

JPM | Special Situations: 2021 Potential M&A Candidates

Neetu Jhamb
(212)-272-5971
neetu.jhamb@jpmchase.com

Healthcare Sector Specialist Julie Murphy and Financials Specialist James Goulbourne have summarized potential M&A candidates in their respective sectors below.

Healthcare (Julie Murphy)

As evidenced by recent deal flow, the weeks/days/hours leading up to the JP Morgan Healthcare Conference historically have been a busy deal period in biotech (CELG/BMY, DERM/LLY, LOXO/LLY, RXDX/Roche, ARIA/TAK) inevitably setting the early tone for both the biggest conference of the year (NBD) but also for the broader group over the next 12 months. We may be virtual this year, but 2020 already showed this doesn't mean deals won't get done and the **JPM Biotech Team believes M&A will be a potential tailwind for 2021 (Sector Outlook slide deck [here](#)).** With that in mind, see below a list of 1) who is browsing; 2) what are some hot items this year that we also like fundamentally; and 3) how to take advantage via a basket play (JPBIOMNA Index).

Quick refresher on who's shopping (per mgmt commentary): For buyers, we highlight the usual large cap suspects including **AMGN, ABBV, MRK, PFE, LLY, BMY, GILD, BIIB, GSK** – all with varying degrees of appetite, urgency to backfill impending revenue cliffs, concentration risk, and balance sheet flexibility. So how much cash is on hand? An aggregate **\$37B of cash** among large and midcap biotechs!! Inline with the recent buy-side survey results, most conversations as of late tend to center on **MRK** and **PFE** deal appetite post their respective spins (MRK to close in 2021) as well as **BIIB's** outlook post FDA decision. **BMY** is also a growing focus as a potential \$6.4B "bonus" could hit in 2021 if the CELG CVR is not paid. Interestingly, survey respondents name **VRTX** as potential buyer, a notable switch from the "M&A target list" in years past (and likely dependent on AATD data expected in 1H21)...and don't forget all that SPAC activity this year!

What's hot on the biotech asset wish list? With over 700 publicly traded biotech assets out there, the pickens are aplenty. Based on conversations with investors, commentary from mgmt teams, and highlights from the JPM Biotech team, the generally consistent themes we hear for attractive assets includes (but not limited to):

1. De-risked assets – plug & play
2. Hot technology – Gene therapy/editing/cell therapy, etc
3. Attractive therapeutic areas – CNS, Oncology, Orphan disease

On stock specifics, our buy-side survey respondents named 36 attractive take-out targets (full list below) with ACAD, MRTX, and TPTX most frequently listed. Some names in our coverage that we like fundamentally, but also check some/all of these thematic boxes, and are often named by investors as attractive strategic targets include: ACAD, BMRN, ITCI, FOLD, MRTX, TGTX. **Note, we have no knowledge of deals, just a framework for attractive biotech assets

ACAD: No brainer name to own for DRP label expansion in 2021. Recall, Nuplazid's April 3rd PDUFA effectively increases the addressable patient population by 10x from current approved indication of PDP. Kasimov models risk adjusted nuplazid revs moving from ~\$450M in 2020 to \$3.3B in 2027. Checks all the right boxes of de-risked clinical data, near term commercial launch, attractive growth profile, and large addressable market (with room for further expansion). ACAD is also the most often named "take-out target" in this year's buy-side survey!

Market cap: \$8.6B

SI: 6.7%

JPM Rating: Cory Kasimov, OW, PT of \$60

BMRN: The next mid-cap name to go? While 2020 has been disappointing on a regulatory front, 2021 should refocus light on the BMRN pipeline potential (with ph3 roctavian update & 2yr vosoritide updates both expected in Jan) on top of the solid core business (already seeing some of that enthusiasm creep back into the stock this week). Looking at the model, Kasimov's DCF gets to \$75/share in commercial base business with vosoritide and roctavian accounting for \$34/share (risk-adj) or \$51/share (taking POS to 100%) plus an additional \$18/share in other pipeline/platform assets. Risk-adj DCF gets Kasimov to \$131/share...with upside to current price/market share assumptions. Deep dive slide deck from Kasimov [here](#).

Market cap: \$16.5B

SI: 6.6%

JPM Rating: Cory Kasimov, OW, PT of \$131

FOLD: Best-in-class Pompe ERT asset...all eyes on data in early 2021. Why is FOLD a top pick for Rama? 1) strong commercial core with Galafold franchise; 2) best-in-class ERT potential in AT-GAA (key ph3 read out with homerun/win scenario supporting fundamental valuation in the high \$20s to mid \$30s range); and 3) broader gene therapy optionality in other therapeutic areas. Slide deck [here](#).

Market cap: \$6.2B

SI: 11.3%

JPM Rating: Anupam Rama, OW, PT of \$29

ICTI: De-risked asset in attractive CNS space. Following the 2nd positive ph3 data for key asset lumateperone in bipolar depression, the de-risked clinical story shifts to a massive commercial opportunity in 2022 and beyond. Jess Fye remains bullish on ICTI where she believes current valuation underappreciates the full commercial potential for luma given the potential for a broad label for bipolar depression in patients with Bipolar I and II disorders as monotherapy and adjunctive therapy, along with a favorable safety profile. Look for sNDA filing in 1Q with potential approval in late 2021...which fits well with companies looking for near term growth (and plug & play potential for established CNS salesforce). Our DCF yields a PT of \$36 (40% upside from current levels) assuming US peak sales of \$500mm+ for Caplyta in schizophrenia, 90% risk-adjusted credit for \$1bn+ peak US sales in bipolar depression, and more heavily risk-adjusted credit in MDD, along with royalties for ex-US sales. Note [here](#).

Market cap: \$2.2B

SI: 8.7%

JPM Rating: Jess Fye, OW, PT of \$36

MRTX: Strike while the KRAS iron is hot... While the KRAS debate is likely to continue in 2021 (finally see some differentiation?), data from MRTX to date continues to impress in NSCLC and the door to differentiation vs AMGN's 510 remains open. Recall, at the Triple meeting, we saw at the 600mg BID dose, 1) ORR in 2L+ NSCLC of ~45%; 2) DOR/depth of response shows encouraging trends, 3) activity observed in indications beyond NSCLC, and 4) overall clean safety / tolerability profile. For reference, the JPM team estimates the **KRAS G12C TAM is approximately \$4.2-\$5.5B in lung** (based on our comp analysis). Deep dive deck [here](#).

Market cap: \$12B

SI: 9.7%

JPM Rating: Anupam Rama, OW, PT of \$238

TGTX: Best-in-class against validated targets, primed to disrupt the old guard. TGTX shares have outperformed the sector in 2020 on the heels of a number of key clinical catalysts, including positive top-line phase 3 UNITY-CLL and ULTIMATE RMS results, and solid updates from pivotal programs UNITY-CLL and -NHL at ASH 2020. Key events to watch: i) FDA action for umbralisib in r/r MZL and r/r FL (PDUFA dates Feb. 15, 2021 and June 15, 2021) where Eric Joseph models a combined \$450M peak sales opportunity in the US, and regulatory submissions for ii) ublituximab in RMS (~\$2.2B peak US forecast in our model), and iii) U2 in r/r and first-line CLL (~\$1.2B peak US potential). Also watching for longer-term results from the phase 1/2 study of U2+venetoclax and follow-up data for TG-1701, both of which should provide clarity on the development path forward. In all, Eric views the coming year as value defining for TGTX's heme-oncology franchise along with compelling optionality held by ublituximab in an expanding antiCD20 RMS market. Recent note [here](#).

Market cap: \$7B

SI: 11.2%

JPM Rating: Eric Joseph, OW, PT of \$67

Gotta catch 'em all? The JPM Delta One Team has updated our **JPM Biotech M&A Index** to reflect this year's buy-side survey results. The **JPBIOMNA Index** provides exposure to potential take-out upside while minimizing some idiosyncratic single stock risk. Key stats for the basket and constituents:

12/16/2020	JPBIOMNA
Summary	
# of names	36
% of top name	3.7%
% of Top 10 names	35.8%
Div Indicated Yld (Wtg Avg if Index)	0.00%
Market Cap (\$B) (Wtd Avg)	\$6.0
Liquidity	
Time to Trade \$10mm (20%POV)	16-20 mins
Sector	
Health Care	100.00%
GICS Sub Industry	
Biotechnology	92.16%
Pharmaceuticals	7.84%

Charts from the JPM 2021 Biotech Outlook Slide deck – link [here](#)

“If M&A were to increase, which companies might be M&A candidates?” **also constituents of the JPMBIOMNA basket

Company	Number of Responses	Percentage (n=168*)
ACAD	9	5%
MRTX	7	4%
TPTX	6	4%
IOVA	5	3%
BPMC	5	3%
TRIL	4	2%
SRPT	4	2%
KURA	4	2%
ITCI	4	2%
INSM	4	2%
CNST	4	2%
ARNA	4	2%
ALXN	4	2%
TGTX	3	2%
STRO	3	2%
RCKT	3	2%
NBIX	3	2%
LEGN	3	2%
BMRN	3	2%
BHVN	3	2%
XLRN	2	1%
SWTX	2	1%
SAGE	2	1%
KOD	2	1%
KDMN	2	1%
HZNP	2	1%
HRTX	2	1%
FMTX	2	1%
DCPH	2	1%
CCXI	2	1%
ASND	2	1%
ALXO	2	1%
ZYME	1	1%
ZGNX	1	1%
VKTX	1	1%
VIE	1	1%
TBIO	1	1%

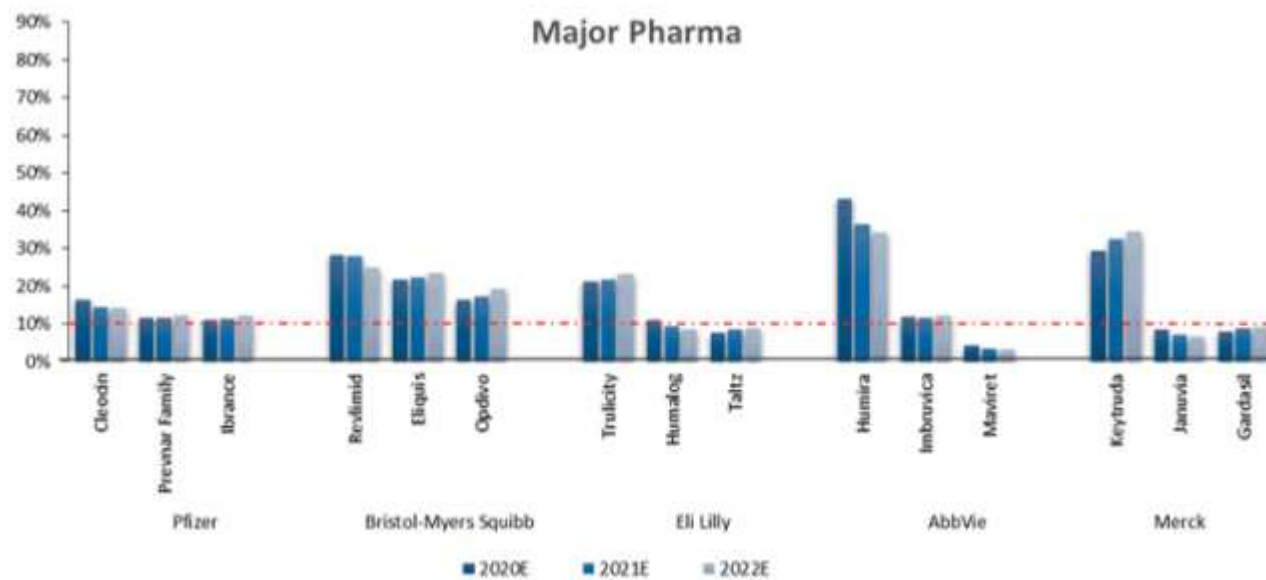
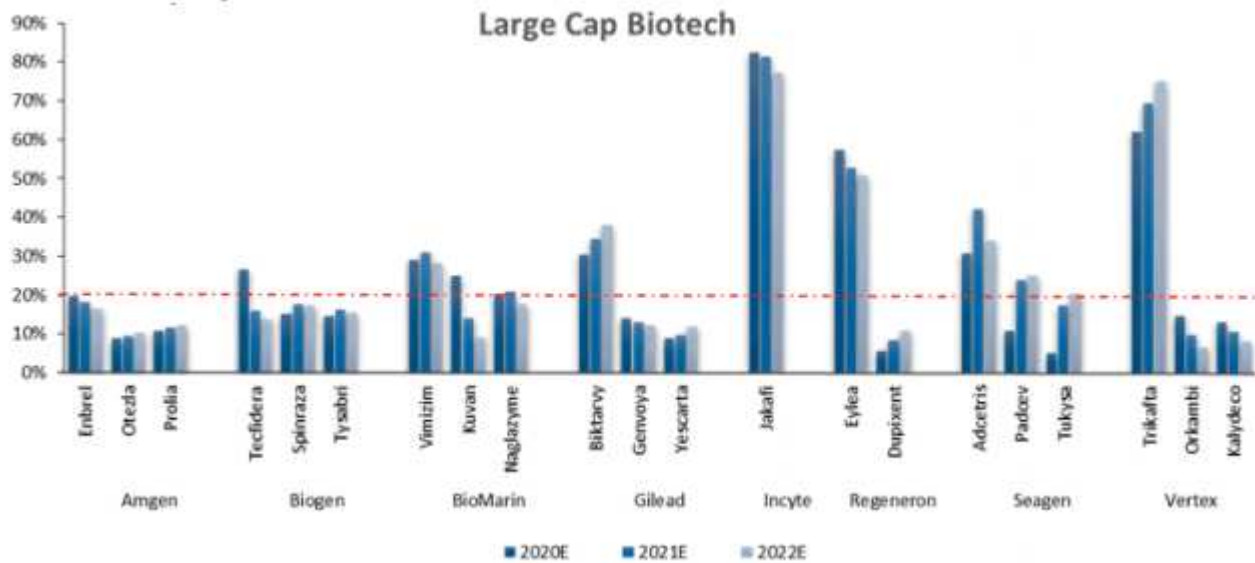
*Note some respondents offered more than one candidate

“If M&A were to increase, which companies might be M&A acquirers”

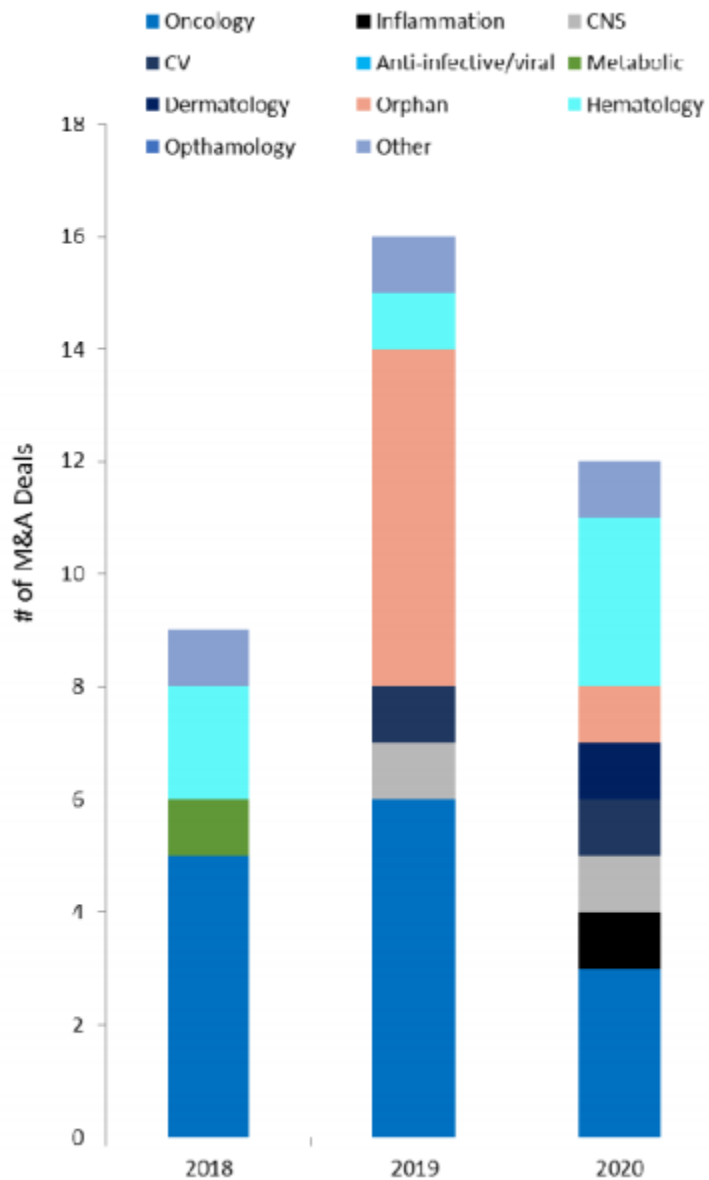
Company	Number of Responses	Percentage (n=175*)
BIIB	22	13%
MRK	20	11%
PFE	20	11%
AMGN	18	10%
GILD	16	9%
VRTX	13	7%
NVS	11	6%
ABBV	10	6%
SNY	8	5%
LLY	7	4%
ROG SW	6	3%
AZN	5	3%
BMJ	4	2%
GSK	4	2%
JNJ	2	1%
ALXN	2	1%
Any Large Cap BioPharma Co	2	1%
TAK	1	1%
BMS	1	1%
NVAX	1	1%
LUN DC	1	1%
REGN	1	1%

*Note some respondents offered more than one candidate

Where is the concentration risk?



Which therapeutic areas have we seen deals since 2018?



Show me the (cash) money!

	Current Cash Position* (\$B)	Current Debt Position (\$B)	JPMe EBITDA 2020E	Current Net Debt/ EBITDA 20E	Debt Capacity (2x)	Debt Capacity (3x)	Debt Capacity (4x)
AMGN	\$12B	\$34B	\$15B	1.5x	\$8B	\$23B	\$37B
BIIB	\$5B	\$8B	\$6B	0.5x	\$10B	\$16B	\$22B
GILD	\$11B	\$35B	\$4B	5.5x	-\$15B	-\$11B	-\$7B
Total	\$28B	\$77B	\$26B	1.5x	\$2B	\$27B	\$53B
REGN	\$2B	\$4B	\$4B	0.5x	\$6B	\$10B	\$14B
VRTX	\$6B	\$1B	\$3B	-1.9x	\$11B	\$14B	\$17B
Total	\$9B	\$5B	\$7B	-0.7x	\$17B	\$24B	\$31B

Reach out with feedback/question to Julie...

Financials (James Goulbourne)

With M&A activity in the traditional asset management space accelerating into year end, an increasing number of questions on potential takeout candidates from here. Detailed thoughts below, with FHI, JHG, and IVZ assigned the highest probability of a bid, although as this emerges as a key theme into early FY21 we would see selling into strength across the group given challenging underlying industry dynamics. Transactions will be driven by a requirement to gain scale to position defensively as fee pressure remains acute, with ongoing flow migration towards passive products. At the single stock level, IVZ is the most vulnerable on the downside into H1, where despite recent optimism surrounding the activist stake, its unappealing asset mix, poor organic growth profile, and size makes it an unlikely acquisition target. For those looking to gain thematic upside exposure, FHI screens as the most compelling proposition given both its digestible size and attractive ESG product niche.

The challenging fee and flow environment has made active managers a popular secular short, and has driven covering over Q4 on concern over further M&A - we expect this source of demand to abate as the necessary repositioning comes to an end over H1. Beyond activist pressure, it's also worth noting that a number of banks (including GS, STT, and NTRS) have been looking to follow in Morgan Stanley's footsteps (after their EV acquisition) and opportunistically accelerate inorganic asset management growth - with current restrictions on capital distribution likely coming to an end in FY21, we expect greater capital distributions to shareholders, reducing the number of strategic buyers across the sector and supporting a retracement of recent price strength.

Quick recap on what we've seen this year...

- **Activist activity** – In October activist manager Train took 9.9% stakes in both IVZ and JHG, with the capital coming from a fund built with the goal of bringing further consolidation to the asset-management industry.
- **Eaton Vance** – Acquired in October by Morgan Stanley for a 38% premium in a \$7bn cash and stock deal. EV had seen consistently strong inflows (4% avg. FY17-19), supported by a product skew towards both ESG (with the Calvert acquisition enhancing this), and tax-managed investing, which has a clear tailwind under a Biden administration.
- **Waddell & Reed** – Acquired in December by Macquarie for a 48% premium in a \$1.8bn cash deal. Despite the large premium relative to comparable transactions, the product mix was skewed towards more traditional areas. The majority of AUM sat in equity focused strategies with particularly large exposure on the active side – note that this product tilt had driven a consistently negative organic growth profile ahead of the transaction.
- **Legg Mason** – Acquired in February by Franklin for a 23% premium in a \$4.5bn cash deal.

Who could be next (most to least likely)...

- **FHI** – Size (\$2.9bn market cap) makes the asset easily digestible, with a strong organic growth profile driven by a very sophisticated ESG product offering. While FHI doesn't have an ETF business (unlike most peers), they are planning to address this in FY21 to support organic growth. While the founding family retains control, both the elevated premiums being offered for sub-par franchises and the funding capacity of large-scale buyers elevates the probability of a transaction.
- **JHG** – A more traditional product set vs FHI limits attractiveness (64% active equity), although the key appeal remains the retail distribution franchise in the US, as well as relationships across Japanese distribution channels.
- **IVZ** – On the product side, strengths in both ETFs (after the 2006 purchase of PowerShares) and private market real estate. Despite this, since the 2019 acquisition of Oppenheimer flows have been extremely challenged (and put pressure on the operating model with a 50% dividend cut earlier this year) - a new CFO was recently appointed to address balance sheet concerns who is at the margin less likely to encourage a near term transaction.
- **BEN** – Relatively large (\$12.6bn market cap), and with an unappealing product set for a potential acquirer with a limited number of business segments demonstrating organic growth. Fixed income the primary strength, with assets acquired in the Legg Mason transaction, along with a private markets real estate business.

Size remains a key determinant of M&A potential

	Price 12/16/2020	JPM Rating	Market Cap.	2019A	2020E	2021E	2022E
BLK	\$698.37	OW	\$107,839	24.5x	21.4x	20.1x	17.6x
FHI	\$29.13	N	\$2,896	10.8x	9.5x	9.7x	9.7x
BEN	\$24.75	N	\$12,625	9.8x	9.3x	8.9x	9.7x
IVZ	\$17.45	N	\$8,025	6.8x	10.2x	8.0x	7.4x
JHG	\$32.49	N	\$5,894	13.2x	12.0x	12.0x	11.6x
TROW	\$150.43	UW	\$34,228	18.7x	16.6x	14.9x	13.7x
Avg.				14.0x	13.2x	12.3x	11.6x

Reach out with feedback/question to James...

J.P. Morgan North American Special Situations Contacts

Special Situations Analyst:

Neetu Jhamb neetu.jhamb@jpmchase.com (212)-272-5971
Peter Paganessi peter.paganessi@jpmorgan.com (212)-622-2950

Special Situations Trading:

Phillip "Tex" Polito phillip.a.polito@jpmchase.com (212)-622-2775
Manasa Datla manasa.datla@jpmchase.com (212)-622-2973
Derivatives: Brian Alvarez brian.c.alvarez@jpmorgan.com (212)-622-2667

Special Situations Sales:

Brian Frank brian.frank@jpmorgan.com (212)-272-4847
Logan Scott logan.m.scott@jpmorgan.com (212)-622-7094
Derivatives: Jonathan Simon jonathan.m.simon@jpmchase.com (212)-622-2856

J.P. Morgan EMEA Special Situations Contacts

Sector Specialist:

Li Dunlop li.dunlop@jpmorgan.com +44 207 134 1953
Zara Patel zara.patel@jpmorgan.com +44 207 134 1953
Davide Contu davide.contu@jpmorgan.com +44 207 134 1953

Generalist Sales:

Simon Parrott simon.parrott@jpmorgan.com +44 207 134 1953
Cerys Parkin cerys.h.parkin@jpmorgan.com +44 207 134 1953

Sales-Trading:

James Creager james.creager@jpmorgan.com +44 207 134 1953
Keshan Vaikunthanathan keshan.vaikunthanathan@jpmorgan.com +44 207 134 1953

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