M&A update
Healthcare

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Mid-market pharma dominates M&A activity

Globally, mega deals continue to abound, domestically the mid-market and PE have been the core drivers of activity.

Globally, it's been a busy year for pharma merger and acquisition (M&A) activity, with four more $1bn plus deals compared to this time last year. Drivers include the second "patent cliff" ($251bn of sales are forecast to be at risk between 2018 and 2024), and the continuing impact of the 2018 US Tax Cuts and Jobs Act, which has provided a predicted $160bn of cash for industry multinationals to deploy. M&A on a local scale has been notable too, although deals have focused on the mid-market and private equity (PE) investment has been an increasing driver of activity, either directly or from PE-backed businesses consolidating niches.

Mega deals set the pace for 2019

It was a strong start to the year. Eight days in, Takeda announced it had completed the $62bn acquisition of Shire, the largest ever foreign acquisition by a Japanese company and one of the largest pharma acquisitions in history. The acquisition brings Shire's successful rare disease portfolio to Takeda, which is struggling with patent expirations on its blockbuster products and lacks late stage molecules in development. It also catapults Takeda into the top 10 companies in the global pharmaceutical industry by revenue.

Before this ground-breaking deal had a chance to close, an even larger deal was under way. On 3 January, BMS announced its $74bn acquisition of Celgene. The deal creates a giant in haematology, immunology and cardiovascular disease, and comes on the back of a strong 2018 for Celgene – during which it acquired Juno Therapeutics for $9bn and Impact Biomedicines for $7bn. Celgene went onto announce they were selling the worldwide rights to Otezla to Amgen for $13.4bn in August. January finished with GSK strengthening its pipeline and commercial capability in oncology via a $5.1bn acquisition of Tesaro.

The ground has already been laid for big deals to close at the beginning of 2020, with AbbVie's $63bn bid for Allergan and Novartis's $9.7bn bid for The Medicines Company. The Allergan deal should make AbbVie less dependent on blockbuster Humira, due to come out of its various patent protections in the US in 2023. Investors were not immediately enamoured. Unlike the BMS-Celgene deal which combines two experts in oncology, AbbVie and Allergan have different historical focuses. Allergan has been successful in aesthetics, eye care and neurology, while AbbVie has its roots in immunology and haematology. After the deal was announced, AbbVie's share price took a significant dip. Novartis acquiring The Medicines Company will bring atherosclerotic heart disease treatment inclisiran into its portfolio, which is consistent with their objective to become a focused medicines company, acquiring to create pipeline depth in key therapeutic areas. The Medicines Company is expected to file submissions in the US by the end of 2019 and in Europe in 2020, making inclisiran a near-term revenue opportunity. This focused strategy has been well received by the market.

> Trade buyers are the most active acquirers in the UK. However, private equity has driven a significant amount of this year's growth. Strong private equity appetite has driven valuations up as the supply of money looking for a home outstrips demand from business owners and management teams pursuing value creation events, whether that is securing additional investment or an exit.

TOM COWAP,
DIRECTOR – HEALTHCARE

Globally, other large deals this year include Pfizer's $11.4bn acquisition of Array Biopharma, which strengthens Pfizer's "category leadership in oncology" by bringing on board Array's portfolio of small molecules targeting cancer. Eli Lily's $8bn acquisition of Loxo Oncology further strengthens its oncology pipeline, after adding ARMO Biosciences and AurKa Pharma last year. Novartis spun off its eye-care device business Alcon and acquired Takeda's eye-care drug Xiidra for $5.3bn. Roche announced their $4.3bn acquisition of Spark Therapeutics, which has since been delayed several times.

Diversified players use M&A to sustain growth

Diversified players have contributed to deal flow this year. A consortium of investors led by PE house EQT have acquired the medical and consumer skin health solutions business of Nestle, Nestle Skin Health, for $10.1bn. This was EQT's second investment in the sector this year, having closed their $694m investment in Karo Pharma in January. In February, Danaher announced its plan to acquire the biopharma business of General Electric for $21.4bn. GE Biopharma, which provides instruments, consumables and software that support the research, discovery, process development and manufacturing workflows of biopharmaceutical drugs, has annual revenues of c.$3.2bn. US medical device maker Boston Scientific closed its $4.2bn acquisition of UK BTG in November, adding, among other products, technology to fight cancer to its portfolio.

Private equity creating value in the UK

Trade buyers continue to be the most active acquirers in the UK. However, PE has driven a significant amount of this year's growth, with its share of deal making up 30% on 2018. One blockbuster example was London-headquartered Permira's $2.4bn acquisition of leading small molecule CDMO Cambrex. Permira also invested in Quotient Clinical, a Nottingham-headquartered CRO and CDMO, in July. Quotient is a great example of PE successfully partnering with high quality businesses in the sector. It first took investment from Bridgepoint in 2013, when the business was employing c.200 people and had two sites in the UK. GHO replaced Bridgepoint in 2015, helping the business expand into the US and grow to over 850 people across six sites in the UK and US before Permira came in this year. Quotient's next deal is likely to be a mega event of its own.

PE is still sitting on record levels of capital and, in a period of political and economic volatility, have been reluctant to invest in cyclical assets, preferring defensive global sectors like pharma. Strong PE appetite has driven valuations up as the supply of money looking for a home outstrips demand from business owners and management teams pursuing value creation events, whether that is securing additional investment or an exit.

PE dry powder hasn't been the only thing driving up valuations. The rising quality of pharma service businesses' earnings, driven by Big Pharma increasingly outsourcing development work and treating CROs and CMOs as true strategic partners, and more development coming from smaller and even virtual biotechs which outsource more consistently, makes them a safer and higher value investment. This was evident in Permira's premium valuation for Cambrex and GHO's return on Quotient. PE houses are looking for the next big platform in pharma services, examples include CBPE Capital investing into CRO Simbec-Orion, buying-out Wales Life Sciences investment alongside CEO Ronald Openshaw; and GHO and the business's management team buying UK CMO Sterling Pharma Solutions from Indian drug maker Strides Shasun.

CROs and CMOs are sectors that have matured with PE investment, competition for quality businesses is now high. Investors are looking to other areas such as medical communications and pre-clinical-focused CROs to replicate this success. LDC-backed Fishawack has become a serial acquirer, snapping up American-based 2e Creative, Blue Latitude, Healthcare Advertising and Dudnyk in the last 12 months alone; expect Fishawack's next exit to be at a substantially higher value than the £38m LDC invested on. Phoenix Equity's 2017 investment into pre-clinical CRO Sygnature, which provides end-to-end preclinical drug discovery solutions, was a hard-fought win. Investors quickly realised businesses offering these services at scale are scarce. Companies like RxCelerate, which acquired molecular imaging provider Prosarix this year, are benefitting from the ongoing outsourcing trend in this space.

In 2020, expect further activity from PE investors in the UK in areas where their CRO and CMO success can be replicated, whether it's investing in medical communications players like Fishawack or helping to consolidate nascent sectors like pre-clinical CROs.

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If you would like to discuss this report in more detail or to learn about Alantra's advisory services, please email Tom Cowap at:

tom.cowap@alantra.com or call +44 (0) 20 7246 5000

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