

## How Will Charles River's Acquisition of WuXi AppTec Affect Global and Chinese Pharma Outsourcing Industries

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Yesterday (April 26, 2010) Charles River Laboratories announced to acquire leading Chinese CRO WuXi AppTec for \$1.6 billion. The deal represents about 5.8 times of the service revenue of WuXi in 2009. More importantly, the deal will not only provide Charles River a firm foothold in the Chinese pharma outsourcing market, but also create a truly globalized CRO that offers fully integrated drug discovery and development research service to pharma and biotech companies worldwide.

### Brief background of the acquisition:

Through (a small scale) acquisition of Shanghai BioExplorer, Charles River got a foothold in the Chinese market in late 2007. About six months ago, it indicated to look for a second site to expand its China facility though its renovated Shanghai site has just started providing service for less than two years. The Shanghai site, which is primarily focused on preclinical research, is contained in a 65,000 ft<sup>2</sup> facility. The acquisition of WuXi will nearly quadruple the China preclinical research service capacity of Charles River as WuXi just opened its 190,000 ft<sup>2</sup> preclinical/toxicology study facility which is located in Suzhou, about 1.5 hours drive from downtown Shanghai. The construction of the Suzhou site contained two phases. The first phase, which became operational more than a year ago, primarily accommodates WuXi's non-GLP, *in vitro* ADME/Tox service; whereas the just completed second phase is planned to offer certified GLP service. WuXi is currently relying on Johnson & Johnson to provide training in order for it to obtain internationally recognized certifications.

### Rationalizations of the deal:

Although the deal will significantly uplift both the capability and capacity of Charles River's China preclinical research service, under its current overall business structure, to Charles River, it is more complementary than overlapping.

Although WuXi starts providing a full scope of preclinical research service, its service capability in this area is still at preliminary stage. At present the service revenue from this segment accounts for less than 15% of its total service revenue. The acquisition of WuXi won't instantly increase Charles River's service revenue in this area, but it does provide a platform for it to greatly and rapidly expand its presence in the Chinese market in very near future.

What more meaningful to Charles River are WuXi's strong service capability in discovery area and its reputation in the industry. They are complementary to Charles River's current capability and service in China. WuXi's primary service and strength lie

in its chemistry-based laboratory research (i.e. drug discovery research). Currently, about 60% of WuXi's service revenue results from its lab-based chemistry service. More importantly, WuXi successfully achieved nearly 30% net profit margin (at least in 2009) in this type of service which is growing in more than 25% annually. Moreover, WuXi has gained a strong reputation in this area in the industry which empowers it to attract both large pharma and small biotech companies as its customers. The rest of WuXi's revenue comes from its AppTech site (about 20%, mainly medical device testing service) and the large scale manufacturing service provided by its Jinshan site (about 10%).

More importantly, WuXi's past growth history and still huge future growth potential are the additional elements attractive to Charles River. For example, according to JZMed, in less than ten years, WuXi has been growing in about 89% annually on average. Even in 2009, while most global CROs all experienced a negative growth, primarily because of the financial crisis, WuXi was still able to achieve ca. 7% growth (JZMed originally predicted a 10% growth for WuXi in 2009).

With most of its service focused in preclinical research (and, to a less extent, clinical research), Charles River has now gained a truly fully integrated service capability spanning the entire value chain of drug R&D and manufacturing. It also covers both small molecule drugs and biologics. More importantly, it has gained a strong presence and large share in this rapidly growing Chinese industry. The acquisition will not only instantly make Charles River the largest player in the Chinese CRO industry but also enable it to potentially become the world largest (public) CRO in near future.

Based on its past development history, Charles River may, however, eventually abandon the manufacturing service it is going to inherit from WuXi as it is not its expertise and occupies only a small share in its total revenue.

#### **Impacts of the deal on Chinese and global pharma outsourcing industries:**

Needless to say, the deal has created a significant impact on both the Chinese pharma outsourcing industry and the same industry of the world. It might prompt many other companies to follow.

In fact, according to JZMed, in less than six months, there have been four such relatively large M&A deals (including this one) between Chinese companies and multi-national CROs. The other three deals are:

- In October 2009, PPD, another multi-national CRO, acquired China-based CRO, Excel PharmaStudies (which was primarily focused on clinical research service. The size of the deal was not disclosed but JZMed estimated to be around \$30-40 M based on our estimate of Excel's latest service revenue);
- In November 2009, PPD, once again, acquired another China-based CRO, BioDuro for \$77 M (BioDuro has very similar business structure to WuXi except that it is much smaller in size and younger in age);

- In January, 2010, Pharmaron, a Chinese-run CRO with most of its service focus in drug discovery and process R&D, acquired Bridge Laboratories, a US-based CRO with most of its operation performed by its Beijing facility (Bridge Lab also offers preclinical research service). The acquisition will enable Pharmaron to greatly expand its service scope.

In addition to these three, more recently (April 2010), ICON, an Irish CRO, formed an alliance with Tigermed, another Chinese-run CRO, to access the Chinese clinical research outsourcing market.

As was predicted in JZMed's 2009 annual review on Chinese pharma outsourcing industry, more such consolidations will very likely take place in the following one to two years in the Chinese pharma outsourcing industry. All these deals will accelerate the maturation of the currently highly fragmented Chinese industry. More importantly, they will make its service capability quickly reach the international standard, which will in turn further drive up its development as this Chinese industry is relatively young and used to be considered only able to provide low-end services.

Another factor that will further drive up the development of the Chinese pharma outsourcing industry is the increasing focus of the world major pharma companies on the Chinese drug market. All major pharma companies have been currently shifting their marketing focus more on to the emerging markets as they are expected to contribute most of the future growth of the world pharmaceutical market. Whereas among all emerging markets, China is currently standing out noticeably. A number of major pharma companies including Pfizer, Novartis, Roche, Bayer Schering, etc. all have uplifted the supervising focus level of their China business (needless to say their commitment to more investment in China). While they are increasing their presence in the Chinese market, their current China facilities, both R&D and manufacturing, are still barely able to meet their development need. This will very likely create more need of outsourcing service within the local area. To a large extent, all these latest M&As are primarily triggered by this future development potential of the Chinese pharma outsourcing industry.

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