

Leveraging location, low costs, and strong legacy companies with a skilled labour pool, the pharmaceutical industry is a quiet success story in Central and Eastern Europe (CEE). The sector is a major contributor to exports and R&D spending in several countries, and has become a magnet for M&A deals in recent years.

International pharmaceutical companies have a strong manufacturing presence across the CEE region, producing and exporting a wide range of products. US multinational Teva, for example, gained CEE assets – including two generics factories in Bulgaria and oncology drugs facility in Romania – when it acquired Allergan’s Actavis Generics in 2016.

Meanwhile, Sanofi announced earlier this year that it would carve out its active pharmaceutical ingredient (API) business as a standalone company, creating the world’s second-largest API manufacturer.^[1] Its production facilities will include a plant in Ujpest, Hungary. Basel-based Novartis has invested nearly €2bn in Slovenia since 2003, largely through its generics and biosimilars business Sandoz, which has four locations in the country. And in 2019 Sandoz itself announced a deal for the global commercialisation and distribution of a biosimilar to combat multiple sclerosis, to be developed and manufactured by Gdansk-based Polpharma Biologics.^[2]

An export edge

Generics manufacturing in particular relies on three factors: low costs, reliable supply chains, and a skilled workforce – including a regulatory team able to spot products coming off patent. CEE has all these factors, making it a prime manufacturing location for the rest of Europe and beyond. It also has growing domestic markets, driven by ageing populations with longer lifespans and rising incomes.

Poland, the region’s most populous country and biggest economy, had a pharmaceutical market worth €6.4bn (\$7.2bn) in 2017, according to the European Federation of Pharmaceutical Industries and Associations (EFPIA). It was followed by the Czech Republic (€2.8bn, \$2.9bn) and Romania (€2.5bn, \$2.8bn).^[3] Hungary is the region’s biggest exporter (with sales worth €5bn, \$5.7bn in 2017), followed by Poland (€4bn, \$4.5bn) and Slovenia (€2.7bn, \$3bn).

However, given that regional production is slanted towards lower-value (if profitable) generics, only a few countries in CEE have a positive pharmaceutical trade balance, including Slovenia, Hungary and

Croatia.

Poland is the region's leader in pharmaceutical R&D, investing €340m (\$383m) in 2017, according to the EFPIA. Meanwhile, Hungary invested €176m (\$198m) in R&D in 2017, and the sector accounts for 40-45% of the country's R&D overall.

But Slovenia leads the way in per capita terms, with €180m (\$203m) in investment in a country of just 2m people. Slovenia exports 80% of the pharmaceuticals it produces, with 20% of that going to Germany, and the sector has been a major driver of export growth in the past year.^[4] Production has traditionally been dominated by Novartis's subsidiary Lek, and local generics producer Krka, which are two of the country's top three exporters. Krka's global sales rose 12% in 2019 to nearly €1.5bn (\$1.7bn), 94% of that coming from exports.

The current coronavirus crisis has raised concerns that API imports to the region from China and India could be hit. This would cause significant disruption in the sector, as would labour shortages caused by shutdowns or widespread illness. At the time of writing, this scenario was viewed as unlikely, but not impossible.

M&A deals and private equity investments

The pharmaceuticals sector attracted one of the biggest inbound M&A deals in the CEE region in recent years, with the €1.9bn (\$2.1bn) acquisition of Czech firm Zentiva by US private equity fund Advent International from French pharma giant Sanofi in 2018.^[5] Zentiva traces its roots back to a medieval Prague pharmacy, but since the late 1990s has focused on generic drugs. In 2008 the company was acquired by Sanofi, which developed it as a generics platform.

Advent aims to develop Zentiva as an "independent European generics leader, investing in R&D and the manufacturing network, and expanding its market footprint.

Pharmaceuticals is a highly-regulated sector which requires high levels of specific expertise, and drug development cycles are long and capital-intensive – reasons why private equity (PE) has traditionally steered clear of the industry. However, large, mature companies like Zentiva with ample cashflow are suited to PE investment.

Furthermore, with funds worldwide sitting on a record amount of dry powder, the hunt for yield is pushing them towards hitherto less-explored territory – not just big pharma, but less-mature life

sciences companies. And that has coincided with growing interest from international PE in the CEE region. Meanwhile, regional PE players have also grown. Czechia-based Penta Investments and London-based, CEE-focused Mid Europa have invested in pharma and related companies, including manufacturers of nutritional supplements, and a medical laboratory chain.

Adding value

The challenge now facing the pharmaceutical sector in CEE is how to build value and boost profitability. Ongoing consolidation is helping, improving economies of scale and allowing bigger players to broaden their product portfolios by acquiring smaller companies.

The growth of innovative pharmaceuticals business is also significant. To take one example, the Czech Association of Innovative Pharmaceutical Industry (AIFP) estimates that the segment contributes around CZK42bn (\$1.8bn) to the country's GDP overall. It calculates that every dollar spent by innovative pharma companies generates a broader economic impact of \$2.40, a multiplier effect marginally higher than that of the ICT sector. ^[6]

The pharmaceuticals sector overall contributes just 0.5% of Czech GDP, compared to 1.5% in Hungary – closing the gap would boost the industry's value by \$4.4bn, according to the AIFP. As of October 2019 nearly 7000 new medical products were being developed in Hungary, three-quarters of them applying "a completely new approach in its field," according to Hungary's Association of Innovative Pharmaceutical Manufacturers.^[7] Eight out of the top 10 global drug and biotech companies now have manufacturing or R&D capacity in Hungary; local company Gedeon Richter, the region's largest independent pharmaceutical company, employs 1000 people in R&D alone.^[8]

Innovative pharmaceutical companies in the region received mixed support from governments. The Czech industry association praises the backing it receives, while Hungary's argues that the national subsidy system and support for clinical trials could be improved. Even in the European market, companies must contend with a thicket of regional, national, and EU regulations and procurement systems. And the scale of the markets and relatively shallow capital markets means that CEE is unlikely to challenge giant pharma producers across the board. But the region is home to some world-leading generics producers, and the space for boosting R&D and innovation is likely to be an increasing draw for investors in the medium term.

Andrew MacDowall is a correspondent and consultant focusing on emerging markets, particularly central and eastern Europe. He has bylines for publications including the Financial Times, Guardian, and Politico, and advises clients on opportunities, risks, and target assessment in a range of markets.

Sources:

[1] Sanofi press release Feb 24 2020

<https://www.sanofi.com/en/media-room/press-releases/2020/2020-02-24-16-03-59>

[2] Sandoz press release Sept 3, 2019

<https://www.sandoz.com/news/media-releases/sandoz-announces-global-deal-commercialize-proposed-biosimilar-natalizumab-key>

[3] EFPIA “The Pharmaceutical industry in figures” 2019

<https://www.efpia.eu/media/413006/the-pharmaceutical-industry-in-figures.pdf>

[4] Reuters Oct 10, 2019 “Slovenian export growth boosted by pharmaceuticals – government institute”

<https://www.reuters.com/article/slovenia-exports/slovenian-export-growth-boosted-by-pharmaceutical-s-government-institute-idUSL5N26V4PA>

[5] Advent International press release Oct 1, 2018

<https://www.adventinternational.com/advent-international-completed-acquisition-of-zentiva-from-sanofi/>

[6] AFIP Economic Impact study <https://inovaceprozivot.cz/en/economic-impact/>

[7] AIPM media release Oct 17 2019

<http://aipm.hu/en/news/olvas/the-power-of-innovation-vilaggazdasag>

[8] https://hipa.hu/images/publications/hipa-life-sciences-in-hungary_2018_09_20.pdf

Featured Image © Shutterstock.com