

The global recession has forced some of the world's leading companies to reduce their costs through staff reductions and other cost-cutting exercises. **Jyoti Ranjan Padhi** of analysts GlobalData looks at the effect of this situation on mergers, R&D and financing methods.

# CRUNCH TIME

**W**hile the pharma industry struggles with the negative publicity relating to undisclosed payments to doctors, misleading direct-to-consumer (DTC) advertisements and liability lawsuits. It continues to grapple with ongoing concerns of tightening regulatory scrutiny, increasing R&D expenses and a shortening pipeline. All these coupled with the global financial crisis has not left many options for the industry. Big pharma is restructuring like never before, primarily in a bid to bolster the sagging pipeline and to reduce costs while maintaining significant cash reserves.

Pfizer, the world's largest pharmaceuticals company by sales, let go more than 14,000 employees worldwide in 2007-2008. While layoff stories are not new within the pharmaceuticals industry, the scenario is different this time. Traditionally, global pharma majors have laid off their sales forces as part of their strategy to 'right-size' the sales strength. However, Pfizer's announcement to cut up to 800 research jobs in 2009 is possibly an admission of the fact that the company's research labs have failed to provide significant return on investment (ROI). Incidentally, the company spent \$7.9 billion on R&D, 16.5% of the revenue the company generated in 2008.

More than 75,000 jobs were cut by the pharmaceutical and biotechnology industries in 2008. Layoffs were at a peak in the fourth quarter with 7,200 jobs slashed by Merck & Co alone. The layoff streak continued in the first quarter of 2009 with many pharma biggies joining the league - King Pharmaceuticals, Pfizer and AstraZeneca announced the layoff of 22%, 13% and 11% of their staff respectively. Is cost reduction through job cuts the only solution left for the pharma industry? Certainly not - evident from the array of initiatives that the big pharma is exploring. Consolidation is definitely emerging as the preferred strategy.

## 2009 - the year of M&A

As the large pharma companies sit on huge cash reserves, diversification through acquisition has become the rule of the game. The drive is not just to get bigger but also



### Contributor profile



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to ensure portfolio diversification. Roche's acquisition of Genentech, Abbott's acquisition of Advanced Medical Optics (AMO), Johnson & Johnson's (J&J) acquisition of Mentor Corporation, Eli Lilly's acquisition of ImClone Systems and Takeda's acquisition of Millennium Pharmaceuticals were some of the deals that indicate that the big pharma's intention is clear - invest wisely. All these incidentally are non-Pharma acquisitions. Genentech, ImClone Systems and Millennium Pharmaceuticals are biotech players while AMO and Mentor are established medical device manufacturers. The strategic objective is very clear - to hold a portfolio that is well diversified to absorb the industry-specific risks.

Deals that seemed unthinkable in the recent past are beginning to see the light of the day. While Roche has completed the acquisition of Genentech, Pfizer has entered into a definitive merger agreement under which the company will acquire Wyeth in a cash-and-stock transaction. Merck & Co and Schering-Plough announced that their Boards of Directors have unanimously approved a definitive merger agreement under which the companies will combine, under the name Merck, in a stock and cash transaction.

The year of mega M&As has just started taking shape. With sizable cash in their coffers, companies like GlaxoSmithKline (GSK) and J&J are well positioned to capitalise on declining valuations. J&J, as of 28 December 2008, had more than \$18.9 billion in cash, cash equivalents and short-term investments. GSK, as of 31 December 2008, had more than \$12.6 billion in cash, cash equivalents and short-term investments. What

should emerge out of all these M&As is not just a new competitive landscape but also a host of other structural changes, primarily in the form of cost cutting initiatives. While the buyers might not find it financially viable to retain the entire staff of the acquired company, they will also hand over pink slips to some of their own staff in a bid to build synergy. Incidentally, following its acquisition of Wyeth, Pfizer is expected to cut approximately 15% of the combined workforce. While reporting its fourth quarter and full-year 2008 results and 2009 financial guidance the company said it will implement a new cost-cutting initiative, which is expected to achieve incremental cost savings of approximately \$3 billion. As part of this initiative, the company is expected to downsize its workforce by about 10%, cutting jobs across different functions including administration, sales, manufacturing and R&D. Pfizer also announced its intention to close five of its 46 manufacturing sites.

### R&D: tough days ahead

The top five pharma giants, Pfizer, GSK, Sanofi-Aventis, Novartis and AstraZeneca, have approximately 448 pipeline products in different stages of clinical investigations and registration. As the global financial crisis progresses it would be overly optimistic to say that the existing drug pipeline will remain unaffected. While a majority of these companies will do everything possible to advance these forward, the biggest impact will be on early-stage products, primarily the ones in preclinical and earlier stages. Many leading giants might not find it financially viable to take these forward unless they show significant promise to emerge as potential blockbusters.

Pfizer has started taking out compounds that do not fit into its strategy of focusing on niche and underserved disease areas which are less competitive and where the company stands a chance of dominating the competition. As a result, the company's drug pipeline count reduced to 100 in April 2009 from 114 in September 2008. The fact that the company's Phase III pipeline count remained static at 25 compounds is indicative of its strategy to continue to pump in money to further advance the compounds already in advanced clinical phases. The drive is to find replacements for blockbusters awaiting generic competition.

As some of the biggest blockbusters await patent expiration, R&D restructuring seems inevitable. Pfizer's announcement to cut 800 R&D jobs is not the only one of its kind. In 2008 GSK announced the planned layoff of as many as 850 R&D jobs, representing about 6% of the total R&D staff. Restructuring doesn't only come in the form of layoffs, certainly not in the pharma industry. Several companies have already decided to narrow their research efforts to specific diseases and therapeutic areas. Wyeth is contemplating a move to reduce its focus

therapeutic areas to six from 14 and focus disease areas to 27 diseases from 55. The company is expected to focus less on primary care medicines and more on severe disease segments in the areas of oncology and CNS. Meanwhile, in September 2008 GSK announced the formation of a newly integrated oncology R&D organisation. GSK Oncology combines the company's drug discovery and clinical trial scientists to create a dedicated oncology R&D organisation.

Gone are the days when the leading pharma giants continued to pump in money in a bid to develop the next blockbuster that will revive their fortunes. The top ten pharma companies invested more than \$58.6 billion in R&D efforts in 2008. Pfizer led the pack with R&D expenses amounting to \$7.9 billion. Pfizer has seven blockbusters that contributed 50% to the company's total global revenues of \$48.3 billion in 2008. Lipitor, the world's largest-selling drug, earned revenues of \$12.4 billion in 2008. With a large number of its best-selling drugs including Lipitor on the verge of patent expiration in the near future, Pfizer is not left with any other option but to restructure – evident from its planned acquisition of Wyeth and the cost-cutting initiatives it has implemented

### Outlook for 2009 and beyond

In July 2008 Eli Lilly announced that it had established an arrangement with TPG-Axon Capital and NovaQuest – the partnering group of Quintiles Transnational – for the Phase III development of the company's two lead molecules for Alzheimer's disease. While Lilly received \$325 million in the process, the deal was significant because a pharma manufacturer securing hedge fund money for drug development was previously unheard of. As the global financial crisis deepens making it difficult to obtain funding, deals like this are expected to become the norm. The motivation is not just to secure external financing but also to moderate the risk of losing money if the project fails. The other model that pharma companies have traditionally and will continue to rely on is risk-rewards sharing agreements with other pharma companies. In 2007 Bristol Myers Squibb inked a partnership agreement with Pfizer to co-develop and co-promote apixaban, a Factor Xa inhibitor for thrombosis. The same year, the company struck another partnership with AstraZeneca to co-develop and co-promote the Bristol Myers Squibb-discovered potential treatments for Type 2 diabetes, saxagliptin (a DPPiv agent) and dapagliflozin (an SGLT2 inhibitor).

The future is set to see more global pharma majors driving efforts to seek external financing. As companies seek to boost their liquidity position and drive efforts to cut costs, the pressure to replace the blockbusters approaching patent expiration will build. Research partnerships and licensing agreements seem to be the strategies of choice. **WPF**

#### R&D: THE FACTS

# 75,000

Jobs cut by pharmaceutical and biotech industries in 2008.

# 448

Pipeline products in clinical stages from top five pharma.

# \$58 BILLION

R&D investment from top ten companies in 2008.