

Life Sciences
Global Capital Confidence Barometer

May 2017 | ey.com/ccb | 16th edition

The EY logo consists of the letters 'EY' in a bold, white, sans-serif font. Above the 'Y' is a yellow chevron shape pointing to the right.

Building a better
working world

A yellow traffic light is mounted on a grey pole against a dark grey stone wall. The pedestrian signal is lit green, showing a walking figure. The light is partially obscured by a yellow graphic element.

**Can economic
uncertainty
and record
M&A coexist?**



The better the question. The better the answer. The better the world works.

Key findings



46%

expect to **actively pursue acquisitions** in the next 12 months



33%

have **five** or more **deals** in their **pipeline**



22%

look at **cross-border deals** to secure market access and grow their customer base



59%

see the **global economy improving**



97%

expect corporate earnings to either **improve** or **remain stable**



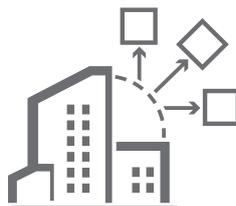
48%

cite a broad range of **geopolitical or emerging policy concerns** as **greatest risks** to growth



64%

have increased the frequency of their **portfolio review process**



66%

plan to **outsource routine operations or back-office functions** in the next 12 months



49%

cite **cybersecurity** concerns as a reason for canceling a planned deal

Policy reform and portfolio rationalization heighten dealmaking activity across the life sciences spectrum

The strong finish to 2016 and elevated dealmaking so far in 2017 are helping keep executives' intention to enter into deals themselves well above trend, according to the latest edition of EY *Capital Confidence Barometer*. Forty-six percent of life sciences executives surveyed say they plan to actively pursue deals in the next 12 months, while 92% of life sciences companies with greater than US\$5b in revenues are likely to pursue deals. One third of executives say they have five or more deals in their pipeline – last year, only 6% of executives had five or more deals. Of the larger companies (revenues of US\$5b+), 79% have more than three deals in their pipeline, and 55% of these expect their pipeline to grow.

About 40% expect the global M&A market to continue to improve in the next 12 months, a view even more prevalent among medtech companies, with 65% of the respondents expecting the M&A market to improve – not surprising given the ongoing consolidation of medtech's key customers, hospitals and other providers.

So far, the 2016 US election results and the impending exit of the UK from the EU have done little to dampen the fundamental strategic drivers of M&A. While 32% say that greater clarity around the EU's Brexit negotiations has had no impact on their likelihood to invest in the UK, 45% indicate that the recent US policy announcements will create more M&A opportunities. In addition to a potential reduction of the US corporate tax rate, repatriation of trapped cash by US companies could add a potential US\$200b to dealmaking resources.

Not to be underestimated in this drive to execute deals are payer pressures across the life sciences sector – particularly on pricing – changing consumer preferences, and the impact of digital technologies on business models and competitive advantage. These disruptive forces have life sciences executives contemplating not whether they should invest, but rather how they should invest and with what deal structures, partners and business models. The need to grow market share (25% of respondents), expand into new geographies (22%) and acquire/access new technology (16%) are the key drivers underpinning dealmaking intentions.

Most of these transactions, though, are likely to be bolt-on; the largest deal size for 52% of life sciences executives who have deals on their radar is less than US\$250m. Most of the larger deals are likely to be driven by pharma/biotech companies with revenues greater than US\$5b.

Life sciences companies are tackling another area that has been increasingly important to generating shareholder value – portfolio optimization. Sixty-four percent of executives report having increased the frequency of their portfolio review process to capitalize on disruptive forces in their sector. In doing so, life sciences companies are finding assets that are ripe for divestment, even as they search for acquisitions that will improve competitive advantage, demonstrate value and ease pricing pressures.

Although life sciences company valuations have increased since late 2016 as stock prices have rebounded, almost half of those surveyed (49%) expect to close two or more deals in the next 12 months. Larger companies (revenues of US\$5b+) expect to execute at a faster pace, with 50% of executives likely to close three or more deals in the next 12 months. Consequently, we expect dealmaking to continue at a healthy pace throughout the course of the year.



Jeff Greene
EY Global Transaction
Advisory Services Leader,
Life sciences

Life sciences companies are feeling optimistic as economies continue to strengthen

Life sciences executives are showing cautious optimism. With positive economic data, momentum around tax reform, stock markets continuing their upward trajectory and strengthening economies in the US, the EU and emerging markets, there is good reason for 59% of respondents to be feeling positive about the global economy.

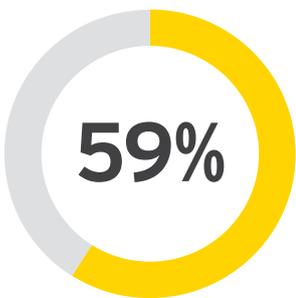
A positive outlook across macroeconomic fundamentals underpins this optimism. Demand for life sciences products has produced positive corporate earnings for many life sciences companies. Consequently, the first quarter of 2017 saw stock prices increase in the double digit range for the industry on average.

That said, pricing pressures (particularly in the US) and payer pushback on formulary inclusion, as well as hospital and payer consolidation are tempering corporate earnings and stock price expectations. As credit availability continues to improve, life sciences companies look to more actively pursue M&A in an effort to offset some of these challenges to reach their financial goals.

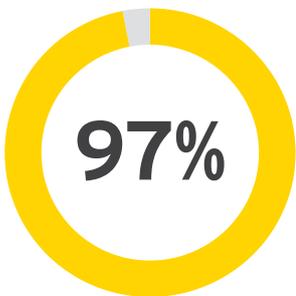
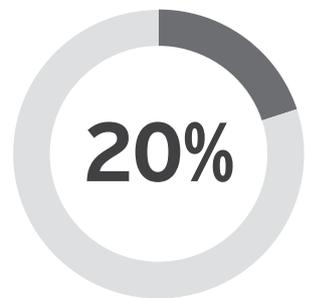
Considering risks over the next 6 to 12 months, life sciences executives cite high levels of market, currency and commodity volatility (16%), increasing government intervention in corporate decision-making (16%) and immigration and trade restrictions as the greatest threats to their core business.

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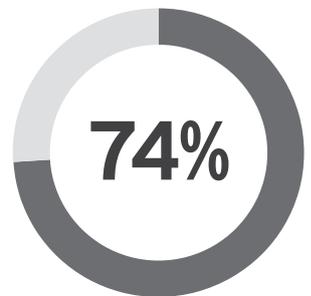
October 2016



see the state of the economy as improving



express stable to improving confidence in corporate earnings at the global level



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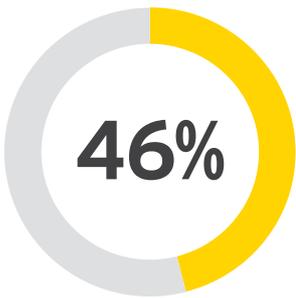
Disruptive forces have life sciences companies looking at all options to boost growth and competitiveness

While organic growth remains an important driver there is an increasing shift toward inorganic growth drivers. Compared to 20% in October 2016, 25% of executives now expect growth to come from M&A activity with an additional 21% growth coming from joint ventures and alliances in the next 12 months. With

pharma blockbuster pipelines and medtech innovation slowing, life sciences companies continue to look outside for strategic alliance and acquisition candidates, many of which are emerging companies.

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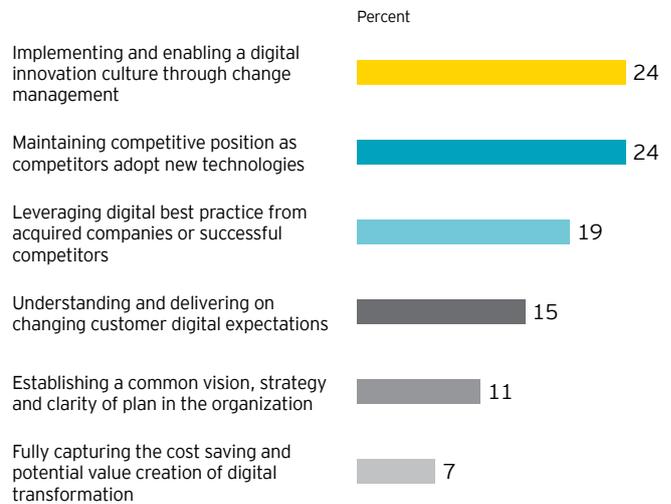
expect growth from within their company to come from inorganic strategies in the next 12 months



Life sciences companies are also on the hunt for alliances and acquisitions that can help them remain relevant in the digital age. The question is no longer whether companies should invest in digital technologies, but rather how they should be implemented – with what deal structures, partners and business models. Managing the cultural shift that needs to take place within the organization to support the digital strategy is key. For nearly a quarter (24%) of respondents, implementing and enabling a digital innovation culture through change management has been the most difficult part of their digital transformation. An equal percentage cite maintaining their position as competitors adopt new technologies as a significant hurdle.

Both payer pressures and digital transformation are forcing life sciences companies to continue with portfolio optimization. Sixty-four percent of executives say that they have increased the frequency of their portfolio review process to capitalize on disruptive forces in their sector. In doing so, life sciences companies are unearthing a broader group of assets, from legacy products to R&D candidates, where growth prospects have declined and are ripe for divestment. Conversely, portfolio reviews are also revealing core areas that life sciences companies want to bolster in an effort to drive scale and ease pricing pressures.

Q: What do you think is the most difficult part of digital transformation?



Deal pipelines remain full as life sciences companies look to drive scale with M&A

As we mentioned in EY M&A Outlook and Firepower Report 2017, *Will payer leverage and post-election optimism shift dealmaking into a higher gear?*, portfolio rationalization and a preference for bolt-on deals are continuing to feed appetites for acquisitions in 2017. Life sciences executives surveyed for this report reinforce the trend; 46% expect their company to actively pursue mergers and acquisitions in the next 12 months, while 92% of life sciences companies with greater than US\$5b in revenues are likely to pursue deals. Of those surveyed, 4 in 10 anticipate M&A activity will only improve over the next 12 months. Medtech companies are even more optimistic, with 65% of executives expecting the market to improve.

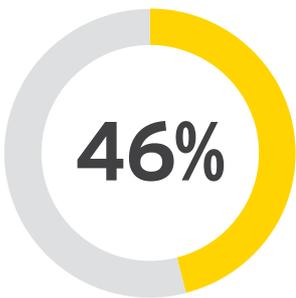
In addition, there are payer pressures, a deal tail wind from macro forces and an unusually full M&A pipeline – one third of executives say they have five or more deals in the pipeline. Of the larger companies (revenues of US\$5b+), 79% have more than three deals in their pipeline, and 55% of these expect their pipeline to grow in the next year.

Acquisitions are likely to remain accretive versus transformative over the next 12 months. Only 6% of the deals in the life sciences pipeline are greater than US\$1b in size compared with 16% from a year ago. While some of this may be due to higher valuations, several US companies are waiting for potential tax reform to repatriate cash and execute larger deals. More than half of respondents (52%) say their largest deals are valued at less than US\$250m. Most of the larger deals are likely to be driven by pharma/biotech companies with revenues greater than US\$5b.

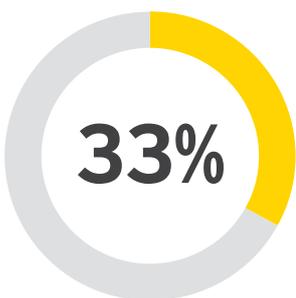
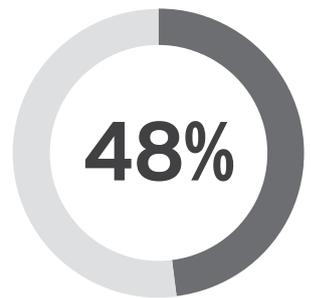
The vast majority of executives surveyed (79%) expect asset prices to increase or stay the same in the next 12 months. We also expect that with geopolitical and policy uncertainty becoming the norm, fewer deals will be derailed than in previous cycles. Although the majority of life sciences companies (71%) plan to complete one to two deals in the next 12 months, almost 30% expect to complete three or more deals. Despite higher deal valuations, more than a quarter (27%) of executives expect deal completions to improve in the next year versus the last 12 months.

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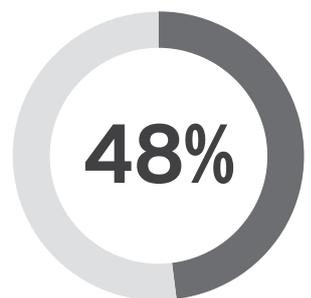
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expect their company to actively pursue mergers and acquisitions in the next 12 months

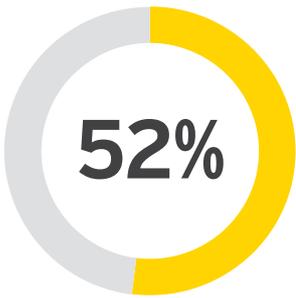


have five or more deals in their pipeline

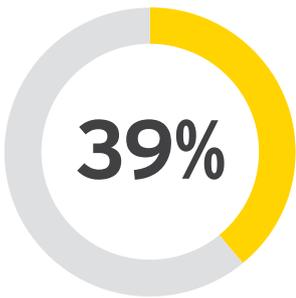


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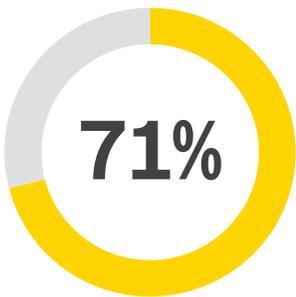
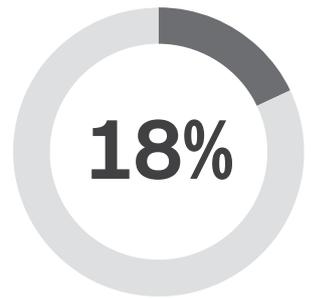
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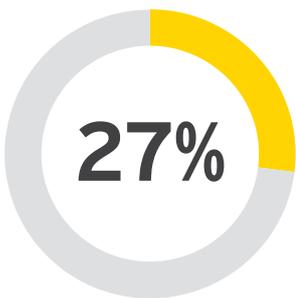
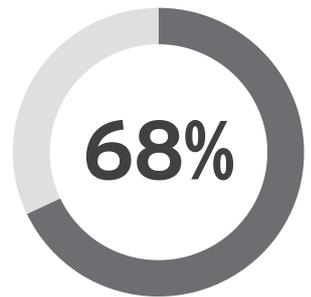
say they are looking at deals valued at less than US\$250m



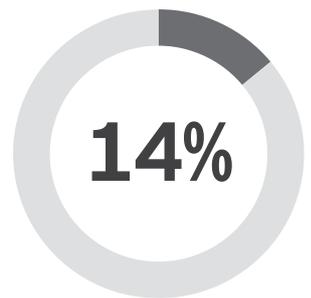
expect prices/valuation to increase in the next 12 months



expect to complete one to two deals in the next 12 months



anticipate deal completions will increase in the next year versus the last 12 months



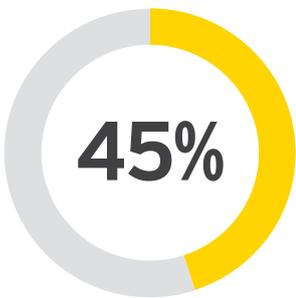
Changes to US tax policy present new opportunities for life sciences companies

Although Brexit in June 2016, the US election in November 2016 and elections in Europe have created uncertainty in the market, some see the policies coming out of these events to be advantageous for life sciences businesses. Interestingly, 32% of life sciences executives say that greater clarity around the EU's Brexit negotiations has had no impact on their likelihood to invest in the UK. However, changes to US policies are expected to spur M&A activity.

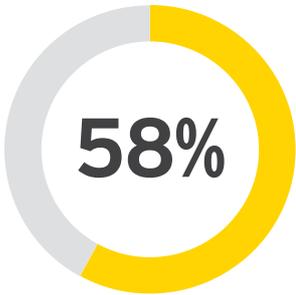
There have been long-held concerns about the competitiveness of the complex US corporate income tax regime. The US corporate tax rate is one of the highest in the world and has remained

unchanged, while other nations have made dramatic cuts. The US administration's recent announcement that it wants to reduce the corporate tax rate to 15% as part of a larger tax reform package may further motivate life sciences companies to transact.

There is also the issue of cash repatriation by US companies. Changes to the US corporate tax code may unleash as much as US\$200b in additional firepower, increasing competition for US-based assets.



45% see recent policy announcements by the US administration creating more M&A opportunities



58% are factoring the possibility of trapped cash repatriation and potential revisions to the US corporate tax code into their M&A strategy

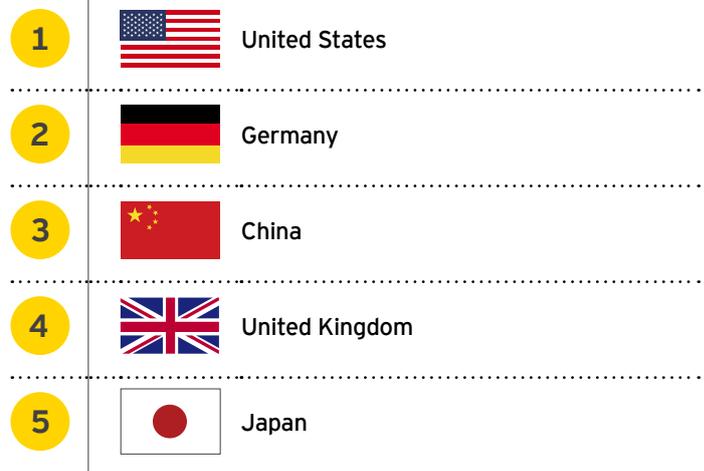
Changes to the US corporate tax code may unleash as much as US\$200b in additional firepower, increasing competition for US-based assets.

Improving economic conditions and policy changes make the US a top M&A destination

Looking forward, we expect potential policy changes and the need for continued market access to drive cross-border deals as life sciences companies look to protect their global operations. Twenty-two percent of life sciences executives say they will increase their cross-border dealmaking in an effort to secure supply chains and market access.

The combination of a strong uptick in economic outlook and potential tax reform, among other policy changes, makes the US the top investment destination for life sciences companies, followed by Germany and China.

Top five investment destinations



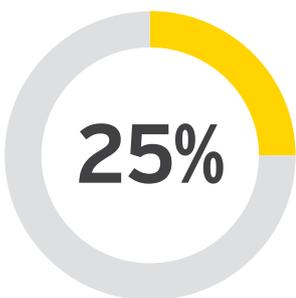
Growing market share and digitalizing are top priorities, but not at any cost

In terms of drivers for deal activity, strategic growth remains a top priority for boards as life sciences companies look to grow market share and expand into new geographies. Life sciences companies will also likely continue to pursue deals that drive scale to maximize reimbursement, ease pricing pressures and improve R&D capabilities in core therapeutic areas.

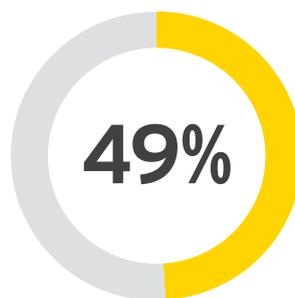
Life sciences companies also see M&A as the fastest route to future-proofing their businesses in an environment of technological innovation, digitization and increased competition from outside the sector. This helps explain why joint ventures and alliances are seen as a key component of any inorganic growth strategy. For 16% of life sciences executives, partnering offers faster access to innovation than making a full acquisition. However, life sciences executives face headwinds as competitors

look to gain a digital edge. For nearly a quarter (24%) of respondents, maintaining their position as competitors adopt new technologies is a significant hurdle. For an equal percentage, implementing and enabling a digital innovation culture through change management has been the most difficult part of their digital transformation.

Yet, despite the drive for deals that will position them to both survive and thrive, life sciences companies remain willing to walk away; 86% of executives say they have failed to complete a planned acquisition in the last 12 months. The reason? Almost half (49%) cited concerns about cybersecurity. Understanding cyber risks throughout the M&A and divestiture life cycle can preserve value and protect deal rationale.



are pursuing acquisitions to grow market share



cite cybersecurity concerns as the main reason they failed to complete or canceled a planned acquisition

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About the survey

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The *Global Capital Confidence Barometer* gauges corporate confidence in the economic outlook and identifies boardroom trends and practices in the way companies manage their Capital Agendas – EY framework for strategically managing capital. It is a regular survey of senior executives from large companies around the world, conducted by Euromoney Institutional Investor Thought Leadership (EIITL). Our panel comprises select global EY clients and contacts and regular EIITL contributors.

- ▶ In March and April, we surveyed a panel of more than 2,300 executives in 43 countries; 58% were CEOs, CFOs and other C-level executives.
- ▶ Respondents represented 14 sectors, including financial services, consumer products and retail, technology, life sciences, automotive and transportation, oil and gas, power and utilities, mining and metals, diversified industrial products, and construction and real estate.
- ▶ Surveyed companies' annual global revenues were as follows: less than US\$500m (21%); US\$500m-US\$999.9m (23%); US\$1b-US\$2.9b (17%); US\$3b-US\$4.9b (10%); and greater than US\$5b (29%).
- ▶ Global company ownership was as follows: publicly listed (62%), privately owned (32%), family-owned (3%) and government-/state-owned (3%).

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