Big Pharma's Renewed Appetite For M&A Will Put Pressure On Ratings

February 1, 2019

Key Takeaways

The stars are aligning for a new wave of M&A by big pharma in 2019. Three significant transaction announcements already in January, and a decline from very high valuations in 2018 are likely to increase companies' M&A appetites this year. Still elevated cash balances following U.S. tax reform in 2018 will likely further support this trend. Companies also see M&A as a defensive move against rising pricing pressure from both government and private payors.

Rapid development in oncology in particular present some attractive opportunities. Several companies have recently articulated a strong appetite for acquisitions in this space and we see a particular eagerness among big pharma in general to participate.

The rising cost of pharmaceutical R&D and the crowded field for drug research increase the appeal of less-risky late-stage assets. Small early-stage drug companies need the infrastructure of big pharma to extract the full commercial value of their successes.

Some transactions could lead to downgrades. Although it varies by company, most players can absorb midsize acquisitions within the current rating, but larger debt-funded deals would likely result in downgrades. Financial policies in the industry have become incrementally more aggressive over time, with a greater willingness to lever-up the balance sheet and sacrifice high ratings for M&A, suggesting potential for downward pressure on pharma company ratings in 2019.

Recent Transactions Open The Door To More M&A

Three notable M&A transactions by big pharma companies in the first few days of 2019 are likely to act as a catalyst for more M&A among their peers.

The three transactions are:

- On Jan.3, 2019, Bristol-Myers Squibb Co. (BMS) announced plans to buy Celgene Corp. for about $94 billion (including assumed debt) funded partially with debt and cash on hand. As a result, we placed the ratings on BMS on CreditWatch with negative implications, indicating that we expect to lower the long-term ratings to 'A' from 'A+' upon completion of the transaction.

- On Jan. 7, 2019, Eli Lilly and Co. announced plans to acquire Loxo Oncology Inc. for about $7.2 billion (net of cash at the target), funded partially with debt and cash on hand. We placed the
ratings on Eli Lilly on CreditWatch negative, with an expectation of lowering the rating to 'A+' from 'AA-' upon completion of the transaction.

- On Jan. 8, 2019, Takeda Pharmaceutical Co. Ltd. closed its takeover of Shire PLC, paying about $77 billion in mix of debt and equity. Although we see the deal as transformative for Takeda's business risk profile, the significant increase in leverage led us to lower the rating to 'BBB+' from 'A-'. The outlook is negative.

The pharmaceutical industry is currently characterized by a shortage of new compelling assets relative to the number of companies seeking to expand their portfolios or pipelines, and rising competitive and pricing pressures in the industry. In this context, we are not surprised companies are seeking M&A to deepen their portfolios and pipelines to maintain their market share and strategic positions. This has led to companies being more willing to act quickly and pay higher prices when there is a perception that competitors may be interested in and pursuing the same assets. We also believe it's easier for management teams to convince their board of directors that M&A is strategically important, even at high valuations, when many others are pursuing the same M&A strategy. In some cases, management may be motivated to acquire out of concern they could otherwise become a target.

Comments from several companies, including Gilead Sciences and Pfizer (both with recent changes in senior management), indicate a significant appetite for M&A in the wake of these recent transactions.

Aside from these competitive and behavioral reasons, we believe pharmaceutical companies are particularly likely to pursue acquisitions in 2019 for several reasons:

- Pent-up demand following relatively muted M&A in 2017 and 2018;
- Still elevated cash balances following U.S. tax reform in 2018;
- As a defensive move in the face of increasing pricing pressure in the U.S., both from the U.S. administration and from consolidation among pharmacy chains, pharmacy benefits managers (PBMs), and insurance payors;
- Companies, in our view, are eager to participate in the rapidly advancing high-growth oncology space; and
- Available late-stage products offer good risk-adjusted returns given the rising importance of speed to market in the crowded and increasingly competitive landscape, with many focusing on the few large therapeutic opportunities.

There is Pent Up Demand For M&A Following Calm In 2017-2018

In addition to deepening their pipeline and increasing their "shots on goal", drug companies often eagerly seek out M&A to fill gaps in their pipeline (thus smoothing the pace of launches) or offset patent expirations, to maintain a steady pace of revenue growth. With both 2017 and 2018 having been relatively quiet for M&A (2017 experienced uncertainty about tax reform, and 2018 saw sky-high valuations) we believe there is pent-up demand for at least midsize M&A. In addition, some key products are now two years closer to patent expirations.
U.S. Tax Reform Has Given Pharmaceuticals More Cash To Splash

Most market participants expected significant pharma M&A in 2018 on the heels of U.S. tax reform that made overseas cash and foreign earnings more readily available (that is, without further repatriation tax) and lowered the U.S. corporate tax rate.

We believe cash balances at the top 10 U.S. pharma and biotech companies increased in 2018 versus 2017. As of the third quarter of 2018, seven of the large U.S.-based pharmaceutical and biotech companies had almost $150 billion combined in cash and equivalents that could be deployed in M&A. Gilead leads the pack with $32 billion, followed by Amgen with $30 billion, Pfizer with $24 billion, Johnson & Johnson with $20 billion, and Merck & Co. with $18 billion. AbbVie and Eli Lilly each have more than $10 billion.

See the Related Research section at the end of this article for our report on the impact of U.S. tax reform on the health care sector.

Mergers Are A Defensive Move To Offset Pricing Pressure In The U.S.

With total spending of about $450 billion in 2017, the U.S. remains the largest and the most profitable prescription drugs market. Pricing pressure is intensifying, however, driven by rapid consolidation on the payer side of the market. The three PBMs--CVS, Express Script, and Optum--now control 80%-85% of the market. The consolidation among PBMs means that pharmaceutical companies that rely on drugs in competitive therapeutic areas--like diabetes, cardiovascular, or respiratory--are facing increasing pricing pressure where multiple substitute products exist.

We believe consolidation between health care insurers, PBMs, and pharmacy companies in 2018--such as CVS/Aetna, Cigna/Express Scripts, and various service providers that UnitedHealth Group is buying--will likely increase pressure on pharma pricing, with many pharma companies modeling in negligible increases in net price for 2019. It also means that incremental changes within life-cycle-management are no longer sufficient and new drugs generally need to provide significant benefits or address an unmet need to get attractive pricing.

In addition, there is bipartisan support among U.S. legislators for reducing drug prices, albeit with much debate on how to achieve this. We believe this is also likely to add pressure to industry profitability.

We think industry consolidation could help big pharma offset some of the pricing pressure by providing drug companies more opportunity to bundle products (especially in the context of combination therapies); increasing scale, which typically provides incremental negotiating power; and by offering incremental cost efficiency (economies of scale). Consolidation also reduces the number of remaining competitors, which eases the intensity of competition (providing the market remains competitive enough to be acceptable to anti-trust authorities). Finally, consolidation helps companies spread the risk of outsized pricing pressure hitting a certain product or therapeutic area by reducing concentration.

Opportunities In Oncology Offer Big Incentives

The oncology market presents a unique opportunity to drug companies, as advances in the understanding of cancer (which is a diverse family of diseases) is generating many potential pharmacological solutions including a range of promising and already approved products.
(including combination therapies). Oncology is also attractive for investment because it still represents a significant unsolved opportunity and oncology drugs have very strong pricing power. Therefore, it's not surprising that a significant portion of research and development (R&D) budgets, and many recent M&A transactions, have been targeting oncology products.

We believe that companies with ambitions to participate in this growth opportunity will likely want to establish and strengthen their oncology presence in these early stages of growth to build the institutional knowledge, relationships, and reputation as a foundation to enhance long-term growth prospects.

### Opportunities In Oncology

- One of the newer technologies that companies are using to target cancer are PD-1 checkpoint inhibitors. These drugs expose cancer cells that are effectively hiding from the immune system, so that the immune system will destroy them. So far, Merck (Keytruda; PD-1 checkpoint inhibitor) seems to be in the lead, while BMS (Opdivo; PD-1), AstraZeneca (Imfinzi; PD-1), Roche Holding AG (Tecentriq; PD-1), Sanofi (teaming up with Regeneron), and Merck KGaA (together with Pfizer) have alternatives. Each of these are under combinational studies.

- Whereas Novartis also has clinical trials underway for inhibitors of PD-1, it is also—along with Gilead—at the forefront of chimeric antigen receptor T-cell (CAR-T) therapy. This is another new technology used against cancer. Both products (Kymriah for Novartis, and Yescarta for Gilead) were approved in 2017. Celgene’s CAR-T product, JCAR017, is in late-stage development, with potential Food and Drug Administration approval in 2019. This therapy involves collecting and programming a patient’s own immune cells to destroy the cancer cells.

- A third technology uses poly ADP ribose polymerase (PARP) inhibitors, which trap PARP proteins on DNA as well as blocking their catalytic action. This interferes with replication, killing cancer cells, which grow faster than non-cancerous cells. The PARP inhibitors have primarily been used in ovarian cancer and certain breast cancers. Companies leading in this area include AstraZenca (Lynparza, which could achieve blockbuster status in 2020); Tesaro (Zejula), which is in the process of being acquired by GSK; Pfizer (TALZENNA); and Clovis (RUBRACA).

- Checkpoint inhibitors do not apply to all kind of cancers but have already shown strong performance in many cases. One of them is skin cancer. Immuno-oncology results have shown early promise for melanoma. About 20% of advanced melanoma patients are surviving now beyond 10 years with no other therapy.

### Other Avenues For Growth Are Declining

Pharmaceutical companies have traditionally posted strong profitability with EBITDA margins well above 30%. However, we see rising pressure on revenue growth rates, profitability levels, and free cash flow generation. This is due to softening pricing power, competition increases earlier in the life cycle, continuing patent expirations, and drug development becoming more difficult and expensive. We believe the fewer avenues for growth are driving some companies to broaden their
product pipelines and technology bases through acquisitions.

Thus, to increase chances of success in an era of value-based care, companies need to increase their number of prospects with compelling products. This will help them achieve market share gains and favorable pricing, and access future growth targets. Companies also have to invest in new technologies that enable them to target patients who are more likely to be responsive to their products, and generate and collect data demonstrating the efficacy of their drugs to payors. For example, Roche acquired Flatiron Health, an oncology electronic health records (EHR) software company, for $1.9 billion to help the company leverage realworld evidence for cancer research.

**Sacrificing Financial Policies For M&A Could Squeeze Ratings**

Past waves of M&A in the big pharma industry suggest that the current increased willingness to compromise financial policy strength to acquire new business is likely to pressure the credit ratings on some companies. It has been nearly 20 years since the pharmaceutical industry experienced a wave of creditor-friendly transformative M&A transactions with price tags of over $70 billion. Notably, Pfizer executed the takeover of Warner-Lambert (owner of Lipitor) in 1999 for about $82 billion in all-stock bid, and in 2000, Glaxo Wellcome PLC and SmithKline Beecham PLC merged, leading to creation of GlaxoSmithKline PLC (GSK), again all-stock financed. At that time, Pfizer maintained a 'AAA' rating, while GSK was assigned a 'AA' rating, reflecting, among other factors, relatively low post-merger leverage for both deals.

Another wave of notable deals came in 2008 and 2009, although the prices were slightly lower, at about $40 billion-$60 billion. This time pharmaceuticals' financial polices had become more aggressive with the use of debt and cash to pay for the assets.

Notable transactions include:

- In 2008, Roche acquired the remaining minority stake in Genentech Inc. for about $44 billion. The Roche/Genentech transaction was fully debt-funded, leading to an increase in leverage and a lowering of its rating by two notches to 'AA-' from 'AA+'.

- The Roche deal was followed by Pfizer acquiring Wyeth for about $67 billion, and Merck buying Schering-Plough for about $41 billion.

- Pfizer raised about $22 billion of new debt and used about $23 billion of cash to pay for Wyeth, which led to S&P Global Ratings downgrading it to 'AA' from 'AAA'.

- The 'AA-' rating on Merck was affirmed as about half of the acquisition price was funded with equity, supplemented with asset disposals.

- Novartis was also downgraded from 'AAA', in this case to 'AA-', after buying the majority stake in Alcon for about $39 billion in 2008, in an all-debt financed transaction.

The M&A activity in 2008 and 2009 led to a spate of downgrades, including the loss of 'AAA' ratings as mentioned above. Ever since, M&A transactions have followed that trend, being typically at least partially funded with debt and often leading to lower ratings. With big pharma gearing up for another wave of M&A, we expect pharma company ratings to face pressure.

While significant M&A doesn't always lead to a downgrade, many acquisitions occur at high EBITDA multiples and are financed primarily with debt, significantly increasing the acquirers' initially low levels of debt leverage. More specifically, the increased financial leverage of debt-financed acquisitions for investment-grade ratings nearly always outweighs the benefits such deals provide to a company's business profile. This is partially because the high EBITDA multiples paid for sizable acquisitions significantly influence the investment-grade acquirer's
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Initially low level of debt leverage. In addition, the increase in scale, diversity, competitive position, or related considerations generally needs to be substantial for us to view an investment-grade company's business profile as having improved materially.

Table 1
Pharmaceutical Companies' Debt Capacity

<table>
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<tr>
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<tbody>
<tr>
<td>AbbVie Inc.</td>
<td>A-/STABLE</td>
<td>14.2-14.9</td>
<td>2.5-2.9</td>
<td>3.0</td>
<td>9.0-10.0</td>
<td>10.0-12.0</td>
</tr>
<tr>
<td>Amgen Inc.</td>
<td>A/STABLE</td>
<td>13.0-13.5</td>
<td>0.8</td>
<td>2.0</td>
<td>11.0-11.5</td>
<td>20.0-25.0</td>
</tr>
<tr>
<td>AstraZeneca PLC</td>
<td>BBB+/STABLE</td>
<td>4.0-4.5</td>
<td>4.2</td>
<td>4.0</td>
<td>0.5-1.0</td>
<td>0</td>
</tr>
<tr>
<td>Bayer AG</td>
<td>BBB/STABLE</td>
<td>11.8</td>
<td>3.8</td>
<td>4.0</td>
<td>1.5-2.0</td>
<td>0</td>
</tr>
<tr>
<td>Biogen Inc.</td>
<td>A-/STABLE</td>
<td>7.1</td>
<td>0.4</td>
<td>1.5</td>
<td>9.0-9.5</td>
<td>10.0-15.0</td>
</tr>
<tr>
<td>Bristol-Myers Squibb Co.</td>
<td>A+/CWN</td>
<td>5.3-6.0</td>
<td>0</td>
<td>N.A.</td>
<td>N.A.</td>
<td>N.A.</td>
</tr>
<tr>
<td>Celgene Corp.</td>
<td>BBB+/CWP</td>
<td>7.7</td>
<td>2.2</td>
<td>N.A.</td>
<td>N.A.</td>
<td>N.A.</td>
</tr>
<tr>
<td>Eli Lilly &amp; Co.</td>
<td>AA-/CWN</td>
<td>7.4</td>
<td>1</td>
<td>N.A.</td>
<td>N.A.</td>
<td>N.A.</td>
</tr>
<tr>
<td>Gilead Sciences, Inc.</td>
<td>A/STABLE</td>
<td>11.5</td>
<td>0</td>
<td>1.5</td>
<td>7.0-8.0</td>
<td>15.0-20.0</td>
</tr>
<tr>
<td>GlaxoSmithKline PLC</td>
<td>A+/NEGATIVE</td>
<td>11.0-11.5</td>
<td>2.9</td>
<td>3.0</td>
<td>0.5-1.0</td>
<td>0</td>
</tr>
<tr>
<td>Johnson &amp; Johnson</td>
<td>AAA/STABLE</td>
<td>26</td>
<td>0.9</td>
<td>1.5</td>
<td>19.0-19.5</td>
<td>30.0-35.0</td>
</tr>
<tr>
<td>Merck &amp; Co. Inc.</td>
<td>AA/STABLE</td>
<td>13.5-14.0</td>
<td>0.9</td>
<td>1.5</td>
<td>6.0-7.0</td>
<td>10.0-15.0</td>
</tr>
<tr>
<td>Merck KGaA</td>
<td>A/STABLE</td>
<td>4.0-4.5</td>
<td>2.5</td>
<td>3.0</td>
<td>1.5-2.0</td>
<td>0-5.0</td>
</tr>
<tr>
<td>Novartis AG</td>
<td>AA-/STABLE</td>
<td>16.0-16.5</td>
<td>1.6</td>
<td>2.0</td>
<td>8.0-8.5</td>
<td>10.0-15.0</td>
</tr>
<tr>
<td>Novo Nordisk A/S</td>
<td>AA-/STABLE</td>
<td>7.5-8</td>
<td>0</td>
<td>1.5</td>
<td>4.0-4.5</td>
<td>10.0-15.0</td>
</tr>
<tr>
<td>Pfizer Inc.</td>
<td>AA/STABLE</td>
<td>21.5-22.0</td>
<td>1.8</td>
<td>2.0</td>
<td>16.5</td>
<td>15.0-20.0</td>
</tr>
<tr>
<td>Roche Holding AG</td>
<td>AA/STABLE</td>
<td>20.0-21.0</td>
<td>0.9</td>
<td>1.5</td>
<td>7.0-7.5</td>
<td>15.0-20.0</td>
</tr>
<tr>
<td>Sanofi</td>
<td>AA/STABLE</td>
<td>14.0-14.5</td>
<td>2.2</td>
<td>2.0</td>
<td>6.0-6.5</td>
<td>0.0-5.0</td>
</tr>
<tr>
<td>Takeda Pharmaceutical Company Limited</td>
<td>BBB+/NEGATIVE</td>
<td>9.8</td>
<td>4.9</td>
<td>3.0</td>
<td>3</td>
<td>0</td>
</tr>
</tbody>
</table>

Note: Debt capacity shown reflects the downside cushion to the leverage threshold plus two years of discretionary cash flows for deleveraging. This assumes (1) EBITDA is relatively flat over the next two years, (2) that funds are used for M&A with no near term EBITDA contribution, (3) that we are convinced the company will prioritize deleveraging over the next two years, (4) no share buybacks in 2019 and 2020, (5) we view the acquisition is strategically important, (6) we view the transaction and elevated leverage as likely to be infrequent, (7) these calculations assumes no impact, positive or negative, to EBITDA, discretionary cash flows, or our view of the business profile from the acquired assets, and that there are not elevated risks to our base case.. In contrast capacity would be lower if the company were not committed to prioritizing deleveraging, or if the leverage was raised for the sake of shareholder returns. ICR--Issuer credit rating. N.A.--Not available. E—Estimate.

Which Companies Could Strike?

Some companies have expressed interest in M&A, and others might feel pressure to seek M&A to offset revenue declines from patent expirations. Nevertheless, it's difficult to predict which
companies will act and impossible to accurately project how much they might spend, what multiples they might pay, and how transactions would be funded. As such, our effort below to quantify M&A spending capacity at the current rating is only intended as an approximation.

Companies’ capacity to undertake debt-financed M&A without affecting the rating depends on their current leverage cushion within the rating. For investment-grade companies we'll often consider deleveraging commitments over the next two years in our rating analysis, so EBITDA growth and discretionary cash flow generation over the next couple of years are also important.

Pharmaceutical companies have historically used cash to pay healthy dividends and exercise share buybacks. Companies rarely turn off their dividends, whereas share repurchases are generally more discretionary.

**Most likely contenders**

- Gilead has been communicating interest in M&A, likely driven in part by the drop in sales of its hepatitis C franchise, and significant cash balances, despite its $11 billion acquisition of Kite Pharma in late 2017. We estimate Gilead has $20 billion-$25 billion of spending capacity at the current rating level.

- Pfizer has tended to be more aggressive than most on the acquisition front, in part as its R&D spending is below peers’ (as a percentage of revenues) and because organic revenues have been stagnant. Despite a relatively well-populated pipeline, we believe the company is still seeking M&A opportunities. We expect Pfizer to divest its stake in the consumer health care joint venture (JV) it recently entered into with GSK, potentially increasing its capacity for acquisitions, at the current rating.

- Amgen has the benefit of a relatively well-stocked pipeline. However, should the sales of its legacy products erode more quickly than anticipated or newer products fail to establish themselves in the market, the company may become more aggressive on the acquisition front. Amgen has not completed a significant acquisition since 2013, when it acquired Onyx Pharmaceuticals, which added Kyprolis to Amgen's portfolio. We believe the company has been actively looking for targets, but has remained disciplined in the types of assets it is pursuing and the multiple it is willing to pay.

- Novartis is facing generic competition to its formerly bestselling drug Gleevec, although new products seem to be able to offset the decline. We therefore believe that the strength of the group's pipeline does not make external growth compulsory. However, we believe Novartis will continue to focus on targeted acquisitions to gain access to technology and innovative medicines, following on from the 2018 purchases of AveXis for $8.7 billion and Advanced Accelerator Applications for $3.9 billion. Last year, Novartis sold its share of the consumer health care JV to GSK for about $13 billion, signaling its focus on core pharmaceuticals while shoring up cash to finance external growth. This refocusing strategy was furthermore demonstrated by the decision to spin off Alcon, the group's eye care business. We understand that proceeds from this sale could finance additional acquisitions.

**Companies that could strike**

- Merck has made fewer major acquisitions in the past few years, as its immune-oncology franchise, Keytruda, continues to drive growth. However, if a target piques its interest, Merck is well positioned to use its strength and low leverage for M&A.
- **Novo Nordisk** is looking to diversify from diabetes. Given its high cash reserves and outstanding cash flow generation, it can afford to bid high for attractive assets. The unsuccessful bid on Ablynx was the first significant external growth attempt by the group in many years. Tough market conditions in the U.S. for diabetes treatments might prompt Novo Nordisk to become more acquisitive, which would be indicated by the group reducing its substantial share buyback programs.

- **Roche** has built very strong positions in oncology and immunotherapies, and its combinational therapies have the potential to extend the life of existing drugs that are facing strong generic competition on a stand-alone basis. In 2018 and 2017, Roche focused on acquiring technology and data and diagnostics companies. We believe that Roche will continue with bolt-ons to enhance its R&D potential in cancer.

- **AbbVie** has been acquisitive in the past and has debt capacity approaching $12 billion. Following the Stemcentrx acquisition, the company has been relatively quiet with respect to M&A and has instead used its cash to fund share repurchases. AbbVie has a promising pipeline, but also high aspirations for growth. Should growth fall short of its expectations, and as the prospect of biosimilar competition for Humira in the U.S. approaches, it could become more acquisitive.

**Least likely to strike**

- **AstraZeneca** is unlikely to be among the acquirers. It is currently at a crossroads, focusing on delivering value from its recently approved products. The group’s new products in cancer, diabetes, and asthma are enjoying a strong uptake, so AstraZeneca does not need to beef up its pipeline by acquisition. At the same time, its partnering deal with Merck on combination therapies makes it a less attractive target, in our opinion. It also carries relatively high leverage as it has been partially financing its dividends using debt.

- **Johnson & Johnson** is facing relatively low growth given increasing generic and biosimilar competition to certain key products, such as Zytiga and Remicade. However, the company already utilized a significant amount of its capacity with the $30 billion acquisition of Actelion Pharmaceuticals Ltd. at the beginning of 2017, and we believe it will look to reduce adjusted debt leverage before contemplating another large transaction.

- **GSK** was a serious contender for Pfizer’s consumer products assets (valued at $20 billion), which would have complemented the group’s over-the-counter (OTC) portfolio. Instead, GSK decided to buyout Novartis’ stake in the joint OTC venture and enter into a JV with Pfizer. GSK is looking to bolster its oncology franchise, as demonstrated by the purchase of Tesaro for $5.1 billion in December 2018. We expect to see more from the company in this space as we see GSK as a latecomer to cancer treatment. However, GSK's financial flexibility is extremely limited at the current rating level, and a fully debt-funded transformative acquisition would most likely result in a downgrade.

- **Sanofi** could look for more deals to increase its size and presence in rare diseases to offset its declining diabetes franchise. Last year, Sanofi was in competition for Actelion, which Johnson & Johnson purchased for $30 billion. Sanofi was able to absorb its recent purchases of Bioverativ and Ablynx within the current rating level. These two acquisitions have substantially reduced the group's flexibility for additional acquisitions at the current rating. The impact of additional sizable deals would depend on the financing mix and speed of subsequent deleveraging.

- **Bristol-Myers Squibb Co., Celgene Corp., and Eli Lilly & Co.** are all in the process of acquiring or
Big Pharma’s Renewed Appetite For M&A Will Put Pressure On Ratings

being acquired. Takeda just completed the acquisition of Shire.

### Pharmaceutical Groups’ Ability To Pursue M&A

<table>
<thead>
<tr>
<th>Company</th>
<th>Below average</th>
<th>Average</th>
<th>Above average</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>AbbVie Inc.</td>
<td></td>
<td></td>
<td></td>
<td>The company has the capacity to pursue a sizable acquisition and still maintain the rating. It isn’t critical for the company to make an acquisition because the company has a promising pipeline, but the company also has high aspirations for growth. Should its growth fall short of its expectations and as the prospect of biosimilar competition for Humira in the U.S. approaches, it could become more acquisition-friendly.</td>
</tr>
<tr>
<td>Amgen Inc.</td>
<td></td>
<td></td>
<td></td>
<td>Substantial cash, substantial capacity within the rating, tolerance for substantially higher debt leverage. Company’s portfolio is undergoing a transition as older products decline due to biosimilar competition. We believe the company is open to acquisitions to deepen its near term product pipeline.</td>
</tr>
<tr>
<td>AstraZeneca PLC</td>
<td></td>
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<td></td>
<td>Focusing on capitalizing newly launched products that should drive growth, no need to buy at this stage.</td>
</tr>
<tr>
<td>Bayer AG</td>
<td></td>
<td></td>
<td></td>
<td>Digesting Monsanto acquisition.</td>
</tr>
<tr>
<td>Biogen Inc.</td>
<td></td>
<td>*</td>
<td></td>
<td>Biogen has been relatively quiet on the M&amp;A front versus most of its biopharmaceutical peers and we expect it to remain so for now as it develops its pipeline, including its Alzheimer’s treatment prospects.</td>
</tr>
<tr>
<td>Bristol-Myers Squibb Co.</td>
<td></td>
<td>*</td>
<td></td>
<td>Given the pending acquisition of Celgene, we believe the likelihood of the company pursuing another sizable acquisition is low.</td>
</tr>
<tr>
<td>Celgene Corp.</td>
<td></td>
<td></td>
<td></td>
<td>N.M. - Celgene is being acquired by Bristol-Myers.</td>
</tr>
<tr>
<td>Eli Lilly &amp; Co.</td>
<td></td>
<td></td>
<td></td>
<td>Company has already contracted to acquire Loxo Oncology for $8 billion, in Jan. 2019.</td>
</tr>
<tr>
<td>Gilead Sciences, Inc.</td>
<td></td>
<td>*</td>
<td></td>
<td>Substantial capacity, substantial cash, declining revenues, comments indicating appetite for acquisitions.</td>
</tr>
<tr>
<td>GlaxoSmithKline PLC</td>
<td></td>
<td></td>
<td></td>
<td>Limited capacity within the rating although could make bolt-ons into oncology, spent $5 billion on Tesaro.</td>
</tr>
<tr>
<td>Johnson &amp; Johnson</td>
<td></td>
<td></td>
<td></td>
<td>JNJ spent over $30 billion acquiring pharma company, Actelion in 2017, and leverage is at a historic high. However, we believe JNJ will continue to be acquisition-friendly, though at a much more moderate rate, as its does liver type acquisitions in support of its diverse healthcare businesses.</td>
</tr>
<tr>
<td>Merck &amp; Co. Inc.</td>
<td></td>
<td></td>
<td></td>
<td>We believe Merck’s near term pipeline is relatively light on major prospects and the company maintains significant capacity to conduct acquisitions. However, with Keytruda’s strong long term growth prospects, we feel Merck is not as pressured as some of its peers to pursue M&amp;A.</td>
</tr>
<tr>
<td>Merck KGaA</td>
<td></td>
<td></td>
<td></td>
<td>Likely to be more active in Life sciences.</td>
</tr>
<tr>
<td>Novartis AG</td>
<td></td>
<td></td>
<td></td>
<td>High cash balance following the sell of JV to GSK and disposal of Alcon, future M&amp;A likely to be technology focused.</td>
</tr>
<tr>
<td>Novo Nordisk A/S</td>
<td></td>
<td></td>
<td></td>
<td>Good cash position and proven appetite, although limited track record of closing transactions.</td>
</tr>
<tr>
<td>Pfizer Inc.</td>
<td></td>
<td>*</td>
<td></td>
<td>Substantial capacity, substantial cash, stagnant revenues, comments indicating appetite for acquisitions.</td>
</tr>
<tr>
<td>Roche Holding AG</td>
<td></td>
<td>*</td>
<td></td>
<td>Likely to do a series of bolt-ons.</td>
</tr>
<tr>
<td>Sanofi</td>
<td></td>
<td></td>
<td></td>
<td>Limited headroom within the current rating, although could invest into oncology.</td>
</tr>
<tr>
<td>Takeda Pharmaceutical Company Limited</td>
<td></td>
<td></td>
<td></td>
<td>Digesting Shire acquisition.</td>
</tr>
</tbody>
</table>

Source: S&P Global Ratings.
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M&A Versus Pledge To Delever

One of the most common questions we are asked is how we balance the immediate deterioration in credit measures that follows a company’s debt-financed acquisition with its commitment to prioritize deleveraging.

The key elements we consider in that assessment are the feasibility, credibility, reasonableness, and time frame of that deleveraging.

Although companies often share their multiyear forecasts with us, we evaluate the feasibility of their stated deleveraging plans based on our typically more conservative financial projections. For example, we often take a skeptical approach to projections relating to revenue synergies and tend to discount the company's expectations for cost synergies, especially when the savings are not clearly identified or seem optimistic. The potential for deleveraging that we’ll include in our forecast, whether stemming from the allocation of free cash flow toward debt reduction or through EBITDA expansion, will be implicitly constrained by the assumptions we’ve used in our projection model.

We evaluate credibility based on the strength of the company’s stated commitment to deleveraging and on the length and consistency of its track record of maintaining leverage at more conservative levels. A company that has maintained a more conservative level of debt leverage for a decade has more credibility about the strength of its commitment than one that has only just returned to its stated leverage target after its most recent debt-financed acquisition.

In this regard, we view a clear publicly stated commitment to deleveraging made to all investors, including equity investors, as materially stronger than a commitment expressed exclusively to us. Similarly, a capital structure that requires a rapid pace of debt amortization reinforces the narrative of a debt reduction story. We also consider how strategically important the acquisition is. If however, we don’t view the acquisition as particularly strategic or good value, we might view the company’s commitment to the more conservative leverage level to be less certain.

We also consider how likely the company is to constrain its spending on competing priorities over the period of planned deleveraging and whether we could reasonably expect that plan to survive in the hypothetical context of a change in management. We’d question a company’s commitment to extreme austerity on share buybacks and tuck-in acquisitions for two full years when those have traditionally been part of the financial policy and business model. Similarly, we’d view stated plans for future share issuances or divestitures with a large dose of skepticism.

Moreover, other than for transformative events, we generally limit the influence of future expectations to a period of two years for investment-grade companies (compared to the roughly one-year forecast horizon for speculative-grade companies). More specifically, our ratings analysis incorporates weighted-average credit measures across multiple years, including historical levels for the last two years, current levels, and expected levels over the next two years, with broad analytical discretion as to the relative weightings. Within that framework, our expectations for future periods tend to be most influential and heavily weighted. Thus we’d generally limit the influence of deleveraging to that which occurs within the next two years.

Perhaps the silver lining in M&A is that over the longer term it tends to strength of the acquiree’s business risk profile. Indeed, while M&A is typically credit negative, creditors would rather see cash used for M&A than for shareholder returns, which provide no future value to creditors.
Big Pharma's Renewed Appetite For M&A Will Put Pressure On Ratings

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