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Action Trumps No Action

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The US$13.7 billion question this summer is, "What do you think about Takeda's acquisition of Nycomed?" If you do not answer instantly the person posing the question will wax eloquently about what he or she thinks.

Answers to the question come in many forms. Here are a few examples:

"Takeda paid too much."

"No one else wanted to buy the company."

"Nycomed has no pipeline of new products."

"Integrating Nycomed's 12,500 employees will be a major challenge."

"Takeda bought emerging market presence."

"A strong yen made the decision easier."

Many of these same questions were raised when Takeda bought the Japan Amgen business and the Millennium company in the US. There is always an undercurrent of criticism, i.e. Takeda is wasting its money.

My own answer to the question is "Time will tell." Buying a company is not like buying a new toaster oven. In this case you know within days or at most a couple of weeks if you spent too much on a lemon or in essence, wasted your money. The economic advantages or disadvantages of buying a company take years to unfold. Pipeline products can go bust or become blockbusters. What looks expensive today may look cheap a few years hence.

Having said this, all these questions and answers miss the key point. And that is the fact Takeda acted instead of sitting on their money or buying back their own shares. We should turn our criticism on those who do not act. Taking action is good, not acting is bad for both employees and shareholders.

In acting to acquire Nycomed, Takeda now has a significant presence in Europe and the so-called emerging markets. How much time and money would it take to internally build the same presence? Takeda now has more employees outside Japan than inside Japan. It is no longer a local Doshomachi Osaka company. How many opportunities would be forfeited by staying a pure Japanese company?

Listen to the words of Dr T. Takenaka, recently retired chairman of Astellas. He said, "Of the nearly 70 firms belonging to the JPMA, only about 10 are developing the new drugs that can help them win in global competition". He added, "Both leading and mid-tier firms should find partners with the conviction that the first one to do so will win." These candid remarks are usually not heard in the "business as usual is good" crowd of 60 JPMA members.

Nothing Is Permanent

Recent disasters in Japan once again demonstrated that dramatic change can and will occur. Some of us take a long time to realize nothing is permanent. A Pennsylvania Dutch expression says it best, "We get old too soon and smart too late."

Many Japanese employees are finding out employment is not permanent, e.g. lifetime employment is a myth. As are annual seniority wage increases. As is unending sales and income growth. When times are good it is easy to say "Don't rock the boat." But that is exactly the time to make changes.

Takeda has been the most admired pharma company in Japan for a long time. They are the sales leader and account for a very significant percentage of the total pharma industry market valuation on the Tokyo Stock Exchange (34%). There does not appear to be anything wrong with their business model if you only focus on Japan.

But globally Takeda is not a top 10 company. Teva has a higher market cap than Takeda. In other words, Takeda's success in Japan is a problem unless it expands outside Japan and acquisitions expedite that process.

Unavoidable Restructuring

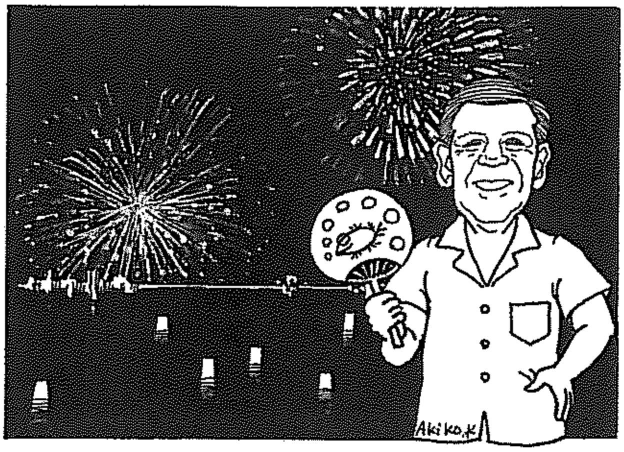
Dr Takenaka, cited above, also was quoted as saying, "A reorganization is unavoidable for Japan's pharmaceutical industry." In my view the main driver of restructuring will be enforced double digit percentage price reductions of long listed drugs. The 60 JPMA companies not developing new drugs are highly dependent on long listed drugs. So far the price reductions of these drugs were rather moderate, painful but not acute enough to keep management awake at night.

But if the pressure is on to save money in the health care system, and the pressure to do so is rising, then the savings must come from lowering the reimbursement prices of long listed drugs. That is where the real money is, not as is often stated, in promoting the use of generics.

Promoting generics is a growth strategy which certainly helped the so-called hybrid companies post revenue gains without launching new branded products. This is good for one segment of the industry but the impact on health care spending has been minimal.

Thus the resistance to arbitrarily cutting long listed drug prices will crumble. Price revisions in April 2012 could easily average 16%. Six percent for the market price reality and 10% to "save" money. Ouch.

This brings us full circle back to the premise that action trumps no action. If Takeda did not buy Nycomed, it would be retreating to where all its eggs are in one market where price reductions and high development costs inhibit growth. The status quo is not acceptable.



Takeda will not have an easy time to extract value from its US$13.7 billion investment in Nycomed. Some in Japan may wish for bad results, particularly those without the intestinal fortitude (guts) to change their own comfortable but precarious business models.

But at the end of the day my guess is an investment in Takeda stock will reward those who elect to buy versus those who invest in companies that believe their past success is permanent.

P. Reed Maurer was employed by a university, two pharma companies, and an industry association. He naively thought each was permanent.

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