Mergers and acquisitions in pharmaceutical industry

Businesses grow externally by acquiring, or combining with, other ongoing businesses. When two companies combine, the acquiring company generally pays for the acquired business either with cash or with its own securities, and the acquired company's liabilities and assets are transferred to the acquiring company.

A merger is technically a combination of two or more companies in which all but one of the combining companies legally cease to exist and the surviving company continues in operation under its original name. A consolidation is a combination in which all of the combining companies are dissolved and a new firm is formed. The term merger is generally used to describe both of these types of business combinations. An acquisition is also used interchangeably with merger to describe a business combination.

1. 1 Types of Merger

Mergers are generally classified according to whether they are horizontal, vertical, or conglomerate. A Horizontal merger is a combination of two or more companies that compete directly with one another. A vertical merger is a combination of companies that may have a buyer-seller relationship with one another. A conglomerate merger is a combination of two or more companies in which neither competes directly with the other and no buyer-seller relationship exists.

1. 2 Form of Merger Transactions

A merger transaction may be a stock purchase or an asset purchase. The acquiring company buys the stock of the to-be-acquired company and assumes its liabilities. In an asset purchase, the acquiring company buys only the assets (some or all) of the to-be-acquired company and does not assume any of its liabilities. Normally, the buyer of a business prefers an asset purchase rather than a stock purchase, because unknown liabilities, such as any future lawsuits against the company, are not incurred.

1. 3 Joint Ventures

Some companies who don't want to merge are choosing an option of joint ventures. In joint venture two (unaffiliated) companies contribute financial and/or physical assets, as well as personnel, to a new company formed to engage in some economic activity, such as production or marketing of a product.

2. 0 Pharmaceutical M&A

Mergers are not new in the pharmaceutical industry; however, in last few years there is lot of heat at the level of pharmaceutical merger activity and many firms are using joint ventures and strategic partnerships to develop and market new products. The pharmaceutical industry is highly regulated, extremely complex, and filled with financial and economic challenges and points of interest. Finance managers in the industry are faced with many issues including; managed care, insurance, reimbursement, patents and generic competition, licensing, royalties, co-promotions, joint ventures, co-marketing rights, high risk and high cost research and development, parallel import issues, and international regulations. These issues need to be explored in an effort to understand the reasons for the industry's current structure and how that structure is driving increased consolidation through mergers and acquisitions.

The pharmaceutical industry is by most standards a mature industry and highly profitable for those companies lucky enough to develop blockbuster medical treatments which are patent protected for lengthy periods to help companies recover their research and development investments. The pharmaceutical industry has experienced a high rate of M&A activity in the 1980s and 1990s. Most of the leading firms in 2003 are the result of one or more horizontal mergers – for example, GlaxoSmithKline's merger includes GlaxoWellcome and SmithKline Beecham; Pfizer is the combination of Pfizer, Warner-Lambert, and Pharmacia, which included Upjohn.

3. 0 Reasons for M&A

To increase market share

To gain control of a blockbuster drug existing or potential

To gain entry into a high growth therapeutic area

To enhance R&D productivity

Access to new technology platform

To expand Geographic scope

Patent expiration

Pipeline Stuffing

At pharmaceutical firms both large and small, profits are under constant pressure because blockbuster drugs that have made immense profits for many years eventually lose their patent protection and face vast competition from generic versions. In the U. S., generic drugs now hold between a sixty and seventy percent market share by volume. This puts pressure on large research based drug firms to develop new avenues for profits. One such avenue is partnerships with and investments in young biotech companies, but profits from such ventures will, in most cases, be slow to appear. Meanwhile, the major, global drug firms are investing billions in-house on biotech research and development projects, but new blockbusters are elusive.

For example, Pfizer historically invested about $7. 8 billion yearly on R&D. That money is invested in carefully designed research programs with specific goals. As of early 2010, Pfizer had about 500 projects in development, with 133 of those in Phase I trials or beyond. Biologic drugs accounted for 27 projects under development, and they were part of the firm's " invest to win" areas that focus on potential blockbuster drugs.

Much of the future success for the world's major drug companies will lie in harnessing their immense financial power along with their legions of salespeople and marketing specialists to license and sell innovative new drugs that are developed by smaller companies. There are dozens of exciting, smaller biotech companies that are focused on state-of-the-art research that lack the marketing muscle needed to effectively distribute new drugs in the global marketplace. To a large degree, these companies rely on contracts and partnerships with the world's largest drug manufacturers. In addition to money to finance research and salespeople to promote new drugs to doctors, the major drug makers can offer expertise in guiding new drugs through the intricacies of the regulatory process. While these arrangements may not lead to blockbuster drugs that will sell billions of pills yearly to treat mass market diseases, they can and often do lead to very exciting targeted drugs that can produce $300 million to $1 billion in yearly revenues once they are commercialized. A string of these mid-level revenue drugs can add up to a significant amount of yearly income.

One of the most obvious reasons to merge or acquire is a shortfall in the R&D pipeline. This was the position Glaxo faced in 1995 when Zantac, the world's best-ever selling drug at the

time was coming to the end of its lifespan. Following its timely acquisition of Wellcome,

the company renewed its pipeline to create a substantial and innovative asset, which

included drugs like Seroxat still in the global top ten seven years after the deal. Astra and

Zeneca achieved geographic expansion and increased critical mass and, above all, shored

up two increasingly vulnerable portfolios with their 2000 merger.

4. 0 Risks of M&A

The payoff of growth resulting from a merger can be enormous for pharmaceutical companies. However, some statistics about mergers and acquisitions across industries and in general communicate the inherent risks in choosing to proceed with the integration of two different companies. Some of the researched statistics, noted in Pharmaceutical Executive in January 2001, are as follows:

75% of large mergers fail to create shareholder value greater than industry averages

Productivity drops 50% following the announcement of a merger

Leadership attrition soars to 47% within three years following a merger

Employee satisfaction drops 14% following mergers

80% of employees feel senior management cares more about economics than about product quality or people

5. 0 History of Pharmaceutical M&A

In 1927, Merck merged with Powers-Weightman-Rosengarten, which used to produce antimalarial quinine. In 1959, Johnson & Johnson acquired McNeil laboratories and added Tylenol to its product list. In 2000, Pfizer acquired Warner- Lambert Company and Lipitor was added to Pfizer’s portfolio. The trend continues till today with Sanofi and Aventis and last year, we saw mega mergers like Pfizer acquired Wyeth for $68 billion and after six weeks of the mega merger, Merck acquired Schering Plough for $41. 1 billion. Moreover, Roche inked a deal of $47 billion deal with Genentech and small player Biotech heavyweight Gilead (GILD) also paid $1. 4 billion for CV Therapeutics (CVTX).

5. 1 Merck and Schering-plough Merger

Merck has entered into a definitive merger agreement with Schering-Plough. According to the agreement, Merck and Schering-Plough has combined, under the name Merck, in which the surviving entity is Schering plough and because of that the merger is known as reverse merger transaction. This transaction valued at approximately $41, 100 million ($41. 1 billion) payable in cash and stock. Under the terms of the agreement, Schering-Plough shareholders receive 0. 5767 shares and $10. 50 in cash for each share of Schering-Plough. Each Merck share will automatically become a share of the combined company. In the merger, Merck shareholders own approximately 68% of the combined company, and Schering-plough shareholders own 32%. The aggregate consideration will be comprised of a combination of approximately 44% cash and 56% stock.

This merger had benefited Merck in several ways. It added up to 18 products in Merck’s pipeline. This merger is structured in an unusual manner, this is generally done for tax saving purposes but here is some other reason. Schering Plough and Johnson and Johnson has contract over the sale of Ramicade and Sympony. The contract said that if ownership of any of the company changes then the other company is entitled for both the products but as the merger is reversely structured and Schering Plough is the surviving corporation the chances to breach the contract is less; though the surviving corporation as the name “ Merck” . Then also Johnson & Johnson has filed for arbitration over the contract. The legislation is still in the process and Merck is having the advantage of both the products.

5. 2 Pfizer and Warner-Lambert merger

Pfizer's hostile bid for Warner-Lambert resulted from Warner-Lambert's attempt to merge with American Home Products. Actually, Pfizer was not looking at taking over Warner-Lambert and was happy with them as an independent company. However, Warner-Lambert's actions put the company at play. The result of the hostile merger resulted in Pfizer as the clear leader of the two companies. The difficult merger included the trading of stock for stock and the breaking up of the other deal. Warner-Lambert was also happy as an independent company. However, even though the merger was hostile, Warner-Lambert did seem to like Pfizer's products, reputation, and values. Prior to this merger, basically all of the industry mergers of the past decade failed to increase, or even maintain, market share and value. As a result of ongoing productivity initiatives and cost savings from the Warner-Lambert integration, Pfizer's operating margin has improved more than eight full percentage points since 1995. This is one of the best performances in the industry.

5. 3 Sanofi-Aventis Merger

On January 26, 2004, Sanofi-Synthelabo announced an unsolicited exchange offer for shares of Aventis Pharmaceuticals. They offered fifty five billion dollars, or forty-seven billion euros for Aventis shares. This offer price came along with estimation that they could create two billion dollars in synergies by combining the two firms. They also reaffirmed that the offer was based on the total portfolio, and that they didn't intend on divesting any products that didn't have any anti-trust conflicts.

The Supervisory Board of Aventis unanimously rejected the bid from Sanofi responding that it was not in Aventis shareholders and employees best interest to allow Sanofi to acquire Aventis shares. French newspapers buzzed with rumors that several firms might step up and try to be a " white knight" to Aventis. Those firms included Johnson and Johnson, Pfizer, and Novartis. Sanofi's management was confident that they would not have to increase their offer for Aventis since most firms would not be in a position to merge with Aventis. It was also rumored that if Sanofi was not successful in buying Aventis, that they would be subject to an acquisition from another firm. Glaxo was rumored to be interested in buying Sanofi for their pipeline.

Aventis had been repeatedly rejecting the offer from Sanofi arguing that the bid is severely undervaluing their company. Aventis's management believed that they were better off as a stand-alone firm so that they can focus on organic growth. Aventis's chief executive, Igor Landau, openly disputed the offer from Sanofi saying that they would have to improve the bid by at least forty or fifty percent to make Aventis interested. However, Aventis tried to find a " white knight" to enter into a friendly merger with to fend off Sanofi.

The potential white knight that showed the most interest was Swiss drug maker Novartis Pharmaceuticals. Novartis said that they would be interested in entering merger negotiation with Aventis, if the French government would remain neutral. Sanofi wasn't too concerned about any white knight scenarios being that they had the support from the French government. In late April, Novartis agreed to enter into talks with Aventis regardless of the French governments public opposition to a Swiss firm ruining their chances for a French national champion. Rumors were circulating that Novartis was prepared to offer a bid of up to eighty-three billion dollars, or seventy billion euro. This would be a significant improvement for the shareholders compared to the Sanofi offer. These rumors caused the French government to encourage talks between Sanofi and Aventis board members.

Finally on April 26, Aventis accepted an improved bid from Sanofi to create the third largest drug company in the world. The improved bid is valuing Aventis at sixty-four billion dollars, or fifty-four billion euros. The improved stock and cash offer was approximately a fourteen percent increase from the original takeover offer. This is the conclusion to three-month takeover battle between these two companies. Aventis has been trying to defend their company against Sanofi for the past three months. They both entered into a “ cooling off” period after three months of publicly sniping at each other and filing lawsuits. On April 27 the European Commission approved the planned merger, followed by the Federal Trade Commission’s approval on July 29. By early August it was known that the tender offer had been a success leading to the birth of Sanofi-Aventis on August 20.

6. 0 Ten-Year Data on Pharmaceutical Mergers and Acquisitions

During the 10 years ended December 31, 2009, a total of 1, 345 mergers and acquisitions of pharmaceutical assets and pharmaceutical companies were announced, with disclosed prices totaling more than $694 billion, according to DealSearchOnline. com. GlaxoSmithKline was responsible for the largest of the pharmaceutical mergers and acquisitions. GlaxoWellcome announced a $74 billion merger with SmithKline Beecham in 2000, resulting in the entity now known as GlaxoSmithKline.

Pfizer, Inc. announced two of the largest pharmaceutical mergers and acquisitions of the decade, including its $68 billion acquisition of Wyeth, Inc. in 2009 and its $56 billion acquisition of Pharmacia Corporation in 2002. Five of the pharmaceutical companies that were acquired in the past 10 years posted revenues in the tens of millions at the time of acquisition: SmithKline Beecham, Wyeth, Aventis, Pharmacia and Schering Plough. Further, in all but one of the 55 largest pharmaceutical mergers and acquisitions announced during the past decade, each of which is valued at a price exceeding $1. 5 billion.

Most of the 25 largest pharmaceutical mergers acquisitions announced in the past 10 years feature an acquirer that made five or more deals during the decade ended December 31, 2009, including Pfizer. In addition to Pfizer, these pharmaceutical acquirers include Abbott Laboratories, Johnson & Johnson, Bristol-Myers Squibb and Teva Pharmaceutical Industries. Teva Pharmaceutical acquired Barr Pharmaceuticals for $8. 96 billion in 2008 and Teva Pharmaceutical acquired Ivax Corporation for $7. 96 billion in 2005. Abbott Laboratories acquired Solvay Pharmaceuticals for $7. 6 billion in 2009 and Abbott Laboratories acquired Knoll Pharmaceutical for $7. 2 billion in 2000. Johnson & Johnson acquired Pfizer’s consumer health care unit for $16. 6 billion in 2006 and Johnson & Johnson acquired ALZA Corporation for $12. 3 billion in 2001.

Three of the top 25 pharmaceutical mergers and acquisitions announced in the past decade were announced during 2009, In addition to Pfizer’s acquisition of Wyeth and Abbott Laboratories’ acquisition of Solvay Pharmaceuticals, 2009 saw Merck & Co.’s acquisition of Schering-Plough

Corporation for $41. 1 billion. The mega-deals that comprise the top 25 pharmaceutical mergers and acquisitions of the past decade were announced at the rate of one or two per year from 2000 to 2004, but from 2005 to 2009 increased to the rate of three to four per year. Other notable deals announced in 2000 through 2009 include Sanofi-Synthelabo's $65. 5 billion acquisition of Aventis in 2004 and Bayer AG's $21. 5 billion acquisition of Schering AG in 2006.

Pharmaceutical Mergers and Acquisitions, 2000 to 2009

Year	Dollar Total	Number of Deals
2000	$97, 424, 934, 321	41
2001	$27, 749, 309, 161	87
2002	$66, 093, 147, 595	147
2003	$23, 625, 371, 126	173
2004	$95, 213, 138, 700	171
2005	$46, 553, 632, 500	128
2006	$74, 806, 033, 300	138
2007	$71, 600, 790, 685	180
2008	$40, 664, 107, 740	140
2009	$147, 237, 047, 186	140

10-Year Total $690, 967, 512, 314 1, 345

It's been a busy decade for pharma dealmaking. During the 10 years that ended Dec. 31, 2009, a total of 1, 345 mergers and acquisitions of pharmaceutical assets and companies were announced, with disclosed prices totaling more than $694 billion, according to DealSearchOnline. com. The biggest deal: GlaxoWellcome's $74 billion merger with SmithKline Beecham in 2000 that created GlaxoSmithKline. That year, pharma did more than $97 billion worth of deals.

7. 0 Future of M&A from CEO perspective

Former Schering-Plough Corp. Chief Executive Officer Fred Hassan, who presided over the company's $41. 1 billion sale, last year, said he expects to see more consolidation in the pharmaceutical industry. Large drugmakers will need to merge in order to fund expensive, complex areas of research, such as Alzheimer's disease. Smaller companies also will be forced to sell themselves as they run out of cash in the tight credit markets.

“ One reason deals are necessary is because the innovation investments are becoming larger and larger and it makes it easier when people can combine their resources to make the big, deep bets that you need to make for difficult diseases,” Hassan said. “ That is why you are going to see more of these deals.”

8. 0 Top M&A activity in 2010:

While things have cooled off a bit in big pharma, there is still some major acquisition action going on in 2010. Though year 2010 was not of big mergers but there were still some M&A activity have seen. List of 2010 M&A is shown in table 3.

8. 1Teva- Ratiopharm

Teva, the generics giant bought Ratiopharm for just under $5 billion, beating out Pfizer and Actavis for the German company. Ratiopharm is Germany’s second largest generics producer and the sixth largest generic drug company worldwide. The Ratiopharm purchase marks the biggest takeover in the generic drugs market since Teva bought Barr Pharmaceuticals for $7. 46 billion in 2008.

The combined entity will hold the leading market position in 10 European markets, including the U. K., Hungary, Italy, Spain, Portugal and the Netherlands, as well as a top three ranking in 17 countries, including Germany, Poland, France and the Czech Republic. Teva also expects its sales to nearly double in Canada as a result of the deal. Shlomo Yanai, Teva’s president and CEO, said during an investors call that the acquisition was key component in its 2015 strategy. By that time, the company expects $31 billion in revenue and $6. 8 billion in net income.

Pfizer had been very interested in Ratiopharm, but wasn’t prepared to put significantly more than 3 billion on the table, according to the Wall Street Journal, citing sourcesSources say that Pfizer might cast its eye on Stada, another German generics maker. Stada’s stock shot up 2 percent to an 18-month high after news of the Teva-Ratiopharm deal broke, according to Reuters.

8. 2 Merck-Millipore

Merck completed the acquisition of life science company Millipore on Feb. 28. Millipore's products and services are used for drug discovery, process development and drug manufacturing. Merck acquired Millipore for approximately $7. 0 billion. The companies decided on a price of $107 that was paid in cash per share for Millipore's common stock.

Table 1: Top 20 M&A deals since 2000

Rank

Partners

Date

Value, US$m

1

Pfizer – Warner Lambert

Feb '00

$90, 000

2

Pfizer – Wyeth

Jan '09

$68, 000

3

Sanofi – Aventis

Apr ’04

$65, 000

4

Pfizer – Pharmacia

Jul ’02

$60, 000

5

P&G – Gillette

Jan ’05

$57, 000

6

Roche – Genentech

Jul ’08

$46, 800

7

Merck – Schering-Plough

Mar ’09

$41, 000

8

Boston Sci. – Guidant

Dec ’05

$27, 000

9

Bayer – Schering AG

Mar ’06

$21, 500

10

Dow – Rohm &Haas

Jul ’08

$18, 800

11

J&J – Warner Lambert

Jun ’06

$16, 600

12

AstraZeneca – MedImmune

Apr ’07

$15, 600

13

Amgen – Immunex

Dec ’01

$14, 800

14

Schering-Plough – Organon

Mar ’07

$14, 500

15

Merck KgaA – Serono

Sep ’06

$13, 300

16

Novartis – Alcan

Apr ’08

$11, 000

17

Fisher Sci. – Thermo Elec.

May ’06

$10, 600

18

J&J – Alza

Mar ’01

$10, 500

19

General Elec. – Amersham

Oct ’03

$9, 500

20

Takeda – Millennium

Apr ’08

$8, 800

Table 2: Top M&A deals 2009

Rank

Partners

Date

Value, US$m

1

Pfizer – Wyeth

Jan ’09

$68, 000

2

Roche – Genentech

Mar ’09

$48, 000

3

Merck – Schering-Plough

Mar ’09

$41, 000

4

TPG – IMS Health

Nov ’09

$5, 200

5

GSK – Stiefel

Apr ’09

$3, 600

6

Dainippon – Sepracor

Sep ’09

$2, 600

7

BMS – Medarex

Jul ’09

$2, 400

8

Sanofi-Aventis – Chattem

Dec ’09

$1, 900

9

Watson – Arrow Group

Jun ’09

$1, 750

10

Varian – Agilent

Jul ’09

$1, 500

11

Gilead – CV Therapeutics

Mar ’09

$1, 400

12

Abbott – Adv. Med. Optics

Mar ’09

$1, 300

13

J&J – Cougar

May ’09

$970

14

Lundbeck – Ovation

Feb ’09

$900

15

Onyx – Proteolix

Oct ’09

$850

Table 3: Top M&A deals 2010

Rank

Partners

Date

Value, US$m

1

Novartis/Nestle – Alcon

Aug ’10

$28, 300

2

Sanofi – Genzyme

Aug ’10

$18, 500

3

Merck KgaA – Millipore

Feb ’10

$7, 000

4

Teva – Ratiopharm

Mar ’10

$4, 925

5

OSI – Astellas

May ’10

$4, 000

6

Reckitt – SSL

Jul ’10

$3, 900

7

NBTY – The Carlyle Group

Jul ’10

$3, 800

8

Abbott – Piramal

May ’10

$3, 700

9

Pfizer – King

Oct ’10

$3, 600

10

Grifols – Talecris

Jun ’10

$3, 400

11

Biovail – Valeant

Jun ’10

$3, 300

12

Celgene – Abraxis

Jun ’10

$2, 900

13

Covidien – ev3

Jun ’10

$2, 600

14

Crucell – J&J

Sep ’10

$2, 300

15

McKesson – US Oncology

Nov ’10

$2, 000

16

Wuxi – C. River (term.)

Apr ’10

$1, 600

17

Cardinal – Kinray

Nov ’10

$1, 300

18

Aspen – Sigma (term.)

May ’10

$1, 240

19

Qualitest – Endo

Sep’10

$1, 200

20

Inventiv – Thomas H Lee

May ’10

$1, 100

21

3M – Cogent

Aug ’10

$943

22

Boehringer Ing. – SSP

Feb ’10

$913

23

BMS – ZymoGenetics

Sep ’10

$885

24

Perrigo – PBM Holdings

Mar ’10

$808

25

Avid – Eli Lilly

Nov ’10

$800