Uncertain Outlook for Pharma and Biotech Deals Following 'Turbulent' 2011

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Peter Young, President and Managing Director of international investment bank Young & Partners, looks at what lies ahead for pharma and biotech following a turbulent 2011.

The business outlook for pharma companies for the rest of 2012 and beyond is mixed, as pharma companies struggle to realign themselves to a new business model that will work. The solution will be different for each company.

Although the pharmaceutical industry has been less affected by global economic conditions compared to most industries, going forward the impact will be more prominent as governments attempt to control healthcare costs as part of their deficit reduction efforts. The revenue challenges will be tied more to the difficulties in getting drugs approved, reimbursement challenges, patent expirations, weak product pipelines, and failing business models rather than global economic trends.

The stock market will continue to penalize the ethical pharma industry as long as the structural changes are working their way through the industry and solutions are being implemented.

The major debt refinancings were completed quite awhile ago and new debt issuance will depend on the number and size of M&A transactions that will have to be financed. Non-investment grade debt will be issued more sporadically.

Equity issuance will continue to be modest as the IPO and general equity issuance markets continue to be difficult.

Biotech

The development capabilities of biotech companies are positive overall. Although there will be successes and failures by individual companies, biotech companies are demonstrating their ability to develop new drugs at a faster pace than the larger pharma companies.

Historically, the biotech industry’s relationship with the debt and equity markets has been volatile. The structural challenge has been the misalignment of when the funding sources or industry acquirers are available versus the time and costs to get to those milestones.

However, the funding of biotech companies became very difficult with the global financial crisis and the shutdown in the IPO and debt financing markets. However, there has been a modest recovery in the last two years.

The primary biotech M&A theme will continue to be pharma and big biotech acquisitions of biotech companies for pipeline enhancement. However, pharma and big biotech will continue to use non-M&A methods to achieve their pipeline goals, much to the detriment of biotech companies seeking an exit. Pharma companies clearly feel that they have the upper hand overall, but this is not true for the most promising biotech companies who are attracting high interest and high prices.

Equity issuance will hopefully improve in 2012 if the recovery of the general IPO market continues in sufficient strength to spill over to the biotech sector. Debt issuance has been low and will continue to be very anemic.

2011 Highlights

Pharma merger and acquisition volume in 2011 was stronger than 2010 in terms of number of deals and dollar volume but hare prices were decidedly mixed. The Young & Partners ("Y&P") Generic Pharma stock price index fell dramatically, but the Y&P Ethical Pharma indices did as well or better than the overall market. Nonetheless, P/E multiples are still languishing far below their levels in the 1990s and earlier.

Debt issuance increased modestly in 2011, but equity issuance was anemic was down with very few companies going public and weak investor sentiment.

On the biotech side, the story has been a bit different. After a surge in 2006, M&A collapsed beginning in the 2007–2010 period and continued at low levels in 2011. Acquirers have become selective and other alternatives, such as partnering and licensing, are playing a prominent role.

In the stock market, our large and the small capitalization biotech companies did well, but medium capitalization biotech companies suffered as a group. Debt issuance was modest as expected and equity offering volume was subdued as investors continued to avoid risk.

Stronger Deal Activity — But No Mega Deals

In 2011, 49 deals were completed worth $65.6 billion versus 40 deals worth $34.8 billion for all of 2010. This increase in deal activity was driven by a large number of sizable strategic acquisitions.

Although there were no mega deals, there were seven deals over $1 billion in equity value, the largest of which was Sanofi's acquisition of Genzyme Pharmaceutical for $19.6 billion in enterprise value, followed by Takeda Pharmaceuticals' acquisition of Nycomed for $13.7 billion in enterprise value. Big Pharma has been more cautious about the benefits of mega mergers.

As of December 31, 2011, the value of the deals announced but not closed was only $714 million (11 deals), a clear sign of a slowing market.

Biotech Stock Market — Wildly Mixed

In 2011, the Y&P Biotech Large Cap index increased by 33%, the Y&P Biotech Mid Cap index was down by 7.7% and the Y&P Biotech Small Cap index increased by 55.3%. This strange outcome was driven by a reversal of the previous punishment imposed on the small cap companies and the company specific performance of a few of the large cap companies.

The overall market sentiment towards the biotech industry remains mixed, however, except for a limited number of companies with positive late stage data.

This is understandable since the stock market has been running away from risk and the biotech industry is perceived to be a higher risk sector.

Young & Partners is an international investment bank serving the life sciences and chemical industries globally. Headquartered in New York, the firm provides mergers and acquisitions, restructuring, financial advisory and debt and equity services to large and medium-sized clients in Europe, North America, Latin America and Asia.