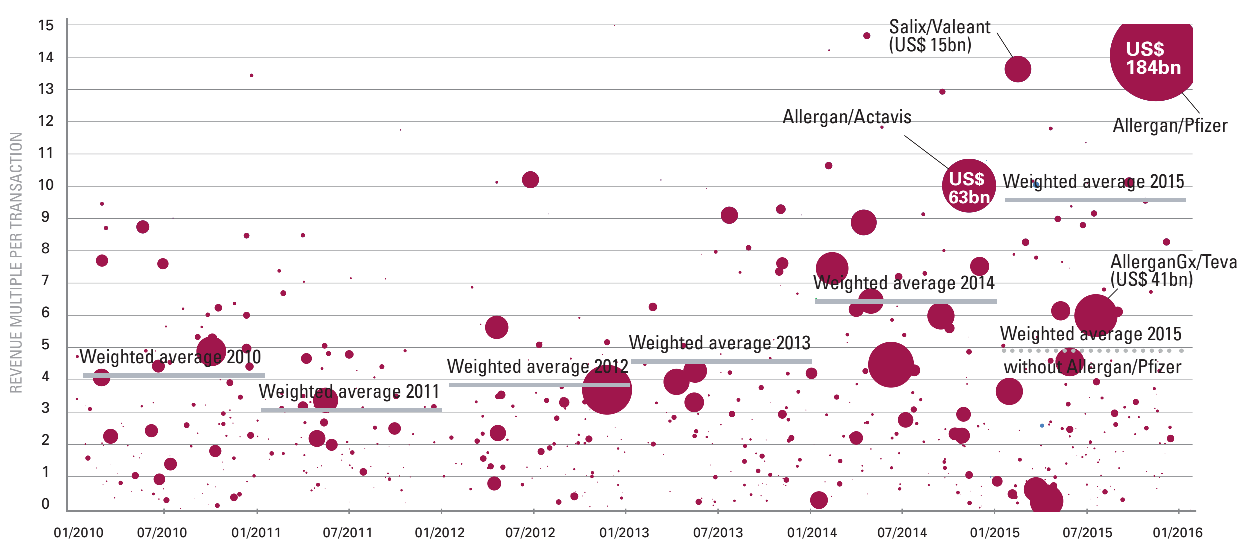
Large deals dominate Pharma M&A

The year 2015 saw a continued high level of M&A activity in the Pharma and Biotech industry. As we show in our long-term view (see Graph 1), deal volumes, the number of deals and average multiples are still at a very high level as compared to the mid-term past.
The word of the year in the Pharma industry – and among deal makers at large – is probably "Pfallergan", a merger of "Pfizer" and "Allergan". Allergan was the only target large enough to enable Pfizer to move its tax domicile through an acquisition (a so-called "inversion"), after the US-based giant was rebuffed by AstraZeneca in 2014. Ironically, Allergan, previously Actavis, has been Irish since only 2013 when its precursor Watson Laboratories changed its legal seat in a tax inversion involving Warner Chilcott.

In our analysis, building on data sourced from global deal database MergerMarket, we compare announced deals over the last three years. The number of deals increased from 371 in 2013 and 438 in 2014, to 494 last year. The cumulative deal values almost doubled from US$ 226bn to US$ 415bn – largely due to the announced acquisition of Allergan by Pfizer. With a deal value which is in excess of US$ 183bn, the Pfizer / Allergan merger makes up more than 40% of the sum of all deal values and skews the statistic significantly. However, even without this huge deal, deal activity in 2015 was at a very high level.
With its US$ 40bn sale of the generics drug portfolio, Allergan also accounts for the second largest transaction in 2015 (see Graph 2). Other large transactions included further generics consolidation deals (Endo / Par and Pfizer / Hospira), Baxter's split, and pipeline acquisitions by AbbVie, Alexion, Shire and AstraZeneca.
Looking at inter-regional transactions (buyer and target in different regions), most of the money was spent, as in the past, on acquisitions between the US and Western Europe (see Graph 3). However, putting aside the huge Pfizer / Allergan deal (a US firm buying a "European" target), much less money was spent on targets located in Western Europe in 2015 compared to 2014 (see Graph 4). This is a consequence of the wave of tax inversion deals in 2013/2014. The acquirers in those deals, formerly US-based, now have tax domicile seats in Europe and continue to spend on acquisitions. They generally acquire targets based in the US,

GRAPH 1 / PHARMA M&A IS ARGUABLY AT ITS ALL-TIME HIGH, WITH UNPRECEDENTED VALUATIONS
Worldwide M&A Transactions with Pharma and Pharma-related targets, 2010-2015



Note: Pharma deals with reported revenue multiples <20x and deal size >US$ 10m: n=607; bubble sizes represent deal size.
Source: IMAP analysis based on data from MergerMarket.

M&A TIMELINE 2015

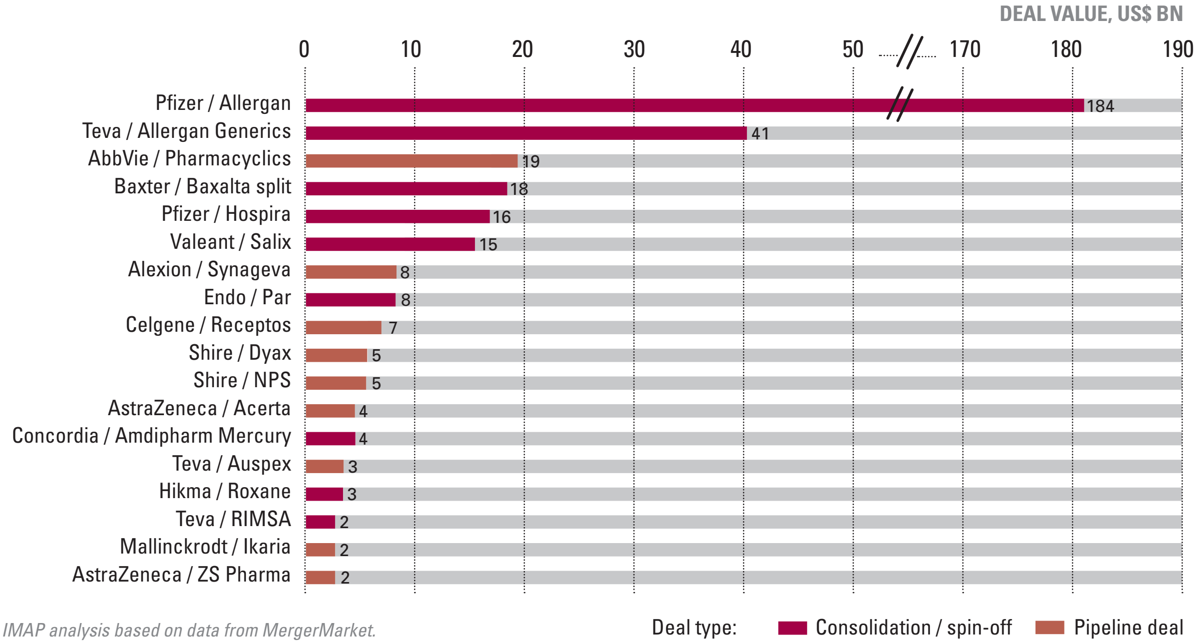
JANUARY FEBRUARY MARCH APRIL MAY JUNE JULY AUGUST SEPTEMBER OCTOBER NOVEMBER DECEMBER

/ Shire acquires NPS for US$ 5bn

/ Valeant picks up Dendreon assets for US$ 495m

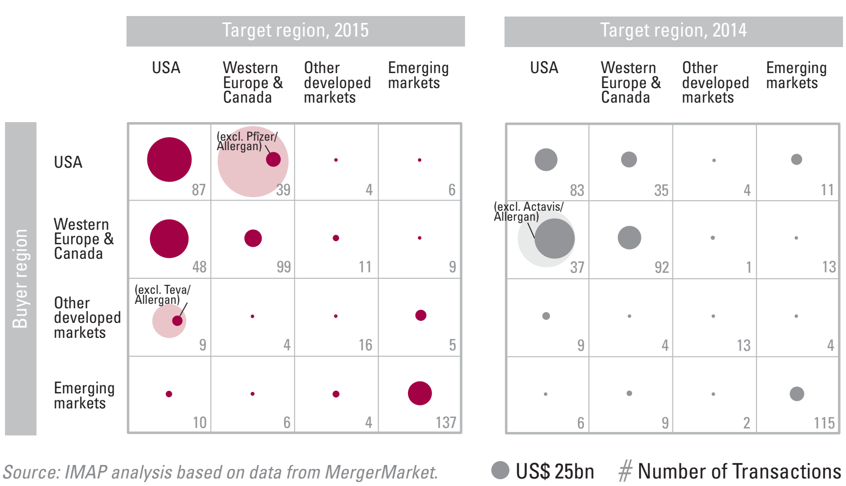
/ Tekmira buys OnCore for US$ 376m

GRAPH 2 / TRANSACTIONS WITH A VALUE OF MORE THAN US$ 2BN IN 2015



Source: IMAP analysis based on data from MergerMarket.

GRAPH 3 / WHERE DID THE MONEY GO? TRANSACTIONS BY ORIGIN OF BUYERS AND TARGETS



Source: IMAP analysis based on data from MergerMarket.

thereby exploiting their tax-efficient set-up.
Valuations have been persistently high and TEVA's acquisition of RIMSA, a branded generics provider in Mexico, was one example of a very expensive deal (10x revenues). Pfizer is also paying a considerable amount for Allergan (14x revenues), as did Baxalta for Sigma Tau's oncology drugs and pipeline (9x revenues). Sometimes, high revenue multiples may have been justified by large synergy effects or strongly growing profits. In other cases, the valuation drivers are not so obvious and may be a result of an ongoing pressure to consolidate. Our long-term analysis of EBITDA multiples in the pharma industry (see Graph 5) shows a strong increase in valuations for larger deals (deal size bigger than US$ 2.5bn) in the last two years.
In the last quarter of 2015, the climate cooled down considerably and some insiders expected markets to crash during a brief time. What happened? When Turing Pharmaceuticals multiplied the price of an old but essential product, the resulting public backlash caused analysts to review the long-term

/ Pfizer boosts Gx, buys Hospira for US$ 16bn

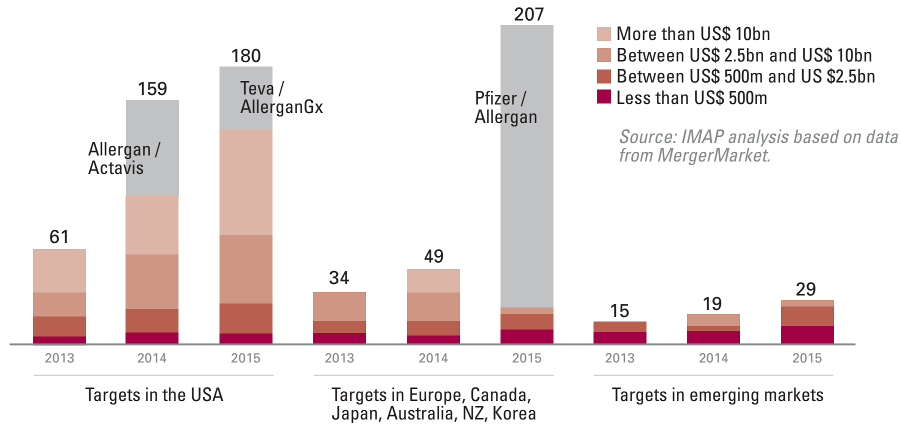
/ Valeant's last large deal: Salix for US$ 15bn

/ BMS pockets Flexus for US$ 800m

/ AZ boosts respiratory, buys Actavis portfolio for US$ 600m

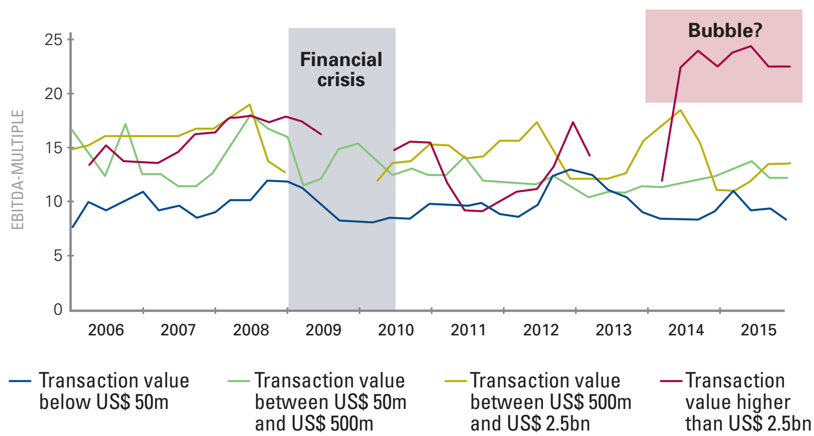
prospects of serial acquirers Valeant, Mallinckrodt and Horizon Pharma. The huge valuations these companies had been able to pay were partly recouped with dramatic price increases of the target's old products, an operational tactic which appeared unsustainable after the public debate caused by Turing. The demise of these companies, in particular of Valeant, was a much discussed drama towards the end of the year.
In parallel, the IPO market – which also extended its boom from 2014 – went through a "soft landing", as hedge funds and other general investors pulled out of pre-IPO and IPO-financing. Valuations of privately held and IPO-ready Biotech firms are likely to suffer in the near future, however, industry insiders do not believe that the IPO and financing machinery will come to a standstill as they did after the dot-com crash. Too much money has been raised by investment funds which needs to be deployed.
What else is to be expected? The changing political climate and more importantly, the scarcity of eligible targets for the usual tax inversions – which are based on ownership ratios post-transaction – means that the wave of purely tax-driven billion-dollar deals will soon come to an end. Another type of tax inversion based on financial ratios between acquirer and target is likely to become an avenue for smaller companies to change tax domicile. If this will play out still has to be seen.
Fundamentally, the industry is still far from being organized. Large deals such as the Pfizer/Allergan merger, for example, will lead to divestments and spin-offs as the organization is too diverse and complex to be manageable in the long term. Even though Pfizer's long-expected spin-off of its generics business has been delayed, it will certainly be implemented. At the same time, a number of companies which came under pressure by recent consolidation waves, such as Johnson & Johnson in the OTC/Consumer Health space, may use their accumulated "war chest" to pursue "transformational" acquisitions.
Thus, we expect that deal activity will remain high, but the nature of deals will shift from multi-billion dollar deals which are financially driven, to comparatively smaller transactions which fundamentally improve the acquirer's strategic position in a given market sub-segment.

GRAPH 4 / CUMULATED DEAL VALUES BY TARGET REGIONS



Source: IMAP analysis based on data from MergerMarket.

GRAPH 5 / PHARMA EBITDA MULTIPLES OVER THE PAST 10 YEARS



Note: Median EBITDA-multiples of Pharma transactions from the trailing twelve months (TTM) preceding quarter shown. Only data points with a minimum of 10 transactions (resp. 6 transactions for the category >US$2.5bn) in the TTM are shown.

Source: IMAP analysis based on data from MergerMarket.

JANUARY FEBRUARY **MARCH** APRIL MAY JUNE JULY AUGUST SEPTEMBER OCTOBER NOVEMBER DECEMBER

/ AbbVie wins Pharmacyclics bid with US$ 19bn

/ Teva buys out Auspex for US$ 3.2bn

/ Mallinckrodt pockets Ikaria for US$ 2.3bn

/ Horizon acquires Hyperion for US$ 871m