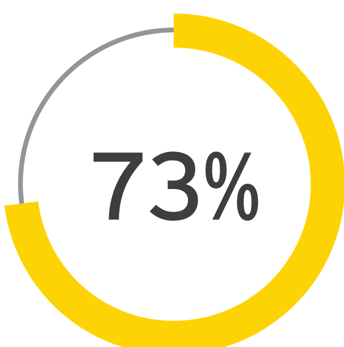
How divestments can fund digital growth in life sciences

2021 Global Corporate Divestment Study

ey.com/divest/lifesciences

Corporate divestments can help life sciences companies shift to a digital future



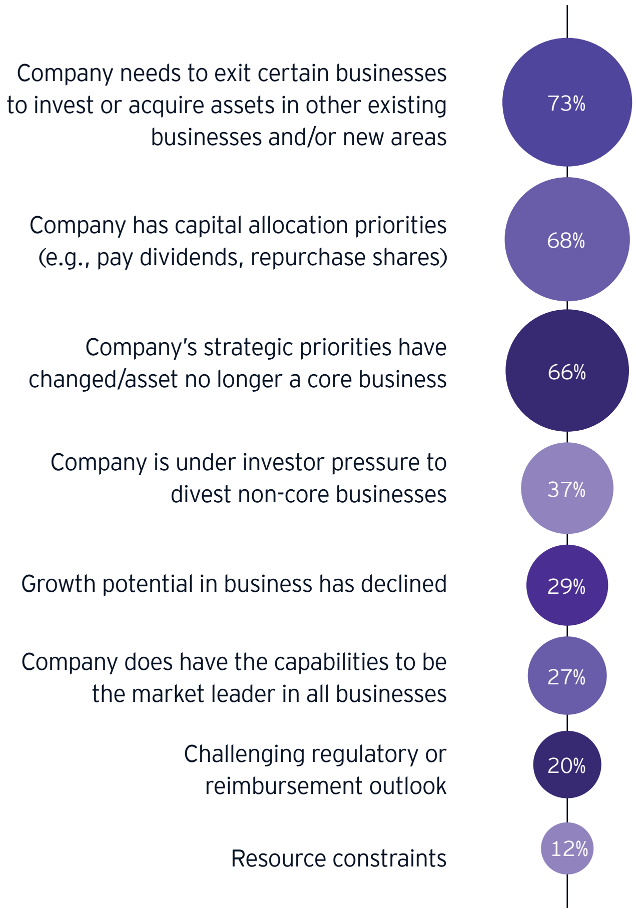
of life sciences companies see exiting certain portfolio businesses as a route to putting more funds to work in new or adjacent areas.

Although mergers and acquisitions (M&A) by life sciences companies, particularly pharmaceuticals, have declined since 2019's peak activity, divestment of non-core assets continues as the sector seeks to adopt leaner, more agile models and increasingly invest in digital capabilities. In the months to come, that activity could increase as companies focus their business models on new or higher-growth opportunities in the wake of the post-pandemic economic rebound, and as the long-term value creation from divestitures becomes more obvious.

The 2021 EY *Global Corporate Divestment Study* shows that almost three-quarters of life sciences companies (73%) see exiting certain portfolio businesses as a route to putting more funds to work in new or adjacent areas. One year earlier this figure was 44%. Shareholder pressure to divest non-core businesses is also growing. More than a third (37%) report this as a driver when reviewing their portfolios, up from 25% in 2020.

Divestments could also be smaller: under a quarter (22%) of life sciences companies plan to divest businesses that represent over 5% of their overall revenues, compared with 42% in 2020.

Q **What are the main reasons you plan to evaluate and potentially narrow your company's business portfolio?**



Base = 41 companies

Independent of divestment, most life sciences companies continue to invest in new technologies and products via partnering and bolt-on acquisitions. But divesting has provided, and can help provide, funds to boost investment, especially at companies with limited dealmaking firepower. Johnson & Johnson (J&J), for example, has actively reviewed and managed its portfolio since 2013, divesting more than US$12b in assets, such as its Ortho-Clinical Diagnostics and Advanced Sterilization Products businesses. At the same time, it has acquired approximately US$50b in assets, including its acquisitions of Actelion, Auris Health and Momenta Pharmaceuticals, in order to focus on specific technologies or therapeutic areas.

Immunology focus renewed

Financially, the COVID-19 pandemic has affected some life sciences companies more negatively than others. Non-COVID-19-related treatments, non-emergent surgeries and diagnostic tests declined as patients and providers deferred certain types of care during the pandemic. This affected the revenues of medtechs and some biopharmas. At the same time, companies developing vaccines, drugs, devices and diagnostics to detect or prevent the virus, treat symptoms, or identify and monitor its spread saw revenue gains. And the inability of patients to visit providers in person also significantly boosted the use of digital technologies, such as telehealth.

Two-thirds (66%) of life sciences companies said that they plan to evaluate their portfolio because their strategic priorities have changed or an asset no longer fits its core business. Interestingly, oncology (32%), where developing new treatments can be expensive and scaling is important for success, is the most frequently named area where companies are likely to divest. This could also be prompted by the number of potential buyers looking to focus in the area.

Beyond oncology, gastrointestinal (30%) and dermatology (28%) are the most frequently mentioned divestment areas. For example, in recent years, Novartis divested its US dermatology business in order to help it focus on generics, value-added medicines and biosimilars; and achieve profitable growth.

So where are companies focusing? For some pharma companies, anti-infectives may be of greater interest, especially with the success of mRNA technology in developing the COVID-19 vaccine. While there is an urgent need for new anti-infectives, incentives for developing them have been lower; not only can pricing be a challenge, but guidelines designed to avoid microbial resistance restrict their broader use, resulting in lower market potential.

Immunology continues to be another top priority, as scientific advances create new opportunities to build on the success of existing antibody therapies and there are opportunities to reach blockbuster sales by winning approval in multiple indications. Companies lacking size or ability to focus in the immunology space should act while interest is high and the opportunity is there to maximize divestment value. This is a crucial aspect for companies in life sciences, as 82% say that value was more important than speed in their most recent divestment.

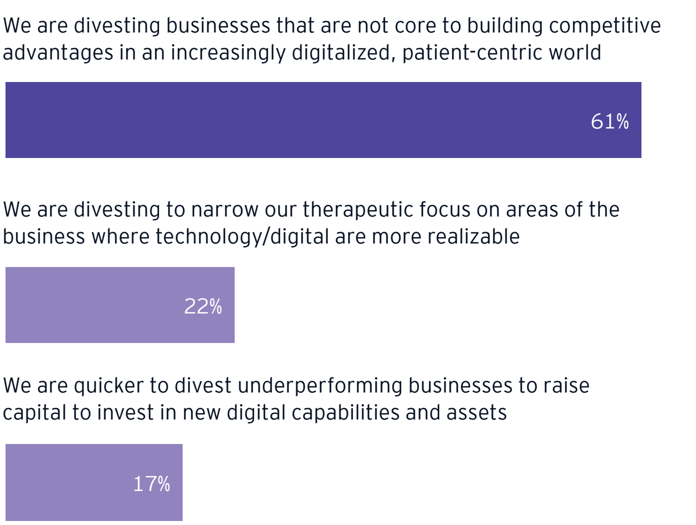
Pharma has opportunity to reinvest in digital

Digital growth potential bolsters the future outlook for each of the key life sciences subsectors. For pharma, digital tools are an important innovation to customize the patient experience and represent new treatment modalities that are faster to bring to market than traditional drugs, protracted research and development model — estimated by Roche to take 12 years and 7 million work hours. With its focus on software-based services and data not product manufacturing, digital health can also be more of an asset-light endeavor. But that doesn't mean companies will see significant declines in their R&D spending; whether pharma companies buy, build or partner to access digital, significant investment will be required.

Behavior change apps, such as those approved by the FDA for smoking cessation and depression, are a key digital opportunity for pharma companies. Since this trend is still in its earliest stages, there is potential to achieve first-mover advantages to create platforms of care.

Divestments, particularly of cash-generative but slower growing businesses, are important in enabling this shift to digital. All companies in the study agree that technology-driven sector convergence and digitalization have a material effect on their divesting activity. Around two-thirds (61%, up from 49% in 2020) are divesting businesses that are not core to building a competitive advantage in an increasingly digitalized, patient-centric world. At the same time, data is also part of pharma's digital growth story.

Q What is the biggest effect that technology-driven sector convergence and digitalization are having on your divestment planning?



Base = 183 companies

Medtech investing in digital

The medtech subsector must address multiple challenges linked to digital readiness, including rethinking the nature of the product. Is a company's core product the medical device itself or the software that operates the device and connects it to other devices as well as providers and patients?

Even as the definition of medtech innovation changes, medtechs also face new competition from technology and consumer companies. Although medtechs have raised significant debt capital lately, they are not as cash rich as certain technology companies that see health care as a major growth opportunity. Microsoft's acquisition announcement of health care software provider Nuance for US$19.7b underscores the dollars tech companies can deploy.

Medtech companies need to be nimble and refocus on higher-growth, more value-added areas that embed them in the health care ecosystem, aided by digital capabilities such as artificial intelligence and cloud computing.

Divestments are one way to refocus and to fund digital capabilities. Medtronic, for example, divested its patient care, deep vein thrombosis and nutritional insufficiency business in a 2017 $6.1b sale, saying it would be able use the funds to invest in higher returning opportunities that more directly aligned with its growth strategies. In 2020, it acquired Digital Surgery, a company focused on surgical artificial intelligence (AI), data and analytics, and digital education and training. It also acquired Medicrea, which specializes in AI for surgical planning, as well as digitally constructed spinal implants and robotic-assisted surgery.

Asset-light approaches, for one example, could potentially lead to divestments of manufacturing capability, as J&J has done in its collaboration with Jabil Inc. for the manufacture of orthopedic and surgical devices. Alternative sourcing may be explored too.

Adjusting business models for greater effectiveness also seems in prospect. For example, Zimmer Biomet (ZB) has announced the intention of spinning off its spine and dental operations in a separately traded company with the goal of strengthening the growth profiles of both ZB and the NewCo, as well as enhancing management focus.

Conclusion

Bringing about the life sciences sector's digital future will require major investments alongside equally major changes in strategy and thinking. Moreover, these will have to be adopted at the same time as navigating a regulatory environment in flux due to the pandemic's impact.

Divestments can play a meaningful role in these shifts, and according to the EY survey, the timing is now. This derives both from the capital they free and the management time and focus they liberate. Companies can consider selling deprioritized pipeline assets and even some parts of their R&D function in order to fund future growth in priority areas.

Contacts

Global

Peter Behner
EY Global Health Sciences and Wellness Leader
Strategy and Transactions
peter.behner@parthenon.ey.com

Ambar Boodhoo
Capital Efficiency Global Solution Co-leader
Strategy and Transactions
ambar.boodhoo@ey.com

Global Divestitures

Subin Baral
Life Sciences Sell & Separate Leader
Strategy and Transactions
subin.baral@ey.com

Americas

Arda Ural, PhD
EY Americas Industry Markets Leader
Health Sciences and Wellness
arda.ural@ey.com

Europe

Klaus Ort
EY Western European Health Sciences and Wellness Leader
Markets, Accounts and Business Development
klaus.ort@de.ey.com

Dr. Marie-Lyn Hecht
EMEIA Life Sciences Strategy
Strategy and Transactions
marie-lyn.hecht@parthenon.ey.com

EYG no. 005344-21Gbl

2010-3600469

ED None

ey.com/divest