Why Pharma Dealmaking is a Sector that's Ripe for Growth

The global pharmaceutical sector is booming thanks to continued growth in R&D spend in new technologies and therapeutic areas, putting the industry back on a more normal track following a tumultuous period during the pandemic. According to a report by the IQVIA Institute, R&D expenditure by big pharma companies reached a record $138 billion in 2022, marking a huge 43% increase since 2017.

It's been encouraging to see pipeline activity innovation regain its pre-pandemic momentum, and we expect this to drive a continued increase in M&A, as cash-rich, mature companies buy access to developing product areas and expertise to drive forward future growth.

According to a report from Goldman Sachs, the global pharmaceutical sector has a war chest of approximately $700 billion to acquire other companies and invest in R&D, a significant amount of potential M&A firepower. This is only growing, as combined total revenue for the largest global pharmaceutical companies reached $737 billion in 2022, representing a 4.7% rise in net sales compared to the $704 billion recorded in 2021, further increasing deployable cash flows.

As ever a major driver remains the need for pharma companies to continue to invest due to the "patent cliff" – the potential sharp decline in revenues upon patent expiry of one or more leading products which then become generics.

A Deeper Insight into Big Pharma

Record levels of drugs in the pipeline, improved speed productivity drivers in clinical trials and the emergence of increasing numbers of smaller biopharma companies are all factors widening big pharma's interest in M&A. With accumulation of substantial cash reserves during the coronavirus pandemic, coupled with investor worries regarding future growth prospects we believe there will be a further upsurge in activity.

Recent acquisitions in the pharmaceutical and biotech industries have completely bucked the overall trend in the M&A market which has been relatively lacklustre. Reuters Breakingviews echoed this sentiment in a recent article, stating that "drugmakers are primed for a shopping spree in 2023" with chief executives having a "potential half-trillion-dollar war chest to use on dealmaking". Therefore, we could be well on track to reach exceptional levels of deals this year, far higher than last year's total value of biopharma deals reaching $127bn.

If a company possesses promising late-stage R&D assets, it becomes that much more appealing as a potential acquisition target for the cash rich major pharmaceutical companies. If the ongoing product development pipeline activity remains at a high, there's no doubt we'll see continued positive sentiment across the sector and M&A, both bolstering share prices and overall capital markets activity.

Earlier this year, Novartis AG, Switzerland-headquartered pharma company, announced its acquisition of United States-based clinical-stage biopharmaceutical company, Chinook Therapeutics Inc. The deal, valued at $3.45 billion, involved Novartis acquiring Chinook at a price of $40 per share, with an additional contingent payment of $4 per share. This transaction exemplifies the ongoing trend of major pharma companies seeking growth opportunities by acquiring smaller counterparts in the industry.

It's likely that established early-stage treatments being acquired by big pharma companies will continue to be a recurring trend if we see this ongoing increase in investment levels.

A Greater Look at the R&D Pipeline

It's promising to see the marked increase in the number of companies contributing to the growing pharma R&D pipeline – over 2,800 companies were reported at the last count, a 49% growth in numbers reported since 2017, according to the IQVIA Institute. This growth lies in part down to a focus on multiple therapeutic areas ranging from oncology development (having seen 5% growth over the past year), rare diseases, as well as areas such as neurology research, centred on Alzheimer's and Parkinson's, alongside the growing significance of depression and mental health conditions.

One of the biggest trends we are seeing in R&D is the greater presence and sizeable investment of China. Products from companies with headquarters in China now make up 15% of the R&D pipeline, up from 2% in 2007 and 6% five years ago. Indeed, this active pipeline from China has more than tripled in the last five years, showing clear scope for growth thanks to the significant investment made into the country's life sciences sector. However, there are clear geopolitical risks associated with China. As reported in the Financial Times, Astra Zeneca may opt to carve out its China business with a separate listing as tensions heighten between the US and China and businesses look to insulate themselves from the region's geopolitics.

Industry experts are also projecting a key area of growth in the next-generation biotherapeutic pipeline, which are focused on gene editing, CAR T-cell and other cell therapies. With a 20% CAGR since 2017, the next-generation biotherapeutic pipeline has expanded dramatically in recent years, according to research from the IQVIA Institute. Given that 40% of these are being researched for a variety of cancers, primarily non-rare solid tumour malignancies, cell treatments make up the greatest portion of the next-generation biotherapeutic pipeline, with nearly all of them being developed for cancer.

Small, Emerging Biopharma Companies are Having Their Moment

Smaller and emerging biopharma companies are making a massive dent in the R&D landscape. Significantly, these smaller companies were responsible for only one-third of innovation in 2002, which has since converted to over two-thirds of the R&D pipeline. Not only that, IQVIA research notes that in 2022, emerging biopharma companies were responsible for 67% of all new drugs, and successfully launched 69% of them, highlighting their increasing self-reliance in bringing innovative products to market.

Interestingly, this trend speaks to the broader growth from China. Indeed, China-

based companies now make up 20% of the global emerging biopharma pipeline, a significant increase from 9% in 2017, surpassing China's share of the overall pipeline. Notably, China experienced the strongest growth in the emerging biopharma pipeline compared to other regions, with a 19% increase in the past year, although there is significant pricing pressure in China. And while the United States remains the largest contributor to the emerging biopharma pipeline, its share has slightly declined in recent years, from a peak of 50% in 2016 to 46% in 2022.

The Acceleration of Clinical Trials Processes

As well as the growing spend and number of companies developing novel products, increased speed productivity drivers in clinical trials, which are essential for driving innovation and treatment approvals, are also on the rise.

Trial success rates and trial durations have remained essentially flat over the last 5 years – due largely to the pandemic but also now the difficulties trials face in recruiting patients to take part in rare disease and longer trials. However, last year, we saw an increase in clinical development productivity for the first time in 10 years, driven by AI, virtual clinical trials and the flexibility of regulators on real world data.

Large pharma has typically not had much expertise in AI and machine learning. It's therefore a gap they are determined to plug. It has exploded in recent times in terms of its application in drug discovery, clinical trials, healthcare analytics, diagnostics and personalised care. These new AI tools are having a significant impact on areas such as speeding up clinical trials, as well as influencing spend on R&D. Many companies are looking aggressively at ways to integrate AI technology into their businesses and M&A is likely to follow this path.

Additionally, there has been a consistent increase in the number of remote, virtual, or decentralised (RVD) trials aligned with industry trial starts. Although RVD trials involve a greater number of subjects, sites, countries, and endpoints compared to traditional trials, they have shorter durations, indicating their potential for accelerated progress. There is also an increased focus on RVD trials whereby data is collected in the context of routine delivery as opposed to clinical trials and where trial controls are not representative of real-world outcomes.

Continued improvements in these areas, meaning faster results from clinical trials which are essential for driving new product innovation, will lead to more and quicker new product releases across the pharmaceutical industry. This in turn will drive the tide of M&A within the pharma industry.

Yet, Big Pharma Acquisitions Can Pose a Risk

The Federal Trade Commission (FTC) created a stir recently by filing a lawsuit to halt Amgen's $28 billion acquisition of Horizon Therapeutics. This was the FTC's first attempt in over a decade to block a merger in the pharmaceutical industry, driven by concerns over rising prices for patients resulting from excessive consolidation within the sector. The FTC employed a unique argument, suggesting that the transaction would grant Amgen the ability to use rebates on its established blockbuster drugs as leverage to pressure insurance companies and pharmacy benefit managers into favouring Horizon's two dominant products. This increasing scrutiny from US antitrust regulators poses a threat to the recovery of big pharma deal-making.

In addition, the US gene-sequencing firm Illumina was fined €423 million for acquiring Grail, the cancer test developer, without its approval. The maximum penalty was intended as a signal to deter others from side-stepping European merger rules.

The tougher stance on pharma/biotech deals risks stifling innovation, as smaller entities engaged in high-risk research, typically acquired by larger companies to complete trials and commercialise drugs, may be deterred. It's also likely to prolong the deal-making process and potentially alter companies' risk appetite when considering M&A activities.

Conclusion

Large pharmaceutical companies remain compelled to persist in their pursuit of M&A despite the introduction of new regulations. This drive stems from the necessity to address the gaps in their drug pipelines and ensure a continuous flow of innovation that will be essential to the health of the sector overall.

Clearly, the need to address the drug pipeline is propelling M&A activity, driving increased investment in R&D healthcare and the introduction of innovation medications. As record-breaking budgets are being allocated to R&D, there is huge scope for expansion of next-generation treatments and medications, that puts both smaller biopharma and big pharma on the same table. So, despite the increased regulatory scrutiny challenges to deal-making, it's an exciting time of innovation for the sector, and we look forward to seeing what's next.

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Michael joined Cavendish in January 2006 and has advised on many successful sale mandates across a range of sectors with a particular focus on business services and healthcare. Michael's transaction experience includes arranging sales to some of the largest global corporates such as the sale of Rapidscan Pharma Solutions to GE Healthcare, Polar Speed Thermologistics to UPS and the sale of Finsbury Orthopaedics to Johnson and Johnson, as well to private equity purchasers such as the sale of Zenith Hygiene to Bain Capital backed Johnson Diversey.