Mergers and Acquisitions in the Healthcare Industry

A collection of A.T. Kearney case studies
The dominant theme across today’s healthcare industry is uncertainty. Growth in global pharmaceuticals and biotech prescription drug sales fell from double digits in 2000 to a forecast of 4 to 6 percent by the end of 2010. Patent expirations in 2014 will put, on average, 46 percent of top 10 pharmaceutical companies’ revenues at risk. Regulatory pressure is building in terms of development and approval, and on the pricing and cost containment fronts. While Big Pharma can access big pockets to combat these forces, the precarious situation that smaller firms and the biotech sector face is exacerbated by significantly constricted credit.

Against this backdrop, pharmaceutical and biotech companies are turning to mergers and acquisitions as a way to bolster their pipelines and improve efficiencies. Figure 1 tracks M&A spending by the top 10 pharmaceutical firms, highlighting the mega-mergers in 2009.

While pharmaceutical and biotech mergers and acquisitions have captured most of the headlines, other healthcare sectors are not just standing on the sidelines. Hospitals, pharmacies and insurance companies are reinventing their business models and making strategic investments and acquisitions to improve access to healthcare, reduce costs and improve quality.

As for future M&A activity, likely scenarios include additional mega deals, acquisition of generic firms, and mergers and acquisitions of biotech and other niche players to bolster dwindling pipelines. Successful deals, regardless of size and type, share key elements:

- Robust due diligence
- Quick wins following post-merger integration
- Long-term strategic and operational improvements
- Improved pipeline development and portfolio management
These elements are built into A.T. Kearney’s approach to healthcare M&A engagements and reflect the firm’s combination of deep industry knowledge and broad functional expertise. More than 200 consultants from the firm’s global Healthcare and Pharmaceutical, M&A and Organization and Transformation practices offer expertise to top pharmaceutical firms, medical device and biotech companies, and healthcare providers and payors.

The following pages provide highlights of healthcare M&A projects that A.T. Kearney has assisted in recent years. As Figures 2 and 3 indicate, our A.T. Kearney teams have worked with clients through all stages of the process, from strategy planning to successful execution and in all business functions from R&D and procurement to manufacturing.

**Figure 2**
The nine case studies span deals across the M&A spectrum

<table>
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<th>Integration planning</th>
<th>Closing</th>
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*Note: Gray shading indicates A.T. Kearney focus.*
### Figure 3
The case studies involve a wide range of business functions

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<th>Research and development</th>
<th>Procurement</th>
<th>Manufacturing</th>
<th>Distribution</th>
<th>Commercial</th>
<th>G&amp;A* and organization</th>
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Note: Gray shading indicates A.T. Kearney focus.
*G&A is general and administration.

Source: A.T. Kearney analysis
“Excellent work — flawless performance.”

CPO OF ACQUIRER’S CONSUMER HEALTH DIVISION
When a large pharmaceutical company combined its consumer health division with that of another major firm, the result was a leading consumer health company with a broad product portfolio and global reach. The new company would operate across 50 countries and require a unique and rapid carve-out from the seller’s global footprint. Within the defined transaction period of six months, the team had to develop more than 100 transfer service agreements (TSAs) to manage the transition of products, assets, services and supplier relationships.

A.T. Kearney was involved from pre-merger planning through post-merger integration. Initially, the team helped define the deal’s synergies and value creation assumptions. Between deal announcement and close, the team assisted in pre-merger planning for the manufacturing, supply chain, distribution and procurement functions.

Merger integration aimed to ensure business continuity, build the new organization, and realize synergies and value. The team and participants from both companies held more than 50 pre-merger workshops to help jumpstart the integration.

- The team evaluated all major SG&A, manufacturing, distribution and procurement processes and developed 120 TSAs (prior to close) across 50 countries to ensure business continuity for the first six months after change in control.
- Following an organizational assessment, the team built the organizational design on a simple concept, leveraging best practices from both organizations.
- More than 150 (pre-defined) post-merger integration projects were launched within the first 30 days after change in control.

The results were impressive by any measure. The combined organization was fully functional after a three-week transition period. The leaders were able to:

- Execute the entire carve-out transaction without significant business interruption
- Realize significant procurement and contract manufacturing synergies within the first 100 days after change in control
- Accelerate the overall timeline of product and distribution resittings or changes, allowing a large percent of the key TSAs to be retired earlier than expected
“Excellent planning and execution of this pre-merger planning and post-merger integration project by A.T. Kearney.”

CHIEF PROCUREMENT OFFICER
Top 10 pharmaceutical company
In 2007, a top 10 U.S. pharmaceutical company acquired the pharmaceutical business of a leading European conglomerate in order to expand into international markets and improve its product pipeline. The transaction carved out prescription, animal health and consumer health businesses that operated independently within a larger business unit.

A.T. Kearney focused on integrating distribution and procurement in the supply chain. The distribution team aimed to realize short-term synergies from consolidating in-country distribution and third-party logistics provider (3PL) agreements in more than 100 countries. An additional goal was to define the mid- to long-term distribution network structure in North America and Europe. In North America, the team assessed the need for dedicated business-specific distribution channels and defined their structures. In Europe, the firm moved from a country to a regional distribution model that included direct-to-hospital, direct-to-pharmacy and direct-to-patient channels.

To integrate procurement, the team defined synergy projects and prepared them for immediate implementation:

- Validated initial synergy targets
- Identified and prioritized more than 100 projects through cross-company synergy summits
- Grouped projects into best price opportunities to address overlapping direct items and suppliers, rapid sourcing opportunities to leverage volume and consolidate suppliers, and custom sourcing opportunities for complex categories
- Prepared documents such as supplier letters and RFPs along with plans for implementation immediately after Day 1
- Combined detailed analyses with state-of-the-art sourcing tools and techniques such as parametric pricing models to realize the opportunities.

Within six months after Day 1, the company had saved more than 15 percent on the combined distribution spend through consolidating distribution facilities and 3PL agreements in more than 100 countries. The procurement work stream achieved even more impressive results: it overachieved initial targets by 100 percent. The company realized 50 percent of procurement savings within six months of change in control and saved double-digit percentages on key categories.
In the first four months, we helped the company identify cost reduction opportunities that exceeded the first-year target by 50 percent.
In a perfect illustration of rapid multi-company industry consolidation, two large pharmaceutical companies merged to create one of the world’s largest prescription drug companies. The acquired company had already carried out a series of recent mergers and acquisitions. The acquiring company broadened its product portfolio and doubled the number of drugs in Phase III development. The acquirer also foresaw potential savings in the multi-billion dollar range.

A.T. Kearney customized its established “JumpStart” approach to develop integration plans more rapidly. Working within the highly regulated pharmaceutical industry, A.T. Kearney was able to talk to both parties separately before Day 1 and developed plans for integrating procurement, contract manufacturing and research:

- Guided 20 global cross-functional teams to develop strategies for achieving short- and medium-term synergy targets as well as establishing a platform for long-term wins
- Worked with R&D leaders from both organizations to design and establish a best practice operating model for managing contract research organizations (CROs) and labs that would improve speed to market and balance costs, capabilities and risks
- Supported decentralized management of direct materials spend across more than 60 acquired sites. The team gathered and analyzed data necessary to achieve savings and optimize the supplier base for API/intermediates, chemicals, packaging and contract manufacturers

In this ongoing implementation, the client identified cost reduction opportunities in the first four months that exceeded the first-year target by 50 percent. The client is continuing to manage strategic trade-offs, and the team continues to expand and accelerate synergy opportunities while positioning the merged organization for long-term success.
With a best-fit logistics service provider, the company expects to reduce warehouse and freight costs by about 15 percent.
A.T. Kearney’s client acquired a peer and created a leading global healthcare company through one the largest M&A transactions of the decade. This acquisition freed the company from its dependence on small molecules and positioned it for stable top-line growth. The combined organization also targeted synergies of more than $4 billion to be realized within three years.

Integrating the distribution network of the two legacy organizations was a top priority. Leaders realized that integrated distribution was necessary to leverage the combined scale and drive many of the synergies. A.T. Kearney assisted in logistics integration with a focus on Spain:

• Joint teams assessed logistics service providers (LSPs) against both quantitative and qualitative criteria such as infrastructure capacity, financial strength, readiness and flexibility, service, quality and transition risk. A.T. Kearney also guided the transition team in negotiations with LSPs.
• Assessed rationale, risks and mitigation actions for each transition activity, and developed a communication and transition monitoring plan
• Presented LSP selection results and transition plan to the Board of Directors to gain their buy-in

Following selection of the best-fit logistics service provider, the company expects to reduce warehouse and freight costs by about 15 percent. Implementation continues in line with the detailed transition road map. A.T. Kearney is currently in discussions with the company to support integration of logistics in five additional European countries.
Due to ramping up five months early, initial savings hit the bottom line within weeks, rather than months.
CASE STUDY

Capturing Purchasing Synergies in Acquisition by Large CPG Company

A consumer and healthcare products company acquired a rival to create a leader in household and personal care markets. With the organization’s total purchasing spend representing more than half of combined revenues, procurement was a key lever in generating savings, and called for speed. However, the government’s anti-trust review was expected to cause a several months delay in change of control and therefore prevent the acquiring firm from beginning to substantiate and plan the integration.

Beginning five months before the change in control, A.T. Kearney clean room management consultants acted as an independent third-party conduit between the two companies. The team used the “JumpStart” approach to determine and realize synergies in the pre-merger phase. JumpStart provides for deep analysis, strong organizational mobilization and thorough preparation for execution. In this case, the team carried out the following activities:

- Reviewed the global operational savings across all direct and indirect spend categories, focusing on the largest suppliers and contracts
- Facilitated synergy workshops with hundreds of buyers from both companies to meet and agree on strategy before change of control.

Thanks to ramping up five months early, initial savings hit the bottom line within weeks, rather than months. At closing, plans were in place for more than 80 percent of the legacy firms’ overlapping spend areas. A week later, approximately 90 percent of the combined supply base was engaged. The company achieved double its initial savings targets one year ahead of time and was able to avoid typical M&A implementation delays.
Since its inception, A.T. Kearney had partnered with the venture’s management team and private equity backer.
A healthcare company was formed as a private-equity backed acquisition focused on specialist therapeutic areas, seeking candidates with attractive growth and margin prospects and low costs to serve. One early acquisition provided a platform technology, mid-stage development candidate and a bundle of cash-generating products with local and export sales. Over five years, the venture has become international—building up coverage in major European markets, and is on the verge of establishing a commercial operation in the United States. Its key development candidate, which will transform the company, is in the last stages of regulatory approval.

A.T. Kearney has partnered with the venture’s management team and private equity backer since its inception. More than a dozen separate mandates have focused on strengthening the portfolio and revenue base, involving activities such as:

- Assessing markets, identifying and profiling targets across numerous geographies and therapeutic areas
- Analyzing and forecasting markets for new products
- Carrying out pre-bid and bid due diligence and supporting management on acquisition opportunities
- Supporting post-acquisition and operational planning to maximize commercial growth potential
- Supporting the management team during its recent refinancing, preparing a commercial review of the business and its prospects

Over the past five years, the venture has grown from concept to viable business with a strong commercial footprint in key European markets. The business has successfully secured multi-million dollar financing to take it to the next level, with the launch of a break-through product and the establishment of commercial operations in the U.S. market.
The pharma deal ranks among the top 10 M&A transactions of the year in China.
A consortium of three large private equity firms was interested in investing in China’s largest pharmaceutical company, which was owned by the state.

The consortium asked A.T. Kearney to conduct due diligence on the target company and market. The engagement required insight into the business and the Chinese market for both chemical and traditional Chinese medicine. In addition, the five-person team worked under typical due-diligence pressures of scope, time and data constraints to carry out its tasks:

• Assessed attractiveness of Chinese pharmaceutical market for both chemical and traditional Chinese medicine
• Analyzed the competitiveness of the target company
• Assessed the overall strategic position of the target company

Drawing upon the due diligence conducted by the A.T. Kearney team, the investment consortium completed the acquisition of the target company. The deal ranks among the top 10 M&A transactions of the year in China.
“We will definitely hire A.T. Kearney again for this type of due diligence.”

INVESTMENT DIRECTOR
Private equity firm
A U.S.-based global private equity firm was bidding for a European private umbilical cord blood bank (UCBB) that had recently entered the Spanish market.

The private equity firm asked A.T. Kearney to conduct the market and commercial due diligence on the UCBB market and to provide an independent recommendation on the potential investment. The team faced two challenges: the lack of public information on this small niche sector and the accelerated timeline of three weeks. Nonetheless, the team accomplished its mission:

• Projected the market over the next five to 10 years through interviews with more than a dozen subject matter experts including medical practitioners and scientists active in this field
• Provided estimates of market size and penetration in benchmark countries, mapped competitors, characterized the value chain, and evaluated the dynamics in markets with public blood banks versus private markets
• Generated an alternative business plan that included sell-side and buy-side cases, after challenging the target company’s business plan and feasibility assessment
• Evaluated the financial feasibility of the transaction. While investment banks usually conduct these analyses, the A.T. Kearney team drew upon its significant corporate finance experience to provide this level of support in a short time.

The A.T. Kearney-authored business plan was used to secure financing from banks for the management buyout. The private equity firm acquired a 67 percent stake in the target company. The acquisition of the blood bank represents the first step in creating a European leader in the collection, isolation and cryopreservation of stem cells. Building on the blood bank’s strong market position in Portugal and Spain, the PE firm plans to increase the group’s international presence by acquiring leading companies in different geographies and diversifying into services related to stem cells and genetic diagnostics.
The clock was ticking. Executives had only two weeks to submit a final bid, and needed a recommendation within 10 days.
CASE STUDY

Rapid Commercial Due Diligence on a Contract Research Organization

A private equity firm was considering the acquisition of a mid-size contract research organization (CRO) that appeared to have higher than normal SG&A costs. To develop its bid, the client needed to understand SG&A in this CRO and potential opportunities to reduce costs. But the clock was ticking rapidly: the client had been down-selected, and with two weeks to submit a final bid, needed a recommendation within 10 days.

The company turned to A.T. Kearney to provide the necessary information. The team:
• Documented how key SG&A processes are performed and what resources are required
• Developed baseline of operating cost by function, focusing on the high-cost areas
• Evaluated key functions against benchmarks, highlighting opportunities to improve by aligning resources, consolidating, improving processes, outsourcing and automation
• Delivered a report on the opportunities, which the client used to validate the investment thesis and establish its offer

Partnering with A.T. Kearney enabled the client to refine its operational assumptions and generate a competitive bid. The team identified short-term cost reduction opportunities of 5 to 11 percent, with an additional 12 to 18 percent targeted in the longer term. Furthermore, improved resource management and project selection could improve utilization by 15 to 20 percent.
A.T. Kearney is a global management consulting firm that uses strategic insight, tailored solutions and a collaborative working style to help clients achieve sustainable results. Since 1926, we have been trusted advisors on CEO-agenda issues to the world's leading corporations across all major industries. A.T. Kearney’s offices are located in major business centers in 37 countries.

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