TEXT 3 - Mergers and acquisitions

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Pharmaceuticals

Convergence or conflict?

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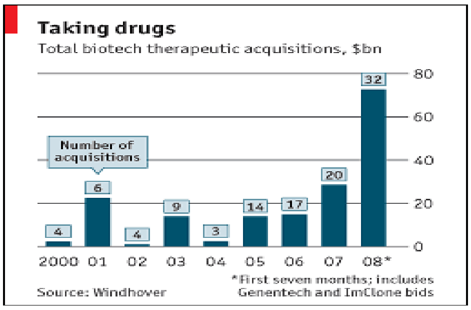
Drug giants' recent attempts to buy big biotech firms have provoked a backlash

Illustration by Claudio Munoz

DALLIANCES between conventional pharmaceutical companies and biotechnology firms are nothing new. Big Pharma, eager to refill its emptying drug pipelines, has in recent years looked hopefully to biotech's upstarts. The drugs giants have pursued all sorts of tie-ups, from alliances to licensing deals to outright purchases of a few smallish companies. But mindful of the sharp cultural differences between the two sorts of firms, they have generally avoided big acquisitions.

Until now, that is. In recent weeks Roche, a Swiss pharmaceuticals giant, has made a surprise $44 billion bid for the 44% of Genentech, the world's biggest biotech firm by stockmarket value, that it does not already own; and Bristol-Myers Squibb (BMS), an American drugs company, has offered $4.5 billion for the 83% of ImClone, an American biotech firm, that it does not already control. These attempts came on the heels of earlier deals in which AstraZeneca, a British drugs giant, bought MedImmune for $15.6 billion, and Takeda of Japan paid $8.8 billion for Millennium.



This frenzy of mergers has been a rare bright spot for investment bankers of late. By one estimate, America saw $60 billion in biotech deals in 2007 and Europe $34 billion. Roger Longman of Windhover, an industry consultancy, notes that the total value of biotech acquisitions by pharmaceutical companies has risen dramatically in the past couple of years (see chart).

What explains the spate of big deals? The familiar underlying problem is that Big Pharma is cash-rich but innovation-poor, so it has resorted to buying in bright ideas while it tries to overhaul its business model. Even so, the industry's new push to acquire large and rather pricey biotech stars is surprising. And the deals seen so far are just the beginning, forecasts Steven Burrill, an industry expert who thinks "the biotech-product 'land grab' by Big Pharma" will soon reach "fever pitch".

Corporate aphrodisiacs

One relatively new factor fuelling the frenzy is regulatory risk. After a series of safety scandals involving Merck's Vioxx, GlaxoSmithKline's Avandia and other problem pills, America's Food and Drug Administration is now decidedly risk-averse. Gobbling up big biotech firms with proven drugs in the marketplace, rather than cheaper but more speculative start-ups, gets around the difficulties of winning regulatory approval for a new drug.

Another motivation may be the looming patent-expiry crisis confronting many big drugs companies. As big blockbusters such as Pfizer's Lipitor go off patent, the industry is about to lose tens of billions of dollars in revenues to generics manufacturers. Biotech drugs provide something of a hedge against this coming calamity, for two reasons. First, they are much harder to copy, so generic equivalents (called "biosimilars") will be slow in coming. Second, big countries including America do not yet have final regulations set up for approving those copycat drugs, thus bolstering the position of the biotech innovators.

The drugs giants also have piles of cash. Although they have shovelled billions of dollars back to shareholders, in the form of share buybacks and generous dividends, they have not succeeded in buying the love of Wall Street, which remains gloomy about the industry's capacity to innovate and worries about possible price-controls on pills. So drugs firms may now have decided to redirect that money into giant acquisitions that could jump-start their innovation machines.

Finally, the weak dollar has made it cheaper for foreigners to take over American firms. Many of today's acquirers are from outside America, but most of the targets are based in the traditional biotech clusters of California and Massachusetts.

Alas for Big Pharma, its courtship of biotech has not been met with open arms. As often happens in May-to-December romances, even a well-financed suitor can encounter resistance from the youthful object of desire. The bosses of both Genentech and ImClone have unceremoniously rejected the offers made by their partners. Some suggest that this is mere posturing, designed to fetch a higher sale price. But there is good reason to think that the fight put up by biotech bosses also has a powerful cultural dimension, too. Many detest Big Pharma, and are convinced that selling out to bureaucratic marketing machines will destroy the heart and soul of their smaller, more agile firms.

Consider Genentech, long viewed as the world's most successful biotechnology firm. Its independent-minded boffins have flourished under the company's famously laid-back approach to research and development. They developed Avastin, a breakthrough monoclonal antibody that already earns $4 billion a year as a cancer fighter, and is on track to become the world's most lucrative drug by 2014. Roche has long recognised the value of that culture, and has wisely remained an arm's length partner to avoid infecting Genentech with its corporate ways.

But the Swiss giant has suddenly changed tack. Why? Trials now under way may, it is said, show Avastin to be a useful treatment for earlier stages of colon cancer than the stages it targets today. If those results, which may emerge in the next few months, are indeed positive, then the drug could be worth many billions of dollars more in annual revenue. So Roche may be trying to grab Avastin on the cheap by swooping before those results come out.

The tussle over ImClone has been an altogether messier affair, thanks to Carl Icahn, a legendary corporate raider who owns a stake and is chairman of the firm. Its main product is Erbitux, a cancer drug jointly marketed with BMS that brings in $1.3 billion a year in sales. Rather than selling the entire company to BMS, Mr Icahn wants it split into two bits: one containing Erbitux and the other inheriting ImClone's future drug-pipeline. He claims BMS used its insider knowledge about his proposal for a split (BMS has its own man on ImClone's board) to make a pre-emptive bid, so it could buy the firm at a cheaper price. He says a break-up would enhance the firm's total value. BMS rejects his allegations and insists ImClone would be most valuable if fully integrated into BMS—a notion that sends shivers down the spines of pharma-haters in the biotech camp.

To see how difficult it can be even for Mr Icahn to get his way, look to the saga at Biogen Idec, another American biotech firm in which the gadfly billionaire owns a stake. He is convinced that the firm would be much more valuable as part of a drugs giant rather than an independent firm. So he pushed it to find a buyer. Biogen Idec's bosses resisted at first, but in the face of lawsuits, boardroom manoeuvring and acrimonious attacks they relented—or so it seemed. Biogen Idec put itself up for sale last year, but the recalcitrant management found clever ways to make the bidding process so onerous and unattractive that nobody made a bid for it.

So will Big Pharma's land-grab succeed, heralding the long-awaited convergence of the two industries? Given how wealthy and desperate the drugs giants are, some deals are inevitable. But many biotech bosses will not give up without a fight.