# Competitive Analysis of U.S. Pharmaceutical Industry

## Revenue & Growth Trends, SWOT Analysis, Ratio Analysis & M&A Assessment, 2011

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SECTOR FOCUS
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# Table of Contents

**List of Figures**

**List of Tables**

# 1. Introduction

"Competitive Analysis of U.S. Pharmaceutical Industry, 2011" report is a detailed analysis of leading pharmaceutical companies in the U.S. pharmaceutical industry. Players analyzed in the report are – Pfizer, Merck, AstraZeneca, Novartis and Eli Lilly. Comparative analysis of companies is done on the basis of their sales and profits and other financial information. Detailed Ratio Analysis compares these companies on the basis of their revenue growth, profitability, efficiency, financial strength and investment returns. Report also presents a brief profile and SWOT Analysis of these companies along with their financial analysis and ratio analysis vis-à-vis industry. Lastly, report analyses the M&A activity in the U.S. Pharmaceutical Industry in recent years.

## 1.1. Key Takeaways

- U.S. healthcare spending in 2010 was US$2.3 trillion or 16% of GDP, more than any other country in the world. United States is the largest pharmaceutical market globally, with 2010 sales of US$307 billion or 40% of global sales.
- In 2010, U.S. pharmaceutical sales grew at 2.3%; and since 2001 market has grown at a CAGR of 6.6%. Pharmaceutical sales in the United States are expected to reach US$328 billion in 2011 and up to US$420 billion by 2015; growing at a CAGR of 6.4% between 2010 and 2015.
- Highly competitive industry with top 5 companies accounting for leading the pack is Pfizer with a market share of 8.52% followed by Merck (6.11%), AstraZeneca (5.95%), Novartis (5.1%) and Eli Lilly (4.65%).
- Merck, AstraZeneca and Eli Lilly had the best profit margins among the peer group while Pfizer and Eli Lilly had better financial condition and efficiency ratio. In terms of investment ratios, AstraZeneca and Eli Lilly are better placed than their peers.
- In last 2 years, apart from Merck, all other companies ended the period with a positive growth in their share prices with Novartis leading the peer group with 17% increase in its share prices.
- With most of the Big Pharma companies already facing or likely to face patent challenges for their blockbuster products, the companies have been looking towards M&As and in-licensing

activities to make up for the loss of revenues that will arise with key products losing patent exclusivity.

## 1.2. Research Methodology

Indagatio Research's industry and company reports are based on the primary as well as secondary research conducted by its in-house team of researchers and analysts. Exhaustive desk research is conducted to source qualitative and quantitative data from a variety of secondary resources like:

- industry associations and trade journals
- national government websites
- broker and analyst reports
- company websites
- annual reports and SEC filings, and
- news articles and press releases

Indagatio Research then conducts primary research using surveys and interviews to fill in the gaps and incorporate the information that is not otherwise available.

All the collected data is then send to our team analysts, who perform data analysis and forecasting using various statistical tools, including MS Excel and SPSS.

Final data is then validated by our team of industry specialists and experts and if required, data is adjusted as per their directions.

From time to time we update our reports in order to give our clients most up to date information.

## 1.3. Industry Definition

This industry comprises companies that manufacture biological, medicinal and pharmaceutical products in various forms including ampoules, tablets, capsules, vials, ointments, powders, solutions and suspensions. The pharmaceutical companies develop, produce, and market drugs licensed for use as medications. Pharmaceutical companies can deal in generic and/or brand medications. They are subject to a variety of laws and regulations regarding the patenting, testing and marketing of

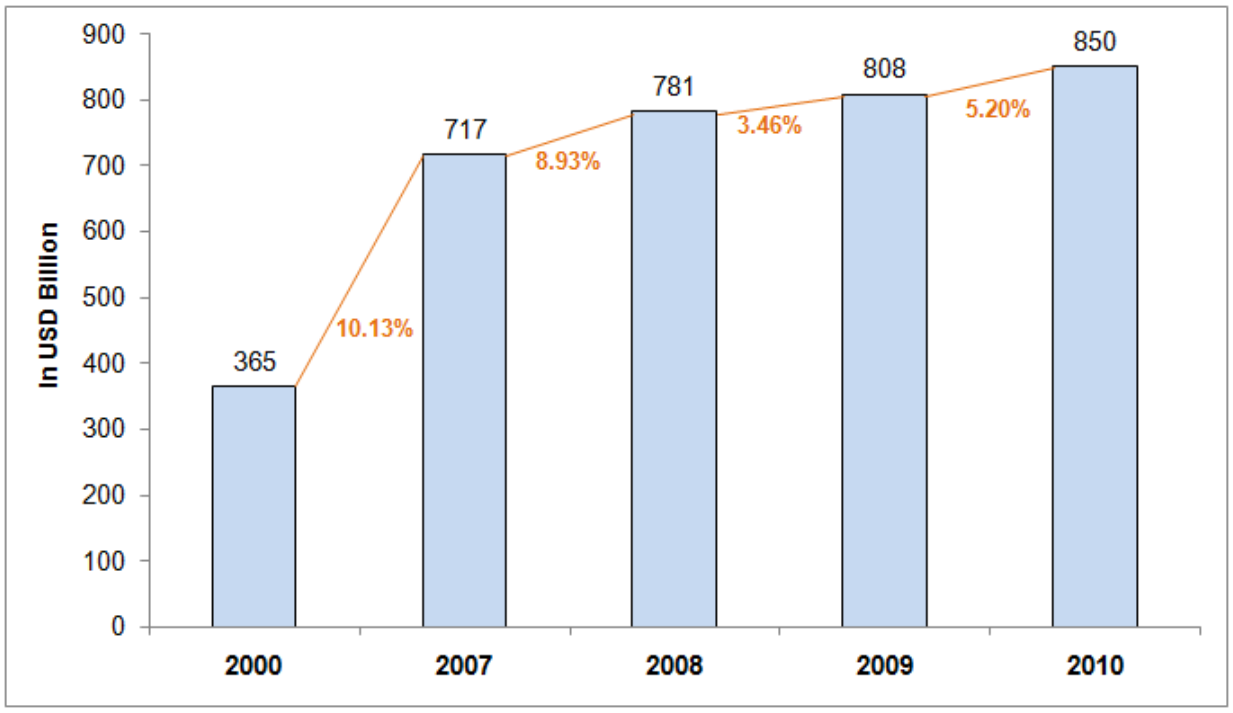
drugs. The products are predominantly distributed via wholesalers and are then sold through a variety of channels including pharmacies and hospitals.

# 2. U.S. Pharmaceutical Industry

## 2.1. Overview

In recent years, global pharmaceutical industry has undergone dramatic changes, spurred on by pricing pressures, the emergence of new channels and new markets, considerable generic growth and the development of specialist driven, low volume products as opposed to high value, high volume primary care blockbuster products. Global financial crunch further dented any growth opportunities that pharma giants could have explored. Despite these constraints, global pharmaceutical industry grew at an annual growth rate of 3.5% in 2009 and 5.2% in 2010. In 2010, global pharmaceutical industry generated revenues of more than US$850 billion, compared to US$808 billion in 2009 and US$781 billion in 2008. Over the last decade, industry has grown at a compound annual growth rate (CAGR) of 8.8% from US$365 billion in 2000.

*Figure 1: Global Pharmaceutical Industry Size in USD Billion, 2000-2010*




*Source: IMS Health*

The next five years are expected to reflect a significant imbalance between new product introductions and patent losses. According to IMS Health, this is the main reason global pharmaceutical market growth will be restricted to the mid-single digits (5-8%) through 2015. Over the next five years, products that currently generate more than US$142 billion in sales are expected to face generic competition. In fact, 2011 itself will see products worth more than US$30 billion losing patent protection. This includes products like Lipitor, Plavix, Zyprexa and Levaquin. These

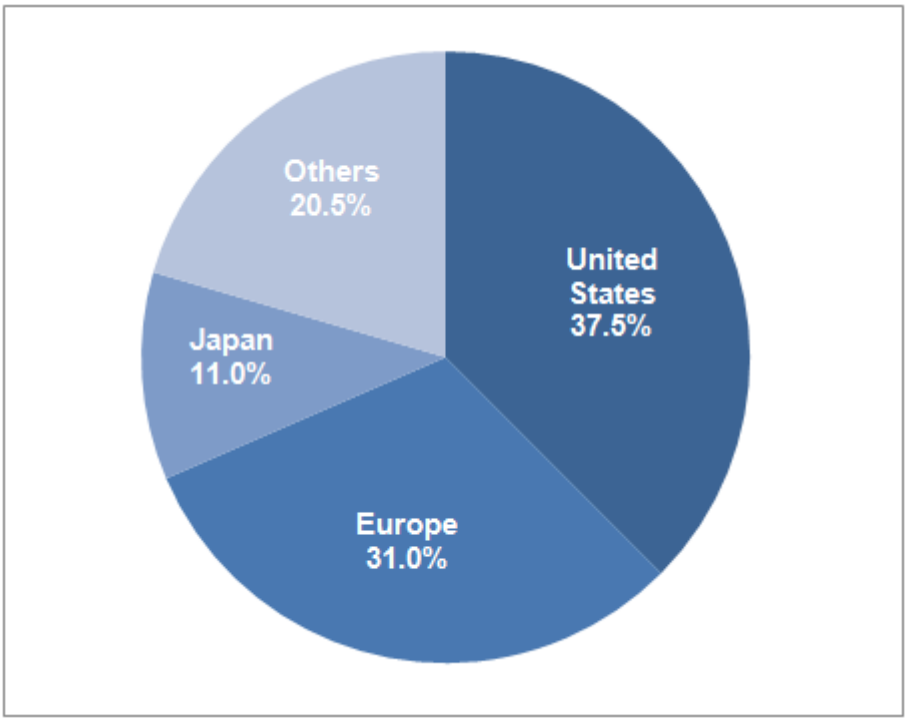
products generated more than US$15 billion in sales in 2010. The effect of the genericization of these products will be felt mostly in 2012, which will be a challenging year for several companies. At the same time, new products are not expected to generate the same level of sales as products losing patent protection. With revenue growth stalling or slowing down, companies have been resorting to cost-cutting and share buybacks to drive bottom-line growth.

## 2.2. Current Industry Size

The United States is the single largest pharmaceutical market globally, accounting for more than 40% of the world's pharmaceutical sales. It is also home to some of the world's largest pharmaceutical manufacturers such as Pfizer, Merck & Co, and Bristol-Myers Squibb. The U.S. pharmaceutical industry has thrived because of the success of U.S. drugmakers in creating novel blockbuster drugs and their ability to penetrate the global market. Over the past two years, however, the U.S. pharmaceutical industry has faced a number of macroeconomic challenges and industry specific issues such as inflation, government healthcare policy, declining levels of innovation, patent losses, among others.

The United States has a relatively free market in pharmaceuticals compared with most other industrialized countries. In fact, by law the federal government is not allowed to negotiate with drug suppliers in order to get better prices. Health plans seek to contain pharmaceutical costs through a variety of methods, including reference pricing, which discourages the use of unusually expensive brands of prescription drugs, formularies (lists of medicines approved for insurance cover) and co-payments. Co-payments may be tiered, for example, requiring patients to contribute more for brand-name drugs than for generics. Medicaid (a joint federal-state program for low-income earners) provides prescription drug cover for its beneficiaries. Advertising for prescription drugs to consumers is relatively unrestricted (protected by constitutional rights to free speech), and this is an important marketing channel in the United States.

*Figure 2: Market Share of Leading Pharmaceutical Markets, 2009*

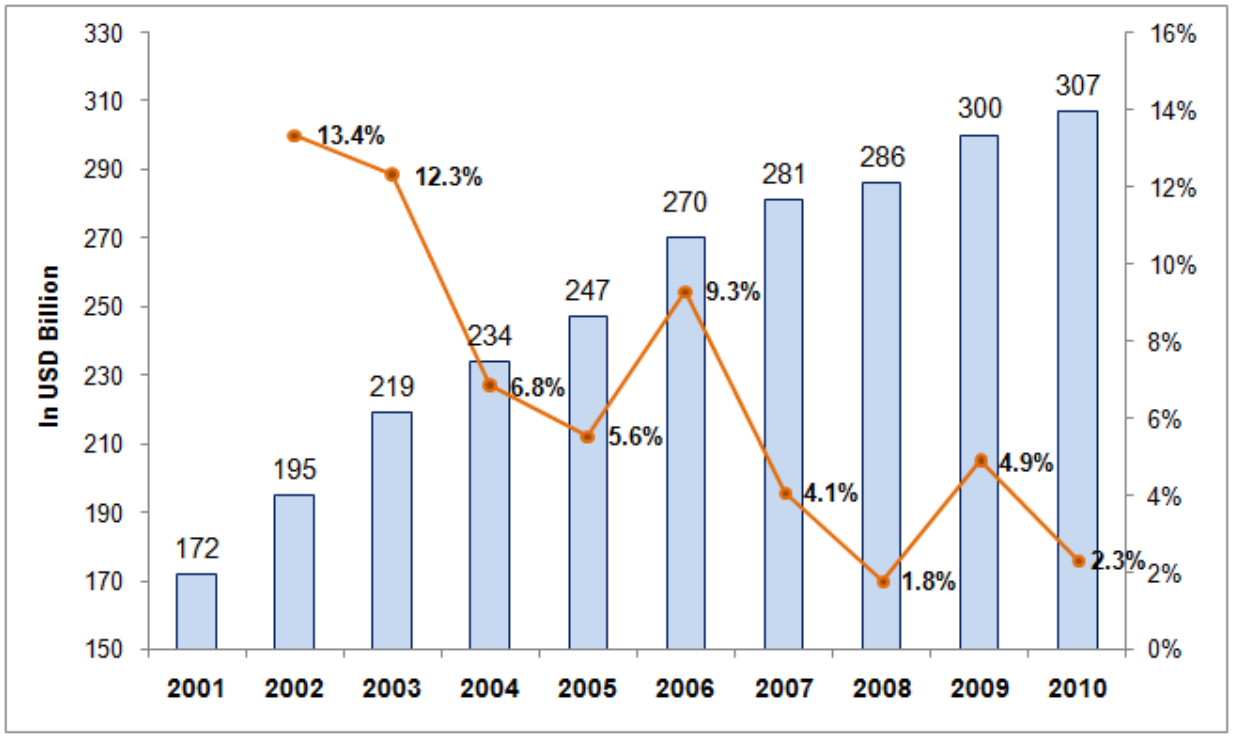



*Source: IMS Health*

U.S. pharmaceutical industry is the global leader in medical innovation, with more than 300 new medicines approved by the Food and Drug Administration (FDA) in the last decade. In 2009, United States was the largest market for pharmaceutical sales, with a market share of 37.5%; followed by Europe (31%) and Japan (11%). Only about one-third of the drugs approved annually in the United States are new compounds; the rest represent modified forms of existing drugs. A record US$67.4 billion was spent in 2010 on biopharmaceutical R&D, an increase of 6.5% from 2009.

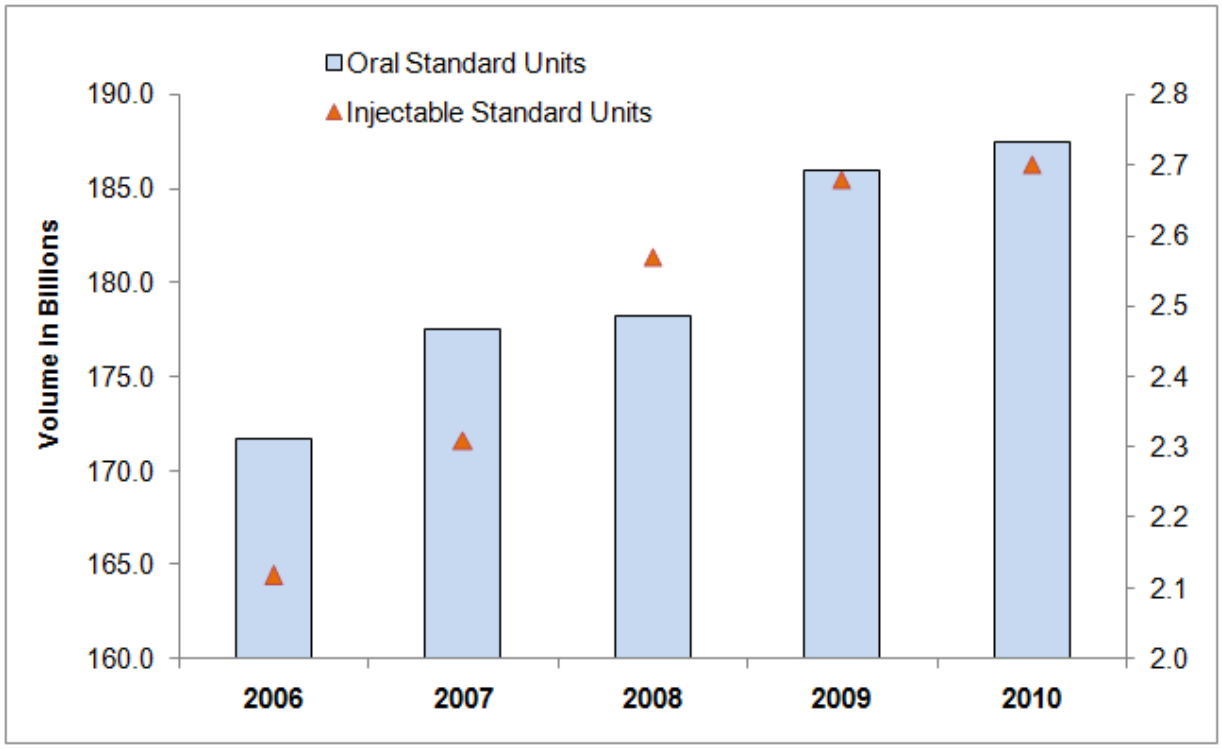
Pharmaceutical majors in the United States saw their sales growth fall back in the first half of 2010, with sales growth ranging from above the global market average of 6-7% to negative growth. One reason was that the majors faced the realities of diminished research pipelines, as well as competition from generics and also emerging markets. However, in the second half of the year, most of the U.S. based pharma giants recovered and rebounded primarily due to the global recovery and the U.S. healthcare reforms, which began to show their affect the industry's financial results.

*Figure 3: U.S. Pharmaceutical Industry Size in USD Billion, 2001-2010*




*Source: IMS Health, Indagatio Research Analysis*

*Figure 4: U.S. Sales Volume of Oral Standard Units and Injectable Standard Units, 2006-2010*



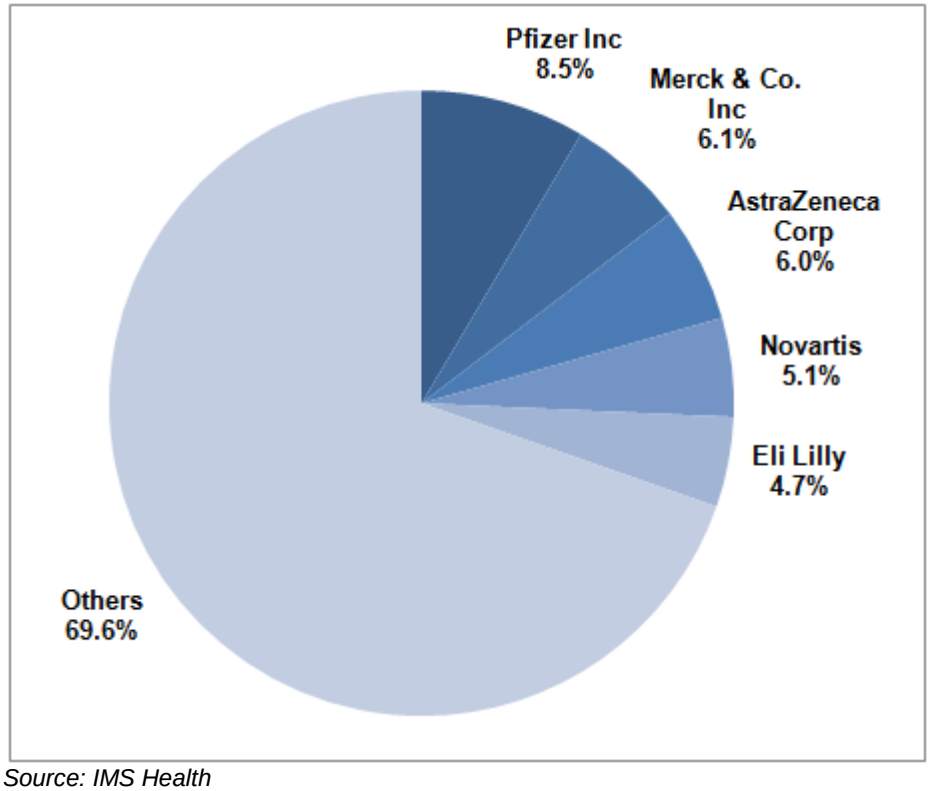

*Source: IMS Health*

# 3. Comparative Analysis of Key Players

## 3.1. Competition Overview

The U.S. pharmaceutical industry is highly competitive with four out of the top ten pharmaceutical corporations worldwide in 2010 were U.S.-based. In recent years though, market has become even more competitive, both within the branded as well as the generic product segments. The "Big Pharma" companies compete among themselves and almost all of them are active in R&D and production of drugs in the segments with the highest potential – such as treatment of infectious, cardiovascular, psychiatric or oncology diseases. In 2010, Pfizer was the market leader with 8.52% market share followed by Merck (6.11%), AstraZeneca (5.95%), Novartis (5.1%) and Eli Lilly (4.65%).

*Figure 7: Market Share of Top Players in U.S. Pharmaceutical Industry, 2010*




*Source: IMS Health*

For the branded and patented products, competition is mainly based on product innovation and R&D. Product innovation in turn tends to be expensive, and involves a high degree of risk as well as long lead times; only one in 5,000 new chemicals discovered actually becomes a medicine. In addition, just three out of 10 approved products recover their R&D costs, while it generally takes around 10 to 15 years and over a US$1 billion to develop a new product. As a result, most companies concentrate their research and development within selected therapeutic classes and

competition is focused on producing either a breakthrough product or a product to compete with a breakthrough product.

*Table 3: U.S. Pharmaceutical Companies by Sales in USD Billion, 2006-2010*

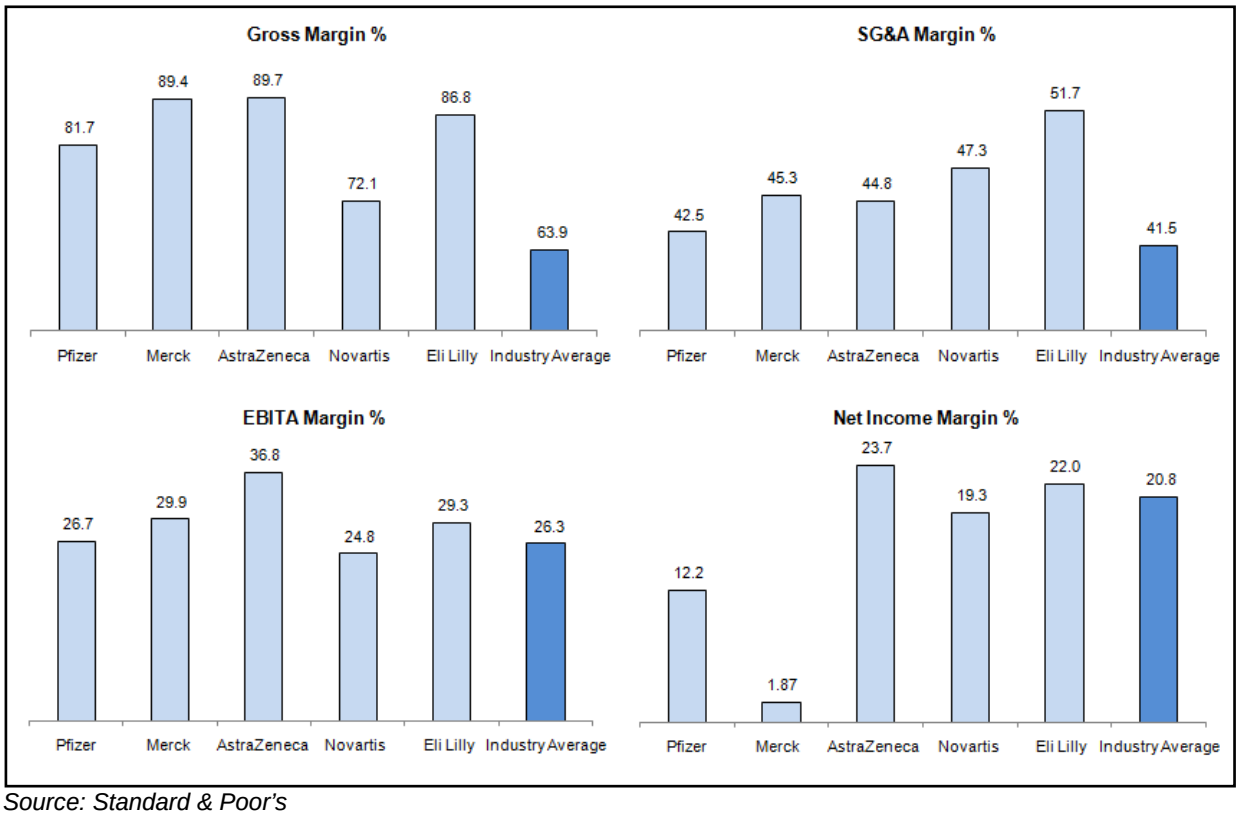
## 3.2. Ratio Analysis

### 3.2.1. Profit Margins

In 2010, Merck (89.4%) and AstraZeneca (89.7%) had the best gross profit margins among the companies that are analyzed in this report and were way better than the industry average of 63.9%. In terms of SG&A margins, all the companies were around the industry average of 41.5% with the exception of Eli Lilly that had SG&A margins of 51.7%. Industry average for EBITA margin was 26.3%; at 36.8%, AstraZeneca had the best EBITA margins among the peer group. Net Income margins for pharmaceutical industry in 2010 were 20.8%; while all the major players hover around this number, Pfizer (12.2%) and Merck (1.87%) had very low net income margins vis-à-vis industry

average and peer group. Pfizer's low margins are attributed to the expenses associated with the acquisition on Wyeth while for Merck it was the growing operating expenses and company's high cost business model.

*Figure 8: Comparative Profit Margins of Top U.S. Pharma Companies, 2010*




*Source: Standard & Poor's*

### 3.2.2. Financial Condition and Efficiency

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