

Mergers & Acquisitions M&A drives shareholder value for life sciences

The current void left by weak research and development (R&D) pipelines appears to be driving the need for life sciences organizations to create shareholder value through non-traditional approaches. That change seems to have fallen most heavily on CFOs who are being asked to take a more proactive role in the creation of shareholder value well beyond their traditional financial and operational duties. This pressure to create value is driving mergers and acquisitions (M&A), divestitures and restructurings at unprecedented levels throughout the industry, and many astute CFOs are leveraging M&A opportunities to drive down effective tax rates, increase company valuations, and capitalize on synergies that allow their organizations to scale rapidly.

In an industry where lead time from discovery to revenue can easily reach 10 years, life sciences organizations need both short- and long-term plans to create shareholder value. Short-term M&A and restructuring activity can help life sciences companies efficiently diversify portfolios, provide new product opportunities, expand scale, and improve their competitive position. However, M&A transactions are complex and involve significant execution risks. Without the required skill sets and experience to efficiently and effectively execute transactions, the process can disrupt organizations and negatively impact shareholder value rather than create it.

Three specific factors currently impacting life sciences M&A activity are patent expirations, pricing pressures, and tax considerations. Starting in 2012, pharmaceutical patents began expiring en masse and are expected to continue expiring at this pace through 2016. Drugs going off patent in 2014 alone will have a \$50 billion impact on the industry, and there is little being developed to replace these drugs and the revenue lost due to generic pricing models.¹

Key takeaway

- As CFOs of life sciences companies are increasingly expected to participate in shareholder value creation, they should consider broadening their role in driving corporate strategy, including creative approaches to mergers, acquisitions, and restructurings.

¹ M&A Trends in Life Sciences and Health Care, Deloitte 2014

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The impact of health care reform and the move toward value-based care has left many life sciences companies battling pricing pressures for both drugs and medical devices. Lower reimbursements, changes in physician practice models, widespread industry consolidation, and the demand for pricing transparency and alternative pricing models have armed those making purchasing decisions with new ways to exert greater leverage to drive down prices. [See Value-Based Care]

Because life sciences intellectual property transfers globally, many organizations are targeting acquisitions in other countries to expand their footprint and drive growth.

The global nature of the industry leaves life sciences organizations uniquely positioned to take advantage of tax considerations abroad, which can significantly lower effective tax rates and impact the value of acquisitions. Tax considerations are primarily a focus for large, experienced acquirers that can achieve tax efficiencies and improved management of global intellectual property through strategic location of the parent company or intellectual property. However, increased regulatory and political scrutiny may limit such tax advantages as countries across the globe fight to keep tax dollars in their respective geographies.

Nevertheless, the current M&A climate for life sciences involves considerable cross border activity. While U.S. spending on traditional drugs grew at a lackluster 2.4 percent in 2013, that number was offset by a 14.1 percent increase in spending on specialty drugs.² Even with considerably lower growth in spending than many emerging countries, the U.S. market is still the largest consumer of life sciences products, nearly quadrupling that of Japan which is the second-highest.³ Therefore, it is no surprise that companies that currently have little exposure to U.S. markets are seeking to invest in the U.S. where they can capitalize on a market that consumes nearly 40 percent of all health care, pharmaceutical and medical devices worldwide.⁴ At the same time, foreign and emerging markets that are growing at several times the rate of the U.S. are prime targets for life sciences companies that are heavily U.S.-based and wish to take advantage of countries where rising incomes and greater access to health care are increasing demand for their products. Regardless of where life sciences companies are based, a 50/50 split between U.S. and non-U.S. interests can create a balanced geographic reach.

According to Deloitte's recent M&A Trends in life sciences and Health Care survey, 48 percent of companies with less than \$1 billion in revenues and 85 percent with more than \$1 billion in revenues plan to engage in M&A over the next three years. Many life sciences companies have significant cash reserves that allow them to self-finance acquisitions, increasing the speed and volume of transactions and creating synergies among entities to increase shareholder value more rapidly.

With the competitive pressures that life sciences companies face, the industry appears to be relying more heavily on M&A and other restructurings to create shareholder value, which puts additional pressure on finance teams to identify and effectively execute against transactional opportunities. As of July 2014, M&A activity was three times what it was for the same period in 2013.⁵ While activity continues to increase, companies are taking a more deliberate and cautious approach to M&A. Given the criticality of agility and accuracy when executing M&A transactions, it's imperative that LS CFOs have skilled and experienced resources at their disposal to help them effectively navigate the M&A landscape.

2 Industry Report: Healthcare September 2014, The Economist Intelligence Unit Limited 2014

3 Pharmacy Data by Country, The Economist Intelligence Unit; and 2015 Life Sciences Outlook, Deloitte 2014

4 Ibid

5 M&A Trends in Life Sciences and Health Care, Deloitte 2014

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