, 12 Dec 2012, Reuters

<sup>15</sup> Pharma deals north of \$10bn seen returning 2013, 7th Jan 2013, Bloomberg

<sup>16</sup> Shanghai Pharmaceuticals taking over Kony Pharma, 13th Feb 2012, Mergers & Acquisitions Weekly

<sup>17</sup> Maturing in Consolidation, 4th Feb., 2013, Medicine Economic News

Chinese companies have to be ‘smart’ as they enter these unfamiliar markets and the market leaders seem to be well-prepared. From this perspective, these companies are no longer domestic, and instead should be labeled “multinational”; just like their foreign peers.

#### **Private and public funding boost for merger deals**

The increase in M&A activities across healthcare will be further geared by sufficient capital funding from different sources.

Tapping funds from the capital markets, whether in China or at international bourses, is one way to secure the funding for development. From 2010 to 2012, around 50 healthcare companies concluded listings on Shanghai, Shenzhen, Hong Kong or Taiwan exchanges. The total funding raised was estimated to be USD 5.8bn which allowed many of the listed companies to expand either through the setting up of new facilities or acquisition of intended targets. An obvious case is Fosun Pharmaceuticals, who acquired 80 percent of Dongting Pharma in 2012, shortly after its IPO on the Hong Kong Stock Exchange.

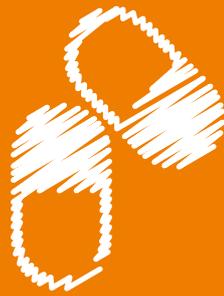
Another option is funding from the investment arms of large pharmaceuticals. These giants, with the intention of diversifying their current portfolios and proactively stepping into a lucrative emerging business, have set up either large in-house investment departments or funds under their groups. Lilly Asia Ventures, a venture capital firm under Eli Lilly, made an investment of USD 20mn in Nantong-based generic producer Novast in 2012. Two leading Chinese players, Sinopharm and Fosun Pharma, have also made a joint effort to tap the funding mechanism by setting up a private equity fund named Shanghai Sinopharm Equity Investment Fund Partners in 2012. The total capital raised is expected to reach CNY 1bn.

Furthermore, an increasing number of Chinese and overseas independent venture capitalist and private equity firms are seeking opportunities in the healthcare industry, providing a third source of potential funding. The comparatively high investment returns in healthcare act as a strong incentive to such investors.

## Summary

Stimulated by internal demand from self-development and capital forces, collaboration and consolidation in China’s healthcare and life sciences industry will see a two or even three-fold increase in its growth rate over the coming years. More sizeable quality giants with high levels of operational efficiency will emerge and exert a profound influence during this rush of advancement, driving on the evolution of the industry.





# Mergers & acquisitions and joint ventures: Emerging model for smarter growth



China's healthcare and life sciences landscape is changing dramatically. Collaboration and integration are the new buzzwords - a mode that combines the advanced technology and quality with economic manufacturing and distribution.

This section examines the varied range of mergers & acquisitions, as well as joint venture set-ups taking place within China's healthcare and life sciences industry. The rationale for companies to undertake complex collaboration effort is many. The most compelling reason for multinationals to enter into tie-ups is the strategic layout of this 'wonderland' – the temptation to plough the market extensively and capitalise on their existing advantages in products, services and management. Foreign players are continuously seeking strategic partners or quality targets and more and more newcomers are trooping in to realise their China dreams.

Encouraged by the long-term ambitious plans of its foreign rivals, Chinese companies too are becoming more proactive. They have embraced the massive opportunities, along with the challenges. Now confronting stricter regulations and fiercer competition, domestic enterprises are endeavoring to define their position and reinventing themselves as market leaders.

#### **Pharmaceuticals: Staying ahead of the curve**

The period 2011-2012 saw 132 deals in China's pharmaceuticals sector, with a total disclosed transaction size of USD 5.2bn for 94 deals. The number of deals and the sheer size of transactions exceed those carried out either in Germany or Japan - an indication of how confidently China has advanced to the position of the second largest pharmaceutical market, right behind the US.<sup>15</sup> There is little doubt that the number of deals and size of pharmaceuticals transactions shall top all such transactions in the healthcare industry.

The prospects for further deals are indeed bright. Multinationals have plenty of motivation for increasing M&A activities within the country – as do their domestic peers. These domestic companies have been undergoing significant development during the past decade and seem to be prepared for a higher and more profound degree of collaboration with their foreign competitors.

“ ... Top multinationals, faced with the loss of patents in 2012, have redefined themselves, whether by specializing in hard-to-make drugs, R&D and patenting of new drugs or through making large acquisitions... ”

The patents cliff, faced mostly by multinationals, will lead to more acquisitions and joint ventures. Multinationals have a strong reason to forge smart alliances. Even with their sizeable range of reputable products, they are facing the challenge of gaining access to China's vast hinterland. Most companies get their concentrated sales from the top 30 – 50 cities, whereas China has 660 cities, a third of which have a population of more than 10 million. Multinationals, even with decent earnings from patented drugs, are desperate for opportunities to diversify and reach new growth points. These aims can be achieved by finding the right Chinese partner.

The deal between Sanofi-Aventis and BMP Sunstone is an example of diversifying the business arena. In 2011, Sanofi-Aventis acquired all outstanding shares of BMP Sunstone, a Nasdaq-listed Chinese OTC medicine provider, for approximately USD520.6mn on a fully diluted basis. BMP Sunstone holds two of China's most recognized brands in lower-tiered regions: 'Hao Wa Wa' (for paediatric cough & cold) and 'Kang Fu Te' (a hygiene brand for women's healthcare). This is a new area for the French giant who is better known for its patented drugs and vaccines. In addition, BMP Sunstone has access to retailers, county hospitals and community clinics in 3rd tier and 4th tier markets which provides Sanofi with access to expanding distribution channels.

Sanofi's current China strategy is to expand their platform in the customer healthcare and OTC segment. This led to the 2011 acquisition of BMP Sunstone and 2010 formation of a joint venture with Minsheng Pharmaceutical, for the development of Vitamins and Mineral Supplements. Vitamins and Mineral Supplements is the largest consumer healthcare segment in China, where Minsheng has established a strong presence with its flagship multivitamin brand of 21 Super-Vita.

The success of the Minsheng joint venture is mainly attributed to the long-term existing relationship between the partners and mutual trust along the execution phase allowing for the development of a solid business plan for the joint venture.

The success of the BMP Sunstone transaction is mainly attributed to the hands-on and pragmatic approach, that Sanofi has taken along the process, the commitment to building a leading OTC franchise, anticipating from the beginning the discussions with the management and integration implications as a whole part of the decision making.

## KPMG: Key steps to success – Integration

A solid business plan is one of the most important success factors of a deal, as indicated by Sanofi's joint venture with Minsheng. The plan requires not only comprehensive considerations beforehand but a practical and achievable integration process to realize the goals set in the plan.

In today's environment of heightened stakeholder scrutiny, corporate managers must be able to clearly articulate where they will extract value from a deal and how they will make the deal work on a day-to-day basis. Accordingly, companies are more than ever focusing on the integration agenda early on in the game in order to better align the deal with the company's strategic vision, identify sources of value, mitigate integration risks, and understand how the deal fits within their overall operating strategy.

For pharmaceutical companies doing deals in China, we offer the following key takeaways:

- Set obtainable synergy targets and maintain laser focus on execution: Deals in China are about delivering growth, rather than reducing cost. A common pitfall is to set overly aggressively synergy targets which underestimate the 'dis-synergies' that come into play when integrating a business with a vastly different business model, company culture, go-to-market approach, and remuneration/incentive structure.
- Ensure a culture of compliance: In the pharmaceutical industry, ensuring compliance in sales and distribution activities in the acquired business in the aftermath of a deal often comes at the cost of short-term revenue deterioration and staff disengagement. Without a culture of compliance, a real or perceived notion of playing on an uneven playing field against more aggressive competitors could 'compel' individuals and organisations to take short-cuts which could run afoul of compliance requirements.
- Move quickly to harmonise processes and policies and integrate systems: Whilst we often advise our clients to pace these activities to better support change management, for pharmaceutical companies harmonising processes and policies from the get-go supports and enables compliance. Also, integrating key systems – such as CRM – would provide a complete set of business data and business intelligence for the sales force, products, pricing, channels, terminals, etc., which will drive synergy planning and synergy capture.

“ Local companies have been unwitting beneficiaries of this patent cliff. Riding on this tide, many domestic makers are contemplating either licensing-in the drugs or manufacturing generics ... ”

In a unique trend, however, Chinese companies are harvesting rewards from the patent cliff. A prominent example of beneficial collaboration is the joint venture between Merck & Co and Simcere Pharmaceutical Group (SMSD) launched in September 2012.

The JV merges the extensive resources and expertise of Merck with Simcere's strong sales capabilities in more than 4,000 hospitals and 70,000 drug stores. Under the agreement, the joint venture has exclusive sales rights of the medicines for metabolic and cardiovascular diseases. These include Merck's Zocor, Cozaar and Renitec – the US-based pharmaceutical's previous blockbuster drugs that have now lost their patents. The JV now plans to extend their life cycle in China's untapped grassroots market. Thanks to the joint venture, Simcere now enjoys massive advantages from license-in of these drugs. The deepening commercialisation of these branded products opens up new revenue and profit channels for Simcere.

The joint venture, nevertheless, is not just a sales platform for Simcere, which sees broader potential collaboration in R&D and manufacturing to improve its core competitiveness. “The new joint venture will cover all aspects from R&D, manufacturing, sales to marketing, including commercialisation of current drugs in China market,” said Ren Pusheng, CEO of Simcere. And the company is right on

track – it has conducted various collaboration projects with Advenchen, OSI and BMS, among others.

Cooperation between foreign and Chinese companies will

“ ...Reaction to the patent cliff from both parties has created potential opportunities for collaboration. The most recent headline-grabbing example is the joint venture between Pfizer and Zhengjiang Hisun... ”

open up tremendous possibilities for market expansion. There are plenty of collaboration avenues, including acquisitions or joint ventures. Before the establishment of Merck and Simcere's JV, Pfizer's Greenfield joint venture with Hisun – known as Hisun-Pfizer Pharmaceuticals Co. - is also poised for a symbiotic relationship.

It is difficult to state which method is better for companies – an acquisition or a joint venture. Acquisitions grant buyers controlling power but joint ventures can be of tremendous advantage when synergies are optimised. Whatever the case, there is one common ground rule that cannot be ignored – as the experience of Sanofi-Aventis and Pfizer indicates, identifying the right target or partner and knowing them well is the key to success. The potential partner or acquisition target can be a previous business partner, a competitor or rival and even an unknown entity. If a company is unable to forge an alliance with a long-standing partner, as Sanofi-Aventis was able to do, collaboration projects can become that much tougher and more challenging.

The Chinese pharmaceutical market has unique dynamics that determine not only the lifecycle of products but also impacts decisions about joint ventures and collaborations between global and local companies.

One example of China's uniqueness lies in the demand for 'branded generics.' More than 80 percent of the multinational revenue comes from off-patent products and less than 20 percent may come from patented drugs. Pfizer therefore sees the potential of the branded generics sector. According to Evan Goldberg, Pfizer's Sr. Director of Strategy & Business Development in China, 'branded generics' represent an attractive market segment for us in some emerging markets, partly because doctors and consumers want to be confident in the quality of medicines they use. A company's reputation or brand can be an important differentiator in this market.

In 2012, the company has closed an important joint venture in this regard. Pfizer and Chinese major Hisun invested together to create a Greenfield JV - Hisun-Pfizer Pharmaceuticals Co. Ltd. The new entity is 51 percent

owned by Hisun and 49 percent owned by Pfizer (total investment is USD 295mn). The JV plans to manufacture and commercialize off-patent pharmaceutical products in China, boosting both Pfizer and Hisun's presence in the domestic branded generics space and building a high quality generic drug business here.

Pfizer is continuing to actively pursue strategic partnerships in China, while it remains conscious about challenges to complete acquisitions or joint ventures in China. “There are still few cases of MNCs successfully acquiring Chinese pharmaceutical companies. The main challenge is to identify high quality partners or acquisition targets with objectives that are aligned with ours. Although China has a well developed domestic pharmaceutical industry with thousands of companies, I believe there are not many attractive companies for acquisition right now,” says Goldberg. A good target company for acquisition or joint venture should have a differentiated product portfolio & pipeline, unique capabilities, and a strong management team who wants to work with us to achieve shared goals, says Goldberg.

## KPMG: Key steps to success — Due Diligence

A robust due diligence process is must-have in China, especially in sectors such as life sciences. There are too many potential issues to a successful M&A or JV – compliance risks, sales practices and risks of financial irregularities among them. Yet, performing due diligence is typically challenging, particularly with the availability and quality of financial and commercial information often limited.

“Engaging due diligence advisors who understand the sector in China is critical. Most potential ‘deal-breakers’ can be quickly identified if you know what you are looking for going in. They are not going to be readily apparent in the information provided or disclosed in interviews if you don’t ask the right questions,” says Ryan Reynoldson, KPMG Partner, Transactions & Restructuring

As a result, our due diligence work is often conducted in phases, with a short initial ‘rapid assessment’ phase focused on identifying the major risks and issues, and a longer ‘confirmatory’ in-depth phase after a client’s initial go/no-go decision. Most companies in China’s life sciences sector are going to have various risks and issues from a multinational’s perspective, so a key output of our initial ‘rapid assessment’ due diligence is to benchmark a potential target versus our expectations, helping clients understand whether the issues faced are more than, less than or the norm. The earlier we are involved in the process of target identification and assessment, the earlier we can provide this vital feedback.

Our ability to provide benchmarks based on our experience is not limited to financial due diligence, it also extends to the critical area of commercial due diligence, where similar informational challenges exist. Leveraging our understanding of China’s life sciences sector, we support our clients throughout the transaction process, including M&A strategy refinement and alignment with global strategy; target identification along the value chain for acquisition and partnership; and commercial due diligence focusing on identification of M&A deal breakers.

“Carrying out detailed commercial due diligence of the Target – covering its products in the market, customer base, reputation and manufacturing capability – is key to helping ensure the strategic rationale for the deal is maintained,” said Mei Dong, KPMG Partner, Commercial Due Diligence

“ ...Two major approaches have been adopted to cut costs. One is economies of scale — by way of either horizontal or vertical consolidation ... ”

A major challenge for drug companies is price control and cost-cutting. If the patent cliff drags down volumes sold, price control further shrinks revenue by exerting ceilings on unit price. Volume drops can be resolved by deepening the market, but pricing is dictated by government regulation, over which companies have no control. Therefore, cost cutting is sometimes the only option for pharmaceutical players.

In this context, vertical consolidation is a smart method to realise economies of scale. A typical example is Sichuan Kelun Pharmaceutical. In late 2012, Sichuan Kelun signed a definitive agreement to acquire a 12.29 percent stake in Lijun International Pharmaceutical (LIP), half of whose business is antibiotic API, for a consideration of HKD1.05bn (USD135mn). After the transaction, Sichuan Kelun plans to increase its shareholding in LIP to 30 percent using no more than CNY2bn via open market operation or other legal methods, elevating itself as the biggest shareholder of LIP.

Such transactions are part of Kelun’s attempt at optimisation of its value chain, under challenging circumstances of stricter regulatory restrictions and entry barriers that have been exerted on China’s antibiotics market. During the turmoil, Kelun has methodically cemented its antibiotics business - acquired Guangxi Kelun, established Xindiya Chemicals, carried out mergers with Pearl Pharmaceuticals and Zhongnan Kelun, as well as started antibiotic intermediary project in Yili. The acquisition of LIP further strengthened Kelun’s strategy as LIP has an extended portfolio in antibiotic API and formulation which can enrich Kelun’s product lines and streamline its value chain from API to end-sales. These decisions have helped the company fight the negative impact of price control and build its scope for profit and market leadership.

“ ...As an alternative, many companies are seeking to develop new products which are not subject to price controls... ”

Another way to cope with price control is developing new drugs and buying a company with a good pipeline can be an effective short cut. Yunnan Walvax Biotech’s acquisition of Shanghai Zerun highlights the pharmaceutical company’s endeavor to build a strong portfolio. In 2012, Yunnan Walvax

Biotech paid USD49.2mn to acquire a 58 percent stake in Shanghai Zerun Biotech, a China-based company engaged in R&D of HPV vaccines for cervical cancer treatment.<sup>19</sup>

With 500,000 new cases worldwide each year, cervical cancer is the second-leading cause of cancer death in women. Apart from Merck and GSK, Xiamen Innovax Biotech Co and Shanghai Zerun are the only two pharmaceutical companies involved in R&D of HPV vaccine in China. For Walvax, the deal improves its R&D capability in recombinant vaccines, while adding to the pipeline of marketed vaccine and seven others in various stages of development.

Pharmaceutical companies are continuously turning to deals to get access to new drugs. Joint venture for the purpose of R&D cooperation is also emerging — to spread risk and share in the income. R&D in new areas is also going up, especially in the emerging trend of examining the prospects of traditional Chinese medicines.

In 2012, global food titan Nestlé and Hutchison China MediTech Ltd have announced an agreement to establish a medical joint venture — Nutrition Science Partners — to develop traditional Chinese medicine-based drugs for the treatment of gastrointestinal diseases. The stake will be equally split between Nestlé Health Science (a subsidiary of Nestlé S.A.) and Hutchison China MediTech. The new company will also be engaged in the development of experimental drug HMPL-004 as well as the supervision of late-stage clinical test of drugs for the cure of ulcerative colitis and Crohn’s disease. The partnership will bring Nestlé exclusive access to Hutchison China MediTech’s botanical pool that contains over 1,500 purified natural products and 50,000 medical plant extracts.<sup>20</sup>

Pharmaceutical players, fighting to stay ahead of the curve, are triggering a profound and lasting revolution. Mergers and acquisitions, as well as joint ventures, are becoming more commonplace. Multinational ‘newcomers’, with their branded products, need the assistance of Chinese partners to reach far-flung areas. For their part, multinationals can offer products, expertise and also potential overseas markets as a quid pro quo.

Domestic buyers, however, remain deeply rooted in this market and pursue acquisitions in China with the aim of gaining quality products and technology. Overseas transactions by leading Chinese companies are few, but some big pharmaceuticals are said to be searching for good targets abroad. The tide will turn when Chinese companies grow more mature and good targets come in sight.

Although Chinese players have developed swiftly in recent years, gaps between them and multinationals remain wide. The collaboration trend is slowly narrowing the gap, enabling a batch of Chinese pharmaceutical leaders to gradually attain the same stature as their foreign peers.

<sup>19</sup> Yunnan Walvax Buys 58 percent Stake in Vaccine-Maker Zerun Biotech, 14th Jan, 2013, ChinaBio Today

<sup>20</sup> SinoCast Health Care & Medicine Beat, 29th Nov 2012

## Selected recent transactions in China pharmaceutical industry

Date	Target	Bidder / investor	Target Business	Transaction size & share percentage	Rationale
13/02/2013	Oriental Medicine Company Limited	Reckitt Benckiser Group Plc	"- Private Owned Enterprise ("POE") - China based manufacturer of herbal medicines"	"Transaction size not disclosed 100 percent stake"	"The transaction provides an opportunity for Reckitt Benckiser to further diversify and expand its business in China."
16/01/2013	Guilin Tianhe Pharmaceutical Co., Ltd.	China Resources Sanjiu Medical & Pharmaceutical Co., Ltd.	"- POE - The biggest pharmaceutical manufacturer of external use sticking plasters"	"CNY 583mn 97 percent stake"	The investment enriches China Resources' OTC osteology market product line, adding external use plasters to its production of pills.
22/12/2012	Hunan Dongting Pharmaceutical Co., Ltd.	Shanghai Fosun Pharmaceutical (Group) Co., Ltd.	"- POE - China based pharmaceutical manufacturer of astringent and psychiatric medicines"	"CNY 586mn 78 percent stake"	The investment further enriches Fosun's CNS product line and also strengthens the competitiveness of its pharmaceutical business.
28/12/2012	Lijun International Pharmaceutical (Holding) Co., Ltd.	Sichuan Kelun Pharmaceutical Co., Ltd.	"- Hong Kong listed - China based pharmaceutical manufacturer of antibiotic APIs and formulations, as well as infusion products (mainly non-PVC soft bag infusions and PP plastic bottle infusions)"	"HKD 1.05bn 12 percent stake"	"The acquisition bolsters Kelun's position as a leader in antibiotics and supplements its infusion offerings. Lijun has sales advantages in northern China, where Kelun's sales force is relatively weak. Lijun's registered trademark in 48 countries and regions can be leveraged by Kelun to accelerate its overseas development."
07/12/2012	"Shanghai Zerun Biotechnology Co., Ltd.	Walvax Biotechnology Co., Ltd.	"- POE - China based pharmaceutical manufacturer focusing on HPV vaccines for cervical cancer treatment"	"CNY 131mn 44 percent stake"	The acquisition enables Walvax to build a strong portfolio in vaccines for cervical cancer treatment.
14/09/2012	Hisun-Pfizer Pharmaceuticals Co., Ltd.	"Pfizer Inc. Zhejiang Hisun Pharmaceutical Co., Ltd."	"- Greenfield joint venture - The joint venture focuses on manufacturing and selling of generic drugs, covering cardiovascular disease, infectious disease, oncology, mental health, and other therapeutic areas"	"USD 295mn Hisun holds a 51 percent share and Pfizer holds 49 percent"	"The joint venture aims to build a robust sales network that covers most areas and hospitals in China and to enter the international market by leveraging Pfizer's global business network. The joint venture brings benefits to both parties by taking advantage of the generic drugs boom in China."
31/08/2012	Winteam Pharmaceutical Group, Ltd.	China National Pharmaceutical Group Corporation	"- Hong Kong listed - China based pharmaceutical manufacturer of Chinese traditional patent medicines, chemical medicines and biological medicines"	"HKD 2.55bn 85 percent stake"	"The investment helps China National to fill the gap in the Traditional Chinese Medicine market. China National aims to develop Winteam into its group TCM platform."
09/02/2012	Guangdong ShunFeng Pharmaceutical Co., Ltd.	China Resources Sanjiu Medical & Pharmaceutical Co., Ltd.	"- POE - China based pharmaceutical manufacturer of medicines for external use"	"RMB 700mn 100 percent stake"	"The investment helps China Resources Sanjiu to strengthen its position in the antifungal market and further reinforce its leading position in external skin medicines."
01/08/2011	C&O Pharmaceutical Technology (Holdings) Limited	Shionogi & Co., Ltd.	"- Singapore listed - China based pharmaceutical manufacturer of OTC medicines"	"CNY 1.2bn 24 percent share"	C&O's production line is similar to Shionogi's. Through this transaction Shionogi will be able to enter the China OTC market.
22/07/2011	SMSD Pharmaceuticals Limited	"Merck & Co., Inc. Sincere Pharmaceutical Group"	"- Greenfield joint venture - The joint venture focuses on the distribution of medicines for metabolic and cardiovascular diseases in China"	"Transaction size not disclosed Merck holds a 51 percent share and Sincere holds 49 percent"	"The joint venture extends the lifecycle of Merck's drugs and further helps the foreign giant to penetrate China's grassroots market."
22/06/2011	Hainan Litzman Pharmaceutical Limited; Vinise Pharmaceutical Limited	Sihuan Pharmaceutical Holdings Group, Ltd.	"- POE - China based manufacturers of Chinese patent drugs for post-cerebrovascular surgery recovery"	"CNY 775mn 100 percent stake"	"The transactions help Sihuan Pharmaceutical to extend its product portfolio into Chinese patent drugs for post-cerebrovascular surgery recovery."
29/01/2011	Dalian Aleph Bio-medical Co., Ltd.	Fosun Industrial Co., Ltd.; Shanghai Fosun Pharmaceutical Industrial Development Co., Ltd.	"- POE - China based manufacturers of biopharmaceutical products"	"CNY 675mn 75 percent stake"	This acquisition enables Shanghai Fosun Pharmaceutical to enter the vaccine business.
22/07/2011	SMSD	"Merck & Co Sincere Pharmaceutical Group"	"Greenfield JV The JV will focus on the distribution of medicines for metabolic and cardiovascular diseases"	"Transaction size not disclosed Merck holds 51 percent of the share and Sincere holds 49 percent"	Extend the lifecycle of Merck's drugs and further reach the grassroots market of China
22/06/2011	Hainan Litzman Pharmaceutical Limited; Vinise Pharmaceutical Limited	Sihuan Pharmaceutical Holdings Group Ltd.	"POEs Chinese patent drugs for post-cerebrovascular surgery recovery"	"CNY 775m (USD 119.9m) 100 percent shares of both"	"To extend the product portfolio into Chinese patent drugs for post-cerebrovascular surgery recovery"
04/04/2011	Tianjin Precede Medical Trade Development Co., Ltd.	China Medical System Holdings Limited	"POE Prescription pharmaceuticals"	"HKD 1402.5m (USD 180.36m) 11.2 percent of the existing issued share capital of the company"	China Medical System will be able to expand its product portfolio, increase their product sourcing capability, and help them in achieving synergies in sales model, network coverage and the selection and range of products
29/01/2011	Dalian Aleph Bio-medical Co. Ltd	Fosun Industrial Co. Ltd.; Shanghai Fosun Pharmaceutical Industrial Development	"POE Bio-medical products"	"CNY 675m (USD 102.46m) 75 percent shares"	This acquisition will enable Shanghai Fosun Pharmaceutical to enter into the vaccine making business.

### Medical devices: foreign and domestic players eyeing each other's territories

During 2011 and 2012, there were at least 36 closed deals in medical devices in China, with a total disclosed transaction size of USD1.6bn for 22 deals. Neither the deal number nor the size is large compared with many developed markets, but a couple of deals in 2012 and 2013 stand out as a benchmark, indicating that medical devices is a hot sector for acquisitions.<sup>21</sup>

Now, with foreign and domestic players eyeing each other's territories, there will be fiercer competition with more deals coming up. Foreign manufacturers are building a bigger and more direct local presence by acquiring and merging, rather than setting joint ventures, with Chinese counterparts. Chinese companies are seeking to upgrade and offer better quality products in and beyond their current portfolios and markets.

“...foreign manufacturers are turning their attention to second and third tier cities and even villages to address the needs of the lower-tier market, which requires more affordable products, in-depth channels and specialised sales forces...”

One of the two sensational deals in medical devices recently is Medtronic's acquisition of China Kanghui Holdings. Kanghui, once a New York-listed Chinese company, engages in the development, manufacture, and sale of orthopedic implants in trauma, spine and joint reconstruction. For the acquisition, Medtronic paid approximately USD816mn in cash (USD30.75 per American depository share). And the total value net of Kanghui's cash was approximately USD755mn.

Medtronic has good reasons for the buy. Kanghui is China's second biggest orthopedics medical device provider, occupying a large market share. Apart from the broader product portfolio, local R&D and manufacturing facilities, the Chinese company brings along a perfect marketing and distribution platform with its affordable tailored products to lower-tiered markets, which is the most important rationale for the deal. Through its controlling in Kanghui, the US behemoth is also able to inject all its products in the newly-bought company to boost its sales, providing sustainable advantages in the fast-growing Chinese orthopedic segment. This deal has been exceptionally swift as it took Medtronic barely three months from initial approach of the target to signing the acquisition agreement.

Just one month after acquiring Kanghui, Medtronic further pumped up its presence in China by investing USD66mn in LifeTech Scientific, a producer of advanced minimally invasive interventional medical devices for cardiovascular and peripheral vascular diseases.

The second major deal, also in the orthopedic segment, involves US medical device giant Stryker Corporation's offer to buy Chinese orthopedic maker, Trauson Holdings, for USD764mn in cash in early 2013. The price offering provided Trauson a 66.7 percent premium over its closed price as at 7th January 2013. Trauson started its business in orthopedic products for trauma and spine fixation in China in 1986 and got listed on the Hong Kong Stock Exchange in 2010. With years of operation, it has become the top orthopedic manufacturer in China, whose sales were approximately CNY62mn in 2011.

The two parties were familiar with each other for several years before reaching the deal — Trauson has been manufacturing instrumentation sets for Stryker under an OEM agreement since 2007. Stryker's acquisition rationale is similar to Medtronic. Marketing and distribution platforms remain the first priority for foreign companies and Stryker had the added advantage of knowing its target well.

“...Two routes are open to companies hoping to achieve this — either an organic 'do-it-yourself' ("DIY") approach or inorganic growth through M&A...”

Even those multinational companies accustomed to the 'do-it-yourself' philosophy of organic growth in China seem to be lured by its massive market and the rationale for inorganic growth through M&As. Johnson & Johnson, a multinational company that has been in the market for decades, has never acquired a Chinese medical device company during its previous operations in the country. In May 2012, however, J&J made its first acquisition of a local company named Guangzhou Bioseal Biotechnology Co, which manufactures porcine-plasma-derived products for controlling the bleeding during a surgery.<sup>22</sup>

After the integration, Bioseal serves as J&J's main R&D and production platform for China and other Asia Pacific regions with a lower cost. Also, the acquisition offers J&J a direct connection to the distribution channels owned by Bioseal in Guangzhou and other South China regions.

<sup>21</sup> Capital IQ

<sup>22</sup> 'Medtech mergers and acquisitions remain robust in 2012', Dec. 3rd 2012, Medical Device & Diagnostic Industry

Leading Chinese companies have also been active. An important trend-setter is Mindray Medical, a Shenzhen-based New York listed leading provider of medical devices. In 2008 Mindray acquired US company Datascope's patient monitoring business - a milestone for any Chinese medical device company aiming for outbound M&As. The acquisition launched Mindray into the ranks of leading international medical device vendors.<sup>23</sup> The synergies here are huge, involving brand-new markets and advanced products. By acquiring the business, Mindray has been able to capture an established and successful service and direct sales channel in the North American and European market.

What's more, it was also able to expand product portfolios along with the ability to tailor product functionality for specific end-user requirements. For example, Mindray obtained NetGuard after the acquisition, a brand-new innovative wireless patient monitoring solution which had been approved by the US FDA.

The Chinese company is also hungry for more growth in other niche markets. In its start-up stage, Mindray's product portfolio was mainly in diagnostic imaging. In 2012, however,

the company completed three M&A deals and expanded its product lines to include endoscopes, orthopedics and other surgical equipments. One of the deals involved buying a controlling stake in Wuhan Dragonbio Surgical Implant Co., a local producer of surgical orthopedic tools, specialising in spine, joint and trauma products, for USD35.5mn. Through this deal, Mindray has given itself a chance of breaking into the Chinese orthopedics market, which has a high barrier to entry.<sup>24</sup>

The acquisition of the top two Chinese orthopedic manufacturers by foreign companies will further stimulate consolidation in the market. Foreign high-end market leaders have made it clear that they are looking at lower-end expansion; even as Chinese companies want to break new ground with these foreign-owned domains. Fierce competition for good, but hard-to-find, target companies that possess widespread marketing and distribution networks, is expected to propel future transaction sizes to record highs.

<sup>23</sup> Mindray acquires Datascope patient monitoring', Mar. 12th 2008, Medical Connectivity

<sup>24</sup> Mindray snaps up Chinese orthopedics maker for USD 35.5M', June 7th 2012, Seeking Alpha



## Selected recent transactions in China medical device industry

Announced Date	Target	Bidder	Target Business	Transaction size & share percentage	Rationale
17/01/2013	Trauson Holdings Company Limited	Stryker Corporation	"- HKEx listed - China based leading manufacturer of orthopaedic products - The largest domestic producer of trauma products and one of the top three domestic producers of spine products"	"HKD5.8bn 100 percent stake"	The transaction broadens Stryker Corp's presence in China and helps its expansion into emerging markets through a well-established brand and extensive distribution networks.
15/10/2012	LifeTech Scientific Corporation	Medtronic Inc.	"- Nasdaq listed - China based leading manufacturer of advanced minimally invasive medical devices for cardiovascular and peripheral vascular diseases and disorders"	"HKD361mn 19 percent stake"	"Post transaction, Medtronic becomes the majority stake holder of LifeTech. Medtronic is able to obtain access to the minimally invasive medical devices market in China. LifeTech is able to obtain an access to the global market, where Medtronic will be a distributor of Life Tech products."
28/09/2012	China Kanghui Holdings	Medtronic Inc.	"- NYSE listed - China based leading manufacturer of orthopaedic implants/instruments for use in trauma, spine, cranial maxillofacial and craniocerebral treatments"	"USD816mn 100 percent stake"	"Kanghui brings Medtronic a broad product portfolio, a strong local R&D and manufacturing operation, a vast China distribution network and an exceptional management team. This move provides Medtronic with a foothold in China's fast-growing orthopaedic market."
07/06/2012	Wuhan Dragonbio Surgical Implant Co., Ltd.	Mindray Medical International Limited	"- POE - China based manufacturer of orthopaedic products"	"USD35.5mn Controlling stake"	Mindray gains access to the fast-growing Chinese orthopaedic market.
03/05/2012	Guangzhou Bioseal Biotechnology Co., Ltd.	Johnson & Johnson (China) Investment Ltd.	"- POE - China based biopharmaceutical company specialising in porcine plasma-derived biologic products for controlling bleeding during surgery"	"Transaction size not disclosed 100 percent stake"	"This transaction reinforces Johnson & Johnson's commitment to China and to delivering innovative medical device solutions to the Chinese market. This is the first time that J&J has bought a Chinese target in the pharmaceutical industry."
09/09/2011	Suzhou Xinrong Best Medical Instrument Co., Ltd.	MicroPort Scientific Corporation	"- POE - China based manufacturer of orthopaedic implants and medical instruments"	"CNY110mn 100 percent stake"	"MicroPort strengthens its position as a leader in medical devices in China. The acquisition provides MicroPort with instant access to the China orthopaedic market and a well established stage for business expansion. "
12/06/2011	JW Medical Systems Limited	Biosensors Interventional Technologies Pte., Ltd.	"- Biosensor's joint venture with Weigao - China based manufacturer of heart stents and other medical devices"	"CNY2.3bn 65.24 percent stake"	"This acquisition enables Biosensors to strengthen its position and customer base in China."
31/03/2008	Datascope	Mindray Medical International Limited	"POE medical device in interventional cardiology and radiology, cardiovascular and vascular surgery, anesthesiology, emergency medicine and critical care Datascope's patient monitoring business achieved revenues of USD161mn in 2007"	"USD209 million Patient monitoring business"	The transaction represents a unique combination of strengths that will help transform Mindray from a largely China-based company into a global leader, and substantially further its strategy of building a leading on-the-ground presence in the United States and Europe



### Pharmaceutical distribution: Sector consolidation and integration top priority

During 2011 and 2012, China saw 56 closed deals in pharmaceutical distribution — a sensational record, especially when compared with other countries. In this period, the US saw 34 deals closed, Germany saw 5 and Japan notched up 18, making China an undisputed leader. Over this period, 43 of the 56 deals disclosed had a total transaction size of USD 2.8bn, which is much lower when compared with US deal size. The total disclosed transaction size for 19 deals in United States is a high USD 6.6bn. The significant differences in terms of transaction size is mainly attributable to fragmented China market.<sup>25</sup>

Thus, the distribution industry is headed for inevitable consolidation to deal with this high level of fragmentation, egged on by government support and the aspiration of companies for self-development. Efforts will go into building a stronger distribution network and strengthening key enterprises to the standards of leading international rivals.

“...The process has already started and is being led by large state-owned enterprises and big private Chinese companies. ...”

Consolidation will start from the wholesale sector with the emergence of mega-size distributors. As domestic M&A trends indicate, large-sized state owned enterprises, which are keen to capitalise on their networks, are leading the M&A boom.

Sinopharm is the absolute front runner and occupies around 13 percent of the market share.<sup>26</sup> The state-owned giant has established a national coverage, with a large proportion of its sales carried out through second-tier distributors. In January 2011, it announced the acquisition of 60 percent of Hebei province-based Shijiazhuang Le Ren Tang Pharmaceutical Chain, together with the distribution business and four subsidiaries of Le Ren Tang Pharmaceutical Group, for approximately CNY1.3bn. As the top pharmaceutical distributor with a market share of approximately 30 percent in Hebei, Le Ren Tang's distribution networks cover more than 3000 customers in the province, including 3A hospitals, town hospitals and health centers, while the company is still working to increase its scale by collaboration with more than 2000 drug producers in China. Later in 2011, the state-owned giant further announced its plan to use funds raised from bonds (USD309mn) and shares (USD436mn) to purchase retail and distribution businesses in smaller Chinese cities.<sup>27</sup>

Shanghai Pharmaceuticals too has been active in acquisitions. The front running state-owned distributor has already established itself as the leader in the East China market and has been scrambling for new territories nationwide in an attempt to compete with Sinopharm. Its acquisition of China Health System (CHS) in 2011 is viewed as a strategic breakthrough towards achieving its national ambitions. Shanghai Pharmaceuticals acquired a 65.24 percent share of China Health System for CNY2.3bn. The target ranks as one of the top three Beijing pharmaceutical distributors, with revenues over CNY6bn in 2010. As is widely known, Beijing has always been the most important healthcare resource cluster and the biggest healthcare center in North China. Through CHS's strong presence in Beijing, Shanghai Pharmaceuticals is able to extend its network to other North China regions such as Tianjin and Hebei, gradually establishing and reinforcing its national distribution networks by connecting its current strong base in East China and South China.

China Resources Pharmaceutical Group, also one of the top state-owned distributors in China, completed its acquisition of 100 percent equity in Beijing Pharmaceuticals Group in 2011, a company that achieved sales revenue of CNY 2.9bn in 2009. The competitiveness of the target not only lies in its strong financial performance and coverage, but also in its shareholders - Beijing Municipal Government, which was granted with one third equity of China Resources Pharmaceutical in exchange for its shares in Beijing Pharmaceuticals Group. With the help of the Municipal Government, China Resources is able to integrate its pharmaceutical resources and further expand in Beijing and its periphery.

Standing apart from these state-owned distribution giants, is Jointown Pharmaceutical Group, a leader in its own right. This leading Chinese privately-owned distributor achieved phenomenal success by wholesaling and delivery business in lower-tiered healthcare institutions and distributor such as town health centres, village clinics, drug stores and secondary distributors. Within the span of 10 years, the company has forced its way into the ranks of the top distributors, competing with state-owned giants at every level —from introducing foreign investment and getting listed, to establishing a nation-wide delivery network. As part of a deliberate company strategy, the company does not pursue large-sized mergers. In 2010, Jointown expanded its network in Sichuan and Chengdu via several joint ventures, acquisitions and collaborations with local distributors. The overall transaction size, however, was less than CNY 100mn. Besides, the company is also strengthening its retailing forces in recent years. Its acquisition of drug chain operator Henan Xinglin Pharmacy Co. Ltd. is an indication of its range of activities.

<sup>25</sup> Capital IQ

<sup>26</sup> JP Morgan broker report, 3rd, Dec 2012

<sup>27</sup> BMI

## “...Foreign investors are also keen to become stakeholders in pharmaceutical distribution...”

Meanwhile, foreign investors are also eager to entrench themselves into this distribution network. Alliance Boots, the owner of Europe's largest pharmacy chain, has an extremely ambitious expansion plan in the country. In 2007, Alliance Boots announced an agreement to form a 50:50 joint venture with Guangzhou Pharmaceuticals Corporation, the third largest pharmaceutical wholesaler under the listed state-owned Guangzhou Pharmaceutical Company in China. Guangzhou Pharmaceutical held a strong position in its home province of Guangdong with 16 percent market share and 3 percent nation-wide share then. On completion of the transaction, the joint venture was expected to operate 29 retail pharmacies, this being the maximum permitted under the regulations for a 50:50 foreign-invested joint venture of the time. The total transaction size was around GBP 38mn.

Stefano Pessina, Executive Deputy Chairman of Alliance Boots, with responsibility for strategy and M&A, has stated that this joint venture has brought together Guangzhou Pharmaceutical Corporation's strong local management and Alliance Boot's extensive experience in running pharmaceutical wholesaling businesses. With rapid expansion of the Chinese healthcare and life sciences market, further consolidation opportunities may arise.

In 2012, the European distributor made a fresh attempt at acquisition and announced its plan to buy a 12 percent stake in Nanjing Pharmaceutical Co Ltd for about USD 91mn. The Shanghai-listed Nanjing Pharmaceutical is China's fifth-largest pharmaceutical wholesaler. It has distribution centers in 12 cities across eight provinces and one autonomous region. On completion of the deal, Alliance Boots will become the second-largest shareholder in the company with board and operational management representation, with its largest shareholder as Nanjing Pharmaceutical Group Ltd.<sup>28</sup>

With the help of these two deals and its partners, Alliance Boots now has a market share of around 4 percent in China's pharmaceutical distribution.<sup>29</sup> The deals further strengthen the company's ties with the Chinese government and regulators. Backed by its current position in China, Alliance Boots is now eyeing 20-30 percent of the Chinese pharmaceutical distribution market.

Another reputable foreign player stepping into the market is Cardinal Health. The mega US drug distributor made a dramatic entry by purchasing Zuellig China for USD 470mn in 2010. Zuellig China had managed to cover 31 of the 34 provincial-level administrative units in the country through its direct-to-customer distribution center network and its comprehensive network of wholesalers.<sup>30</sup>

Post transaction, Zuellig China has been repositioned with a focus on three major segments – pharmaceutical third party logistics, product allocation and reach to regional end users. This is not surprising because Cardinal Health is renowned for its delivery, repackaging and third party logistics. Starting from Zuellig and centering on its core business, Cardinal went on to make a few more transactions to flex its muscles in China.

In 2012 Cardinal further spent USD 120mn to acquire six local drug distributors, paying less than USD 30mn for each. The company said the goal with each transaction was not revenue volume but greater geographical reach. The acquisition targets, however, have not been named.<sup>31</sup>

It could be argued that an extensive network and sizable revenue are the two most important parameters in pharmaceutical distribution. Sector consolidation and integration led by state-owned enterprises has resulted in a succession of bn-yuan deals, backed by capital market funding and government support. Mega distributors continue to seek top regional players as potential targets, encouraged by the possibility of bns in revenue. Moreover, the merger trend is expected to continue through to retailing, as indicated by the emerging trend of acquisitions of drug chain stores in recent years.

Leading Chinese and foreign distributors will accelerate their national network layouts in the near future. Increasing number of inbound and domestic deals will push forward the integration and consolidation process. But going overseas, even when supported by favorable government policies, still remains a long-term goal for Chinese players.

<sup>28</sup> Alliance Boots to buy stake in China pharma wholesaler, 16th Sept 2012, Reuters

<sup>29</sup> JP Morgan broker report, 3rd December, 2012

<sup>30</sup> 'Cardinal Health acquires Zuellig Pharma China for \$470mn', Nov. 29th 2010, News Medical

<sup>31</sup> 'Cardinal Health has acquired six China drug distributors for \$120mn', Feb. 6th 2013, China Bio

## Selected recent transactions in China pharmaceutical distribution industry

Date	Target	Bidder	Target Business	Transaction size & share percentage	Rationale
16/09/2012	Nanjing Pharmaceutical Co., Ltd.	Alliance Boots GmbH	"- SHEX listed - Top China based pharmaceutical company engaged in pharmaceutical distribution"	"USD91mn 12 percent stake"	"Post transaction, Alliance Boots GmbH will become the second largest shareholder of Nanjing Pharmaceutical. The transaction will help in evolving the present market and is considered to be a strategic step towards Alliance Boots' long-term development in the region."
18/06/2012	Zhejiang Dasheng Medic Co., Ltd.	Cardinal Health Inc.	"- POE - The second largest pharmaceutical distributor in Ningbo, with 58 hospitals and 975 clinics in its client base"	"Transaction size not disclosed Controlling stake"	Post transaction, Zhejiang Dasheng Medic becomes the operating headquarters of Cardinal Health in Zhejiang Province, extending the foreign giant's geographic reach in China.
24/06/2011	Beijing Purenong Pharmaceutical Co., Ltd	China Resources Pharmaceutical Group Limited	"- POE - The biggest private-owned pharmaceutical distributor for hospitals in Beijing - Mainly focused on the high-end market in Beijing"	"CNY250mn 25 percent stake"	The acquisition further reinforces and enhances China Resources Pharmaceutical Group's position in Beijing's pharmaceutical distribution market.
26/01/2011	"Lerentang Medical Group Co., Ltd."	China National Pharmaceutical Group Corporation (Sinopharm)	"- POE - The largest pharmaceutical distributor in Hebei province, with a 30 percent market share in the province"	"CNY1.3bn 60 percent stake in Shijiazhuang Lerentang Pharmaceutical Chain, together with a distribution business and four subsidiaries of Lerentang Pharmaceutical Group"	The acquisition further strengthens Sinopharm's distribution networks in the second and third tier cities of Heibi Province.
29/01/2011	China Health System Ltd.	Shanghai Pharmaceuticals Holding Co., Ltd. and its wholly-owned unit Shanghai Industrial Pharmaceutical Science (Group) Co., Ltd.	"- POE - China based pharmaceutical wholesaler which carries out its business through CITIC Pharmaceutical Industrial - Among the top three pharmaceutical distributors in Beijing"	"CNY1.24bn 35 percent stake"	Post transaction, China Health System is 100 percent owned by Shanghai Pharmaceuticals. The transaction assists Shanghai Pharmaceuticals to consolidate its pharmaceutical distribution market share in Beijing, and sets a solid foundation for its extension to other regions of northern China.
29/11/2010	Zuellig Pharma China Corp.	Cardinal Health Inc.	"- POE - China based manufacturer of pharmaceutical wholesale products - Focused on third-party pharmaceutical logistics, product allocation and reach to regional end users"	"USD470mn 100 percent stake"	The transaction helps Cardinal Health to enter the China market and extend its distribution channels nationwide.
02/01/2011	China Health System Ltd.	Shanghai Pharmaceuticals Holding Co., Ltd. and its wholly-owned unit Shanghai Industrial Pharmaceutical Science (Group) Co., Ltd.	"- POE - China based pharmaceutical wholesaler which carries out its business through CITIC Pharmaceutical Industrial - Among the top three pharmaceutical distributors in Beijing"	"CNY2.3bn 65 percent stake"	"The transaction helps Shanghai Pharmaceuticals to reinforce its pharmaceutical distribution network in Beijing."
15/10/2009	Sinopharm Group Beijing HuaHong Co Ltd	"Mitsubishi Corporation; Medipal Holdings Corporation "	"POE under Sinopharm Pharmaceuticals wholesaler and distributor."	"USD31m 39 percent stake"	"Huahong will be re-registered as a Sino-Japan JV Mitsubishi and Medipal have sent their experts to the Huahong to provide expertise in hospital management and internal operations The transaction is a part of strategic alliance between the companies and will enable Mitsubishi and Medipal to enter Chinese pharmaceutical distribution and wholesales business and also enable Huahong to expand its market throughout China"
29/01/2007	Guangzhou Pharmaceuticals Corporation	Alliance BMP Limited	"SHEX listed China based company engaged in the distribution of pharmaceutical products"	"GBP38 m 50 percent Stake"	This transaction will help Alliance Boots to grow their pharmaceutical marketing and distribution business in the Chinese markets.

**Introspection in the era of collaboration**

In spite of the surging tide of pharmaceutical collaboration, the real ground-work involved in deals can be time consuming and exhausting, especially in the case of cross-border transactions. Numerous issues can arise during the interaction process that can easily turn out to be deal breakers.

For one thing, finding a good target and obtaining a thorough understanding of its business is no easy task in China. The vast territories, varied regional characteristics and absence of public information result in layers of obstacles when it comes to target identification and investigation.

Pricing can also be a stumbling block. Inspired by their IPO dreams and a succession of high-priced transactions, quality targets unsurprisingly hold out for a higher price. The values cherished by target companies are not always appreciated by investors and such gaps between offers and expectations often lead to unbridgeable differences.

In some cases, different cultures and compliance practices can smash transactions. Differences in the values and work cultures of eastern and western companies can easily lead to a time-consuming and inefficient communication process. Understanding each other’s work culture not only requires a change in mindset but also changes in work style and daily operations. Corporate values may conflict and company vision may differ. Although Chinese players are quickly maturing, foreign companies sometimes find the lack of compliance in their partners unacceptable. This is especially true in the case of multinationals that are new to the market for M&A and joint ventures.

Last but not the least, deals never succeed without integration. Integration is the premise for synergy realisation and maximisation. Promising future depicted beneath the terms on contracts needs proper execution. However, the China market is complex and ever-changing, preventing investors, especially multinationals, from fully understanding local practices and utilisation of existing resources. Acquisitions, and even joint ventures, in China are crying out for well-planned integration projects that will optimise capital and resources input.

Although challenges can emerge at any part of the deal process, there are plenty of ways to mitigate or eliminate problems. Good planning, comprehensive reviews, structured work-flows, as well as proper deal strategies and tactics are all helpful in achieving a successful transaction. For future survival and development in a changing market landscape, it is essential that all players work to cut through complexities.

Boehringer Ingelheim (BI) has been reinforcing its China operations with long-term growth plans. The company has developed a range of business strategies for its various units — prescription medicine, consumer health care, animal health and bio-pharmaceuticals — in China. BI has also established a strong pipeline for prescription medicines, which is expected to increase the launch speed and quantity of new medicines. For its animal health business, BI has set up an Asian R&D center in Shanghai and will establish a joint venture manufacturing base soon. In 2012, it signed an agreement with Taizhou China Medical City in Jiangsu Province to set up a veterinary vaccine manufacturing plant. Bio-pharma has large potential, complied with government strong support in this sub sector.

BI is open to the concept of inorganic growth in China, in particular for the consumer healthcare sector. “We believe that understanding and managing cultural difference is critical in carrying out BD in China,” said a member of BI China management team.



## KPMG: Key steps to success — Corporate Finance

Multinationals remain keen to expand their businesses in China, making M&A high on the corporate agenda. But despite their growth agenda, all multinational companies face a similar challenge: they are keen to grow, but struggle to find suitable acquisition targets. Identifying potential M&A targets remains a challenge due to the fragmented nature of the industry in China and the business practices employed by many of the domestic industry participants. Many multinational companies have literally screen hundreds of potential acquisition targets without identifying a single opportunity that matches their corporate objectives. The competition and pricing for the few attractive acquisition targets is intense.

Even once an attractive acquisition target or JV partner is identified, negotiating and concluding a successful transaction remains a challenge. In our experience, more effective approaches include:

- Interactive and frequent communication between the parties with an advisor / facilitator who can help bridge the culture differences and establish the trust between the parties
- Understanding the motivations of the counterparty when formulating the negotiation strategy, including discussions on valuation and other key commercial terms, as well as addressing due diligence findings and other risks which may not be perceived as as important by the counterparty
- Being well advised when assessing the risks and their potential financial and operational impacts by utilising experienced advisors with both an in-depth understanding of China's life science sector and M&A market and an understanding of a multinational company's mindset. This ensures the 'real' issues are identified and addressed within the context of the China market and innovative solutions considered
- Taking the future integration needs into consideration during negotiations in order to get all parties' commitments and assess the likelihood necessary integration plans can be successfully implemented



# Incubating a healthy future



It is inevitable that China will become one of the largest healthcare consumption markets in the world as the huge demand potential of its 1.3bn plus population is released in the next 10 to 20 years. To satisfy the substantial demand is not only a major task of the Chinese government, but a mission and an opportunity for the players in the healthcare and life sciences industry. Intense competition over a variety of low priced, poor quality products in a fragmented market will be replaced by overall industry upgrading, accompanied by popularization of high-quality and effective new products. The future of the industry will be supported by a renewed emphasis on R&D, affordable healthcare expenditure, improved manufacturing and distribution efficiency, as well as a sound regulatory environment that encourages fair competition in a compliant way.

Obviously, the development of healthcare and life sciences industry calls for the emergence of strong players who can ensure that quality healthcare is delivered to China's massive population. In this context, consolidation and collaboration between local companies, as well as between domestic companies and multinationals, will be inevitable. More active transactions with sizable transaction value will come up, accelerating industry integration and advancement.

No doubt, pharmaceuticals, medical devices and distribution sectors are now witnessing China's healthcare and life sciences boom. Other areas are also emerging and developing as growth points for the industry.



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