

PFIZER: WHY IT'S TIME FOR A BREAKUP

MAY 23 • 2011 EDITION

Forbes

◀ DYLAN
LAUREN,
DAUGHTER
OF RALPH

Like Father, Like Daughter

IS ENTREPRENEURIAL SUCCESS INHERITED?
8 FAMILY CONVERSATIONS ... PLUS THE SCIENCE

\$5.99



0 71658 01638 5

Pfizer's Radical Surgery

Will new CEO Ian Read break up
the world's largest drug company?
Wall Street sure hopes so.

BY MATTHEW HERPER

When Pfizer's new chief, Ian Read, held his first earnings call in February, he uttered the seven most exciting words investors had heard about the company in years. Thirteen minutes into his remarks he promised to review each of the company's businesses to figure out where they can create the most value, "be it inside or outside of Pfizer."

Was Read, a 57-year-old Scottish accountant and company lifer who took over in December, really considering breaking up the \$68 billion (sales) leviathan he had helped create? "Had we not heard it firsthand, we might not have appreciated just how serious he is about potentially splitting up the company," Bernstein Research analyst Timothy Anderson said on Mar. 14, recounting a meeting with Read. Three days later Pfizer's research chief, Mikael Dolsten, said at an investor meeting that the company was considering spinning out "adjacent businesses" and would decide which would "create more value for shareholders ... outside the company."

Since then Pfizer shares are up 18%, to levels not seen since 2008. Pfizer could split into as many as five pieces, spinning off units that make baby formula, over-the-counter products, veterinary medicines and generic drugs. Analysts say that the separate parts could be worth \$180 billion, 11% more than Pfizer's current value (see "Sharpening Their Scalpels," p. 88).

For beleaguered Pfizer investors any change would be welcome at this point. Shares are down an adjusted 55% since 2001. Its flagship cholesterol drug, Lipitor, which generates \$5 billion a year in U.S. sales and \$11 billion

globally, is about to lose patent protection. More than \$250 billion in megamergers over the last decade have failed to produce a similar blockbuster. In 2009 the company's aggressive marketing of the painkiller Bextra, pulled because of safety risks, resulted in the largest criminal fine in U.S. history.

"The stock can only go up if they break up the company and cut research and development," says Jami Rubin, a pharmaceuticals analyst at Goldman Sachs who has been pushing a Pfizer breakup for three years. "When Read was announced as the new chief executive Wall Street was skeptical, but he's listening and he's responding to what we have been saying. My sense is he's already made up his mind."

In a statement Pfizer told FORBES that Read plans to complete his review of the company by the end of the year: "It's important to remember that at this point no decisions have been made about specific businesses and assets." Read declined to comment. Corey Goodman, a former Pfizer R&D executive who left the company in 2009, is impressed with Read's tenure so far. "If anyone gets it, it's Ian," he says. "He is transforming the very core of R&D, making painful but necessary cuts and, more important, looking toward new models to harness external innovation and drug discovery."

Not everyone agrees that a breakup is the right fix for Pfizer, which has struggled to invent new blockbusters even as it acquired Warner-Lambert for \$114 billion in 2000, Pharmacia for \$60 billion in 2003 and Wyeth for \$68 billion in 2009. Those big mergers sidetracked its researchers and salespeople and created baroque man-

Sharpening Their Scalpels

Investors predict Pfizer's parts could fetch \$180 billion, 11% more than the current value.

Division: Baby Formula

POSSIBLE VALUE: **\$8 BILLION**

The \$60 billion acquisition of Wyeth gave Pfizer a \$1.9 billion nutrition business whose biggest product is baby formula. One idea: a 20% initial public offering followed by a split-out to shareholders that would allow dissatisfied investors a way to get out of Pfizer stock.

Division: Animal Health

POSSIBLE VALUE: **\$16 BILLION**

Pfizer Animal Health has \$3.9 billion in annual sales. There are some benefits to selling medicines to both pets and people—Pfizer sells a failed human antidepressant to dogs—but not many.

Division: Consumer Health

POSSIBLE VALUE: **\$6 BILLION**

This business, which came as part of the Wyeth deal, generates about \$2.8 billion from brands such as Advil for pain, ChapStick, Centrum vitamins, Dimetapp cough syrup and Preparation H.

Division: Established Products

POSSIBLE VALUE: **\$40 BILLION**

A tricky call would be whether to spin off this unit, which sells its drugs after they have gone generic. Lipitor alone will remain a \$2 billion- to \$3 billion-a-year drug in 2015 thanks to foreign sales. This business is likely to have sales of \$15 billion or more in a few years.

Division: "Innovative Core"

POSSIBLE VALUE: **\$110 BILLION**

Stripped of these other businesses, the new Pfizer would be a \$40 billion (revenues) pure-play pharmaceutical company.

Sources: Bernstein Research; Goldman Sachs; company statements; FORBES.

agement structures—at one point there were 17 layers between the chief executive and the lowest employee. Critics say undoing them risks similar distraction. As one fund manager said, a breakup would just mean the investment bankers and lawyers who got rich putting Pfizer together will now get richer taking it apart, without improving its ability to invent and market drugs, already a struggle. "I think it's financial engineering. I think it makes the stock more valuable," says Les Funtleyder, a fund manager at Miller Tabak. "From a strategic point of view, would it solve the problem? No."

"It's got to be humbling when the two things that move the share price are you change the CEO or you say you might break up the company," quips Erik Gordon, of the University of Michigan's business school.

Pfizer was founded in Brooklyn in 1849. Its first product was a treatment for intestinal worms. The company rose to prominence in the 1940s when it became one of the first companies to manufacture penicillin for U.S. troops. During the 1990s, under chief executive William Steere, it became renowned for its hard-charging sales operations, staffed with military veterans, and for Viagra, which hit the market in 1998. After publicly decrying big deals, Steere set Pfizer on the mega-merger path by buying Warner-Lambert, its partner on Lipitor, to get full rights to the drug. Steere stepped down from the board on Apr. 28, a sign of real change under Read's leadership.

Read's confidence at the helm doesn't surprise those who know him well. His predecessor, Jeffrey Kindler, a garrulous lawyer who had previously turned around McDonald's Boston Market business, was seen as fresh blood with big ideas

when the board promoted him in 2006. Read, his second-in-command, was the nuts-and-bolts veteran with lots of experience dealing with government price pressures on drugs. He is smaller and sharper-elbowed than his former boss, with penetrating eyes.

Born in Scotland, Read studied first chemical engineering and then accounting. He joined Pfizer as an auditor in 1978. During a period when the drug industry's growth occurred largely in the U.S., Read ran Pfizer's international businesses. In 1996 he was named head of Pfizer's marketing operations in Latin America and Canada. In 2000 he was put in charge of European operations. By 2002 he was running all of Pfizer's marketing outside the U.S. and Asia. His most eye-catching performance was in a tense battle with the German government over the cost of Lipitor.

In November Read hit a lucrative career milestone. The sum of his age (57) and his tenure (33 years) triggered a Pfizer policy known as "the Rule of 90," which, in his case, increased the value of his pension by \$11 million. Whether or not he stayed with the company, his compensation would be roughly the same as Kindler's the year before.

When Kindler quit suddenly in December, citing exhaustion, Read took over. He immediately killed the British lab that invented Viagra, slashed 2,400 research jobs and saved \$1 billion a year to ensure Pfizer would make its 2012 earnings forecasts. He told reporters he would also improve Pfizer's dismal record at developing new products.

That will take some doing. After dumping \$70 billion into research and development over the last decade, the company has launched only two drugs that have managed to pass \$1 billion in annual sales: Lyrica, a pain medicine invented at

Stumbling Giant

Pfizer epitomizes the pharmaceutical industry's problems.

A decade ago there was serious talk about Pfizer as a growth stock that would ride a wave of biological innovation. Instead shares are down 55%, worse than the industry as a whole. Like many of its peers it has stumbled under the weight of unproductive labs, drug safety scandals and expiring patents. Much of the growth now is in emerging markets and vaccines.

Pfizer Stock Disappointing Decade



Pfizer By The Numbers

SALES:	\$67,809 MILLION
PROFITS:	\$8,257 MILLION
ASSETS:	\$195,014 MILLION
MARKET VALUE:	\$161,343 MILLION
EMPLOYEES:	111 THOUSAND
INTERNATIONAL SALES:	\$38,763 MILLION
NUMBER OF DRUGS >\$1 BILLION IN SALES:	14
BIGGEST COMPETITOR:	NOVARTIS

Worldwide Reach Emerging Presence

Pfizer's international sales are up 37% over the past year, accounting for 57% of total sales. Emerging markets played the biggest part, leading all segments with 67% sales growth.



TOP DRUG

Lipitor
 ANNUAL SALES: \$10.7 BILLION
 TIMES PRESCRIBED IN THE U.S.: 45 MILLION

Top Products Look Into The Future

Pfizer's Prevnar moves past Lipitor, becoming biggest seller by 2015.

2010 ANNUAL SALES (\$BIL)	
LIPITOR (CHOLESTEROL)	\$10.7
PREVNAR (VACCINE)	\$3.7
ENBREL (EX-U.S.) (R. ARTHRITIS)	\$3.3
LYRICA (PAIN)	\$3.1
VIAGRA (ERECTILE DYSFUNCTION)	\$1.9

2015 (ESTIMATED) ANNUAL SALES (\$BIL)	
PREVNAR	\$5.6
ENBREL (EX-U.S.)	\$3.9
LYRICA	\$3.9
LIPITOR	\$2.7
TAFOCITINIB (RHEUMATOID ARTHRITIS)	\$1.4

JOB CUTS IN THE PAST TEN YEARS:

52 THOUSAND

THE LARGEST CRIMINAL FINE EVER, FOR PAINKILLER BEXTRA:

\$1.2 BILLION

MARKET VALUE AS OF APR. 26. SOURCES: CHALLENGER, GRAY & CHRISTMAS, INC.; COMPANY STATEMENTS; IMS HEALTH; INTERACTIVE DATA VIA FACTSET RESEARCH SYSTEMS; FORBES.

Northwestern University that came with the Warner-Lambert acquisition and generates \$3 billion a year, and Sutent, a cancer medicine that came as part of its 2003 purchase of Pharmacia. It generates \$1.1 billion.

Pfizer managed to get nine different new medicines past the Food & Drug Administration between 2000 and 2010, placing it third among drug companies. But most didn't sell. The most infamous case was an inhaled insulin that Pfizer pulled from the market because there was no demand, taking a \$2.8 billion charge. There have also been two cases where Pfizer spent more than \$1 billion on a biotech company only to resell its assets for a small fraction of that amount a few years later.

There have been some recent successes. Pfizer's tofacitinib, a pill, could disrupt the \$15-billion-a-year

market for rheumatoid arthritis injections, according to Credit Suisse. But side effects like high cholesterol could crimp its market share. More profits could come if its Prevnar 13 pneumonia vaccine is shown to decrease the spread of the infection in adults. Already approved for use in kids, the new use could generate several billion dollars more in sales.

New research chief Dolsten, a Swiss M.D./Ph.D. who was head of R&D at Wyeth when Pfizer bought it, says he is trying to turn around the labs by changing their culture. The best example so far is a new cancer drug, crizotinib, now being submitted to the FDA for approval. Pfizer scientists used new genetic technology to identify the 5% of lung cancer patients who would benefit. "It's a grand example of where the identification of a gene allowed us to capitalize on a finding," says Dol-

sten. "What looked like an incremental drug in lung cancer, we turned it into a transformational drug." In an age where cancer drugs cost \$100,000 per treatment or more, it could also be worth \$1 billion a year.

Pfizer also created a system where particular business units—like oncology or primary care—reserve the right to refuse drugs developed by Pfizer's scientists if they don't think they'll be profitable. If none of Pfizer's units wants the products, the labs are free to sell them outside the company.

Dolsten is even considering compensating scientists based on whether the drugs they invent make it to market, potentially transforming a job at Pfizer into a lucrative alternative to toiling at a small biotechnology company. "We want to build entrepreneurial science and business leaders that really think through both science and return on investment," he says. "It's really a part of a culture of how you can become more successful as a scientist or entrepreneur inside Pfizer."

But Wall Street is sick of promises that drug companies are going to fix their broken labs. Bernard Munos, a former Eli Lilly researcher now at InnoThink Center for Research, a consultancy and think tank, advocates moving even more research spending to a network of smaller companies. Bruce Booth, a partner at Atlas Venture in Boston and a FORBES contributor, points out that Pfizer's \$7 billion annual R&D budget could fund 900 small biotechs.

What excites investors is that Pfizer just sold its \$752 million (sales) Capsugel unit, which makes pill capsules, for \$2.3 billion to Kohlberg Kravis Roberts & Co., the leveraged buyout firm. This is seen as a trial balloon for further deals.

"I don't see a downside to restruc-

JIMMY JOHN'S®
GOURMET SANDWICHES

★ More ★
EFFICIENT

★ More ★
SYSTEMIZED

★ More ★
DISCIPLINED

★ More ★
PROFIT

AMERICA'S FAVORITE SANDWICH
"DELIVERY GUYS"™

CHECK US OUT, YOU DECIDE!
JIMMYJOHNS.COM - 800.546.6904

©2009 JIMMY JOHN'S FRANCHISE, LLC. ALL RIGHTS RESERVED. THIS OFFERING IS MADE BY PROSPECTUS ONLY.

turing. Now I'm looking at the company, the fact that there's new management, there's new blood, and he is looking at things with new eyes," says Mark C. Minichello, chief investment officer of QCA Capital in Los Angeles.

Breakup or no breakup, the biggest financial event of 2011 for Pfizer will be the expiration of the patent on Lipitor. Within two years a dozen or more companies will launch commodity-priced knock-offs. So far Ranbaxy Pharmaceuticals, which has the exclusive right to launch generic Lipitor first, has not received FDA approval to do so. Any delay benefits Pfizer, potentially boosting earnings by as much as 3%, according to Goldman Sachs.

Pfizer could also get a hand from its programs to offer consumers \$50 coupons for Lipitor to pay their insurance co-payments, keeping them on the brand-name pill even after generics arrive (Lipitor costs about \$150 a month at pharmacies). That could add another 2% to next year's earnings, Credit Agricole Securities says.

Further on, the big question is whether the breakup idea is more a story than a strategy, a way to get investors to stop thinking about Pfizer as a money pit and get them excited about the company's potential again. Sure, Read will probably spin off the baby-formula and over-the-counter businesses, but will he really split off generic drugs, which are growing in emerging markets? If all goes well, he might not have to.

But as any longtime investor in Pfizer's stock will tell you, very little has gone well for either Pfizer or the pharmaceutical business in the past decade. Stripping away ten years of failed deals may be Read's best bet at this point. One more run of bad luck and it will be the only option he has left. **B**

Patent **Protectors**

Can Washington help the drug business? A Forbes.com discussion.

MATTHEW HERPER (FORBES):

People say that Medicare Part D is a \$1 trillion giveaway to industry, but it hurts pharma companies by leading them to protect their dying business in mass-market drugs, which has essentially turned gangrenous. Industry only fought for this because the focus is always on taking things away from them—and not giving anything in return.

If you wanted to offer the drug industry a giveaway that would actually do it some good, you might offer extensions on the patent lives of drugs being developed for cardiovascular disease. Testing a new heart drug costs easily more than \$1 billion. Most of these drugs don't make it to market.

WORLD OF DTCT MARKETING COMMENTED

The patent clock should start ticking when drugs are approved, not when they are still in development. That way drug companies will spend the time and money to conduct good clinical trials without rushing to cut corners. It means safer drugs for patients and it means that drug companies can get a good return on their investments.

DRKENROMEO RESPONDS

I agree with you, but I always consider that patent protection is the drug industry's best defense against industrial espionage and the outright theft of intellectual property. But many of today's "new drugs" are nothing more than a combination of two older drugs working symbiotically to solve a medical problem. Perhaps we would be better served as a nation by spending a little more in physician education on the proper use of the drugs that are available.

GITCHIGUMMI COMMENTED

Everyone would be served better if we shifted drug development to our universities, where the bulk of the underpinning research happens already. Some historic drugs developed at major academic institutions benefited those institutions greatly in the form of revenues that are ultimately put back into the institutions rather than investors' pockets. This changes motivations for drug development. Drug research, development and marketing are also seriously hindered by our litigious society. Everybody wants a big payout if something goes wrong, so new drugs are killed at the first sign of a possible problem. We need to stop expecting that all new drugs will be all risk and no benefit.

MATTHEW HERPER RESPONDS

No academic institution can afford to spend the \$40 million to \$2 billion that it costs to develop a drug. I do think our risk aversion is one reason for pharma's problems (Vioxx is a defining factor in my thinking about the industry). But we're accepting all sorts of risky drugs when they treat serious diseases.