Evaluate Vantage

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Vantage Point – Stars align for AstraZeneca to team up with Bristol for Shire swoop

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As the clock ticks down to January 31, when AstraZeneca's new CEO, Pascal Soriot, will unveil his strategic vision for the company, the stars are aligned for what could be a bonanza of corporate finance activity.

Few big pharmas are in as dire need of a shake-up as the UK firm, and few can be as well placed to execute one. M&A bankers eager for something to get their teeth into could look to a buyout of Shire – not by Astra alone but through a joint venture with an increasingly important partner, Bristol-Myers Squibb – as well as offering investors an equity carve-out of Astra's ailing R&D division in a move that might result in value being attributed to it at last.

Shire has long been seen as a takeover candidate, and has been linked to Astra on more than one occasion. But acquiring it is no simple matter, requiring a deft touch to prevent its entrepreneurial edge being lost in a big organisation with the ability to fork out $25bn.

Which is where Bristol – and more specifically a Bristol/Astra joint venture – comes in. The two companies already have alliances around saxagliptin and dapagliflozin, as well as co-developing a combination of saxagliptin with metformin, and joining forces last year to acquire Amylin Pharmaceuticals for $7bn.

A growing role

Bristol is destined to play a growing role in Astra's future, and there is no reason why the companies' joint-venture activities should stop at diabetes. Indeed, a full takeover of Astra by its US partner has been mooted, and greater ties between the two would maintain the hope that this might eventually happen, buoying Astra's stock despite the obvious reputational damage that it might bring.

True, Shire might not be the most obvious target, given its therapy focus and highly efficient structure, which leaves little room for elimination of costs. But desperate times call for desperate and creative measures, and Astra's patent expiries and myriad R&D failures are well documented (*AstraZeneca needs new strategy after boardroom shake-up, April 26, 2012*).

Recent deals have shown that niche therapy areas are of increasing interest to big pharma, and it can be argued that linking Shire to a bigger sales presence and tapping it into Europe and perhaps even emerging markets could unlock value. Shire is already highly cash generative: its EBIT is forecast to total $1.5bn this year and is expected to grow at a 9% CAGR in the medium term.

The possibility of allowing Shire to run at arm's length – under our speculated risk-sharing joint venture with Bristol – could help maintain the smaller group's entrepreneurial edge, which in the words of one analyst might even teach its owners a thing or two.

It could also help get around the sorts of difficulties that had derailed GlaxoSmithKline's licensing deal for Shire's Vyvanse for the US ADHD market – the partners ended up in litigation. Throwing in some contingent value rights would give an added incentive.

As for the price, a $25bn valuation seems realistic, implying a 28% premium to today's price, or an 18% premium to Shire's all-time high of last February. Given today's low interest rates it would make sense to fund a deal with debt, which if secured against the three companies would imply net gearing of a manageable 2x pro forma 2012 EBIT.

Of course, a bid for Shire might bring other big pharma buyers out of the woodwork – Lilly and J&J spring obviously to mind – and make Shire unaffordable, but that risk would have to be run. Both Astra and Shire are in periods of leadership transition (*Pascal Soriot answers AstraZeneca's 911 call, August 28, 2012*).

Distance from R&D

The second part of Astra's hypothetical recovery strategy could be to distance itself further from early-stage R&D, which currently accounts for a large part of its annual $5bn R&D bill and yet has practically no value attached to it.

The company has already moved to transfer some research into a “virtual” innovative medicines unit, and it could go further. For instance, much of its R&D portfolio could be set up as an independent unit that would raise its own cash like a mid-sized biotech group, while the senior group focused on drug marketing and more advanced projects.

One need look no further than Abbott’s AbbVie spin-out and rumours of a further break-up of Pfizer to see that business splits are all the rage. True, Astra is already very much a pure-play pharma company, having earlier spun out its Astra Tech division, but there is no reason why it should not, for instance, consider an equity carve-out of much of its R&D.

A minority interest in the unit could be floated, to be followed by a tax-friendly share exchange, with Astra retaining some rights to opt back in to developed assets later. With the amounts of cash currently flowing into biotech such a unit should have no trouble attracting funding, and the prospects of a trade sale would underpin its valuation.

The spectre of MedImmune

Although such a biotech unit could be closely centred around what remains of MedImmune, the biotech bought by the UK group at the peak of the market, Astra would have to tread carefully to avoid comparisons and set a realistic valuation on it.

What's left of MedImmune?		
Product	**Status**	**Notes**
Synagis (palivizumab)	Marketed	2011 sales: $570m. Loses patent in 2015.
FluMist	Marketed	2011 sales: $161m. Influenza vaccine
Ethyol	Marketed	Total 2011 sales: $95m. Chemoprotectant. Patent expired.
CytoGam	Marketed	CMV prophypaxis, no reported sales.
MEDI-575	Phase II	Glioma, NSCLC.
MEDI-8968	Phase II	COPD.
MEDI-557	Phase I	Anti-RSV MAb.
MEDI4736	Phase I	Cancer.
MEDI-559	Phase I	RSV vaccine.
RespiGam	Withdrawn	RSV immune globulin.
Numax (motavizumab)	Abandoned – phase III	Anti-RSV Mab.
MEDI-8662	Abandoned – phase III	Influenza vaccine.
MEDI-561	Abandoned – phase III	Hsp90 inhibitor.
Urinary Tract Infection Vaccine	Abandoned – phase II	E coli vaccine.
Blinatumomab	Abandoned – phase II	Leukaemia.
MEDI-560	Abandoned – phase I	Parainfluenza virus & RSV vaccine.
Intranasal H5N1 Pandemic Vaccine	Abandoned – phase I	–
RSV/PIV-3 vaccine	Abandoned – phase I	–
MEDI-566	Abandoned – phase I	Influenza vaccine.
MEDI-491	Abandoned – phase I	Parvovirus vaccine.
MEDI-501	Abandoned – phase I	HPV vaccine.
MEDI-547	Abandoned – phase I	Cancer.
MEDI-534	Abandoned – phase I	RSV vaccine.

It would, for instance, be completely unrealistic to expect the unit to be worth anywhere near the $15.6bn that Astra paid for MedImmune in 2007. But although mention of MedImmune would serve as a reminder of the disastrous M&A strategy of Astra's former leadership, a line has to be drawn under the past failures.

Mr Soriot has already shown that he is ready to act: shortly after taking the reins he suspended share buybacks, and has already implemented one management shake-up. His third big move should be to structure a smart, transformational deal that could put Astra on the long road to recovery.

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