Interview with Vadim Gennadyevich Muzyayev, President, Protek

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Tags: Protek

In spring of 2010, Protek became the first Russian wholesaler to enter the public stock market, raising $400Mn in the biggest Russian IPO since 2007. You offered the IPO directly after the world financial crisis, which hit Russia particularly hard. Why did you choose this very risky period for the IPO, and what was the plan/project behind the offering?

We actually wished to offer the IPO in 2008, and were fully prepared to do so. However, with the onset of the crisis, we were forced to hold off. Thereafter, we awaited positive signals that the market had calmed.

In spring of 2010, we felt we found quite a good window. Actually, this window was quite small; subsequently, the market again took a tumultuous turn. In any case, we successfully utilized the window we found. You might say that we were lucky.

At the time of our IPO, a number of Russian companies were simultaneously making their first foray onto the public market. In all, they were all relatively successful in this venture. If a volcano had not erupted in Iceland, we would have been even more successful!

Any shareholder that takes their company public seeks two objectives. While I am not myself the shareholder, I can speak to their intentions. The first objective is to realize a part of the capitalization of the company, earned over years of its operations. The second objective is to receive capital that can then fund company growth: in our case, this means investment into

pharmaceutical production and pharmacy. From the $400Mn that we received from the IPO, $200Mn went to our shareholder. The other $200Mn was syphoned back into the company; we continue to utilize this latter sum to develop various investment projects.

One of the most significant moves following the IPO was the recent acquisition of AnviLab, which was very well received in the market. How does AnviLab fit into your strategy of becoming Russia's third largest domestic manufacturer? Will there be more acquisitions or do you plan on investing in manufacturing capacities?

After we acquired funds from the IPO, we set a strategy to invest into acquiring new brands rather than building additional production capacity.

Our Sotex facility is geared toward the production of ampules and liquid formulations. Therefore, the majority of our Sotex-produced portfolio is for the hospital segment. This is a rather narrow segment, with complex, prescription therapeutic areas such as oncology, neurology, and etc. In order to broaden and diversify our offering, we took the decision to bring in OTC products.

The OTC market is completely different than the Hospital market, and is paid out-of-pocket. Within Russia, the out-of-pocket segment has the most lucrative prospects.

We did not plan to develop our portfolio organically, but rather decided to grow by acquisition. One aspect of the realization of this strategy was our acquisition of AnviLab, which has a very strong, and quite famous, portfolio of anti-flu products.

From this acquisition, we attained more than 42 marketable products, patents, and undeveloped assets. From these, only five are currently well known on the market. But there are a number of already formulated products that need only to be commercialized and brought to market, and this potential makes our acquisition further worthwhile.

Therefore, our purchase of the AnviLab portfolio will give us a certain degree of instant market growth and diversification, and provides us with a number of prospective assets that should prove lucrative within two or three years.

How do you explain the specific Russian situation wherein distributors are not afraid of entering the manufacturing segment, hence breaking the golden rule of not competing with your clients? And in your specific case you not only compete with the manufacturers, but also with the pharmacies. How do you ensure that there are no conflicts of interests?

Indeed, vertically integrated holdings are virtually unheard of in our industry. We have extensively traveled to America, and to Europe, and found no such holdings there. We understand the American mindset, and understand why they do not consolidate business in this way. However, conversely, Americans will never understand the Russian mindset! We always do things in our own way. Our economical development, for example, takes a unique path—not that of China, nor Europe, nor America. Our pharmaceutical market development similarly takes a unique path.

When we were developing our production business, many experts asked us whether we were creating competition for our own distribution company, because our products could potentially replace the products of other manufacturers. They believed that this could cause tension amongst our suppliers.

We explained that we are not worried: most major Western manufacturers with whom we work add about 100 products to our distribution line. Even if Sotex should produce a generic analogue of one such medicine, this will not produce an antagonistic relationship between the suppliers and us. Perhaps there will be some light friction, and they would ask us why we are distributing a product that competes with their own. However, we would answer them quite logically: distribution has extremely small margins; production has huge margins! We also want to enjoy such margins! The supplier agrees, and continues to work with us in 99 products.

Sotex will never be a real competitor for pharmaceutical giants, by definition. It will not be the reason Protek, as a distributor, sours its relationship with a pharma giant. And if Sotex ever does reach Pfizer’s size, and a turnover of $40Bn per year, we will sell the distribution business and remain in the production business only, enjoying huge margins!

When we developed the pharmacy business, an American top manager at McKesson also asked us how many pharmacies we would have to create so that other chains would come to detest us. The Western model is different, and neither a company like McKesson nor Cardinal Health would go into the pharmacy sector—even though they would very much like to. Should they open a pharmacy chain in America, their client would abandon them.

Why did your clients not abandon you, when you yourselves opened a pharmacy chain?

Again, this is a peculiarity of the Russian market. Westerners are ill prepared to understand the Russian mindset!

To speak seriously, even though there is grain of truth in this saying, I will further extrapolate. The retail market is very fragmented. It is not concentrated. Looking beyond the few large chains, most

pharmacies are individual businesses that are owned by individual owners. Perhaps these owners possess a small union of two or three pharmacies. Therefore, when we open one of our chain pharmacies, we create competition only for the individual distribution client that is situated nearby the given location. Should the client then refuse, on principle, to use Protek as his distributor, this will be but a drop in the bucket for our total business.

Speaking about the pharmacies business, we understand that you have two different brands. One operates under Riga and the other under the name of “Bless You!”—a discount chain. You have recently undertaken an optimization program for your retail segment, in order to simplify the regional pharmacies management system. What is your overall development strategy for this business segment?

When we undertook the IPO and spoke with our potential investors, we always maintained that the pharmacy business was one of our main development targets. We continue to execute this strategy, and believe that margins in the pharmacy business are, like in production, much higher than in distribution. Furthermore, noting the fact that the market is not concentrated nor consolidated, there are good opportunities for concentration and consolidation. Finally, owning the retail outlet is very convenient for producers, in terms of moving their products. Therefore, the pharmacy business is very attractive in our industry.

For the next few years, we have set quite rapid development targets in this sector. We believe that we can grow at a rate that approximately doubles the growth rate of the market. We plan to grow both the number of pharmacies, and capacities at existing facilities. To this effect, we plan to invest strongly in our pharmacy business.

Let’s now turn to your main business, which is in distribution. Protek CV has long been ranked first or second in this segment. What do you believe it takes to remain a leader in a fiercely competitive market with 10 main companies vying for the top spot?

Firstly, I would say only three players can really vie for first place—Protek, SIA, and Katren. The other distributors likely do not have such ambitions, nor such capacities.

Distribution is indeed our main business in terms of turnover. However, it is fast becoming a lesser business for us in terms of profit generation. That is why I have already spoken of our intention to focus on production and pharmacy. Nonetheless, distribution remains one of our main directions, because even with small margins, our large volumes ensure that our absolute profits are substantial. Furthermore, since the distribution business is fully realized in terms of investment into infrastructure, we can use our distribution profits to invest into our other businesses.

With this in mind, today, our goal is not to become the highest-grossing distributor. In any case, the top three seem to always change places year over year, and it is unlikely that any one will gain a commanding lead. Rather, our goal is be the most efficient distributor, and to earn the highest profits. Of course, this goal is quite challenging given the intense competition you rightly mentioned.

You have recently decided to partner with ChemRar to develop an innovation-based pharmaceutical cluster around the Moscow Physics and Technology Institute. What do you hope to achieve with this initiative?

We are speaking now of the so-called “Severniy” pharm cluster. The institute where we will base the cluster is one of the leading research centers in the country. The members of the cluster are Protek, the institute, ChemRar, Akrikhin, Skolkovo, and a few other entities.

This cluster is organized around an in-development biotechnological facility, which will be the foundation of the cluster’s work. The facility will have approximately 10 laboratories with the most modern equipment. There, young researchers, including students of the institute, will be able to carry out scientific research related to the development of new molecules for biotechnological medicines.

Of course, to organize such a cluster requires the effort of several organizations. ChemRar is a company that endeavors to develop innovative medicines. This company needs, for its work, to have modern infrastructure, and promising scientists. They have many ideas, but of course there needs to be a mode of realization and commercialization.

Protek has a different role in the cluster. As we are a distributor, producer, and a retail business, we have strong capabilities in marketing. Obviously, the main goal of our collective efforts is not only to develop effective medicines, but also to effectively market these products.

I believe that the collaboration involved in this project is optimal. We are even today concluding agreements with ChemRar, within the framework of the cluster, to conclude the advancement of partially developed assets to the point of registration and marketing. This project, of course, is not one we will complete tomorrow—our vision is for the long term. The biotechnological facility has garnered government funds, and one of the most important characteristics of this project is that it helps to accomplish the goals of Pharma 2020. As our government has delineated, by 2020, the domestic industry should produce at least 50% of medicines on the Russian market. Moreover, these medicines should be innovative. We are working towards this goal.

The company results for the H1 2011 were positive with an overall 4.5% year-over-year rise. Nevertheless, they did not quite match your expectations. What will drive the growth of the group in the future?

It is true that our results were lower than expected—we grew at about half the rate of the market. However, we mean to attain more successful results in the second half of the year.

As I mentioned, more than 80% of our revenues hinge upon distribution. And, again, our goal therein is not to be first or second, but to be efficient and produce strong margins to the extent possible. However, profit efficiency and revenues go hand in hand: if you wish to become more efficient, then the growth rate of your revenues will decrease. We are looking for a golden median in this respect, and I believe our results for the latest month of July demonstrate that we have found them. In this segment, we aim to grow quite strongly in the second half of this year, and, at the same time, to enjoy good margins.

To speak about production, I can again relate that the second half of this year will be better than the first. In H1, we sold a large number of in-licensed products, rather than self-developed products. At this juncture, our strategy is to shift our focus towards products we have developed ourselves. Our own brands obviously sell at lower prices than those we license; however, we earn a great deal more profit from them. As for the pharmacy business, it grew quite well in H1—about 19.5% relative to the same period last year. In H2, we will maintain that pace. If we take the whole group, H2 will produce significantly better results, and we hope to please our shareholders.

Let’s look deeper at the fate of your shareholders. Protek’s MICEX stock price declined from about 105 RUB in April of 2010 to about 26 RUB today, and seems very cheap. Is Protek a good investment today?

Indeed, a decline of 400% is very substantial.

To look at the causes of such a decline, we should first look at the conditions currently present in our industry. And secondly, we should note that investors continue to view our company as a distributor.

All over the world, distribution is a low-margin business. When we offered our IPO, our margins were relatively strong. However, in 2010, there were a number of regulatory changes, including the development of the VED list and the government regulation of price controls. The law on circulation of medicines also introduced a number of challenges. Finally, perhaps the greatest effect on our margins came from the price war between distributors. All of these effects combined forced our

margins down considerably.

Nonetheless, Protek is an excellent investment opportunity. Today, we are very much undervalued. Our personal capital is worth more than the entire market capitalization of the company. Secondly, as I said, investors continue to view us purely as distributors—however, we long ago changed our priorities. Our efforts in developing the production and pharmacy businesses will, within the next three or four years, produce very significant results.

So, if one were to buy stock in the company today for 25 RUB, in three years, they will likely see the valuation rise to 100 RUB—a 400% increase. No U.S. Treasury bonds could produce such returns!

What is your final message to the international readers of Pharmaceutical Executive?

Russia is an emerging economy. In GDP per capita, we cannot yet match Western markets. At the same time, any world economist would maintain that Russia has a great future, and is dynamically evolving.

Therefore, we are sure that the economy will grow, in Russia, much quicker than the world economy. Within this frame, the pharmaceutical industry will too grow very quickly. The greatest impetuses for this industry, as defined by government, will be local production, Pharma 2020, and import substitution. Soon, the proliferation of domestic medicines on this market will be quite a bit higher than it is today. Furthermore, with the growth of the economy, we expect a rise in the purchasing power of its citizens. Simultaneously, the price of medicine will grow—not due to inflation, but because quality will improve.

The Russian pharmaceutical market will, in our view, grow by more than 10% per year. This will allow companies in our sector to realize their potential. Within the next five years, I suspect that we will see several Russian pharma companies commit to IPOs. This will confirm the attractiveness of the Russian pharma market.

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