

“The pharma sector will survive!”



***Strategic vision
of the pharmaceutical sector
- Perspectives 2014 -***

Prize “ESSEC Santé 2010”

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Strategic vision of the pharmaceutical sector

This position paper proposes strategic orientations for pharma companies considering the market environment trends over the period 2010 – 2014

Content

Key point # 1: Pharma companies should be prepared to face drastic and repetitive price decreases

Key point # 2: Pharma sector is and will remain one of the most attractive for investors

Key point # 3: Pharma companies performance will depend on portfolio management and socio-geographical coverage strategies

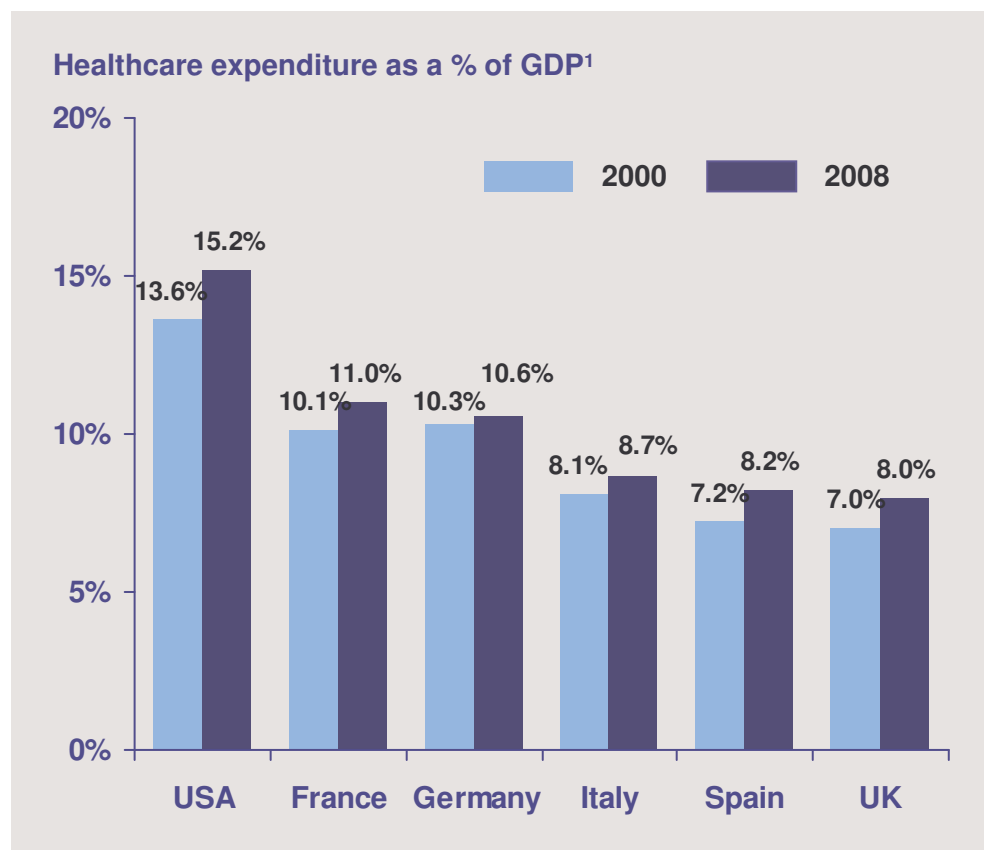
Key point # 4: Portfolio and socio-geographical diversification will affect pharma companies profitability but boost the growth of their operating profit

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Key point # 1

The weight of healthcare expenditure in the economies of major developed countries has increased between 2000 and 2008 and is expected to increase further

Healthcare expenditure as a % of GDP¹



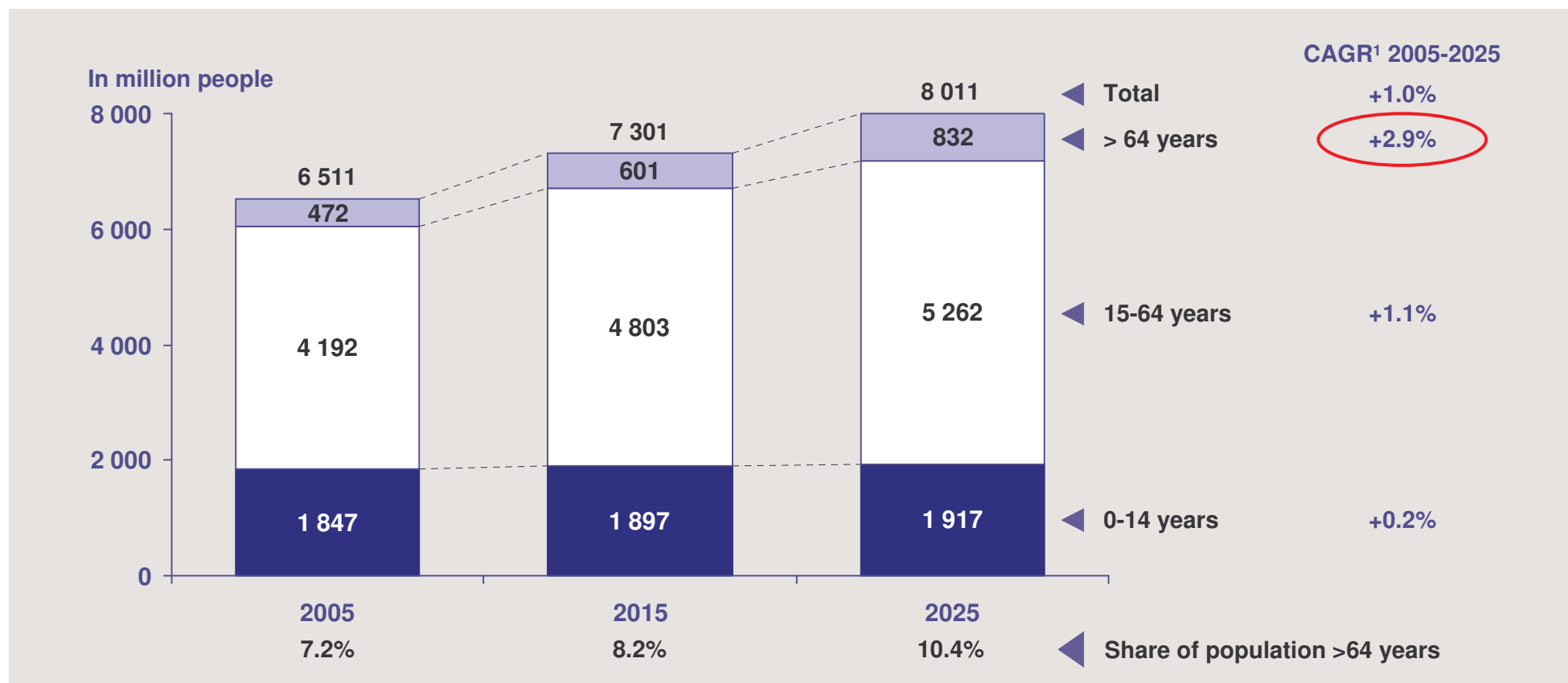
- Healthcare expenditure represents the 1st (USA), 2nd (France, Germany, Spain, UK) or 3rd (Italy) largest source of costs in most developed economies
- At best, health authorities will manage to slow the rise of healthcare expenditure as a percentage of GDP, but not to stop it
- In principle, there is no ideal or optimal level of healthcare expenditure as a percentage of GDP
- The weight of healthcare expenditure is primarily a political decision based on public health considerations

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Key point # 1

Both the steady rise of the global population and the increasing weight of the elderly in the population favor the development of the pharmaceutical market in volume

World population increase and ageing (2005-2025)



Source: UN World Population Database (2008 revision) - Smart Pharma Consulting analyses

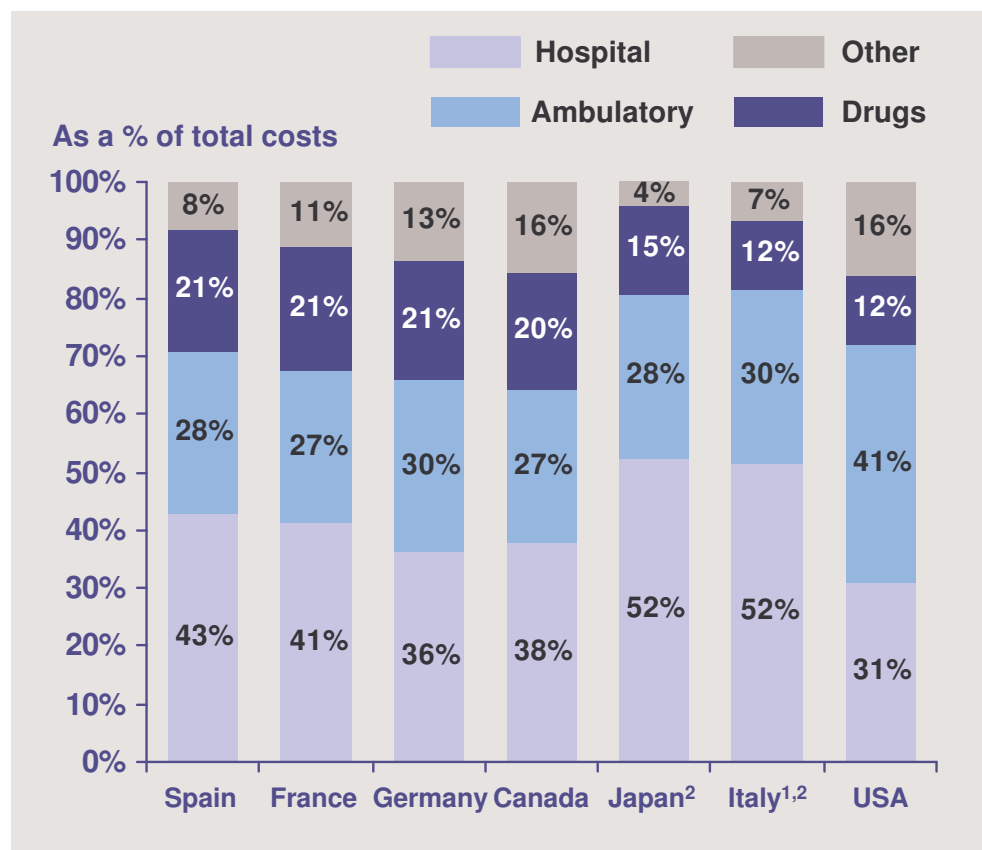
¹ Compounded annual growth rate

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Key point # 1

Although pharmaceuticals are 3rd, far behind hospital and ambulatory care expenditure, it is one where governments can easily put price pressure

Breakdown of healthcare expenditure



- Pharmaceuticals are the 3rd largest bucket of total healthcare expenditure
- To contain these costs, governments cannot afford not to apply cost-optimization measures to all segments of healthcare
- Drugs are the easiest segment to apply cost-containing measures as decisions are:
 - Made unilaterally by payers (either public and/or private), with little/no negotiation with suppliers
 - Much easier politically compared to other segments

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Key point # 2

In spite of price pressure and a decreasing flow of innovative drugs, pharma sector performance has remained very high as compared to other industries

Global attractiveness of the pharmaceutical market (2004-2009)



Source: IMS Health 2010 – Fortune 500 2009 – UN 2009 – Smart Pharma Consulting analyses

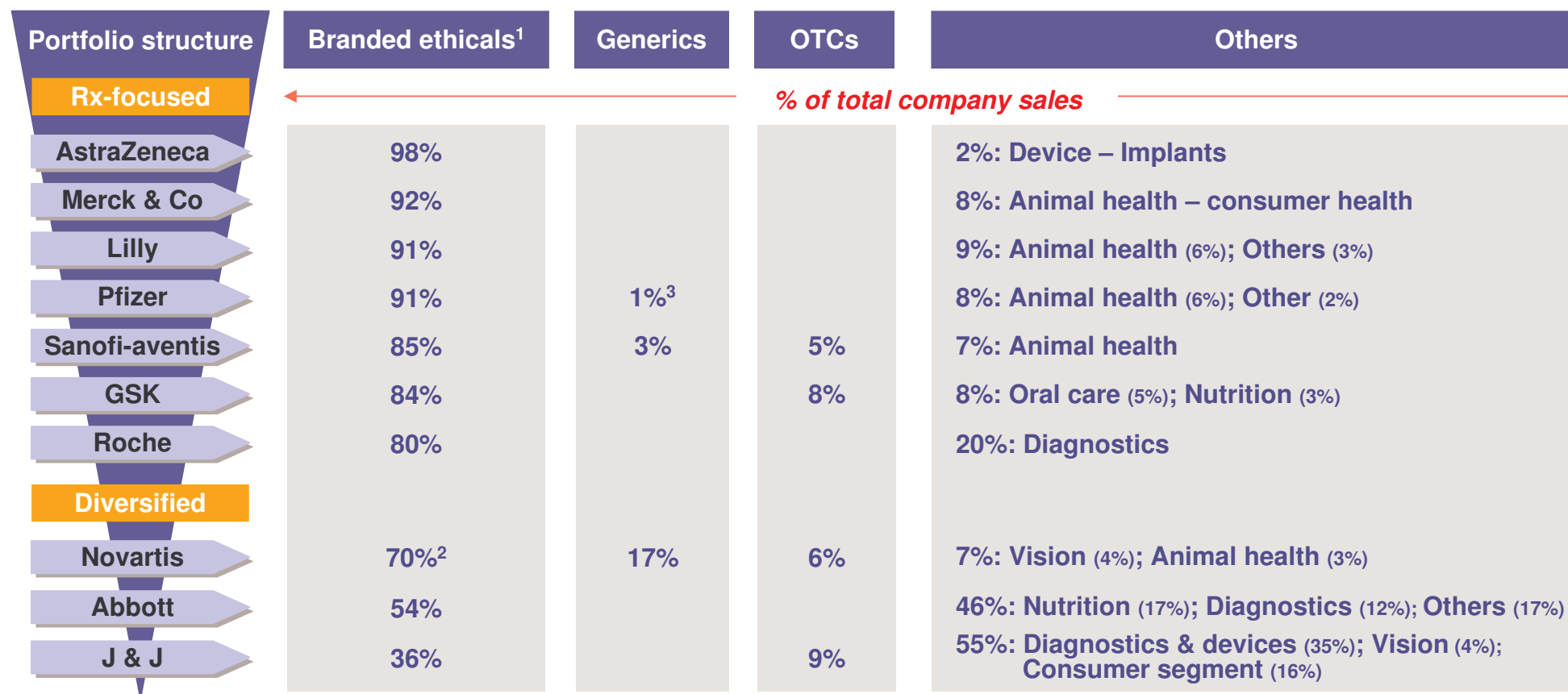
¹ Constant exchange rates, profits are shown after taxes, after extraordinary credits or charges and after cumulative effects of accounting changes – ² Compounded annual growth rate

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Key point # 2

Most leading pharma companies are still focused on the branded ethical segment which continues to be the most profitable one, exhibiting significant revenue growth

Business structure of the leading pharmaceutical companies (2009)



Source: Annual reports 2009 – Smart Pharma Consulting analyses

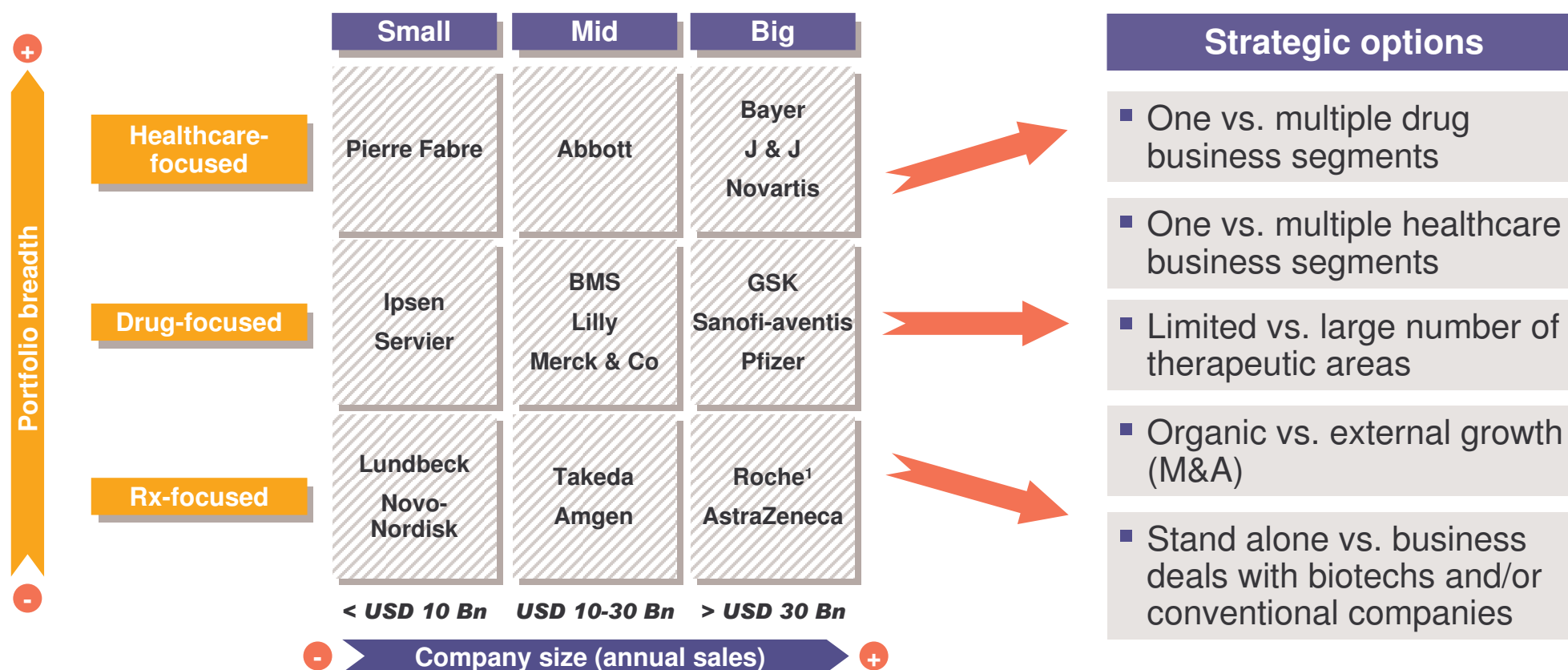
¹ Human drug business segments, including vaccines – ²“Vaccines and diagnostics” category weighs 5% – ³ Legacy from Wyeth

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Key point # 2

Pharma companies' diversification is not size dependent, even if a defensible competitive position in a business segment requires a minimum level of presence

Strategic portfolio matrix for pharmaceutical companies (2009)



Source: Annual reports 2009 – Smart Pharma Consulting analyses

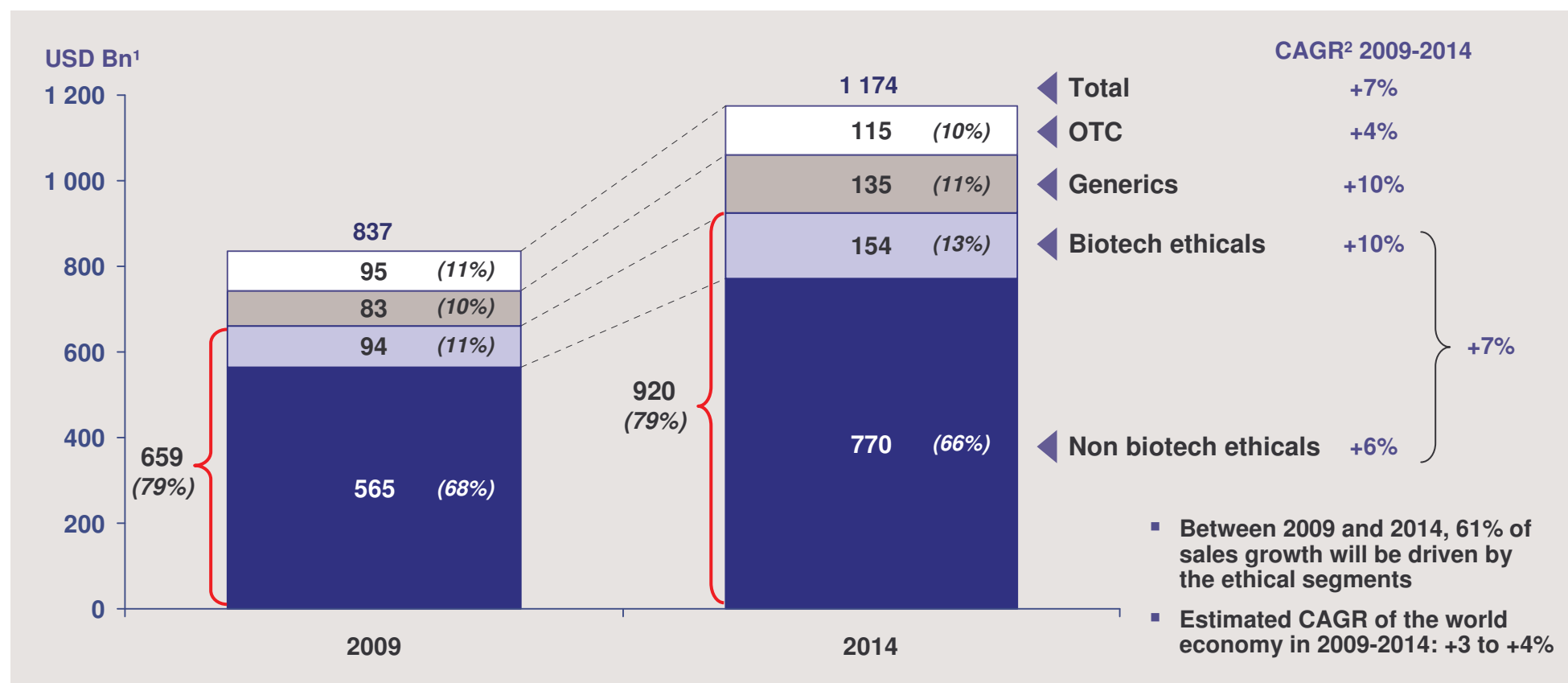
¹ Diagnostics activities have been considered as Rx-focused activities

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Key point # 2

Ethicals segments (biotech + non-biotech) will undoubtedly remain the largest and most attractive both in terms profitability ratio and absolute profit growth

Expected pharma sector growth by key strategic segment (2009-2014)



Source: IMS Health data – Nicholas Hall's OTC Yearbook – IMF data – Smart Pharma Consulting analyses

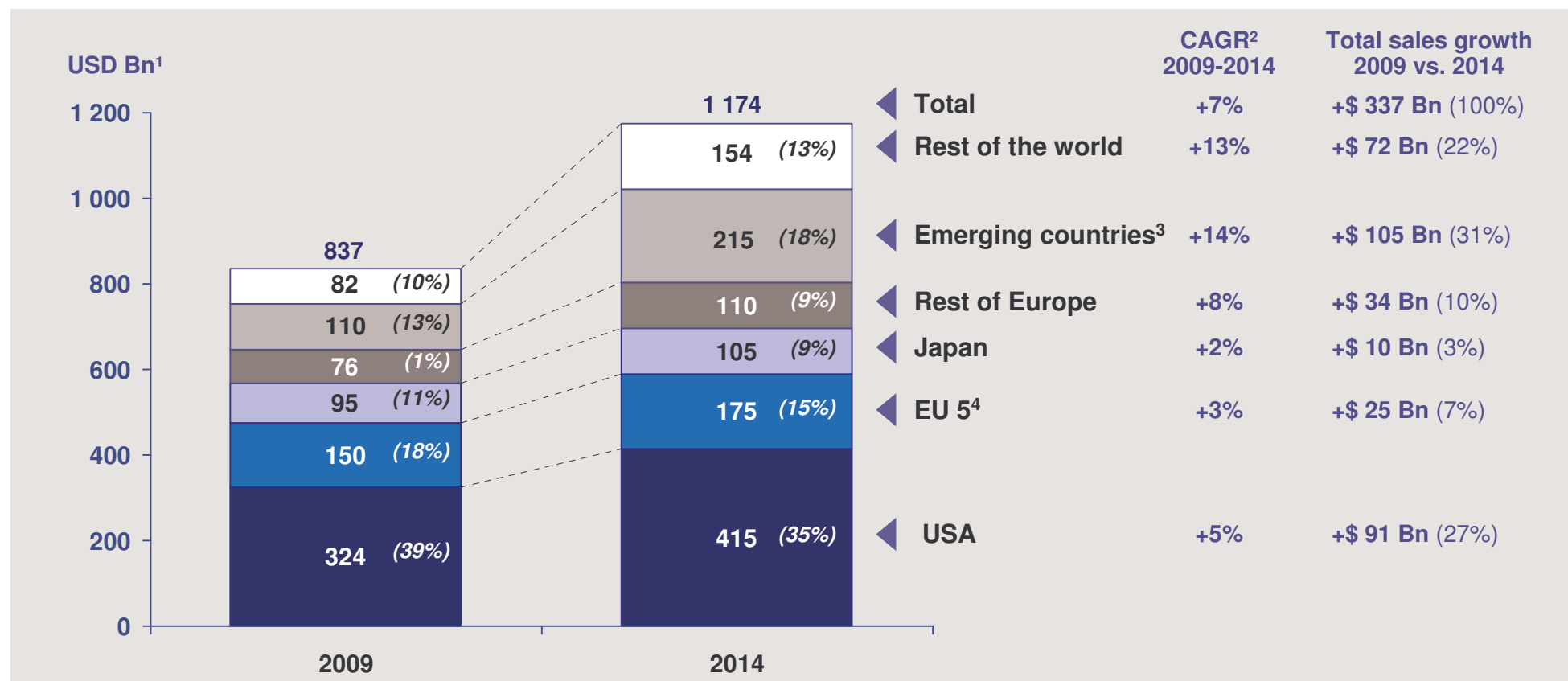
¹ Ex-factory price in constant currency, IMS audited sales – ² Compounded annual growth rate

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Key point # 2

By 2014, USA will become the 2nd contributor to growth, behind emerging countries, but just ahead of “rest of the world” markets which should not be neglected

Expected pharma sector growth by geographical area (2009-2014)



Source: IMS Health data – Nicholas Hall's OTC Yearbook – Smart Pharma Consulting analyses

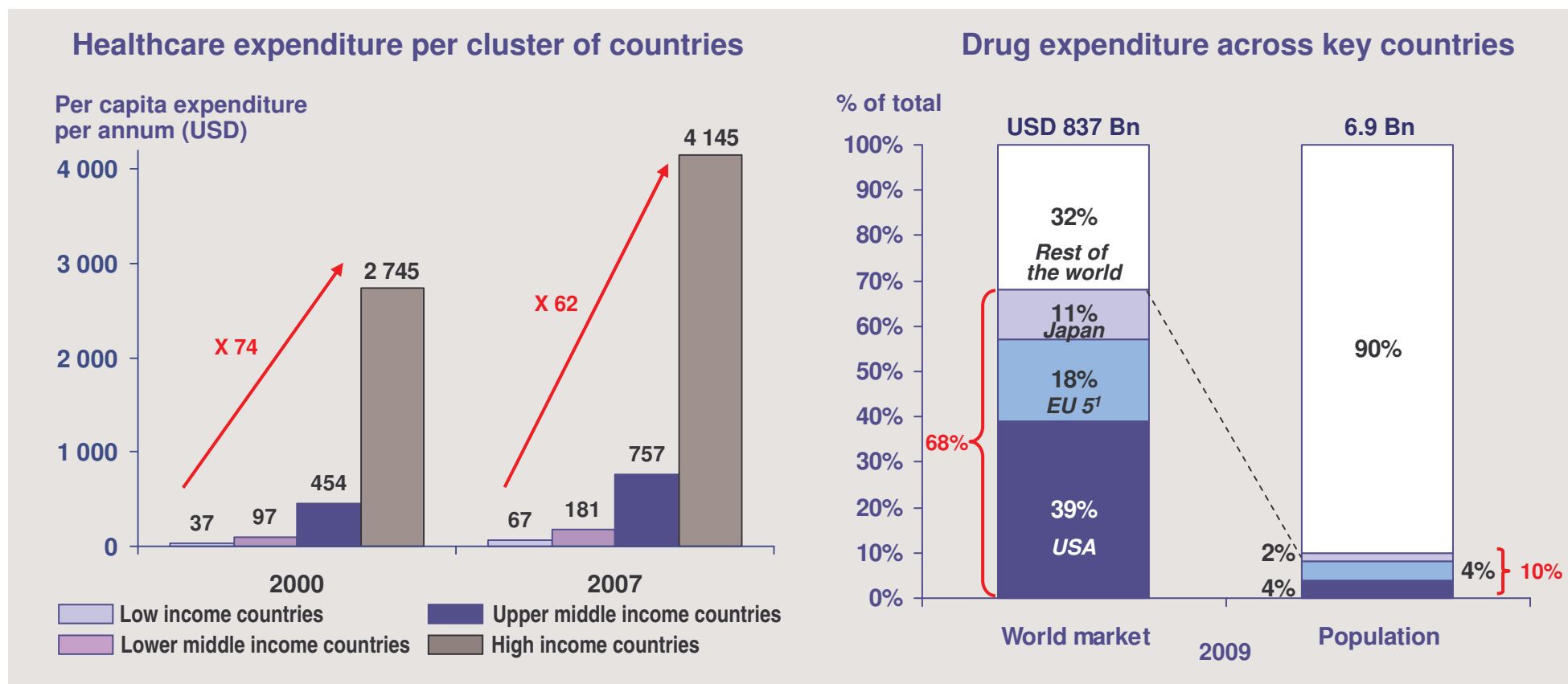
¹ Ex-factory price in constant currency, IMS audited sales – ² Compounded annual growth rate – ³ BRIC + Mexico, South Korea and Turkey – ⁴ France, Germany, Italy, Spain, UK

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Key point # 2

The wide differences in healthcare and drug expenditure across countries reflect the limited or absence of access for a large portion of the worldwide population

Healthcare and drug expenditure gaps across countries



Source: WHO 2010 – IMS Health 2010 – UN 2010 – Smart Pharma Consulting analyses

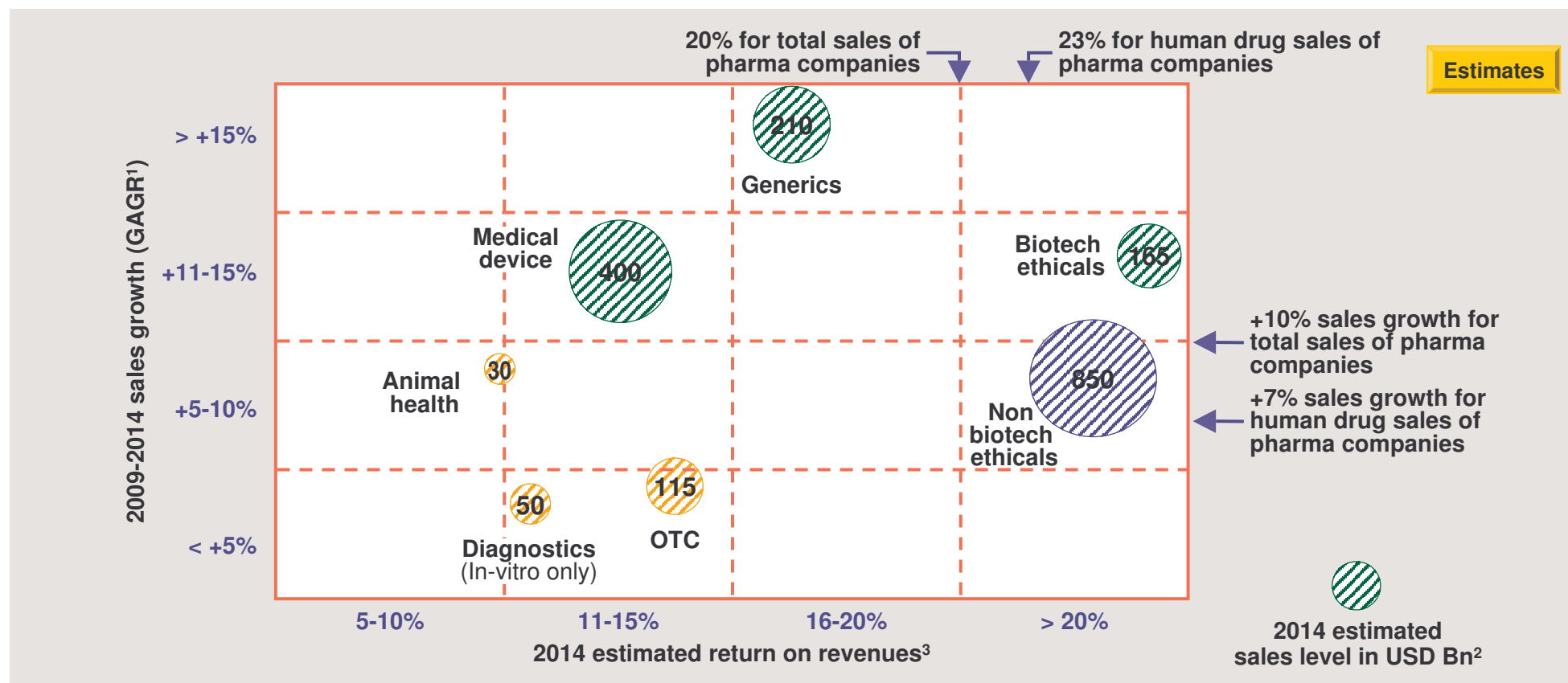
¹ France, Germany, Italy, Spain, UK

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Key point # 3

Diversification strategies outside of the ethicals market segments will boost sales and profit, mitigate business risks, but also deteriorate pharma companies' profitability

Growth potential per strategic segment (2009-2014)



Note: Vaccines are included within ethical segments. They should grow from \$ 21 Bn in 2009 to \$ 53 Bn in 2014 and maintain an average profitability of 20%

Source: Annual reports – Smart Pharma Consulting analyses

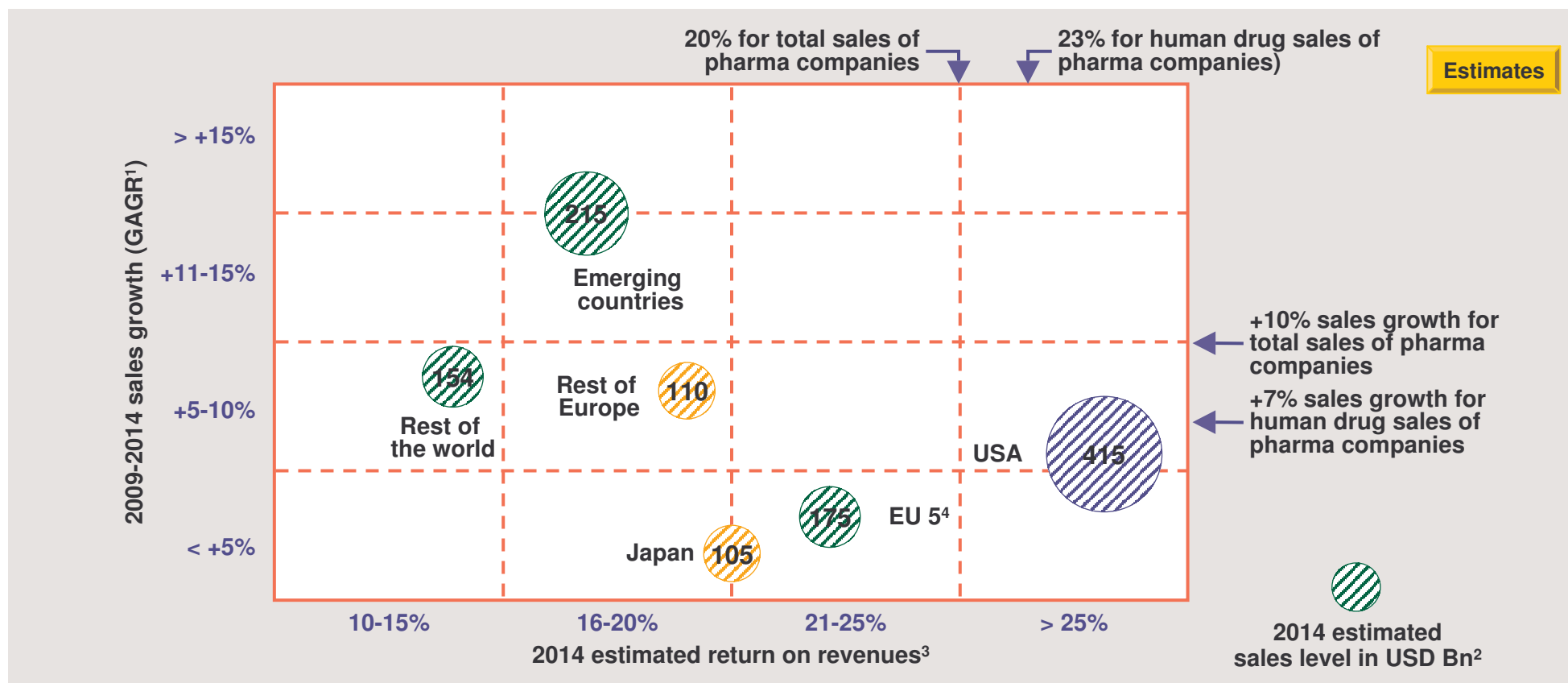
¹ Compounded annual growth rate – ² Ex-factory price in constant currency – ³ Profits after interests and taxes – ⁴ France, Germany, Italy, Spain, UK

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Key point # 3

To benefit from socio-geographical reservoirs, pharmaceutical companies should include cheap drugs in their offer to provide greater access to lower-income patients

Growth potential per socio-geographical area (2009-2014)



Source: Smart Pharma Consulting analyses

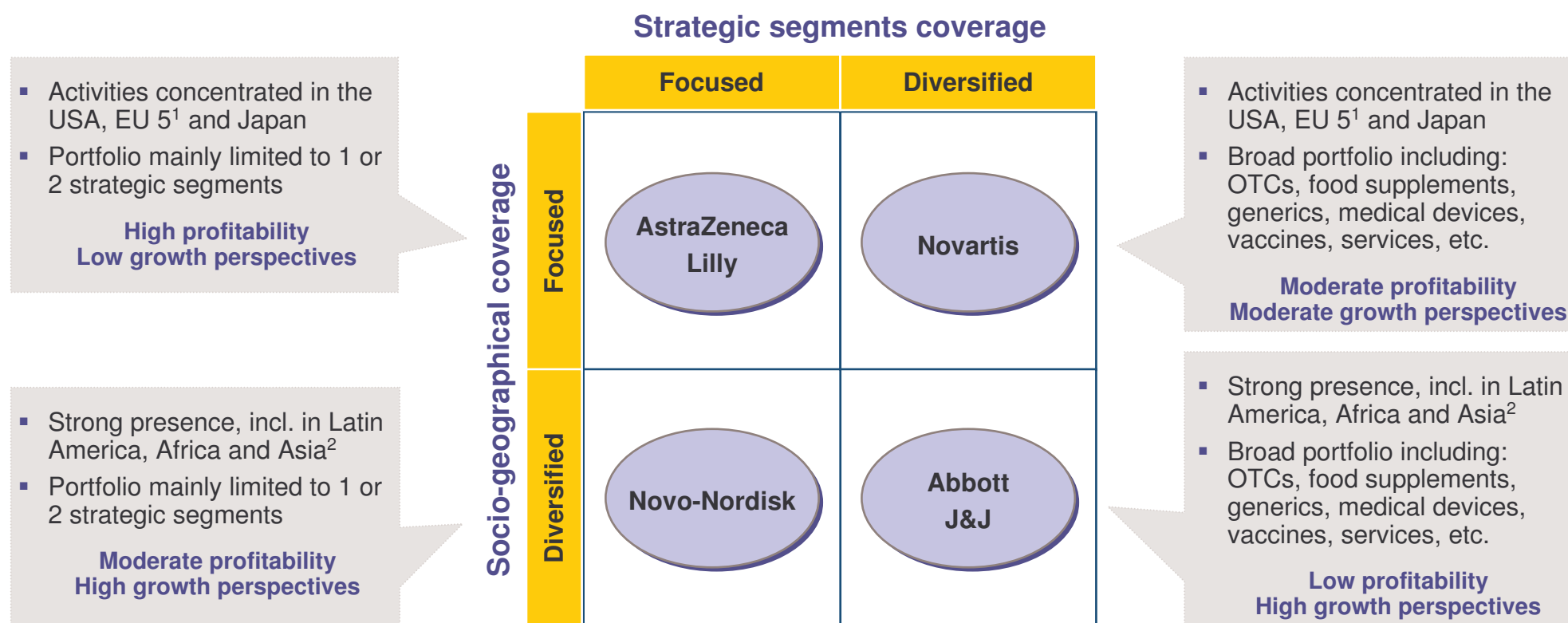
¹ Compounded annual growth rate – ² Ex-factory price in constant currency, including human drug sales only – ³ Profits after interests and taxes – ⁴ France, Germany, Italy, Spain, UK

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Key point # 4

If concentration strategies generate the highest profitability ratios, portfolio and socio-geographical diversification strategies will provide the highest profit growths

Pharmaceutical companies development strategy matrix: Principles



Source: Smart Pharma Consulting analyses





¹ France, Germany, Italy, Spain, UK – ² Including segments of the population with lower income and / or from rural areas

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Key point # 4

Although there is no one-size-fits-all winning strategy, the global healthcare strategic direction seems to be the reasonable long-term default option for big pharmas

Pharmaceutical companies development strategy matrix: Features

| Strategic development directions | Sales evolution | Profitability evolution | Profit evolution | Recommendations |
|--|-----------------|-------------------------|------------------|---|
|  Local ethicals | + | -- | + | <ul style="list-style-type: none"> Strategy showing highest ROI High risk strategy due to price pressure from payers and scarcity of breakthrough innovations Reservoir of growth on the low-priced me-too market¹ |
|  Local healthcare | ++ | -- | ++ | <ul style="list-style-type: none"> Diversification in new strategic segments should be carried out preferably through acquisitions to save time, take advantage of brand equity (especially in the OTC market) of know-how and of access to clients |
|  Global healthcare | +++ | -- | ++ | <ul style="list-style-type: none"> Portfolio diversification is best implemented through the acquisition of global players (e.g. Novartis and Chiron) Socio-geographical diversification is preferable through the acquisition of local leaders (e.g. Abbott and Piramal) |
|  Global ethicals | +++ | - | ++ | <ul style="list-style-type: none"> Geographical diversification implies an “aggressive” direct or indirect presence (through licensing-out deals) Social diversification requires a tier pricing policy or low-priced products to access low-income patients |

Source: Smart Pharma Consulting analyses

¹ The primary care market which accounts for 60% of the total pharma market offers opportunities for me-too products marketed at prices similar to branded generics or unbranded generics with a small premium

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Through diversification, leading pharma companies can manage to sustain high profit growths in the long term, but at the detriment of their current profitability

Key learning

- If pharma companies have managed so far to sustain high profitability levels, it is unlikely they will cope with the drastic cost-containment measures that will occur over the long term
- If pharma companies adopt a pro-active strategy of diversification, they will be able to maintain or even increase their current flow of operational profit
- Diversification should be carried out on top of pharma companies' core business (i.e. the highly profitable ethical segments in high-income countries) following two possible strategic directions:
 - Development in additional healthcare segments, more or less regulated such as generics, medical devices, diagnostics, animal health, such as OTCs, food supplements, etc.
 - Stronger socio-geographical presence in emerging and lower income countries, by marketing low-priced drugs and/or acquiring local brands to access most of the local populations
- However, as these diversification opportunities will be less profitable than the core business of pharma companies, investors and CEOs must be ready to accept lower profitability ratios
- Diversification will succeed or fail depending on the quality of execution and on the strategic relevance of acquired companies and negotiated partnerships

Source: Smart Pharma Consulting analyses