



Strategically acquiring and divesting improves capital efficiency in life sciences companies



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This 10-year study of 5,500 transactions shows that life sciences companies that optimize their portfolio and pursue strategic acquisitions and divestitures tend to use their capital 60% more efficiently than those companies that neither buy nor sell assets.

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The heightened level of transaction activity by life sciences companies since 2014 continues in 2019, unhampered by high valuations, geopolitical concerns or the added regulatory scrutiny imposed in late 2018 for cross-border, inbound investments.

Most companies are pursuing bolt-on acquisitions, allowing them to expand into high-growth adjacencies, access emerging technologies and participate in the ongoing wave of external innovation. At the same time, robust divestiture activity continues and assets carved out of life sciences companies' portfolios provide a stream of supply for buyers. Private equity (PE) firms are actively pursuing those assets, mainly in the medical technology and services subsectors.

Amid this deal activity, the key question C-suite executives need to answer is whether buy- or sell-side transactions contribute to capital efficiency, an important measure for a company's financial health and a key to increasing investors' confidence.

Our analysis shows that companies that utilize a combination of acquisitions and divestitures deploy capital more efficiently than those that only buy or only sell, or do neither.

Research rationale and methodology

A key performance indicator of corporate health is how efficiently life sciences companies utilize capital as measured in return on capital employed (ROCE). This analysis focuses on how companies using transactions as a growth stimulator perform when compared with others that do not, and whether buying assets, selling assets or doing both are more effective in achieving capital efficiencies.

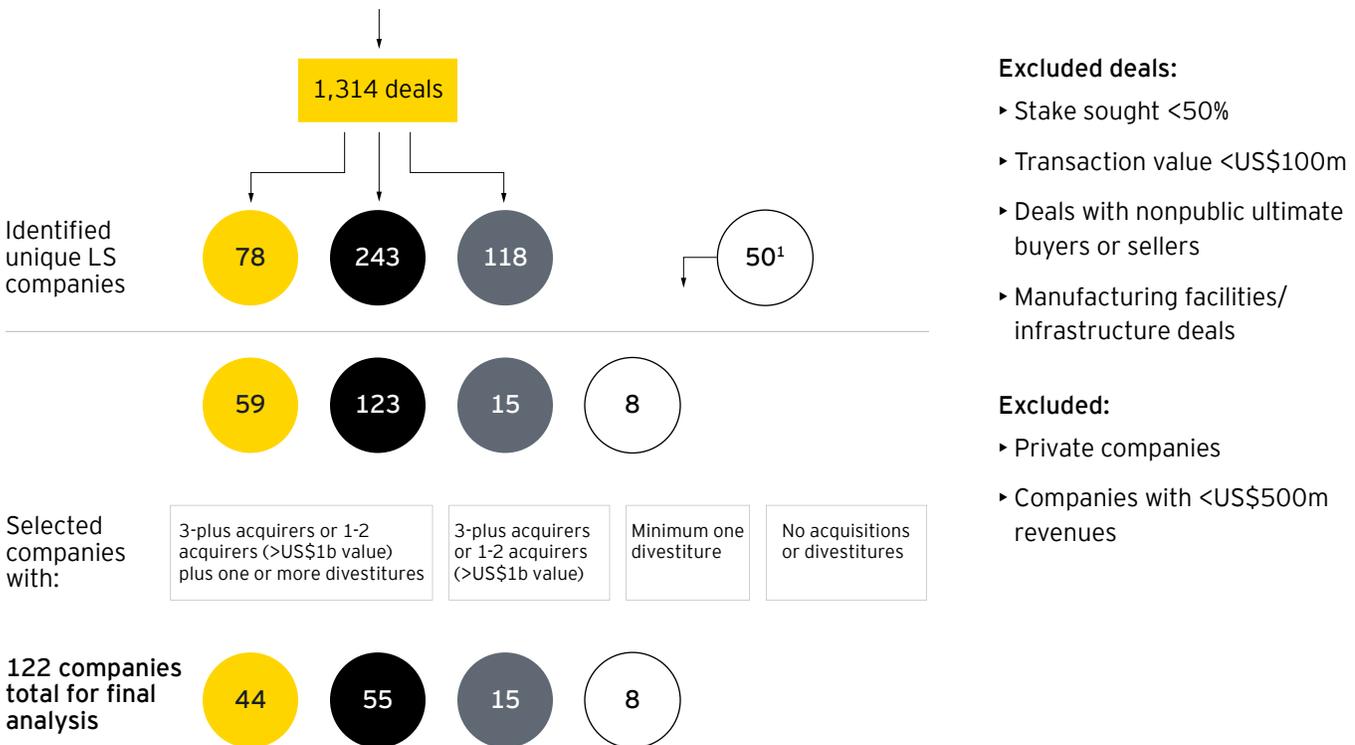
We analyzed approximately 5,500 buy- and sell-side transactions in the life sciences sector from January 2009 through March 2019. Subsectors included: pharma, biotech, medtech, life sciences tools, animal health, health care distributors and health care suppliers.

We reduced the 5,500 transactions to 1,314 by applying the following filters and excluded deals with the following characteristics, as shown in Figure 1.

In total, there were 122 companies, with 52 headquartered in the US (43%) and 70 outside of the US (57%). Subsequently, we have analyzed four cohorts of companies to compare their capital efficiency as measured in ROCE in this 10-year period (Figure 2).

Figure 1

Universe of 5,495 life sciences (LS) M&A deals in the last 10 years (2009-18)



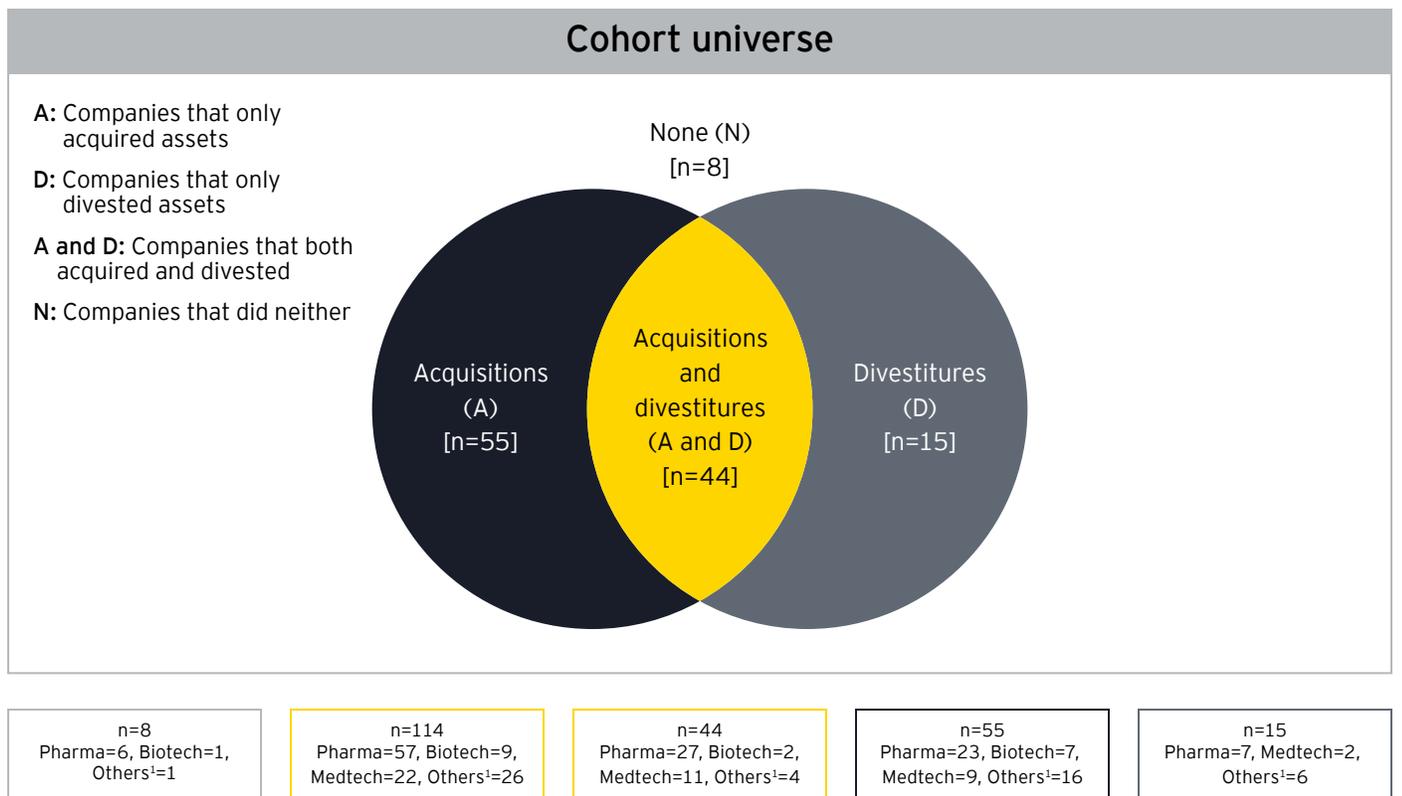
Note: A=Acquirers, D=Divestors
 ROCE calculated as $EBIT \times (1 - \text{tax rate}) / \text{average total capital}$, where total capital includes total common equity, total preferred equity, total debt and minority interest.

¹ Companies that have done no acquisitions or divestitures in the last 10 years

● A and D ● Only A ● Only D ○ None



Figure 2



¹ Includes life sciences tools, health care suppliers, health care services and health care distributors
Source: Capital IQ

Buying and selling together boosts capital efficiency

We found that companies that either bought or sold have an average annualized ROCE of 8.8%, while companies that did not transact at all have a ROCE of 5.5%. This gives a 60% advantage to companies with an active corporate development and portfolio management process.

Breaking the dealmaking companies into those that acquired, those that divested and those that did both reveals that those that both buy and sell fare the best, with a ROCE of 9.2%, compared with 8.8% for the acquire-only cohort and 7.5% for the divest-only cohort.

It is important to highlight that engaging in any type of buy or sell activity individually also compares favorably to the do-nothing (N) cohort's 5.5% outcome.

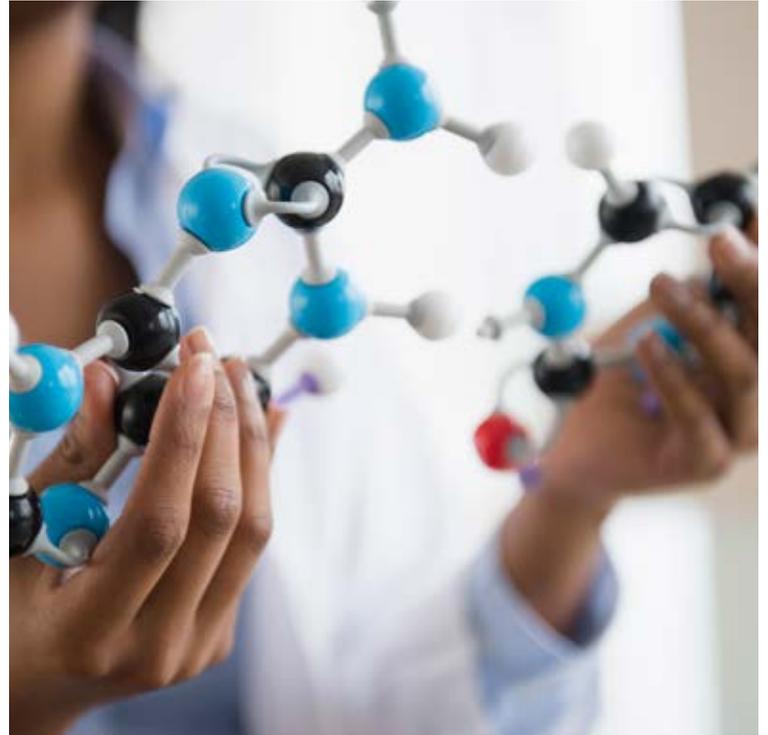
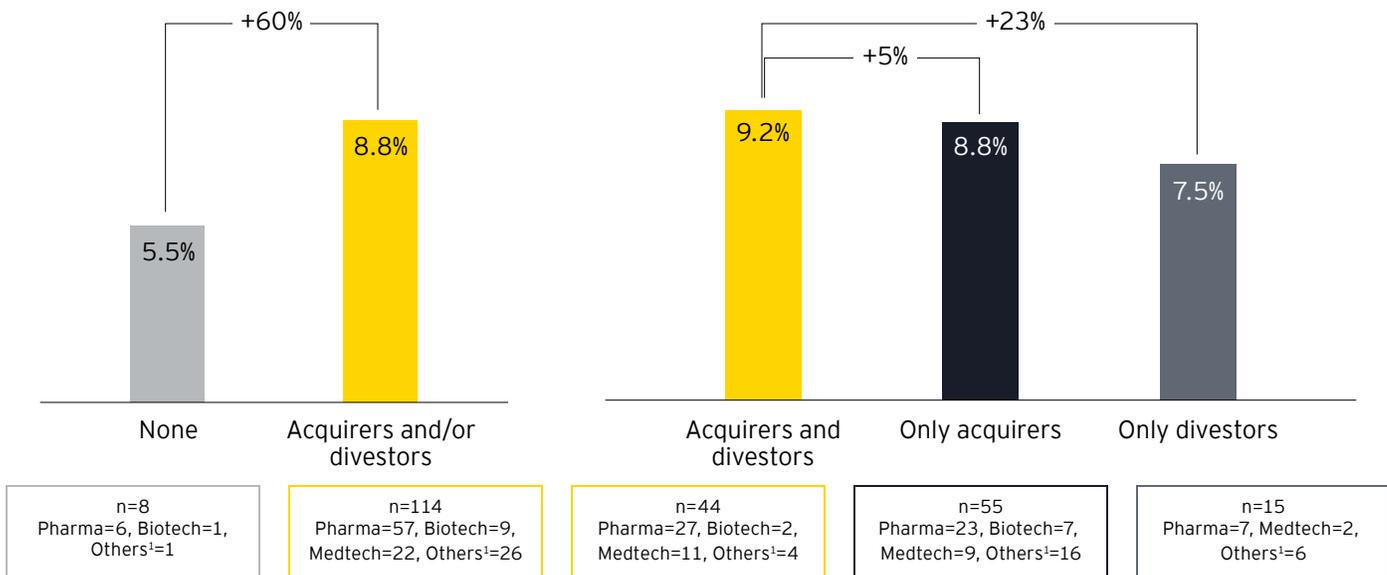


Figure 3

Average return on capital employed in the last 10 years (2009-18)



¹ Includes life sciences tools, health care suppliers, health care services and health care distributors
Source: Capital IQ

Establishing portfolio optimization rigor

This analysis is consistent with the findings of our prior research, [Is your growth strategy a big deal?](#), which indicates that acquisitions, especially those considered as a bolt-on, create shareholder value and increase capital efficiency. Similarly, a second study we published, [Creating capital efficiency and shareholder value through divestment](#), indicates that divestitures lead to improved capital efficiencies. This current analysis underscores that transacting *per se* is a value-generating activity that the C-suite should consider as an effective tool in its corporate finance toolkit. It further raises the stakes for successful planning and execution of these buy- or sell-side transactions to fulfill the investment hypothesis.

A leading practice for C-suites is to have an established mechanism and the discipline to actively reshape their companies for innovation and resilience as part of the

annual portfolio planning process. Rationalizing portfolios by shedding non-accretive assets enhances the capital efficiency of the life sciences company.

Similarly, inorganic growth should always be a key part of the innovation process and capital-growth agenda. Having an active sensing mechanism to detect high-growth technologies on the deal radar, and the leadership with the courage to press the go button for the right technologies at the right time, increases the operational and financial health of life sciences companies, and creates shareholder value.

Life sciences C-suites should be encouraged by these findings and be more proactive with portfolio optimization strategy and execution.



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The notion that companies that both acquire as well as divest deliver higher shareholder returns is a philosophy that we strongly believe in because it shows that you have a thoughtful and strategic approach to managing your portfolio.

Marianne De Backer
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2019 M&A Firepower Report: when data plus technology equals growth, how can dealmaking power the equation?

Life sciences companies are using their firepower to create competitive advantages, and M&A is essential.

www.ey.com/firepower



Creating capital efficiency and shareholder value through divestment in the life sciences sector

Portfolio review and optimization, combined with divestitures, can be a powerful tool in the corporate finance executive's tool box. Knowing what to divest can help the organization focus on future growth and sustainability.

https://www.ey.com/en_gl/transactions/life-sciences-portfolio-optimization-and-divesting



Is your growth strategy a big deal?

EY conducted research based on 278 life sciences transactions that closed between 2010 and 2017 and found that bolt-on deals outperformed other transaction types.

https://www.ey.com/en_us/transactions/bolt-on-acquisitions-are-better-poised-for-value-capture-in-life-sciences

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