Deal activity to surge amid strong market conditions and US tax reform

Uncertainty in the wake of Brexit, the US presidential election and pending US tax reform cooled healthcare M&A activity in 2017. In 2018, however, we anticipate that current market conditions and clarity about the US's new corporate tax rate will lead to a rebound in deal activity, causing global healthcare M&A to rise to US$418 billion, up 50% from US$277 billion last year.

Despite a drop in large pharma transactions in 2017, pharmaceutical companies were still actively shedding non-core assets while pursuing smaller bolt-on acquisitions as well as licensing deals to gain access to the next wave of game-changing treatments in areas such as immuno-oncology, cardiovascular disease and diabetes. We expect to see these activities accelerate in 2018.

"It's the drive to focus on core expertise by spinning off non-core assets to fund investment in strategic therapeutic areas," says Jane Hobson, a healthcare M&A partner based in London. "In the area of immuno-oncology, for example, there are some promising results in clinical trials where genetically engineered T-cells are used to attack cancer cells. What's exciting about immuno-oncology is that it has the potential to treat different types of cancer, not just one."

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> **BEN MCLAUGHLIN**
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> Chair, Global Healthcare Industry Group

One of the largest healthcare deals completed in 2017 was Gilead Science's US$11.9 billion acquisition of Kite Pharma, a clinical-stage biotech that specializes in immuno-oncology therapies — a transaction that Gilead CEO John Milligan called a "pivot into cell therapy."

As further evidence of this trend, Pfizer announced in October that it was considering selling or spinning off its consumer healthcare business, which would potentially put US$15 billion in over-the-counter products up for sale. Germany's Merck KgaA has also expressed interest in divesting its non-prescription products business, while Eli Lilly is mulling the sale of its animal health unit, which generates about US$3 billion in annual sales, to focus on prescription drugs.

"Many big pharma companies are looking to invest in the next blockbuster drug, being acutely aware of declining revenues as patents move closer to expiry and biosimilars challenge biologics," says Ben McLaughlin, chair of Baker McKenzie's Global Healthcare Industry Group. "This is driving pharma companies to chase smaller biotech start-ups that have a lot of products in regulatory review, and driving high sales multiples on transactions."

GLOBAL HEALTHCARE M&A (US$B)						
2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
346	495	306	277	418	414	368

GLOBAL HEALTHCARE IPOs (US$B)						
2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
19.7	15.6	13.7	15.7	22.3	21.4	17.7

Source: Oxford Economics

Meanwhile, healthcare was the most active sector for cross-border IPOs in 2017, raising a total of US$3.3 billion, more than double the US$1.6 billion raised in 2016. This was driven by a number of significant IPOs, including Colombian healthcare firm Biotoscana Investments' US$427 million listing in Brazil, Latin America's first cross-border IPO in a decade.

In 2018, we forecast both domestic and cross-border healthcare IPOs to continue to climb, rising to US$22.3 billion, up from US$15.7 billion in 2017. This upward trend is largely driven by biotech companies wanting to take advantage of high valuations.

"With stock markets at an all-time high, a lot of people who would eventually sell or raise funds through a public offering are thinking they should act before the inevitable market correction occurs," says Alan Zoccolillo, chair of Baker McKenzie's North America Healthcare Industry Group. "A number of analysts are predicting a pullback from the current market levels, so many are looking to go to market quickly to maximize value in their sale or IPO."

Healthcare M&A in 2018: Key drivers

In 2018 we forecast healthcare M&A in North America to surge to US$250.2 billion, accounting for well over half of all healthcare transactions globally. Following North America is Europe with a projected US$104.8 billion of deal activity, followed by Asia Pacific with US$55.1 billion, Africa and the Middle East with US$4.1 billion and Latin America with US$3.7 billion.

Our 2018 forecast predicts that healthcare M&A deal values will rise 66% over 2017 in North America, more than 80% over the previous year in Asia Pacific, triple in Africa and the Middle East, and more than double in Latin America. Europe is the only region where we forecast health M&A to rise only modestly.

GLOBAL HEALTHCARE M&A BY REGION (US$B)

	2017	2018	2019	2020
North America	149.5	250.2	243.2	218.2
Europe	94.2	104.8	103.2	89.1
Asia Pacific	30.7	55.1	57	51.6
Africa & Middle East	1.6	4.1	5.7	4.4
Latin America	1.2	3.7	4.5	4.3

Source: Oxford Economics

As the world's largest healthcare market, the US is also seeing an uptick in M&A transactions that blur the lines between traditional healthcare subsectors. One such example is CVS Health Corp's US$69 billion offer for insurer Aetna as the drug-store chain tries to position itself as a one-stop shop for Americans' healthcare needs by providing prescription drugs, walk-in clinics and insurance plans to cover those goods and services.

Another example is US insurer UnitedHealth Group's US$4.9 billion bid for DaVita Inc., which serves 1.7 million patients through 300 medical clinics. These types of transactions are likely to continue as health insurers try to cut costs by playing a more direct role in providing medical services.

"We're seeing some really interesting combinations between a variety of industry players in an attempt to drive more synergies and change business models," North America Healthcare Industry Group Chair Alan Zoccolillo says.

US tax reform, which will lower the corporate tax rate to 21% from 35%, is also expected to drive higher levels of M&A activity in North America.

"We don't anticipate a near-term trend in which non-US parented companies including 'inverted' companies choose to relocate to the United States," says Melinda Phelan, chair of Baker McKenzie's North America Tax Practice. "Instead, we expect that companies will observe how the act affects taxpayers in the industry and how other countries respond with changes in their own tax rules."

In Asia Pacific, a major driver of M&A transactions continues to be big pharma buying manufacturing sites in lower cost jurisdictions like Vietnam and India. Pharma companies are also acquiring local companies for their distribution networks in emerging markets like China to gain access to the growing middle class that now has disposable income to spend on healthcare.

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> **JANE HOBSON**
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> Partner, Healthcare M&A

In Europe, it's difficult to predict how Brexit will impact healthcare M&A going forward, although many pharma companies have already begun the process of moving the authorizations to market their drugs in Europe to locations outside the UK.

"With the European Medicines Agency moving from London to Amsterdam, we query whether healthcare companies will be setting up regulatory functions in The Netherlands over time or whether this will not be a cause for change given the strong nexus with Brussels for regulatory policy remaining as is," says Jane Hobson, who is based in London. "Only time will tell what the ultimate impact of Brexit will be on the industry but there is clearly concern about the loss of the talented people who worked for the EMA as a result of a relocation to The Netherlands."

Healthcare IPOs in 2018: Key drivers

The total value of IPOs in the healthcare sector rose to US$15.7 billion in 2017, boosted by Chinese drug R&D company WuXi Biologics' debut on the Hong Kong Stock Exchange in June, which raised over US$580 million. In 2018, we forecast healthcare IPOs to become even more active, rising to US$22.3 billion globally.

"We're seeing a lot of biotechs get to the point where they need more capital for R&D and they're debating whether to raise capital through an IPO or just sell the business now to take advantage of all-time high valuations," says Tom Rice, a Baker McKenzie securities partner based in New York. "As a result, we've seen a resurgence over the last year or so of dual-track IPO sale processes seeking to maximize value."

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> Chair, North America Healthcare Industry Group

Healthtech companies are also likely to pursue IPOs to raise capital for R&D and to manufacture and open up new distribution channels for their products.

"The healthcare IPO market is beginning to gain surer footing as IPO valuations become more competitive with M&A," says Ashok Lalwani, Head of Baker McKenzie's International Capital Markets Practice in Asia Pacific. "As IPO valuations rise, we should start to see more of a trend towards companies using IPOs as an exit route as opposed to a trade sale."

Beyond 2018

Following a peak in deal activity in 2018, we forecast that healthcare M&A and IPO transactions will decline in 2019 in line with a larger, worldwide trend of cooling deal activity in developed markets. As interest rates rise, global trade and investment growth slows, and equity prices correct, we forecast healthcare M&A to drop modestly to US$414 billion in 2019, and further to US$368 billion in 2020.

After reaching a five-year high of US$22.3 billion in 2018, we forecast that IPOs in the healthcare sector will drop slightly to US$21.4 billion in 2019 before declining further to US$17.7 billion in 2020.

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