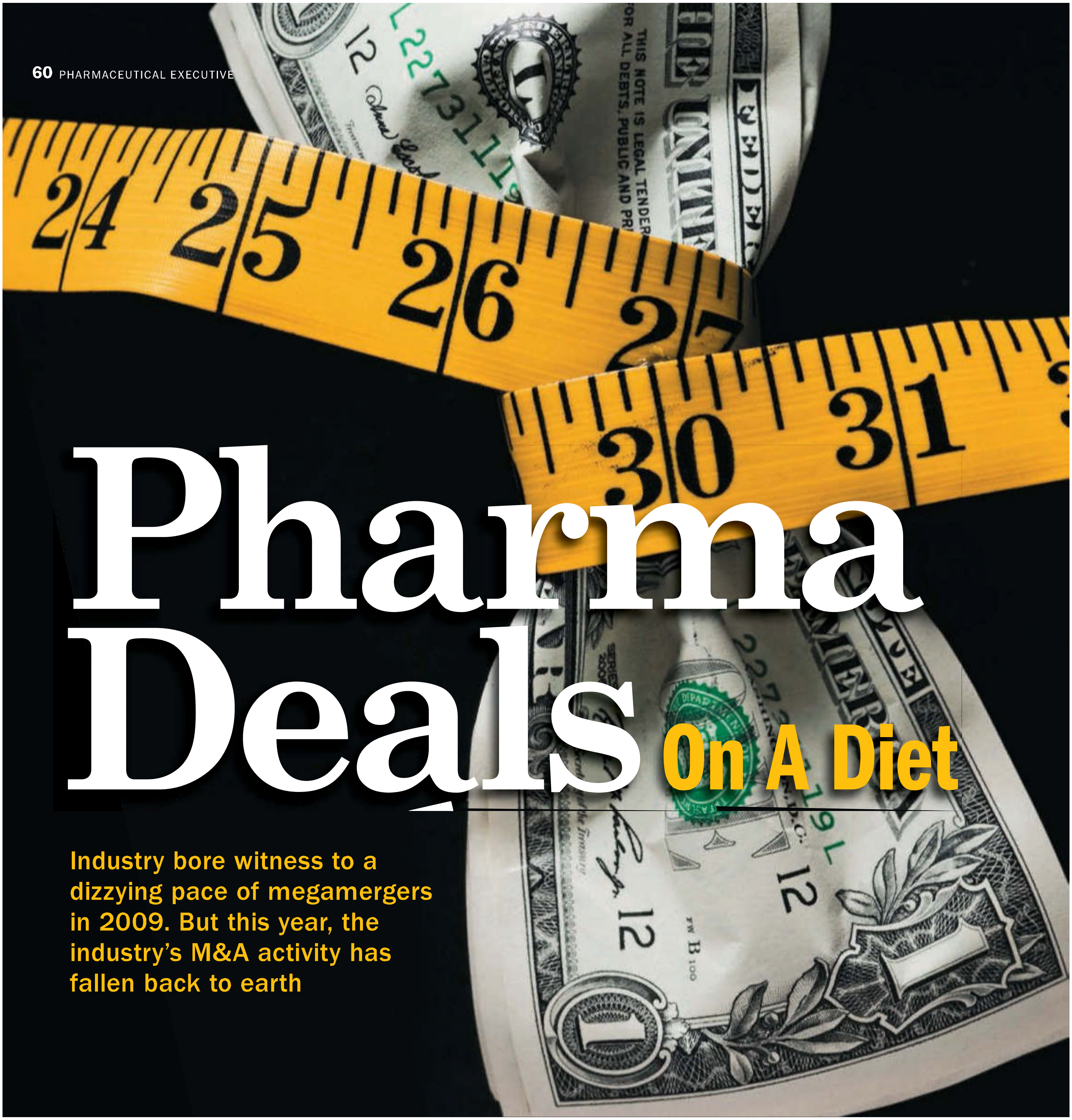

Pharma Deals On A Diet

Industry bore witness to a dizzying pace of megamergers in 2009. But this year, the industry's M&A activity has fallen back to earth

By Peter Young
Young & Partners

Activity this year in pharma mergers and acquisitions is shaping up to be fairly calm and steady, especially compared to last year's roller-coaster ride. In brief, in the first half of 2010, 14 deals were completed worth $15.4 billion, versus 29 deals worth $126.5 billion for 2009. So while the number of deals is keeping pace, the dollar volume has plunged, and the last half of the year gives no sign of yielding anything like 2009's two megadeals—Pfizer's acquisition of Wyeth and Merck's acquisition of Schering-Plough. In the meantime, pharma stock prices continue to be battered, generally suffering more than the declining overall market. But pharma debt and equity issuance has surged.

On the biotech side, the story was, as usual, quite different. After collapsing in 2008 and 2009, M&A activity continues to limp along at the same slow pace in the first half of 2010. In stocks, biotech companies staged a recovery in the first quarter, only to fall even further than the weakening overall market in the second quarter. Debt and equity offerings remain anemic af-

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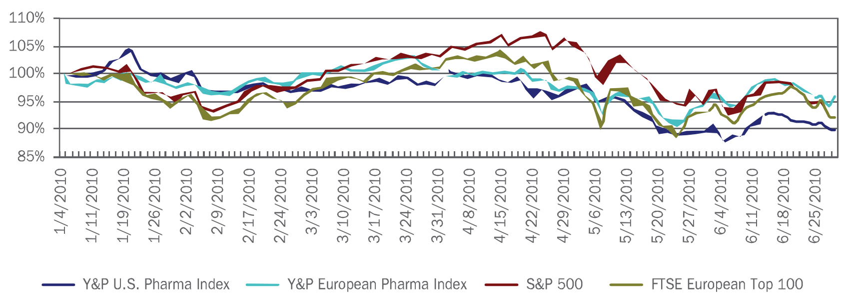
Performance of the Y&P Ethical Pharma Indices: First-Half 2010

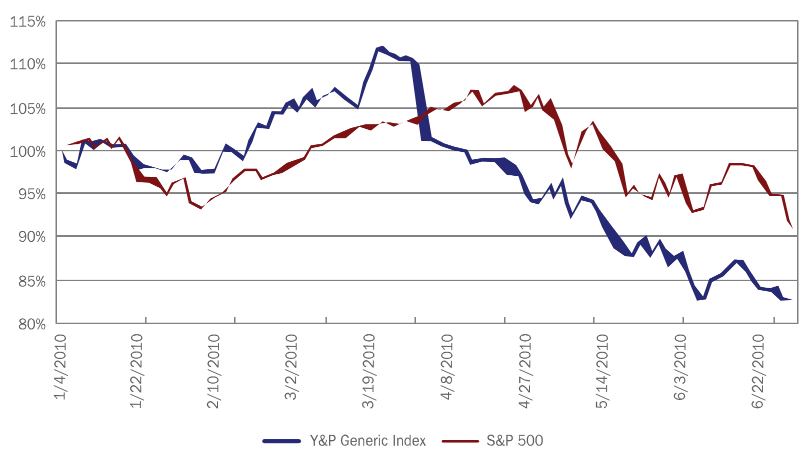
The Y&P US and European Pharma Indices fell by the end of the first half, in line with the decline in the overall market



U.S. Pharmaceutical Index: ABT, BMY, JNJ, LLY, MRK, PFE, SGP (acquiredby Merck), WYE (acquiredby Pfizer) European Pharmaceutical Index: AZN, GSK, NOVN, NOVO B, SAN

Performance of Y&P Generic Pharma Index: First-Half 2010

The Y&P Generic Pharma Index performed well in the first quarter of 2010 in anticipation of the 2010 to 2012 patent expirations. However, in the second quarter of 2010 the Y&P Generic Pharma Index fell dramatically, relative to the S&P 500



Generic Pharmaceuticals Index: KV.A, MYL, TEVA, WPI

ter a difficult 2009 as market sentiment veered decidedly away from risk.

What follows are the key facts and figures from Young & Partners' Strategic, M&A, and Financial Trends Report for the first half of the year—a mixed picture, to be sure. And it's important to keep in mind the troublesome backdrop, including a global economy struggling to grow in regions other than the emerging markets; the ongoing business challenges of pharma and biotech; and the signing into law of the US healthcare reform bill, which eliminated some uncertainties while raising others.

The Big Economic Picture

The global economy appears to have stabilized and to be recovering slowly, if unevenly. Most economists project a relatively sluggish recovery in the US and Europe, with a more robust economic performance in Asia and parts of Latin America. However, the persistently high rate of unemployment and a recent slowdown of economic growth in the US are of great concern right now to business, government, and consumers. Although Europe was faltering earlier in the year, there are signs that the EU may do slightly better than the US in the near future. China has already demonstrated its ability to maintain growth, albeit with significant help from government stimulus programs.

Even the financial markets have partially stabilized, with improved bank lending, a surge in investment-grade and high-yield debt issuance, and some form of steadiness at the financial institutions. However, there are worries aplenty—about major defaults in commercial real estate and certain sovereign nations (despite the current rescue packages), about potential disruptions to the Chinese economy from its own housing bubble, and about how economies and financial systems will handle the withdrawal of numerous stimulative and support programs. These factors are all "wild cards" for the global economy going forward.

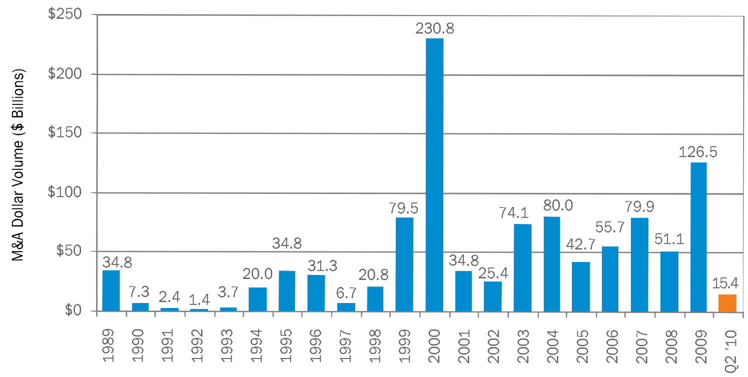
Although the pharma and biotech industries face their share of problems, the global economic crisis has proved not to be high on their list. Pharma has been modestly untouched by the downturn, while biotech sees an unabated demand for new drugs and technology. On the financial side, established pharmaceutical firms are protected by their strong cash flows and high credit ratings, but biotech companies have been severely punished by the financing markets and have little or no access to capital. Until the market's appetite for risk returns, many good biotech companies will be starved for equity capital.

The two industries' particular revenue challenges stem largely from familiar sources—patent expirations, product pipelines, pricing pressures, and failing business models—with the implementation of US healthcare reform adding a potential new twist. Pharma and biotech both look like winners under the 2010 Affordable Care Act that enshrined healthcare reform into law. By coming to an early agreement with the Obama administration to contribute billions of cost savings in government health programs,

Dollar Value of Worldwide Pharma Acquisitions

The value of deals was low for most of the '90s, but M&A escalated in 2000 and has been healthy since. Two mega deals drove 2009 to a high dollar value. With no mega deals in first half of 2010, dollar values have fallen.

Worldwide Pharma M&A Dollar Volume

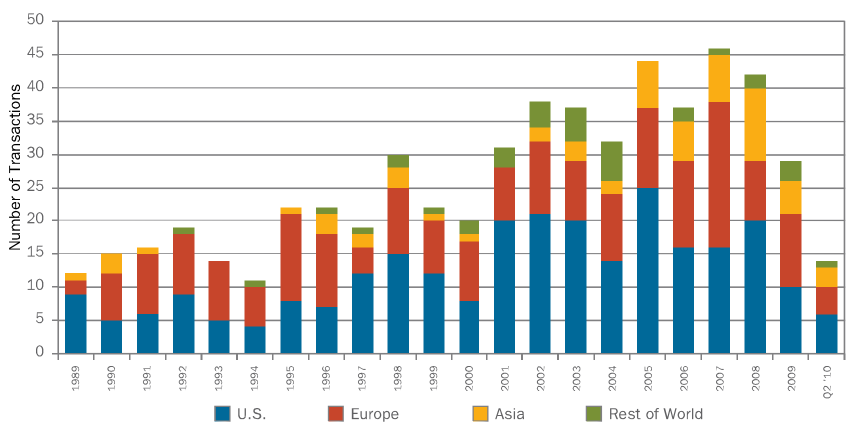


Only Deals > $25 million

Number of Worldwide Pharma Acquisitions—Buyer Origin

The number of deals that have closed has been high since 2001, but slowed modestly in 2009 and this past half year.

Worldwide Pharma M&A Transactions



Only Deals > $25 million

pharma got the promise of higher prescription volumes and avoided many onerous proposed provisions. Key elements include:

» Closing of the Part D coverage gap over time

» Medicaid drug rebate minimums increasing on average to 23.1 percent for innovator drugs and 13 percent for non-innovator drugs

» Favorable branded biologics treatment, with innovator biologics given 12 years of data exclusivity and biosimilar filings delayed until four years after the first license of the innovator product; and

» New annual fees in the single-digit billions beginning in 2010

Pharma's Out-of-Favor Stocks

During the first half of 2010 the overall stock market staged a recovery and then fell dramatically. By June 30, the S&P 500 index had dropped by 9 percent and the FTSE Europe Top 100 fell by 7.9 percent. The pharma industry performance was mixed relative to the market. The Y&P US Pharma Index decreased by 10.3 percent, the Y&P European Pharma Index was down by 3.9 percent, and the Y&P Generics Index was down by 17.0 percent.

Trailing P/E ratios also changed. The Y&P US Pharma Index decreased to 14.1x from 14.4x at the close of 2009, the Y&P European Pharma Index was up to 15.8x from 14.4x, and the Y&P Generics Index increased to 20.0x from 17.9x. These multiples are dramatically down from just a few years ago. This trend is partly due to the fact that pharma companies are no longer the darlings of the stock market; investors have come to understand that pharma's future uncertainties are mounting as it faces the formidable challenge of solving some major structural problems.

The trend in biotech stock is aversion to risk. The Y&P Biotech indices did well in the first quarter of 2010, but followed up with a very poor performance in the second quarter. Even though the overall market fell, biotech as a group did worse. The Y&P Biotech Large Cap Index fell by 15.5 percent, the Y&P Biotech Mid Cap Index by 18.5 percent, and the Y&P Biotech Small Cap Index by 10.6 percent. The market sentiment has been negative overall, but the biotech industry suffered a severe reversal of fortunes as the market fled from investments in the high risk demanded by innovative drug development.

M&A Deal Size on a Diet

Through last June, M&A volume—14 deals worth $15.4 billion—held up on an annualized basis, but the dollar volume fell dramatically because of the back-to-back megamergers in 2009. There were only three deals over $1 billion in equity value in the first half of 2010, the largest of which was Abbott Laboratories' acquisition of Solvay Pharmaceutical for $7.6 billion in enterprise value. Perhaps the clearest indication of the modest level of merger activity was that fact that as of June 30, the value of the 12 deals an-

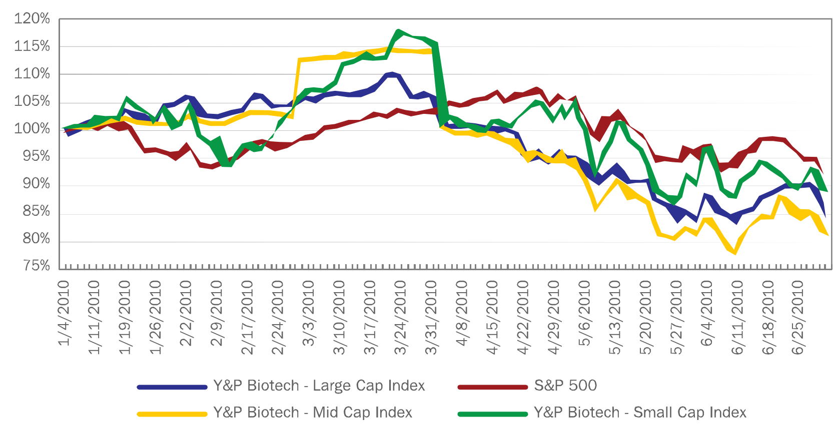
Top 10 Deals, First-Half 2010, by Equity Value

There were three deals over $1 billion in value that closed in 2010.

Close Date	Acquiror Name	Target Name	Equ ($mil)	EV ($mil)
2/16/10	Abbott Laboratories	Solvay Pharmaceuticals	$6,612	$7,653
6/07/10	Astellas Pharmaceuticals	OSI Pharmaceuticals Inc	$4,023	$4,023
2/23/10	Shanghai	Shanghai Industrial	$1,057	$826
4/09/10	Cephalon Inc	Mepha Pharma AG	$628	$628
1/14/10	Biovitrum AB	Swedish Orphan International AB	$576	$585
5/19/10	Sanofi-Aventis Farmaceutica Ltda.	Medley S.A. Industria Farmaceutica	$454	$688
3/30/10	Hosira, Inc.	Orchid's, Generic	$400	$400
2/23/10	Shanghai	Shanghai Zhongxi Pharm	$366	$392
1/29/10	Sigma-Tau Pharmaceuticals, Inc.; Defiante Farmaceutica	Specialty Pharma Bus. (Enzon PharmaceuticalsInc.)	$327	$467
5/27/10	Valeant Pharm Intl Inc	Aton Pharma Inc [Cerberus Capital Management]	$318	$318

Y&P Biotechnology Indices: First-Half 2010

In first-half 2010, the overall market fell and the three biotech indices all underperformed the market.



Y&P Biotechnology –Large Cap Index: AMGN, BIIB, GENZ, GILD, CELG
Y&P Biotechnology –Mid Cap Index: AMLN, CEPH, PDLI, ONXX, OSIP, VRTX
Y&P Biotechnology –Small Cap Index: GERN, ISIS, LGND, PGNX, QLTI, VPHM

nounced but not closed was only $13.7 billion. Pfizer's $3.6 million purchase of King Pharmaceuticals in October will help raise the dollar volume for the second half of the year, but it will likely prove the exception rather than the rule. Meantime, Sanofi-Aventis' $18.5 billion hostile bid for Genzyme will be a drawn-out affair into 2011.

The question in biotech M&As is, where did all the volume go? In the first half of the year, biotech M&A activity was very modest, with only 10 deals worth $3.2 billion in equity value completed. This continues the pattern of very subdued biotech M&As over the last two years. In 2009, 20 deals worth $6.1 billion were completed, while 2008 saw only 19 deals worth $4.8 billion.

Acquisitions of biotechs by Big Pharma and Big Biotech remain an industry imperative, but the deal size is clearly much smaller—partly because the supply of decent-sized biotechs has been depleted. Also, buyers feel less of a sense of urgency to acquire biotech companies given the alternative options to license or form alliances. As of June 30, only four deals worth $755 million had been announced (but not closed). This very modest biotech deal pipeline is a further indication that the biotech M&A market is in a slump.

Debt and Equity Financing

The debt and equity financing activities of pharmaceutical companies surged in 2009 after collapsing in 2008. During the first half of 2010, nonbank debt issuance was $20 billion compared to $86.1 billion for all of 2009, a slower but still very active pace. The market continued to be strong for investment-grade debt, with many of these financings driven by M&As. Equity issuance in the first half was $1.4 billion, versus $3.8 billion issued for all of 2009. The number of offerings was 14 versus 23 for all of 2009. The modest issuance activity has been only partly due to a weak equity issuance market. Pharma's need for public equity capital has also been limited.

As for biotech, there was not a single nonbank debt offering in the first half of 2010. In both 2009 and 2008, only $400 million of nonbank debt was issued. The lack of biotech creditworthiness coupled with a depressed overall debt market were major factors. Equity issuance volume in the first half of 2010 came to 32 offerings worth $2 billion compared to 42 offerings for $3.8 billion for all of 2009. There was a small uptick in equity issuance volume starting in the fourth quarter of 2009 that continued through the first half of this year; six IPOs were recorded: Ironwood, Anthere, Aveo, CorMedix, Tengion, and Alimera Sciences. With a weak overall equity issuance market and a flight to quality, equity issuance will continue to be soft for biotech.

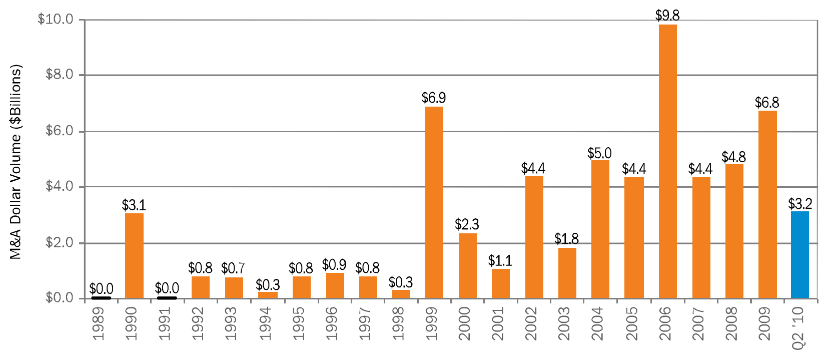
Pharma's Mixed Financial Future

The business outlook for pharma companies remains murky as they struggle to realign themselves to a new business model. The solution will be different for each company. However, the biggest

Dollar Value of Worldwide Biotechnology Acquisitions

M&A volume was chronically low for years until 1999. Since then, activity has generally been high and volatile, fueled by pharma acquisitions of biotech companies and biotech consolidation.

Worldwide Biotech M&A Dollar Volume

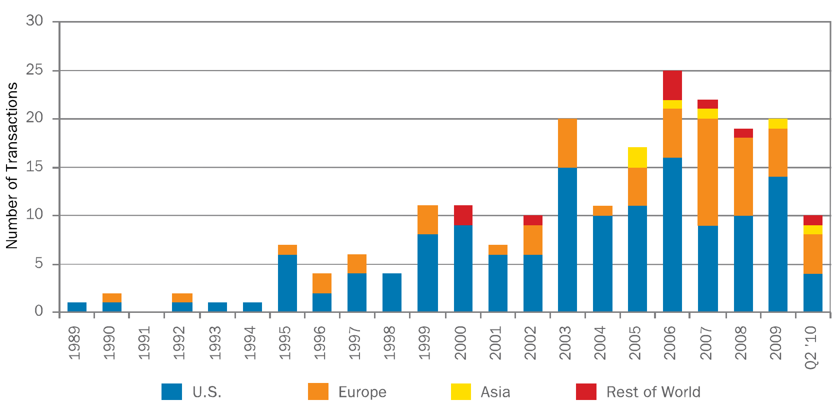


Only Deals > $25 million

Number of Worldwide Biotechnology Acquisitions: Buyer Origin

Transactions were low for years until 2002. The pace has been steady at around 20 per year recently.

Worldwide Biotech M&A Transactions



Only Deals > $25 million

Top 10 Deals in 2010 by Equity Value

There were no deals above $1 billion in value in the first half of 2010

Close Date	Acquiror Name	Target Name	Equ ($mil)	EV ($mil)
4/21/10	Abbott Laboratories	Facet Biotech Corp	$681	$681
1/15/10	Celgene Corp.	Gloucester Pharmaceuticals, Inc	$640	$640
2/03/10	Novartis AG	Corthera Inc	$620	$620
3/03/10	AstraZeneca PLC	Novexel SA	$505	$505
1/06/10	Eisai Co Ltd	AkaRx Inc	$255	$255
4/05/10	Cephalon Inc	Ception Therapeutics	$250	$250
2/10/10	BioMarin Pharmaceuticals Inc	Lead Therapeutics Inc	$97	$97
6/16/10	Minapharm Pharmaceuticals Co	ProBioGen AG	$38	$38
3/10/10	Cosmo Pharmaceuticals SpA	BioXell SpA	$35	$33
1/05/10	Silence Therapeutics PLC	Intradigm Corp.	$32	$32

challenge is on the shoulders of the Big Pharmas whose structural underpinnings have been undermined the most. Healthcare reform will have a positive impact on pharma, especially because some of the most threatening proposals were absent from the final bill.

The stock market will continue to penalize the R&D pharma industry, as long as the structural changes are working their way through the industry and solutions are implemented. Generics will continue to do well as long as they achieve growth, but volatility will remain high. Pharma industry multiples are below the market's and will continue to suffer until the industry outlook improves and regulatory uncertainty is resolved.

Young & Partners expects a continued high level of M&A activity (including in-licensing arrangements and the formation of partnerships and joint ventures) as drug companies merge or acquire to achieve scale and to enhance shrinking product pipelines. However, with no megamergers in the offing, dollar volume will fall. Companies will also continue selling products to one another as they restructure portfolios.

The development capabilities of biotech companies have clearly been validated. Although there will be individual successes and failures, the industry as a whole has demonstrated its ability to develop new drugs at a faster pace than the larger pharmas. The severe negative has been on the funding side. 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. Unfortunately, biotech funding will continue to falter, even with a possible recovery in the overall IPO market. For a select few, public equity funding will be an option. For others, funding or shareholder liquidity will come from the pharma and big biotech companies through partnering, licensing, and M&A deals.