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A note from Peter Behner, EY Global Life Sciences Transaction Leader

Life sciences companies take a 'less is more' attitude toward M&A

The global life sciences industry is on track to achieve US\$200 billion in deals in 2018. While the strategic drivers for M&A remain positive, dealmaking this year has been more muted than anticipated – a sentiment that is supported by the findings of the latest *EY Capital Confidence Barometer*.

With one exception, we have not seen the return of the life sciences mega deals, and we are seeing a “less is more” attitude, with bolt-on acquisitions being used to create scale and divestitures to secure value from non-core assets.

Yet while some life sciences companies, particularly in biopharma, may be pressing pause on M&A in favor of lower-risk ventures such as alliances, asset swaps and JVs, almost half (48%) indicate that they intend to pursue M&A within the next 12 months. Stable-to-improving sentiment around deal pipelines and completions seems to support a robust M&A outlook.

Regulatory and policy uncertainty seen as the top near-term risk for dealmaking

If there is anything that could disrupt their plans, 43% of life sciences executives anticipate disruption will come from ongoing regulatory and policy uncertainty. Over the past 12 months, we have seen a rapid rise in failed and canceled acquisitions, with 98% of life sciences executives unable to close a deal, up 22% from six months earlier. Ongoing regulatory and policy uncertainty (22%) has been cited as the primary reason for not moving forward on these planned acquisitions.

US tax reforms enacted in 2017 and the looming trade uncertainties around Brexit, which have a proportionately larger impact on life sciences than other sectors given the integrated regulatory regime between the EU and the UK, have already cast a shadow across the M&A landscape. About half of the surveyed executives are bracing for the harsh realities that Brexit will negatively impact investments and acquisitions outside the UK and EU, as well as their ability to recruit and retain key talent.

Life sciences companies focus on portfolio optimization to improve performance and free up capital

Given the spate of uncertainty around the world and within the sector, life sciences companies are increasingly relying on portfolio optimization to improve performance and free up capital for reinvestment. Portfolio optimization moves were particularly effective for several European and US big pharma players in Q2 2018.

Digital disruption should be an important agenda item given ongoing vertical integration of payers and providers and the rise of new technology and consumer entrants. Indeed, 30% of life sciences executives surveyed see it as a significant near-term threat. However, there is little evidence that this concern is translating into digital dealmaking at a rate needed to transform business models.

Record-high firepower could fuel more M&A in 2019

Looking ahead to 2019, life sciences companies' aggregate firepower (defined as the financial resources to do M&A) is at an all-time high. This could fuel larger M&A than what we have seen recently, particularly as the widening innovation gap threatens to curtail future growth, and life sciences companies are compelled to consider how to engage in emerging platforms of care, or Life Sciences 4.0.

However, we expect dealmaking to continue more in the form of bolt-on acquisitions and divestitures rather than mega deals. High valuations and fragmentation in key therapeutic areas are part of the story there. The other part lies in private equity's increasing appetite for life sciences assets. We expect medtech and services businesses that support biopharma and specialty clinical laboratories to be their primary focus in the year ahead.

Macroeconomic and external environment

Strong corporate earnings and open credit markets point to a continued upswing in equity markets.

49%

see the sector economy as improving.

55%

see sector corporate earnings improving.

63%

expect the sector M&A market to improve.

Buy and integrate

Executives see the M&A cycle continuing at elevated levels. While some executives look to pause their dealmaking, for others, M&A remains an imperative. Identification and realization of synergies are at the center of M&A value creation.

48%

expect to actively pursue acquisitions in the next year.

52%

are starting integration planning earlier.

48%

say the majority of synergies to be achieved are from technology.

Major M&A themes

Trade and tariff issues are compelling some executives to pause their M&A plans. Private equity is seen to be a major influence in near-term dealmaking, and cross-sector dealmaking is on the rise.

43%

cite regulation and policy uncertainty as the biggest potential risks to dealmaking.

72%

say the main result of their most recent portfolio review was divesting an asset identified as underperforming or at risk for disruption.

46%

expect more competition for assets from private equity buyers.

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