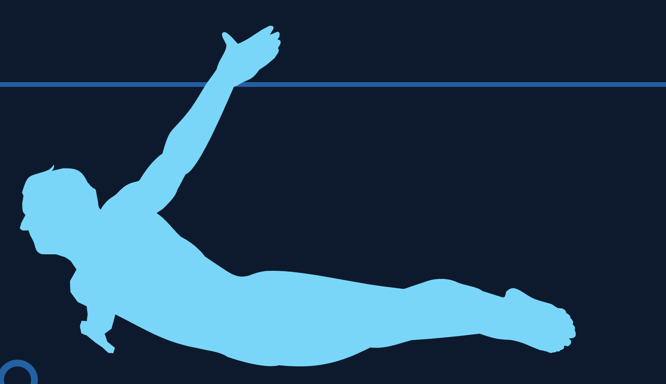
JUMP WHILE THE WATER'S OUT

How Great Leaders Invest in Times of Uncertainty

On the coast of Acapulco lie the cliffs of La Quebrada, where a daredevil family of divers have put on an internationally famous exhibition of bravery and skill for more than 80 years. The 135ft cliffs provide a dramatic theater to watch these performers descend through a narrow gap in the land into shallow breaking surf below. What makes this feat even more amazing is that the water at the bottom of the dive varies between 6 and 16 ft deep, depending on the state of the tides and the cycle of the breaking waves. And because the plunge from the top takes more than three seconds, divers must time their jump precisely. When tides are low, they leave the cliff when the surf is out, and they can see the sand beneath the shallow water below them. By the time they hit the water, the surf has raised the water-levels to non-fatal depths, and thus the show and the divers live to perform another day. These local artisans have learned to "jump when the surf is out" and have faith in the predictability of the rhythm of the ocean to break their fall.

In the world of life science mergers and acquisitions, some of the most transformative, impactful investments have been made when the macroeconomic environment appeared dangerous and shallow. In this piece, we argue that economic slowdowns represent some of the most opportune times to make strategic, well-timed investments.



Finding the Upside

Like the divers of La Quebrada, best in class companies preemptively identify key opportunities for market leadership and use economic downturns to take action (deploy capital) when other companies are afraid to act. We've looked back at a few "best in class" companies and the actions they took during the last bear market ('09-'11) that in many cases directly led to their current leadership positions. The companies that succeeded acted in the face of a downturn, engaging in everything from acquisitions to alliances to deep investments in strategically important assets often inaccessible in bull markets. These companies were prepared to take advantage of three key classes of opportunities. These classes include acquisition of previously unavailable categories, doubling down on their existing business hypothesis, and capturing scale by investing in strategically adjacent businesses.

01 Business Transformation via Acquisition of Previously Unavailable Assets

Market downturns provide an ideal time for companies to branch out of their core spaces to adjacent or even distant spaces that demonstrate sustainable growth, high profits and relative stability and gain eventual market leadership. We have seen companies successfully transform their businesses and change their business mix to a higher portion of attractive and less cyclical spaces. In 2009 Danaher made their first foray into life sciences and IVDs. While Danaher is known for their operational expertise, what is less appreciated about them is the amount of effort they put on strategy development which gives them an advantage in market downturns. This level of focus vaulted Danaher into a market leading position.

In 2009 BMS acquired Medarex when it was a budding biotech with a promising pipeline which included immuno-oncology (IO) monoclonal antibodies. One of these antibodies led to pathway-mediated inhibition of the immune response. It became Opdivo, which propelled BMS to a leadership position in what is now inarguably one of biotechnologies' most promising categories. Astute timing and sound strategic thinking was critical to this success story.

WHAT: Danaher acquires ABSciex/, Molecular Devices for $1.1B and Beckman Coulter for $6.8B.

BACKGROUND: Llimited presence in LS and IVD; executional excellence and strategic rigor

WHEN: ABSciex/MD announced 2009, completed 2010 and Beckman Coulter announced/closed in 2011, both amidst the great Recession and sovereign debt crisis

RESULT: The combined businesses added $4.3B+ annual revenue, catapulting Danaher to a become a leading player in LS tools

WHAT: BMS acquires Medarex

BACKGROUND: Nascent position in immuno-oncology

WHEN: Announced and completed in 2009

RESULT: BMS becomes a leading player in cancer immune therapy and Opdivo enjoys sales of $7.2B in 2019, behind only Revlimid ($10.8B) and Eliquis ($7.9B)

02 The Strategic Double Down

Sometimes the plan you already have is much better than the plan you intend to create. Visionary leaders who have vetted their current path versus the alternatives are often best served staying the course. Against economic headwinds and uncertainty of future demand, this can mean investing in assets that are critical to your existing product portfolio and roadmap. It can also mean using free cash to invest in internal R&D at a time when your competitors might be acting impulsively to control costs. Often investments in the down-turn represent an inflection point where a key competitor falls behind.

Bio-Rad faced a similar situation in 2011 where share gains in the PCR market could only be made through aggressive price reductions at a time when governments around the world were tightening research purse-strings. A bold acquisition of a start-up, Quantalife, put the company on a 5-year path to market dominance in the new, fast-growing field of digital PCR and a leadership position it holds to this day.

Illumina is now the de facto leader in sequencing, but this wasn't always the case. In the faces of both the 2009 downturn and stiff competition from sequencing veteran Applied Biosytems, Illumina doubled down on R&D expenditures and executed the timely acquisition of Aventome, an asset that proved to be valuable for both its technology IP and its talent pool.

WHAT: Bio-Rad acquires Quantalife for $162M

BACKGROUND: Stiff competition in traditional PCR franchise; opportunity identified in the new category of digital PCR

WHEN: Announced and completed in 2011

RESULT: Despite being later to market than other rivals (Fluidigm, ThermoFisher, RainDance) Bio-Rad firmly establishes itself as a market leader in digital PCR

WHAT: Illumina: Internal R&D + Avantome acquisition (~$60M)

BACKGROUND: Nascent NGS market with entrenched incumbent (Applied Biosystems) with deep pockets and dominant mind/market share

WHEN: Continued investment from 2009-2011 despite NIH funding reductions; biotechnology tools downturn

RESULT: Within 5 years, captures 90% share of NGS market, nearly doubles corporate revenues and never looks back

03 Capturing Scale or Share via Logical Adjacencies

Inorganic approaches often provide the quickest means to pick up market share. But during recessions, nervous executives, conservative investors, and gun shy boards often guide companies to make only incremental moves. Sales forecasts are reduced. Business leaders pull back spending. Business alliances are put on hold. Shrewd, confident leaders realize that recessions can provide rare opportunities to gain wholesale access to revenue, consolidate positions and drive efficiencies through acquiring or merging with complementary or competing companies.

In 2011, Ecolab had built a leading 10% share position in the highly-fragmented $55B+ global cleaning and sanitizing business. Nalco Water had built a $4.6B ('11) business focused on cleaning and sanitizing industrial water waste, pollution control and energy conservation. Ecolab announced the merger in July 2011, agreeing to pay what was at the time viewed as a rich sum - $8.3B+, or ~11x EBIDTA, but the result was $300M in cost synergies in G&A and supply chain. By mid '13 Ecolab showed significant margin expansion and double-digit revenue growth and substantial gains in market capitalization.

Throughout the late 2000s Stryker and the surgical device industry saw a slow decline in demand and ever-dwindling margins. As of 2008, Surgical devices was proving to be a low growth (revenue growth <2%), modest net margin (17%) business. In 2009, Stryker acquired Ascent Healthcare Solutions for $525M and followed suit with the acquisitions of Mutoh and OtisMed. Ascent's Instrument repurposing services added a 20% revenue growth service line to Stryker's medical surgical portfolio and increased business unit margins by >4% immediately.

WHAT: $8B EcoLab (NYSE:ECL) Nalco Water Merger

BACKGROUND: EcoLab: strategic focus to build on their 20% share of the fast growing $6B "water management"; Nalco: market leader in water treatment, pollution control and energy conservation with $4.65B revenues

WHEN: Announced and closed in 2011 during the late stages of the Great Recession :

RESULT: Market cap ~tripled ($11-30B) from 2011-2013, combined companies saw $300M in cost synergies, set up clear #1 market position

WHAT: Stryker Acquires Ascent for $525M

BACKGROUND: Surgical device industry faced macroscopic headwinds, device margins dwindle

WHEN: Announced 2009, closed 2010

RESULT: Added high growth services (20%) to existing med-surgical revenue and increased margins >4%

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LEARNINGS

Timing is everything. This is as true for daredevil divers as it is for mergers and acquisitions. Business leaders in the examples above exploited the market uncertainty and were able to deploy capital rapidly as some high prized assets became actionable. These acquirers had a very clear view of what markets to pursue and developed their "proprietary" point of view on what the future would look like. They put significant resources toward understanding market evolution and evolved their strategic thinking ahead of and during uncertain and turbulent times, enabling them to move rapidly when opportunities arose.

These purchases represented much more than just bargain hunting in a downturn. The downturn may have softened prices, or encouraged owners to look for exits, or provided headwinds for competitors. But the winning examples embodied strategic action at a time when macroeconomic pressures magnified the impact of all of these attributes. The leaders were undaunted by recessionary pressures that caused many of their less successful competitors to pause. They jumped when the water was out, and for the most part history has shown that the timing of their jumps set their companies on enduring and positive financial trajectories.

Learn more about how Chrysalis and our strategic partner Zaylan can help you assess the depth of the water in new and emerging heathcare and biomedical research markets: www.chrysalisbiomed.com