News release

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Acquisitions to create scale and digital alliances to bolster life sciences M&A outlook in 2019

- **2018 life sciences dealmaking down almost US$90b against 2014-16 average**
- **Bolt-ons and divestitures to create therapeutically focused businesses are top priority**
- **Digitally focused alliances remain high on the agenda for life sciences companies**

SAN FRANCISCO, 6 JANUARY 2019. Life sciences mergers and acquisitions (M&A) activity totaled US$198b in 2018, as life sciences companies focused on building therapeutic scale and optimizing their portfolios. This is according to the 2019 EY *M&A Firepower report,* launched today. Additionally, the uncertain return on investment and the rapid pace of technology change mean life sciences companies will likely prioritize digital alliances in favor of M&A in 2019.

The EY report finds that 2018 market conditions – especially high valuations for target acquisitions – drove dealmaking away from megamergers toward bolt-on acquisitions and divestitures.

As life sciences companies look to develop innovations that satisfy increasingly empowered health customers, they must accelerate their dealmaking agendas on two fronts: the creation of focused business models and the acquisition of disruptive, data-centric capabilities. The acquisition of these digital capabilities will become increasingly important as new digitally savvy entrants disrupt the larger health ecosystem and life sciences companies' business models.

Pamela Spence, EY Global Health Sciences and Wellness Industry Leader, says:

"The restrained M&A environment that we've seen in 2018 is surprising given expectations that new regulatory and tax environments would result in increased deal activity. Despite this, the need for life sciences companies to use M&A to acquire new capabilities is essential if they are to keep pace with the changing landscape. As digital technologies become the status quo, companies that have already made their therapeutic bets and invested in disruptive technologies will be better positioned to accelerate growth."

The EY *Firepower Index* measures biopharma companies' ability to fund M&A transactions based on the strength of their balance sheets and their market capitalization. A company's "firepower" increases when either its market capitalization or its cash and equivalents rise – or its debt falls. This year marks the seventh year of the *EY Firepower Index*.

Key findings highlighted in this year's *M&A Firepower report* include:

- **Total M&A deal value driven by bolt-ons and divestitures, not megamergers:** Bolt-on deals – small- to medium-sized acquisitions that account for less than 25% of the buyer's market capitalizations – generated 43% of the year's total deal value (US$198b) and 81% of the deal volume.

- **Firepower remains robust but is not being deployed:** Life sciences companies amassed more than US$1.2t in firepower in 2018, but deployed just 16% on acquisitions. That is a steady decline from 2014, when companies deployed 27% of their firepower on M&A.

- **Focused companies outperform less focused counterparts:** EY researchers analyzed the financial results of the 25 top biopharma companies across six different metrics. Companies that generated at least 50% of their biopharmaceutical revenues from one therapeutic area were classified as more focused; companies that didn't meet this threshold were classified as less focused. Across every indicator, the EY analysis shows that the 10 more focused companies outperformed the 15 less focused organizations.

- **Market fragmentation likely to drive additional deals:** As companies strive to create therapeutic focus without adding portfolio complexity, the current high fragmentation in the marketplace could drive additional deals. Further consolidation in four therapeutic areas – oncology, immunology and inflammation, cardiovascular disease, and infectious disease – could unlock more than US$200b in future M&A opportunities.

Implications for 2019

Building a better working world

The report identifies a number of key industry trends likely to drive M&A in 2019 and beyond:

- Continued emphasis on portfolio optimization: In response to a recent EY client survey, more than 40% of life sciences executives indicated that they expect to do more deals in 2019 compared with 2018, and small- to medium-sized acquisitions valued at up to US$10b are of greatest interest. Only 3% of individuals surveyed listed megamergers or digital acquisitions as high priorities, and more than 70% of respondents said that product-focused innovations and portfolio optimization would be primary deal drivers.

- Divestitures will increasingly be used to unlock value: As networks of relationship and therapeutic focus become more important for commercial success, it will be more difficult for companies with low-digit market share to differentiate their products to payers and providers. These companies should consider using divestitures and asset swaps to unlock value in the near-term before the competitive bar for success is raised even higher.

- Digital alliances should be a priority too: To keep pace in the current climate, companies must build relationships with new digital entrants to improve the efficiency of research and development and better differentiate products with real world evidence. As the race to gain access to data-centric capabilities quickens, life sciences companies must consider making sizeable bets – first via alliances and then via acquisitions.

Peter Behner, EY Global Life Sciences Transactions Leader, says:

"In 2019, life sciences companies need to continue to create scale in priority therapy areas using focused M&A and alliances, as well as partnering with health care stakeholders and digital entrants to collect and use data to improve patient outcomes. The most successful companies will be the ones that use dealmaking to create end-to-end capabilities in therapy areas where they hold dominant positions."

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Notes to Editors

About EY

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About the *EY Firepower Index*

Now in its seventh year, the E*Y Firepower Index* measures companies' capacity to fund transactions based on the strength of their balance sheets. It has four key inputs: 1. Cash and equivalents; 2. Existing debt; 3. Debt capacity, including credit lines; and 4. Market capitalization. In constructing the model, the following assumptions were made: first, a company will not acquire targets that exceed 50% of its existing market capitalization; second, the debt/equity ratio of the combined entity created by a transaction cannot exceed 30%.

While some life sciences companies have made acquisitions that go beyond these upper limits, the intent is to apply a uniform methodology to measure relative changes in firepower. The *EY Firepower Index* measures capacity to conduct M&A transactions financed with cash or debt. It does not measure the ability to conduct stock-for-stock transactions. However, increases in a company's stock price do boost its firepower under the *EY Firepower Index*'s formula. That is because equity enables companies to borrow more to finance transactions.

In the report, companies were classified as big pharma, big biotech, specialty pharma/generics or medtech based on their size, geographic reach and product portfolio. Seventeen big pharma companies were analyzed for this report, while 10 specialty pharma/generics firms and 12 big biotechs were included.

How EY's Global Life Sciences Sector can help your business

As populations age and chronic diseases become commonplace, health care will take an ever larger share of GDP. Scientific progress, augmented intelligence and a more empowered patient are driving changes in the delivery of health care to a personalized experience that demands health outcomes as the core metric. This is causing a power shift among traditional stakeholder groups, with new entrants (often not driven by profit) disrupting incumbents. Innovation, productivity and access to patients remain the industry's biggest challenges. These trends challenge the capital strategy of every link in the life sciences value chain, from R&D and product supply to product launch and patient-centric operating models.

Our Global Life Sciences Sector brings together a worldwide network of nearly 17,000 sector-focused professionals to anticipate trends, identify their implications and help our clients create competitive advantage. We can help you navigate your way forward and achieve sustainable success in the new health-outcomes-driven ecosystem.

For more information, visit ey.com/lifesciences.