News release

Sinking profits and accelerated consolidation: Big Pharma facing historic upheavals

ZURICH, 12 MAY 2014. Big Pharma is under pressure: according to an analysis of the biggest pharma companies by the audit and advisory organization EY, sales fell for the past two years, and again in the just reported Q1 2014, operating margins declined squeezing profits. Price pressure from payers, stagnating demand and competition from generics are posing problems for pharma companies. Cost reductions and restructurings alone will not be enough, and the industry appears poised to embark on a new era of mergers and acquisitions, which will comprehensively transform the industry. Long term, Big Pharma must work with payers and build trust.

Analyses by audit and advisory organization EY of the top global pharmaceutical companies shows clearly the impact of pressures faced by the sector. Turnover of the 20 biggest companies sank last year by 3.0% to EUR460b. This marks the second consecutive year of decline. Profits also fell: the top 20 pharma companies’ operating profit (EBIT) declined from 2012 to 2013 by 6.0% to EUR112b. Operating profit margins also fell in the year-to-year comparison from 25% to 24%, marking the second year of declines from 26% in 2011.

Slowdown in research and development

In response, leading pharma companies implemented intensive cost-saving efforts in recent years: they have merged divisions, reduced overhead and trimmed entire business units for efficiency. But one outcome of these cost-saving measures has been a slowdown in research and development (R&D). According to EY analysis, the global top 20 pharmaceutical companies reduced their R&D expenditure in 2013 by 1.8%. R&D spending peaked in 2010 and has declined during the last three years.
It is getting harder for Big Pharma to grow by its own efforts. Globally, the price of medicine is coming under significant pressure from payers and service providers who also need to save costs. Insurers and health authorities expect to see demonstrable added value before they are prepared to reimburse a new drug. Expansion into developing economies may offer some opportunities for growth, but at lower prices than in developed markets, which contributes to squeezed margins. Also, generics are increasingly preferred by payers, rather than more expensive branded drugs.

To generate additional growth and improve their position in individual market segments, pharma companies have been searching for opportunities to partner with or acquire specialized companies with innovative products in their development pipelines. Evidence of this search can be seen in several big transactions in the past month.

**Further consolidation unavoidable**

Given Big Pharma’s background of weak growth, this increase in activity is not surprising — especially as the conditions for M&A are favorable, observes Patrick Flochel, Global Pharmaceutical Sector Leader at EY: "Individual markets are highly fragmented. To expect long-term success, it is becoming more important to establish your company in the top three or four within each market. Very few industries have as much pressure to consolidate as the pharma sector." The general economic environment is also favorable — rates are still low and the markets are generally friendly.

"Pharmaceutical companies, which made sensible acquisitions, focused their portfolios and used their capital efficiently, were rewarded at the stock exchange in the last few years," Flochel says. Further momentum is increasing the current historical radical change in the pharma industry according to Flochel: “Big Pharma has been largely absent on the M&A stage in the last few years, but rising equity valuations, cost cutting and paying down debt have lifted their firepower to pursue deals now. So as not to lag behind the growth of the overall market, they are increasingly looking about for companies and divisions, which would fit their existing portfolios." US companies with cash reserves abroad also have the possibility of avoiding tax disadvantages at home when making acquisitions in Europe.

**Collaboration with payers and matters of trust**

To be successful in the long term, pharmaceutical companies will need to strengthen ties with payers. A new EY survey shows that payers are convinced that pharmaceutical companies can do more to reduce health care costs and improve therapy results. "Payers want solutions which cover the entire treatment cycle and which help them compare products from different manufacturers objectively," explains Flochel.
However, if pharmaceutical companies are to better respond to payers’ requirements, they will have to overcome a significant issue: trust. The survey shows that many payers do not believe pharma companies can be trusted partners. "One of the biggest challenges for the pharmaceutical industry is to regain the trust of payers and the public," Flochel says.

Notes to editors

Survey methodology

For Progressions 2014, EY conducted surveys of 30 US payers, 30 European payers and 18 pharmaceutical company representatives from functions, such as Market Access and Managed Markets. The survey was conducted in January 2014. EY supplemented the survey with in-depth interviews with over 30 senior executives from numerous countries including the US, Germany, UK, Switzerland, the Netherlands and France.

http://www.ey.com/progressions2014

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