PHARMA OUTLOOK FOR 2017

EDITED BY THE DEAL

Tuck-in acquisitions, asset swapping and private equity-led rollups will all drive pharmaceuticals-related M&A. Treatments involved with substance abuse, multiple sclerosis, Alzheimer's, migraines and rare diseases could all become focal points in deal-related activity. Big pharmaceutical companies will accelerate their partnerships with technology companies and even combine with medical device concerns.

An expert panel equated investments and dealmaking to the mammoth, always active and vitally important pharmaceutical sector, during a recent roundtable "Pharma Outlook for 2017." The Deal LLC and Donnelley Financial Solutions co-sponsored the Webcast.

Panelists included **Christopher Missling**, president and CEO of **Anavex Life Sciences Corp.**; **Kara Murphy**, partner at **Bain & Co.** and co-leader of the firm's healthcare private equity team; and **James Sapirstein**, CEO at **ContraVir Pharmaceuticals**. **Daniel Perez**, director of business strategy for **Donnelley Financial Services' Venue virtual data room**, served as moderator.

"We should continue to expect a lot of M&A," Murphy said, citing a desire and need among many companies for what is termed category leadership. Companies want to "build up their portfolios in certain areas, and frankly, fill any gaps with respect to a pipeline and potentially divest things that are noncore," she explained.

Focusing on a company's particular strength and building category leadership makes market and economic sense, the panelists said. According to Murphy, shareholder return for a diversified player is 10% to 15%, while "portfolio-focused players" are getting shareholder return close to 30%. "There is absolute data out there that says focusing matters," Murphy said.

Sapirstein, for one, cited Gilead Sciences Inc. as an example of playing to one's strengths. "Gilead's been exceptionally successful in the virology space and not so successful in some other areas," he said. "They've tried to dabble and diversify, but yet I think they will rebound in virology. They always do."

That kind of specialty focus translates into both tuck-in acquisitions and divestitures.

"We're going to see a ton of tuck-in deals," Murphy said, citing category leadership and "building up that string of pearls to assemble dominance in categories that are really interesting, like rare diseases."

Divestitures, on the other hand, will be more focused on "more established brand products, maybe products that got good cash flow that are on the market, but maybe noncore," Murphy said. "It starts to be harder to divest a bunch of pre-clinical or early-stage compounds if you really believe there could be some good potential."

Major pharmaceutical concerns will continue to rely on acquisitions to build out their portfolio because their size makes it harder to move as quickly as smaller concerns on developing new products and technologies, the panelists said.

"There is a lot of inefficiencies in big pharma, and it's just a lot easier to acquire a technology that fits in nicely into your therapeutic focus," Sapirstein explained.

"There will be always a higher tendency of innovation in small biotech companies, and as long as that is taking place, there will be always acquisitions of novel technologies" by large companies, Missling added.

Not that the panel endorsed M&A across the pharmaceutical landscape. Notably, Murphy cited giant industry megadeals, mergers that top $35 billion. They don't necessarily drive greater value, Murphy said. "I wouldn't necessarily say these megadeals are a good thing."

As they attempt to gain dominance in particular subsectors, various pharmaceutical companies will focus on several specific diseases and types of disease for investment in treatments. Missling cited treatments for rare diseases, 95% of which lack FDA approval, although one-third of all FDA approvals in the past five years were for drugs to treat such diseases. "There are still a lot needed," he said. "That speaks to the ability to address personalized medicine needs."

Other subsectors include next-generation treatment for multiple sclerosis, and the use of calcitonin gene-related peptides, or CGRPs, for migraines, Murphy said.

While HIV and cancer have become chronic diseases, "the brain seems to elude our ability to break into that because of its complexity," Missling added, so there will be a continued focus on treatments for degenerative diseases such as Parkinson's and Alzheimer's.

Oncology-related pharmaceutical concerns are turning to combination therapies, much the same way pharma overcame the AIDS crisis in the 1990s through a combination of drugs. That is spurring acquisitions as well. Pharmaceutical companies are "acquiring earlier-stage companies to see what future combinations they can come up with, and I think you're going to see just a huge rainbow of types of combinations coming forward," Sapirstein said.

At the same time, he added, "you're going to start seeing a combination of therapeutics and medical devices," which will translate into pharma teaming up with medical device companies. And, technology companies will get more into the act as well, especially as data mining becomes so vitally important in healthcare.

With competition for deals growing so rapidly, there's an increased willingness among acquisition-minded companies to pay more for earlier-stage assets. "There's a recognition that competition is fierce. It gets fiercer as you get further through the development cycle," Murphy said. "So pick your spots, lean in early and pay up."

That could translate into more money paid for earlier-stage companies, but fewer deals, Missling observed. That, he said, speaks to both acquisition focus and greater due diligence. "I'm sure that will take longer until a decision is made, but I think that's the direction to put more muscle behind a project," Missling said.

At the same time, institutional investors, who largely pulled out of life sciences after the global financial crisis, "are starting to come back," Sapirstein said, although they, like many others in the industry, are picking their spots. "Institutional investors are becoming more patient now. It's a longer play."

Private equity will continue to aggressively pursue pharmaceutical-related acquisitions, even though valuations are steep and competition from strategics is fierce. "That's not going to dissuade them," Murphy said.

Murphy cited as examples big PE firms like Warburg Pincus, Carlyle and GTCR, which are backing management firms to create rollup plays, and the PE firm CVC, which is backing the specialty generics company Alvogen.

PE firms are active in acquiring contract development and manufacturing organizations. They're also looking at contract research organizations and contract packaging organizations.

"Within private equity, healthcare is a differentially strong returner," Murphy said. "Within healthcare, for private equity, pharmaceutical investing products and derivative services is a differentially strong returner."

With more focus on core competencies, asset swapping becomes increasingly popular as well. "Animal health is a classic one," Murphy explained. "Some people want to be in. Some people don't want to be in and there is asset swapping taking place."

Panelists elucidated various trends in pharmaceutical-related M&A at a time when the industry must grapple with all kinds of public and policy pressures, from drug pricing to the rising overall cost of healthcare.

Meanwhile, the cost of bringing a new drug to market continues to skyrocket even as the FDA struggles to get more products approved.

"I don't think the costs are going to go down, and it's not just the pharmaceutical companies," Sapirstein said. "It's the whole ecosystem that we need to look at."

However, Missling cautioned that streamlining FDA approval shouldn't come at the expense of safety. The FDA is "making a fantastic job so far in approving drugs which are really needed very quickly, like we see in oncology, in other rare diseases, but again, I don't think that this can be compromised or should be compromised," he said.

On the global front, there's anxiety over Britain leaving the EU and excitement over emerging economies. Brexit remains an open question, with concerns related to regulatory issues, pricing and even innovation. "There's been a lot of investment in biopharma in London, and will there be more innovation movements to countries like Ireland, because of the tax benefits and the language, or Germany, because it's also a big market?" asked Murphy, as she listed other unknowns. "These are all open questions, and no one knows with certainty."

Panelists were much more upbeat on China and India. Sapirstein noted that China is beginning to privatize its pharma industry, and India is building up its private market as well. He cited growing cooperation over IP protection and patent rights in both countries. Sapirstein added that Chinese investors are "coming forward and investing in U.S. pharmaceutical companies and growing their business."

On the other hand, he continued, not just biotech, but big pharma as well, is aggressively developing drugs to combat hepatitis B, a huge issue in China, India and other emerging markets, with 350 million individuals infected worldwide. "There are over 40 companies invested in this space right now," he said.

Donnelley Financial Solutions (NYSE: DFIN) provides software and services that enable clients to communicate with confidence in a complex regulatory environment. With 3,500 employees in 61 locations across 18 countries, we provide thousands of clients globally with innovative tools for content creation, management and distribution, as well as data analytics and multi-lingual localization services. Leveraging advanced technology, deep-domain expertise and 24/7 support, we deliver cost-effective solutions to meet the evolving needs of our clients. For more information about Donnelley Financial Solutions, visit dfsco.com.

AS FEATURED ON The Deal.com
TheDeal.com (ISSN 1547-7584) is published by The Deal.