

## Fitch: Sanofi-Aventis Animal Health JV Underlines Diversification Push

Fitch Ratings-London-09 March 2010: Fitch Ratings says that the joint venture (JV) announced today between Sanofi-Aventis ('AA-'/F1+/'Stable) and Intervet/Schering-Plough (ISP) highlights a move by branded drugmakers to diversify into the global animal health market as they seek to become less dependent on ethical pharmaceutical drugs.

"This move is motivated by patent challenges, governments' cost containment policies and a challenging regulatory climate affecting the ethical pharmaceuticals portfolio," says Britta Holt, a Director in Fitch's corporates group.

"In contrast to the USD773bn ethical pharmaceuticals market, the USD19bn global animal health market is a lower risk market. Patent expiration risk exists in the animal health marketplace, but generic drugmakers tend to be less aggressive compared with ethical pharmaceuticals," says Holt.

However, EBIT margins in the animal health sector can be up to 30% for successful players, such as Sanofi-Aventis, with a high exposure to the companion animal industry. This level of EBIT margin is similar to that of strong ethical pharmaceuticals' players.

Acquisition activity in the animal health sector has increased recently. Sanofi-Aventis' investment in a 50%/50% joint venture with ISP follows its September 2009 acquisition of the outstanding 50% stake in animal health JV Merial from its U.S. partner Merck & Co Inc. (Merck, rated 'A+/'F1/'Stable). In addition, Pfizer ('AA-'/F1+/'Stable) recently boosted its market share in the animal health market through the acquisition of Wyeth Inc., which was completed in October 2009.

Following its completion, the JV between Sanofi-Aventis and ISP will provide Merial with greater exposure to the livestock animal health business, which accounted for 38% of Merial's business on a stand-alone basis in FY08. Fitch believes that the JV will help to mitigate some pressure on Merial's sales and profitability arising from the 2010 patent expiry for fipronil (Frontline), a topical anti-parasitic flea and tick treatment for dogs and cats, which represents an estimated 20% of Merial's companion animal health sales. Total companion animal health sales represented 66% of Merial's sales in FY09.

The global animal health market - helped by recent consolidation - is highly concentrated with the top five players accounting for about 65% of the market in FY08 (on a pro-forma basis including the above-mentioned acquisitions). The top three players in this market, Pfizer, ISP and Merial, account for about 50% of the market.

Growth in the animal health sector is generally lower than in pharmaceuticals and somewhat correlated to GDP growth. Market growth has been historically around 4% p.a., compared with 5%-8% for ethical pharmaceuticals over the past five years. Additional growth in animal health is expected from the companion animal market, which represents an estimated 35% of the global animal health market. The companion animal health market is driven by the number of pets in consumer households and the willingness of pet owners to spend more on their animals' health, a trend confirmed in the recent sale of UK retailer Pets at Home Ltd..

The main markets for companion animal health are Europe and North America. Compared to the livestock animal health market - an estimated 65% of the global animal health market - the companion animal health market is more profitable and has historically shown higher annual growth rates. Growth in the livestock market has been driven by increased demand for safe meat and dairy products. The main growth regions in the livestock health market are emerging markets.

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