AP CAPITAL RESEARCH

M&A Deal of The Week

ASTRAZENECA X FUSION PHARMACEUTICALS

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Executive Summary

M&A DEAL OF THE WEEK

Deal Summary

- On March 19th, AstraZeneca (LSE: AZN) announced that it had entered into a definitive agreement to acquire Fusion Pharmaceuticals (FUSN: NASDAQ), a Canadian clinical-stage biopharmaceutical company, for a total transaction value of $2.4 billion.
- This acquisition represents an offer price per share of $21.00 in cash at closing, with an additional $3.00 per share, contingent on a regulatory milestone achievement.
- This acquisition comes at a premium of 97% [or 126% based on the contingent value] compared to the last closing price of $10.84 on 18/03/24.
- This comes a week after AstraZeneca acquired Amoylt Pharma for $1.05 billion.
- This deal will strengthen AstraZeneca's Oncology portfolio. Fusion Pharmaceutical offers an opportunity to accelerate the development of FPI-2265, a next-generation radioconjugates (RCs) cancer treatment, and enhance AstraZeneca's presence in Canada.
- AstraZeneca will acquire the cash, cash equivalents and short-term investments on Fusion's balance sheet, equalling $234 million according to Fusion Pharma's latest earnings in December.
- Susan Galbraith, Executive Vice President of Oncology R&D at AstraZeneca, said" Together with Fusion, we have an opportunity to accelerate the development of FPI-2265 as a potential new treatment for prostate cancer."

Deal and Company Figures

- **Deal Premium:** 126%
- **Closing date:** 2024 Q2
- **AstraZeneca P/E:** 34.4x
- **AstraZeneca D/E:** 75.7%
- **AstraZeneca Price/Book:** 5.2x
- **AstraZeneca Market Cap:** $209.4 billion
- **Fusion Pharma EV/EBITDA:** -16.5x
- **Fusion Pharma EV:** $1.61 billion
- **Fusion Pharma P/E:** - 19x
- **Fusion Pharma D/E:** 26.5%
- **Fusion Pharma Price/Book:** 8.1x
- **Fusion Pharma Market Cap:** $1.80 billion

Company Information

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AstraZeneca (LSE:AZN)

- Founded in 1992 in Cambridge, AstraZeneca is a biopharmaceutical company and the third-largest company listed on the London Stock Exchange. It offers an extensive range of products in all delivery forms and focuses on the discovery, development, manufacturing, and commercialization of prescription medicines.
- They have operations globally, with the main driver of revenue coming from the US, which accounted for 39.6% of 2023's revenue, with the remainder coming from Asia (19.7%), the UK (7.4%) and other segments accounting for the remaining (32.3%).
- Regarding financials, 2023's Revenue of $44.99 billion was down 1% from the previous year, with net income rising 289% from $2.04 billion in 2022 to $5.9 billion in 2023. This significant increase in yearly earnings was due to a large fall in AstraZeneca's cost of sales (from $11.48 billion in 2022 to $4.87 billion in 2023).
- The latest earnings resulted in an EPS of $0.62, which puts their P/E ratio at 34.4x, below the peer average of 35.7x.

Fusion Pharmaceuticals (NASDAQ:FUSN)

- Fusion Pharmaceuticals is a clinical-stage oncology company focusing on developing radioconjugates (RCs), a new cancer treatment method. Fusion has a pipeline of RCs, including their most advanced programme, FPI-2265, a potential new treatment for patients with a specific resistant type of cancer called Metastatic Castration-Resistant Prostate Cancer (MCRPC).
- FPI-2265 is currently in a Phase II trial. On the 16th of February, Fusion entered into an agreement with the European Commission Joint Research Centre, which gave Fusion Pharmaceutical's FPI-2265 approval to conduct the first prostate-specific membrane antigen (PSMA) targeted alpha therapy.
- Concerning financials, Fusion Pharmaceuticals is currently not profitable. Its 2023 revenue was only $2.1 million, up from 2022's $1.4 million, and its net loss was $95 million, up from the previous year's loss of $86 million. The latest EPS is—$1.45, putting its P/E at -19x.

Deal Rationale and Risk

Increased Oncology dominance and other benefits

Increased Oncology Dominance

- The main strategic reason behind the acquisition of Fusion Pharmaceuticals is Fusion's FPI-2265 treatment, a form of RC therapy that delivers a radioactive isotope directly to the cancer cells through precise targeting, minimising damage to healthy cells compared with traditional radiotherapy and has promising results for cancer treatment.
- This recent acquisition has further strengthened AstraZeneca's position in the industry, providing a competitive edge against rival Novartis, with similar market capitalisation. While AstraZeneca specialises in cancer treatments, earning 37% of their revenue at $17 billion from Oncology products in 2023, they previously lacked an RC prostate cancer drug, which put them at a disadvantage compared to Novartis's Pluvicto that's already in the market. However, with this acquisition, AstraZeneca can now compete more effectively with Novartis in this area.

Current Assets and Increased Canadian Presence

- Aside from strategic reasons, other factors include Fusion Pharma's £234 million of current assets and the potential to expand AstraZeneca's presence in Canada, where it currently has only one location.

Risk

Fusion Pharmaceuticals

- One risk to this deal is that AstraZeneca is significantly overpaying to fill a hole in its portfolio. Relative valuation methods put Fusion Pharmaceuticals' value at $0.04 per share, vastly below the $21.00 per share that AstraZeneca is repaying for it. From my objective, risk-averse standpoint, this transaction would not be worth pursuing.

AstraZeneca's debt

- Another risk in this deal is AstraZeneca's debt level and potential liquidity issues. AZN's current debt stands at $28.5 billion, down from $33.4 billion in 2021, placing its D/E ratio at 72.8%. However, this is still considered high.
- Furthermore, AstraZeneca's current liabilities are $30.54 billion, which outweighs its current assets of $25.05 billion, raising some questions about how this liquidity deficit of approximately $5 billion will be financed, either through more debt or equity.

Industry Analysis

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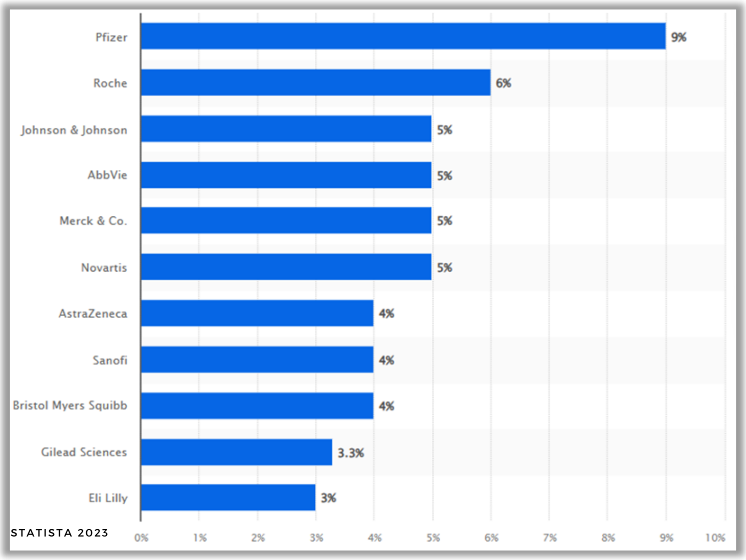
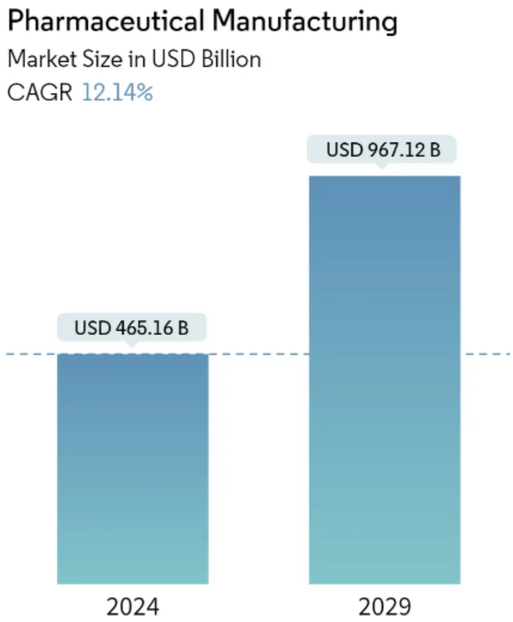
The Pharmaceutical Industry

- The pharmaceutical industry is currently dominated by Pfizer, which has a 9% market share, followed by Roche, which has a 6% market share. AstraZeneca, which has a 4% market share, is 7th in the industry.
- The U.S. currently has the largest pharmaceutical market due to the privatisation of healthcare, with Japan following in second and China closely in third.

Leading pharmaceutical companies worldwide based on market share



Industry growth rate



Individual Company Growth

- Based on an extrapolation of 2023's revenue growth data from Statista, AstraZeneca is expected to be the second fastest-growing pharmaceutical company, with Novo Nordisk predicted to be the fastest-growing in 2024.

Threats

Increased Competition from Generic Pharmaceutical Suppliers

- Pharmaceutical Giants earn revenue through their patents on products, which typically last 20 years. This exclusivity allows these companies to charge a high price.
- Once patents expire, Generic Suppliers can produce a much cheaper and similar product, thus increasing competition in the market, increasing the number of substitutes, and reducing prices. This will reduce the large pharmaceutical companies' margins because the threats of competition force them to lower their prices to remain competitive.

Final Thoughts

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This acquisition is good for AstraZeneca, but they're overpaying too much for Fusion. It fills the hole in their portfolio concerning RC prostate therapy, allowing them to compete more effectively with Novartis, but at what cost?

This deal adds to their pipeline concerning oncology products, with the target of this acquisition being Fusion's FPI-2265 treatment, which is only in stage two clinical trials. This means there is still a final clinical testing stage remaining regarding the process of bringing the product to market, with there already being Novartis' equivalent called Pluvicto present, which you can argue reduces the incentive to produce an RC prostate therapy as you don't have the first mover advantage. This is important in the Pharmaceutical industry as it allows a firm to charge higher prices as there is little to no competition.

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