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# Big Pharma Consolidation Underpins Deal Making In 2014

By **Karlee Weinmann**

*Law360, New York (April 08, 2014, 5:14 PM ET)* -- After a strong finish last year, pharmaceutical companies have again captured deal-makers' attention with a series of major merger proposals in recent days that illuminate ongoing consolidation in the sector fueled in part by a red-hot demand for specialty drugs and skyrocketing costs to bring new treatments to market.

In the past week, prospective pharma mergers collectively worth more than $30 billion have made headlines, in a show of reignited mergers and acquisitions interest in the sector that also capped off 2013 with a busy fourth quarter defined by a string of big-ticket transactions.

On Monday, Ireland's Mallinckrodt PLC agreed to pay $5.6 billion to absorb Questcor Pharmaceuticals Inc., the company behind a popular product for hard-to-treat autoimmune and inflammatory conditions. One day earlier, Sun Pharmaceutical Industries Ltd. outlined a $3.6 billion merger with Ranbaxy Laboratories Ltd. that will form India's biggest drug manufacturer.

Both deals came after Sweden's Meda AB confirmed on Friday that it brushed off the idea of a tie-up with the considerably larger Mylan Inc., an ill-fated proposal that would have spawned a $24 billion global powerhouse.

The transactions reflect a growing appetite for deals amid a general rebound from the financial crisis. Virtually across the board, buyers and sellers are more willing to head to the bargaining table — but the pharma space is somewhat ahead of the curve, said Alan Zoccolillo, a corporate and securities partner at Baker & McKenzie LLP.

“You're seeing more of it in the pharma space because they've held on as a very profitable sector in the economy,” Zoccolillo said. “There are a lot of synergies to be enjoyed by focusing on your core assets and bringing into the fold additional core assets from other companies through acquisitions.”

**Specialization Over Diversity**

Countless drug companies have launched overhaul efforts, a near-total reversal from a trend several years ago that saw companies push to diversify, leaving them with scattershot holdings.

As pharmaceutical outfits of all sizes reshape themselves, specialization has surfaced as a pivotal piece of the puzzle. While outfits of all sizes are flooding the selling block with noncore assets, the most alluring ones are well-developed and proven — typically those that cater to a specific patient group or a niche type of treatment.

“You see quite a few transactions taking place in the specialty pharma sector, acquiring smaller companies and products in an effort to build a franchise in a particular disease space,” said John Hurvitz, co-chair of the life sciences industry group at Covington & Burling LLP.

Canada's Valeant Pharmaceuticals International Inc., for example, has fashioned itself into one of the industry's most prolific acquirers, rocketing its market value from less than $3 billion in 2010 to nearly $50 billion this year — growth heavily driven by several weighty acquisitions aimed at strengthening its dermatology business.

On a wider level, companies that have pursued their own growth-by-acquisition strategies frequently find themselves in the crosshairs of a big pharma rival eager to parlay a carefully cultivated portfolio into a disease- or treatment-specific subsidiary.

**Collaboration Vs. Traditional M&A**

Drugmakers have long been eager to latch onto partnerships that provide a stronger platform to develop and market treatments, sheltering biotech companies from having to develop their own fully integrated pharmaceutical operations. But more traditional M&A activity has also proven an attractive option in recent years, particularly amid a capital markets slowdown in the U.S.

That is changinging, though, as the bustling U.S. capital markets open the door to more opportunities, giving pharma companies more strategic freedom that has frequently landed them in partnerships with other outfits.

A renewed emphasis on collaborative arrangements recently, replacing complete exits or offering a way to boost value before a sale exposes a shift in companies' priorities against the backdrop of an evolving economy, experts said.

“With the economic challenges over the last decade and the changes in the life sciences industry overall, the mantra's changed,” Hurvitz said. “Every company has a different vision, but many are outsourcing and partnering assets to manage risk and focus their business.”

As deal-making prospects brighten overall, collaborative arrangements commonly give way to buyout plays — especially when a certain product proves its viability in the marketplace. In a typical scenario, one partner lobs an offer at the other, cementing the buyer's access to — and payout from — a given treatment.

**Rising Drug Development Costs**

Deal-making has proven itself an effective way to snowball market power and financial reserves, objectives that have taken on a new significance amid tougher parameters for drug development and approval.

The process is generally more time-consuming and costly than ever before, and a high rate of failure for fledgling treatments does little to suppress expenses. That leaves pharma companies of all sizes squeezed to find and introduce new cash-cow products.

To give itself the best chance for success, a drug company must maintain a well-stocked portfolio with a variety of prospective treatments clocking in at all stages of the drug-approval process — a multiphase effort that takes years in the U.S. But even as they enter the final phase of the evaluation, products are far from guaranteed success and could still hit a wall with regulators.

In addition, tighter regulatory regimes in well-established markets, including the U.S., along with a more complex framework for clinical trials, has drugmakers looking to M&A to relieve some of the strain, said E. Saneesh, a financial analyst who tracks health care trends for market research firm Frost & Sullivan.

To skirt around the costs and risks of developing their own products and bringing them to market, pharma players have begun to look to the portfolios of other companies — younger ones, smaller ones and direct competitors alike — as increasingly attractive acquisition candidates.

**A Steep Patent Cliff**

For the past decade or so, pharma giants have watched the clock tick down to the expiration of their patents for brand-name moneymakers, clearing a path for generic-drug manufacturers to swoop in and swipe market share with a comparable, but less expensive, product.

Wanting to better insulate themselves from the next patent cliff, mid-size and larger drug firms have beefed up internal innovation efforts and kept their eyes glued to outside acquisition opportunities, experts said. But the far-reaching effort to capitalize on new treatments has shrunk the pool of late-stage targets in the marketplace.

As a result, deal makers have turned their focus to the next best thing — earlier-stage treatments that, while shakier, give them the best chance to avoid falling revenues and dodge stiff competition when the next round of patents expires.

**Enticing Emerging Economies**

Acquisitions have given the pharma sector — and many others — a ready-made strategy to cash in on fast-rising emerging markets around the globe. The cachet of smaller drug makers anchored in sought-after locales, including Latin America and India, has risen as industry behemoths look for ways to maintain their status and up-and-comers try to gain ground wherever they can.

Aside from enticing potential buyers with burgeoning middle-class populations with deeper pockets and increasing access to better medical care, many fast-growing markets carry an added benefit for drugmakers — fewer regulatory roadblocks to bring products to patients, and market share up for grabs, Saneesh said.

**Capital Markets Outlook**

Moving forward, experts said they expect to see continued shifts in ownership among drug companies of all sizes — including more top-tier activity. But that could deviate from standard M&A deals if the capital markets stay robust.

In recent years, biotech and pharma players have struggled to wring returns out of the capital markets, forging a direct link to the sector's increased M&A activity as venture capitalists opted for surer bets as their investment windows closed.

“With limited, and often unpredictable, opportunities in the capital markets, M&A transactions with more certain, albeit often lower, returns were more attractive to VCs looking for liquidity,” Hurvitz said.

But a healthier capital markets landscape in the U.S. that has taken shape over the past several months could push companies away from more traditional deal-making. With more options — and better chances at generating solid returns — companies and the investors behind them will likely lean toward public share offerings and private placements.

Still, Zoccolillo said, don't write off the prospect for more industry-defining M&A transactions.

“As long as the market remains strong, we'll continue to see a fair amount of activity in this sector both on the M&A and capital markets sides,” he said.

--Editing by John Quinn and Edrienne Su.

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