

Introducing the 'PfizerKline Empire'

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This past May, Deutsche Bank analyst Mr Gregg Gilbert sent a note to the clients writing, 'Introducing PfizerKline', catalyzing an unprecedented [adrenalin rush](#) among pharmaceutical industry giants and investors around the world.

"...As evidenced by Pfizer's interest in AstraZeneca last year, one important goal for Pfizer has been to seek a deal that would maximize access to its balance sheet and improve its tax structure," Mr Gilbert wrote.

He also pointed that this potential combination could be 'materially accretive' to earnings per share and discounted cashflow. According to the calculations, the deal would be valued at an enormous US \$146 billion.

Appealing British cos

The deal would grant Pfizer major tax benefits, as the company would move its legal address to the UK instead of the US, lowering its corporate tax rate in the process.

British drug makers seem appealing mainly because they are in a lower corporate tax region compared to the US.

Estimates have put Pfizer's offshore cash at nearly US \$70 billion, which is held outside the US, so the company does not pay the 35 percent US corporate tax rate.

"This is not the first time that Pfizer has attempted a tax-inversion deal, however. Last year, the US drug giant was in a hostile pursuit of UK drug maker AstraZeneca (AZ), in a deal worth nearly \$120 billion. This would have been the industry's biggest ever acquisition. However, Pfizer faced stiff opposition from the US Treasury, which had tightened regulations and effectively

made it disadvantageous for Pfizer to go ahead with the deal," explained Mr Gianfranco Zeppetelli, deals analyst, GlobalData, a global research and consulting firm.

If Pfizer were to proceed with a GSK takeover, it could face similar opposition from UK politicians, much like it did with the AstraZeneca deal.

Both companies have overlapping development programs and Pfizer would gain access to GSK's newly revamped respiratory portfolio, whilst strengthening its vaccine pipeline, potentially making the combined company a vaccine and consumer health powerhouse.

Mr Zeppetelli said that GSK has been looking more and more vulnerable recently as sales continue to decline, most notably from its once best-selling respiratory product, Advair, amidst increasing generic competition.

"Dutch rival Mylan NV is the latest competitor to add another nail in the coffin, and has recently launched the first bioequivalent copy of Advair, known as Sirdupla," he pointed.

The big boy

What motivates Pfizer to go really big on its [acquisitions](#) like AZ, Hospira and now [GSK](#)? The main driving force behind these large acquisitions is Pfizer's key strategy of buying assets that have the potential for creating value in the short term, allowing the company to boost sales rather than sign deals for long-term drug development.

"Additionally, Pfizer has seen a shortfall in its topline revenue since its patents on Lipitor and Caduet expired. It will also witness a continued drop in sales due to pending and future patent losses on top-selling drugs Celebrex, Viagra, and Zyvox," revealed Mr Zeppetelli.

GSK's battle

GSK's first-quarter earnings were unimpressive, and its strategy, headed by its CEO Mr Andrew Witty, is one that leans on slow but steady growth, emphasizing volume sales over highly-priced medicines.

However, this tepid growth strategy has not been popular with investors who want ROI in the near term, said the analyst.

In addition, GSK's consumer health and vaccines businesses, which the company recently talked up via its sale and swap with Novartis, are lower-margin businesses, meaning that they do not have as high a financial impact as branded prescription drugs.

Why overseas firms?

One of the main reasons for companies to acquire overseas firms is to move their legal addresses away from the US, thereby lowering their corporate tax rates by a significant margin.

Mr Zeppetelli explained, "This enables companies to free up more money, which can be used for other deals, R&D spend, or to return to investors in the form of dividends."

Fallen revenues

During the past few years, patent exclusivity losses have hit Pfizer really hard.

Since 2010, Pfizer's prescription sales have fallen from US \$58 billion to US \$46 billion in 2014, as a result of patents expiring on key drugs, such as Lipitor, Caduet, Xalatan, Geodon, Celebrex, and Viagra.

Pfizer's licensing agreement with Boehringer Ingelheim (BI) to market the COPD (chronic obstructive pulmonary disease) drug Spiriva terminated on a country-by-country basis in 2012, which resulted in a decline in Pfizer's share of Spiriva

revenues. This dragged down Pfizer's alliance revenues related to the drug.

Based on the midpoint of Pfizer's estimated prescription drug sales of US \$43 billion for 2015, the company's Rx sales will have dropped by nearly \$15 billion since 2010.

Overlapping strengths

Respiratory drugs and vaccines for infectious diseases are two main therapeutic areas which overlap between the two pipelines of the duos.

GSK is one of the market leaders in respiratory drugs, and its lead product Advair/Seretide accounted for approximately 23 percent of its total revenue in 2014.

The British drug maker is also counting on four co-developed COPD/asthma products (Breo/Anoro, Ellipta, Incruse, and Arnuity) to drive growth over the next decade, which would fit nicely with Pfizer's product portfolio.

GSK has also strengthened its position as one of the leaders in vaccines, after acquiring the global vaccine business from Novartis last year.

Pfizer has found incredible success with its Prevnar vaccine line and, in buying GSK, would truly solidify the combined entity as a vaccine powerhouse.

Impact on Indian cos

PfizerKline specifically would not have a large impact on the Indian drug market.

"However, we do expect that Pfizer would be carving out its Global Established Products (GEP) business unit, which is largely comprised of its generic drugs, along with some biosimilars, and injectables platforms. This segment achieved combined sales of US \$25 billion in 2014," Mr Zeppetelli noted.

The divestiture would be similar to when Pfizer spun off its animal health (Zoetis), nutrition, and Capsugel business units.

If the deal is a success, PfizerKline's competitors will remain in the branded drug space in continental Europe. These include AstraZeneca, Novartis, Bayer and, to some extent, Roche, Novo Nordisk and Sanofi.

Will GSK give in?

Given GSK's financial struggles, loss in market cap, and recent announcements of lay-offs and restructuring, the company's board might be more open to a deal with Pfizer.

"The key sticking point will be the political pressure and regulatory hurdles in the UK. GSK has a deeply imbedded infrastructure in the UK, and it will be hard for the citizenry to lose one of its top employers," he commented.

[Will Pfizer eye Indian drug makers next?](#) "Not really," Mr Zeppetelli added. "We are talking about branded or innovator companies and not generic drug makers. We do expect Pfizer to spin off its GEP business as a separate generics business entity. This business unit will compete directly with the global generic drug manufacturers, namely Teva, Mylan, Sun, Lupin, Cipla and, to some extent, Actavis and Valeant -- although these companies are shifting strategy to more branded drugs."

Will Pfizer eye BMS in the future? Or will it approach AZ again later this year? "I don't believe so," concluded Mr Zeppetelli.