

Indian Ownership In Natrol's Future

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It's been years since Wall Street has valued Natrol Inc. as highly as founder Elliott Balbert believed it was worth. Now, a company halfway across the world has taken advantage of that weakness to gain a toehold in the huge U.S. nutritional supplements market.

Plethico Pharmaceuticals Ltd., a Mumbai, India pharmaceutical and nutritional supplement maker, is seeking to acquire Chatsworth-based Natrol Inc. for almost double its stock's recent price.

The friendly Nov. 19 offer of \$4.40 per share figures out to about \$81 million. But Plethico's chief financial officer, Sanjay Pai, considers the deal a bargain.

"Everything good comes at a price," Pai said in a telephone interview from his Indian office. "We're looking at a steady growth model, not big bucks at one shot."

Natrol, with annual revenues of about \$66 million, has well-known brand names, including ProLab sports supplements. It also has extensive U.S. and Canadian distribution channels and access to overseas markets where Plethico doesn't yet do business.

"I see this as a win-win for both brands," said Rupa Shah, a Mumbai-based analyst with FinQuest Securities. "Plethico gets its products into the U.S. and the U.K. which have very large Indian communities; and it gets many new products it can sell in its India and overseas markets."

However, the deal is also an unusual one, because until now it's primarily been Indian generic and over-the-counter drug companies that have attempted to buy their way into the U.S. market.

Locally, the most notable example came in 2003, when drug giant Dr. Reddy Laboratories of Hyderabad, India, made a major investment in Carson-based Leiner Health Products. Leiner is one of the nation's largest makers of over-the-counter drugs and nutritional supplements and a supplier to Target and Wal-Mart. The investment happened after Leiner emerged from bankruptcy.

Thumbs up

The offer sent Natrol's shares up 89 percent in one day – Monday, Nov. 19, when they zoomed from \$2.27 to \$4.29. The stock's close on Wednesday, Nov. 21, also was \$4.29.

For Balbert, who founded the company in 1980 and took it public in 1998, the sale is a bittersweet event. Balbert is Natrol's chairman and largest shareholder with 42 percent of shares, which makes his stake worth \$34 million. But he gave up his chief executive role early last year.

"It's unlikely that I'll have an ongoing role with the company, though I'll be happy to assist the new owners if they ask," Balbert said.

Canaccord Adams analyst Scott Van Winkle, whose company was involved in Natrol's IPO, recalls the company's stock, which once traded above \$16, was hit hard when retail supplement giant GNC cut prices and sent the entire market for a loop. Shares began a downward spiral to below \$2 by 2001. The stock has spent the next six years bobbing roughly between \$2 and \$4.

Balbert maintained that problems within the U.S. market for nutritional supplements dragged Natrol's stock down too far for too long.

"I certainly didn't expect this acquisition," said Van Winkle, noting Balbert had brought on a new chief executive last year in a move to boost growth. "But there's no doubt that drug companies in both India and China have gotten aggressive in expanding overseas. Nutritional supplements would be a complementary business."

The Indian pharmaceutical industry has been one of the subcontinent's big success stories. Business management consultants McKinsey & Co project that the Indian pharmaceutical market will grow about 12 percent annually to \$20 billion by 2015 from \$6.3 billion in 2005.

One of India's largest drug companies, Plethico manufactures branded generic pharmaceuticals, herbal and nutraceutical products and over-the-counter drugs, including Travisil cough and cold products. Its products are sold in Europe, Russia, Southeast Asia, Africa and Latin America.

Pai said that the company is focused in the U.S. market on segments with lower barriers to entry, such as nutraceuticals. Generic drugs, on the other hand, require more expensive and time-consuming U.S. regulatory approvals.

The company plans to fund the Natrol deal from \$75 million it raised in convertible bonds last month, plus some of the proceeds from its initial public offering in May.

Meanwhile, Natrol has seen its fortunes sway over the decade as Balbert attempted to broaden the company's product line beyond the standard vitamin and mineral supplements.

One of his biggest successes was obtaining U.S. rights to manufacture Ester-C, a form of Vitamin C that is considered to be easier on the stomach and better absorbed by the body. Ester-C had been the company's biggest seller, accounting for more than 10 percent of revenue for each of the last three fiscal years.

In addition to Ester-C, Natrol also has the top-selling brands of melatonin, a sleep aid, and obesity control supplement DHEA and 5-HTP. The company also rode the low-carb diet fad earlier in this decade with its Carb Intercept, a supplement that blocks starches from being fully digested. That product also accounted for more than 10 percent of revenues in 2004 but then faded.

Other ventures were less successful, prompting Balbert in early 2006 to recruit an Australian entrepreneur named Wayne Bos to become chief executive. Bos has a track record of accelerating growth of small companies into global markets in industries ranging from telecommunications to consumer products.

Hitting the wall

"I decided it was time to fire myself," said Balbert. "I'm really good at the entrepreneurial stage of building a company, but after a while you hit a wall, and I had the wherewithal to realize that it was time to bring in some new thinking."

Bos, who was overseas and could not be reached for comment last week, expanded overseas distribution and added products to the Natrol lineup. The company also established a subsidiary in the United Kingdom and has a Hong Kong partnership that may eventually lead to access into the huge Chinese consumer market.

Over the last 18 months, Natrol has acquired or launched products as varied as an herbal hair growth line and a trendy Acai fruit antioxidant product. In June it added another sports supplement line, MRI.

But like Balbert's experience, some of Bos' gambles fizzled, including an aggressive entry into the faddish hoodia appetite suppressant market. Around the same time, its Ester-C business collapsed when the patentholder of Ester-C's active ingredient was acquired and cancelled all third-party manufacturers, including Natrol.

On top of those setbacks, the company had lingering litigation from its days as a marketer of ephedra-based diet products banned by the U.S. Food & Drug Administration in 2004.

In advance of the Plethico deal, Bos decided to clear the decks in the third quarter, taking a variety of charges totaling \$3.3 million. While net sales were up 31 percent before the changes, the company reported a \$3.16 million loss for the quarter, its poorest showing since 2005.

"We had to do a lot of clean-up," said Bos, during the company's Nov. 14 conference call.

Bos, expected to stay on with the company to lead the integration and global growth effort, said the company should return to profit by the next quarter.

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