FINANCING THE FUTURE OF THE GLOBAL PHARMACEUTICAL INDUSTRY

Philipp Gutzwiller

November 2014
Is the Pharma Market moving from Monopoly to Monopsony?
Healthcare Spend by Geography

Developed Economies

- US: 2.8 USDtrn (5% growth)
- Japan: 0.6 USDtrn (0.5% growth)
- EU Top 5: 1.2 USDtrn (2% growth)

Emerging Markets

- EU Other: 0.5 USDtrn
- BRIC: 0.8 USDtrn (11% growth)

Sources: WorldBank: 2012 data; Bain & Company
<table>
<thead>
<tr>
<th>Region</th>
<th>Developed Economies</th>
<th>Emerging Markets</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>9.6 %</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>8.3 %</td>
<td>1.8 %</td>
</tr>
<tr>
<td>EU Top 5</td>
<td>7.9 %</td>
<td>2.3 %</td>
</tr>
<tr>
<td>EU Other</td>
<td>6.0 %</td>
<td>2.4 %</td>
</tr>
<tr>
<td>BRIC</td>
<td>3.1 %</td>
<td>3.1 %</td>
</tr>
</tbody>
</table>

Sources: WorldBank: 2012 data
Putting Government Healthcare Spend into Perspective

Developed Economies

Emerging Markets

Public Health Expenditure (% GDP)
Budget Deficit (% GDP)
National Debt (% of GDP)

Sources: WorldBank: 2012 data
## P&L Development for Top 10 Pharma* Companies

<table>
<thead>
<tr>
<th>Metric</th>
<th>2003 Today’s Top 10*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$308bn</td>
</tr>
<tr>
<td>Gross Profit %</td>
<td>74%</td>
</tr>
<tr>
<td>R&amp;D Spend %</td>
<td>14%</td>
</tr>
<tr>
<td>SG&amp;A %</td>
<td>32%</td>
</tr>
<tr>
<td>EBITDA %</td>
<td>28%</td>
</tr>
<tr>
<td>EBITDA</td>
<td>$93bn</td>
</tr>
</tbody>
</table>

*Top 10 Pharmaceutical companies by Sales in 2013; Adjusted for major acquisitions & divestures

Sources: S&P CapIQ; Top 10 Annual Reports; Evaluate Pharma; Bloomberg, Lloyds Estimates
## P&L Development for Top 10 Pharma* Companies

<table>
<thead>
<tr>
<th></th>
<th>2003 Today’s Top 10*</th>
<th>2013 Today’s Top 10*</th>
<th>CAGR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$308bn</td>
<td>$470bn</td>
<td></td>
</tr>
<tr>
<td>Gross Profit %</td>
<td>74%</td>
<td>67%</td>
<td></td>
</tr>
<tr>
<td>R&amp;D Spend %</td>
<td>14%</td>
<td>13%</td>
<td></td>
</tr>
<tr>
<td>SG&amp;A %</td>
<td>32%</td>
<td>23%</td>
<td></td>
</tr>
<tr>
<td>EBITDA %</td>
<td>28%</td>
<td>31%</td>
<td></td>
</tr>
<tr>
<td>EBITDA</td>
<td>$93bn</td>
<td>$145bn</td>
<td></td>
</tr>
</tbody>
</table>

*CAGR: Compound Annual Growth Rate

*Top 10 Pharmaceutical companies by Sales in 2013; Adjusted for major acquisitions & divestures

Sources: S&P CapIQ; Top 10 Annual Reports; Evaluate Pharma; Bloomberg, Lloyds Estimates
Observation

Buyers are applying purchasing power.

Impact

Margins and cash flows will come under pressure.
More Volatility, Anyone?
Importance of Emerging Markets

2008

- Total Sales Top 10 Pharma
  - Emerging Markets: 14%
  - Developed Markets: 86%

2013

- Total Sales Top 10 Pharma
  - Emerging Markets: 24%
  - Developed Markets: 76%

Sources: Top 10 Annual Reports; Evaluate Pharma
Russia - Who would have thought?

Total Pharmaceuticals Sales Russia

Sources: IMS Health Market Prognosis, March 2013;
Russia - Who would have thought?

Total Pharmaceutical Sales Russia
USD/RUB Exchange rate

Sources: IMS Health Market Prognosis, March 2013; Russian Central Bank
Thesis #2

Observation

Emerging Markets are here to stay.

Impact

Increased volatility will need to be managed.
Can Pharma afford the Cost of Growth?
# The Cost of Growth…

<table>
<thead>
<tr>
<th>2003 Today’s Top 10*</th>
<th>2013 Today’s Top 10*</th>
<th>CAGR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sales</strong></td>
<td>$308bn</td>
<td>$470bn</td>
</tr>
<tr>
<td><strong>EBITDA</strong></td>
<td>$93bn</td>
<td>$145bn</td>
</tr>
<tr>
<td><strong>Net Debt</strong></td>
<td>~0</td>
<td>$55bn</td>
</tr>
<tr>
<td><strong>No. of Employees</strong></td>
<td>963k</td>
<td>926k</td>
</tr>
<tr>
<td><strong>Dividends Paid</strong></td>
<td>$23bn</td>
<td>$48bn</td>
</tr>
<tr>
<td><strong>Market Cap</strong></td>
<td>$1,400bn</td>
<td>$1,600bn</td>
</tr>
</tbody>
</table>

**2003-2013**

- **Share Buy-Backs**: $255bn
- **Dividends Paid**: $380bn
- **Net Cash for M&A**: $245bn

**Total Outflow**: $880bn

*Top 10 Pharmaceutical companies by Sales in 2013; Adjusted for major acquisitions & divestures

Sources: S&P CapIQ; Top 10 Annual Reports; Evaluate Pharma; Bloomberg, Lloyds’ estimates
…Has put Pressure on Credit Ratings…

Sources: S&P
…But Shareholders are loving it!

Sources: S&P
Observation
Shareholders expect growth AND return of cash.

Impact
How long is this sustainable for?
Possible Solutions

- **Defensive**
  - Cost reduction
  - Mega mergers
  - Increased outsourcing
  - Divestment of non-core assets

- **Neutral**
  - Market-based risk mitigation
  - Break-up of corporate structures

- **Innovative**
  - Alternative pricing models
  - ‘Emerging Markets First’ policy
  - Ruthless application of digital technology
  - Crowd funding