Beyond the Patent Cliff—Signs of Recovery in Biopharma’s New Normal

Accenture Research Note: Biopharmaceutical Industry High Performance Business Study—2012 Update

The patent cliff for blockbuster products has reached its peak and there are now signs of life as the industry faces a “new normal.” Despite the well-known pressures affecting the industry—including shifting global markets, pricing and reimbursement changes, and R&D productivity challenges—our research indicates that from 2013 onwards, the negative effect from sales lost to patent expiry will lessen, while new sales from the pipeline and current portfolio will improve. Our research also revealed there are a few select companies that are successfully adjusting to life in the new normal and are on the path back to sustainable growth.
Research Summary

- Enterprise Value has stagnated over the last eight years with Future Value swinging increasingly negative in most cases, indicating the patent cliff has been largely baked into the company valuations of the 16 “pure biopharma” companies we studied (those with more than 75 percent of their revenue derived from patented or generic biopharmaceutical products).
- A few select companies are showing early signs of notably improved performance indicating investors are beginning to shift their mind set to look beyond the patent crisis and valuing companies with strong cash flow and a visible path to sustainable growth.
- These companies are adjusting to a “new normal” where outcomes-driven innovation is rewarded in developed markets and new growth persists in emerging markets.
- No singular model or operating structure is emerging as the clear winner; there are multiple paths to differentiate in the new normal.
- Success in the new normal requires the commitment and discipline to:
  - Be certain amidst uncertainty with a clearly articulated strategy and a distinctive focus on the areas that you can dominate.
  - Take decisive action in building new capabilities including understanding and increasing how your products contribute to improved health outcomes, mastering the science of multichannel marketing, quick, efficient entry in emerging markets, expedient product launch, and new collaborative R&D models.
- There is light at the end of the tunnel for companies exhibiting these characteristics, and perhaps the industry as a whole, if these key changes are carried forward deftly and swiftly.

Key Findings

There are new signs of life beyond the patent cliff

Our research indicates that the negative impact of the patent cliff is reaching its peak in 2012, but will now diminish over time. Figure 1 on the next page shows the exposure to sales loss from patent expiry reaching its high in 2012, while the ratio of new sales to replace those losses has reached its low. However, from 2013 onwards, we see this trend begin to reverse. The ratio of new sales from product launches and current portfolios compared to sales lost to patent expiry recovers by 2016 providing an engine for a return to growth. This indicates the industry will have weathered the worst of the storm by the end of this year and is poised to close the gap between blockbuster sales loss and new sales over the next three years.

The patent cliff is baked into today’s current valuations

As Figure 2 indicates on the next page, the Enterprise Value (EV) of the 16 global biopharmaceutical companies we studied has been relatively flat over the last eight years. At the same time earnings, measured here by Net Operating Profit Less Adjusted Tax (NOPLAT), have grown 77 percent driven by the top line and improved operating margins. Current Value has in fact been rising over this eight year period of time from $1,118 billion in 2004 to $2,032 billion in 2011—nearly doubling in size.

On the other hand, Future Value (FV) has been plummeting since 2006. While Future Value varied widely among the companies studied, just three had positive Future Value in 2011 and only three had higher Future Value than they did in 2004. Today, Future Value is more than 50 percent in the negative compared to Enterprise Value, implying investors have already baked in the impact of patent expiries into their valuations. However, Figure 2 does show Enterprise Value rising eight percent in the first nine months of 2012—certainly a positive sign—and again indicating that there are signs of life ahead.
FIGURE 1. Sales lost to patent expiry ($ Billion) versus expected revenue from new products in the pipeline—2001-2016 estimated—Total Pharma Industry

Note: Sales replaced in year from portfolio products and new launches (not probability adjusted). Forecast actual sales lost from products with IP expiring in year, or already expired. Total sales at risk = sales due to go off in next 5 years or already off patent.

Source: Accenture Research, August 2012, based on Evaluate Pharma.

FIGURE 2. Enterprise Value ($ Billion) for “pure biopharma” companies studied (2004-11)

Note: 16 pure biopharma companies only. Japanese companies have March year end. Constant USD FOREX used from December 2011. Future value is a measure of investors’ expectations of the value of a company’s cash-flow growth, calculated as the difference between the enterprise value (the market value of debt plus equity) and the current value of operations (the value of current profitability in perpetuity).

Source: Accenture Research, September 2012
Directional change in performance ranking—promising signals from higher performers

Our 2012 study showed significant variation in performance of the 16 companies across the five financial metrics we analyzed (profitability, growth, positioning for the future, longevity and consistency) over an average of one, three, five and seven years. This was consistent with our analysis from two years ago (based on year-end 2009 financials). However, there are some significant movements in individual company rankings when comparing the two analyses. In fact, there are significant movements in 4 of the 16 companies’ rankings. This is rather surprising since this methodology looks at the ability to sustain performance over multiple years as a key indicator of high performance so significant movement over just a two year period is unusual. These changes demonstrate how rapidly and fundamentally some companies have mobilized to be successful in the “new normal,” while others have yet to find a path back to growth amidst the patent cliff.

The analysis revealed a single true high performer and four near-high performers among the peer group (see Figure 3). Novo Nordisk remained the single true high performer from our analysis from two years ago with Teva and GlaxoSmithKline keeping their status as near-high performers. Two companies—Bristol Myers Squibb and Eli Lilly—moved up in ranking from moderate to near-high performers.

Return to profitable growth—high performers are certain amidst uncertainty and take decisive action

The high performers in our study varied widely in terms of their business models, operating structures and product portfolios. Some focus on high margin innovative new drugs, while others focus on a more diversified portfolio of biopharma products. Despite these differences, all the higher performing companies are positioning to capitalize on the areas of the market where growth is still to be found—namely in new innovative products that are backed by data that proves a significantly improved health outcome and/or in branded or true generics in emerging markets.

The equity analyst revenue forecasts in Figure 4 on the next page reveals how starkly the future prospects have changed for several of the companies over the last three years. The four year forecast (2013-2016) remains low for some companies which continue to struggle to navigate a path back to growth after the worst of the patent cliff. A few even face the prospect of a second round of significant patent expiries and are forecasted to have negative growth. However, several companies are forecast to grow in line with the estimated global market growth of 4-5 percent, having articulated a clear path back to growth and making substantial strategic and operational changes.

These companies are adjusting to a “new normal” where profitable growth is still attainable, although harder to achieve. These companies have demonstrated that success requires the commitment and discipline to:

- Be certain amidst uncertainty with a clearly articulated strategy and a distinctive focus on the areas that you can dominate.
- Take decisive action in building new capabilities including understanding and increasing how your products contribute to improved health outcomes, mastering the science of multichannel marketing, quick, efficient entry in emerging markets, expedient product launch and new collaborative R&D models.

For example, under new leadership, Sanofi has made a decisive move to rapidly diversify its portfolio away from a reliance on a few new blockbuster approvals alone. It is now targeting 40 percent of its revenue to come from emerging markets, growing its Consumer Healthcare division and having an active pipeline of new drug launches. Meanwhile, Bristol-Myers Squibb has placed great emphasis on its “String of Pearls” strategy focused on creative collaborations to find and develop innovative high value drugs in key areas of clinical need from both internal and external sources. GlaxoSmithKline (GSK) has developed and executed operational excellence programs and is realigning its global footprint in select growth markets to maintain strong margins in the face of healthcare reform and other industry pressures. The company has also introduced new decision-making and funding structures in R&D that have helped create one of the industry’s leading pipelines that is poised to introduce a multitude of new drugs over the next 18 months. In addition, GSK is also heavily investing in new product launch capabilities to bring these drugs to the target markets quickly and cost effectively.

These are just a few examples of the clear, decisive changes that the higher performers are making that are yielding signs of a better future ahead and act as a guide for the entire sector. While the market environment remains tough, profitable growth is still attainable in the new normal if pharmaceutical companies can quickly mobilize and move beyond the mind set and operational structures of the past.
FIGURE 3. Select companies showed marked improvement in performance over the last two years

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Note: Japanese companies 2011 data based on March 2012 year end, all others have December 2011 year end. Latest restated financials are used, normalized to exclude exceptional items.

Source: Accenture Research, June 2012.

FIGURE 4. Equity analyst revenue forecasts have evolved over last 3 years

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Source: Accenture Research, June 2012 based on S&P Capital IQ.
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Attributions

1. Analysis based on EvaluatePharma database, August 2012.
About Accenture’s High Performance Business Research Program

Accenture embarked on its High Performance Business Program in 2003. We have studied more than 6,000 companies across multiple industries and industry segments and come up with definitive answers regarding business performance. Our High Performance Business research methodology is a proprietary approach for analyzing relative peer company performance across five key metrics. For each company, we capture the metrics for profitability, growth, positioning for the future, longevity and consistency with scores graded along a curve. In our 2010 research, we added a forward looking dimension to our research methodology which analyzed a company’s top line revenue growth and strength of its pipeline relative to its intellectual property exposure. Composite scores demonstrate relative performance within the peer set and highlight the high performers.

About Accenture’s High Performance Business Research for the Biopharmaceutical Industry

Accenture’s study of the Biopharmaceutical industry is in its seventh year and has analyzed the long term performance of “pure biopharma” pharmaceutical companies (those with more than 75 percent of their revenue derived from patented or generic biopharmaceutical products). Our 2012 update is based on year end 2011 financials and analyzes the 16 largest pure biopharmaceutical companies in the world over a 7 year period. Collectively these companies had $487 billion in 2011 aggregate revenue, and represented a 54 percent share of the global pharmaceutical market. The results have been compared with our 2010 study (based on year-end 2009 financials) to identify relative movements in the performance rankings. The analysis pro forma adjusts for the impact of major M&A deals and removes the impact of exceptional costs to reveal an accurate picture of ongoing business operations. A detailed analysis of historic financial performance averaged over 1, 3, 5 and 7 year timeframes is combined with consensus analyst forecasts to gain a forward looking picture of forecast revenue growth from portfolio and new product launches, as well as the impact of patent expiries and mature products.
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