Zentiva shareholders holding out for more might be disappointed

Amy Brown

Zentiva’s shareholders, other than the two main ones vying to takeover the Czech generic drug maker, are clearly in the belief that the battle for control is far from over, with the company’s stock comfortably above the latest rejected bid from Sanofi-Aventis.

It is now up to the Czech pension fund PPF, which owns 19.2% of the group, to decide whether to raise the stakes again. However, with Sanofi-Aventis’s bid pitched at 3 times 2007 sales, in line with other deals seen recently in the generics space - including today’s move on Barr Pharmaceuticals by Teva - it is questionable how much higher a financial group that could not find cost savings would be prepared to go.

Zentiva shares were little changed at Kc1,124 today after officially rejecting the Kc1,050 bid from Sanofi-Aventis, which already owns 24.9% of the company. PPF previously offered Kc950.

The higher price values the company at $2.1bn, 21% lower than its market value 12 months ago. In that time Zentiva has struggled with problems in Romania and pricing pressure in its domestic Czech market, hitting sales and its share price, which touched a three-year low of Kc808 in May. The group now claims it is on the road to recovery, and thus believes that the bids fail to reflect the company’s underlying value and future prospects.

Forced hand

Considering the interest in generic players in emerging markets, piqued by attractive growth prospects and low cost, efficient manufacturing operations, Zentiva was probably undervalued earlier this year. No doubt this fact prompted PPF to act in the first place. A cynic might suggest their action was intended to nudge Sanofi-Aventis, and force a more realistic valuation of the company.

Sanofi-Aventis bought its stake from Warburg Pincus in March 2006 for €430m, equivalent to €45 a share, or Kc1,292 based on historical exchange rates. At that time Zentiva shares were trading at Kc1,318. This suggests that unless the French group believes the company has declined in value since March 2006 it needs to up its offer. However, there is a chance it has come to that conclusion.

Since March 2006, Zentiva has entered the Hungarian and Turkish markets via acquisitions, the latter was a significant move and the biggest deal the group has ever struck, paying €460m for 75% of Eczacibas i Generic Pharmaceuticals. The expansion means analysts expect revenues to jump significantly this year, advancing 56% to $1.08bn, its fastest rate of growth since the company floated in 2004.

Growth concerns

On the downside, profitability has yet to recover to levels enjoyed prior to its 2006 spending spree, although it is improving. Plus, there are also real concerns about ongoing difficult conditions in Turkey and the Czech Republic.

Sanofi-Aventis’s generics unit is already established in similar regions, so it should be able to strip out costs and improve margins. However, the group does not disclose sales of the unit, so it is likely to be fairly small, and cost savings not likely to be substantial. For this reason, and the concerns above, it might be reluctant to raise its price much further.

The two bidders face an interesting quandary; while the winner will want to gain control for as little as possible, the loser will want to extract the highest price possible, meaning further cat and mouse manoeuvrings could be on the cards. However, if PPF raises again, in the hope of eking out a higher offer from its French bidding rival, it will be playing a dangerous game. And other shareholders holding out for a bigger payout might also be disappointed.