Commentary

Mergers & acquisitions (M&A) in the pharmaceutical industry: the wheel keeps on turning

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A prediction was made here in January 2009, that the market for company mergers and acquisitions in the pharmaceutical industry would continue to reach a high level in 2009, even after the announced cases of large M&As (e.g. Novartis/Alcon, Roche/Genentech, Teva/Barr Pharma) in 2008. This forecast was attempted even though it was clear that the so-called 6th M&A wave was drawing to a close after encountering increasing problems in raising outside capital, especially after the collapse of Lehman Brothers in September 2008. And indeed, when considered as a whole, the M&A year 2009 – and the first months of 2010 are not showing any considerable improvement – was a weak M&A year: the global M&A transaction volume fell from approx. US$ 4.200 bn in 2007 (2006: approx. US$ 3.400 bn) to a mere US$ 2.500 bn in 2008, to then only accumulate a volume of approx US$ 1.300 bn in 2009. This decline is even more distinctive at a European level and thus shows that US and Asian companies are increasingly setting the tone for M&A transactions. Furthermore, the global share of financial investors in purchase volume took a plunge from 26% in 2006 to 8% in 2009. Companies - so-called strategic investors - must therefore stem the remaining low M&A volume on their own.

Pharmaceutical M&A remain at a high level in 2009

In retrospect, the prognosis for a strong M&A year 2009 for pharmaceuticals was quite accurate: In January 2009, Pfizer announced they would be taking over their competitor Wyeth for US$ 68 bn. Shortly after, Merck & Co. followed suit with their report on the acquisition of Schering-Plough for US$ 41 bn. Other examples of further large-scale M&A cases in the pharmaceutical sector were the takeover of the Czech generics manufacturer Zentiva by Sanofi-Aventis (approx. US$ 2 bn), the acquisition of the US skin-care specialist Stiefel Laboratories by GlaxoSmithKline (approx. US$ 2.9 bn), the complete takeover of the joint venture Merial (animal health) by Sanofi-Aventis from Merck & Co. (approx. US$ 4 bn) and the takeover of the pharmaceutical sector of Solvay by the Belgian company Abbott Laboratories (approx. € 4.5 bn).
In March 2010, both the announced US$ 5.3 bn takeover of Millipore by the German Darmstadt-based company Merck and the takeover of Ratiopharm by Teva (approx. € 3.6 bn) show that the M&A market wheels are still running smoothly in the pharmaceutical industry. The M&A community is increasingly seeing cases such as Merck/Millipore as an indicator or guiding light for a general re-ignition of the M&A market. What is causing this exceptional situation in the pharmaceutical M&A market and what are the probable developments for 2010 and 2011? Why does the generics business appear to raise interest again even though major pharmaceutical companies had a tendency to part with it in the last decade?

Global weak economic phase promotes consolidation

Generally, it can be said that the worldwide financial crisis is not only influencing the amount of drugs being sold but is also increasingly pressurizing the pharmaceutical industry's pricing. The demographic development of economically advanced nations is leading to a steady increase of health costs - with simultaneous national budget deficits. Pressure is therefore mounting to minimize the costs of the health system by means of regulatory measures. In addition, the drug pipelines are quite low and many blockbuster drugs with bn. US$ turnovers will soon be disappearing as a source of revenue for the pharmaceutical giants.

Generic drug manufacturers such as Teva, Mylan or STADA are growing and are also in the middle of a consolidation process (e.g. Merck Generics being acquired by Mylan in 2007, takeover of Ratiopharm by Teva). Pressure is building up immensely for the group of research-based pharmaceutical companies who were pampered by success so far. They rapidly have to increase their efficiency by tapping into synergies in e.g. R&D, procurement or administration.

Generic drug manufacturers are becoming more attractive

When on their shopping spree, research-based pharmaceutical companies no longer shy away from taking over generic drug manufacturers and thus acquiring a „turnover base line" – even if the margin is not enormous – which they use as a value argument when presenting to their shareholders. One example is the huge interest Pfizer showed in taking over Ratiopharm: the patent protection for several Pfizer drugs will be expiring in the coming years and Ratiopharm would have been a good opportunity to generate further efficient growth. Shortly after the takeover of Wyeth, Pfizer followed high increase in efficiency objectives by closing down sites, for example. It remains to be seen if high takeover prices can be justified, such as the US$ 41 bn paid by Merck & Co. for Schering-Plough and the thus acquired drug pipeline. It is currently hard to predict the transaction value of the approx. 20 phase III drugs that Merck & Co. acquired with the deal.

Biotech as a major driver of pharmaceutical consolidation

Apart from the drivers „Synergy by economies of scale" and „Purchase of drug pipelines", there are increasing signs that pharmaceutical companies are placing their bets on producing biological blockbusters alongside small molecules. Next to the general risk reduction coming along with a product portfolio diversification biotech investments contain a "copy protection" which results from high financial and know-how requirements to copy biotech products. Biotech as a driver for M&A or the intensification of cooperations was probably the motivation driver for the following M&A deals: MedImmune/AstraZeneca (in 2007 for approx. US$ 15 bn), Merck/Serono (in 2006 for about € 10.1 bn), Merck/Millipore (in 2010 for approx. € 5.4 bn) or Astellas Pharma/OSI Pharmaceuticals (offering US$ 3.5 bn in 2010). Takeovers of especially small biotech companies are simplified by the high financial need for product development or market entry. Since these required loans are not available through banks or financial investors, it offers a perfect investment opportunity for large financially sound pharmaceutical players.

Justifying high acquisition prices by efficiency improvement in difficult markets

In conclusion, not only increasing efficiency pressure but also dried-out pipelines will increase the consolidation pressure on the pharmaceutical sector in the near future. In addition, biotech will „mature" and by doing so, will become an integral part of larger pharmaceutical companies. It will become important for the success of pharmaceutical M&A cases to justify the often high acquisition prices with future turnover in partially difficult markets or through cost savings. This is where it calls for the merging partners to implement a high quality post merger integration and in doing so to sufficiently take into consideration the particularities of national clients and also the cultural differences of the own workforce.