PFIZER’S VISION OF R&D

Recently I saw Ian Read, the CEO of Pfizer, on CNBC explaining that the Pfizer/Allergan merger would enable the combined companies to spend more on research and development of new drugs. He also confirmed that Pfizer raised prices on at least 105 drugs for no apparent reason. You can watch a small part of the interview here.

Read tries to pass the price hikes off as some kind of market-driven thing, which is stupid because price hikes are mostly either for drugs protected by patents or for generics which have no competition. The increases averaged 9.4%, far in excess of inflation, and faster than the expected increase of 5.4% in total health care spending. It’s a money grab pure and simple. The CEO then explained that these prices are a drop in the bucket, since drugs account for only about 10% of total health care spending, which comes to a total of about $310 billion, or roughly $1000 per person in the US. Drug prices rose by an average of 10.4% in 2014, so a drop in the bucket is roughly $100 per US person. And anyway, Read says, they do negotiate prices with some providers and cut prices for some poor people; meaning that the rest is paid by drug insurance policy holders. All this public talk is just politics, says Read, who in 2014 received total compensation of $23.3 million. Surely for that kind of money he could do a better job of defending his company’s rapacious behavior.

Pfizer is planning to merge with Allergan and move to Ireland to cut taxes. Read claims he needs the money for research and development of wonderful new drugs. That suggests that Read thinks he doesn’t have enough money for R&D right now. Let’s see what the 2014 financial statements say about that. In 2014, Pfizer reported net income of $9.1 billion. P. 58. It paid dividends of $6.6 billion, and repurchased stock for $5.0 billion, a total return to shareholders of $11.1 billion. With that kind of

management, no wonder there is no money for an increase in R&D.

Remember that R&D expenses are deductible in full in the year incurred, a temporary tax law now permanent thanks to Congress. So let's see what we get for that tax cut. Pfizer reports that in 2012, it had an R&D expense of $250 million to "obtain the exclusive, global, OTC rights to Nexium". P. 28. Pfizer get Uncle Sam to pay about $80 million of that price. In 2014, Pfizer counted as part of its increase in R&D this gem: "$309 million, reflecting the estimated fair value of certain co-promotion rights for Xalkori given to Merck KGaA". That's a non-cash transaction that cut Pfizer's taxes.

And here's a description of the R&D program at Pfizer:

> We take a holistic approach to our R&D operations and manage the operations on a total-company basis through our matrix organizations described above. Specifically, a single committee, co-chaired by members of our R&D and commercial organizations, is accountable for aligning resources among all of our R&D projects and for seeking to ensure that our company is focusing its R&D resources in the areas where we believe that we can be most successful and maximize our return on investment. We believe that this approach also serves to maximize accountability and flexibility.

That's management speak for "we make drugs that will maximize our income."

Turning to the Allergan deal, CEO Read assures us that Pfizer will use the tax savings for R&D. Let's first see what the savings might be. According to Americans for Tax Freedom, Pfizer paid effective world-wide tax rate of 7.5%. That compares with the 25.5% reported on its 10-K. P. 28. ATF offers a detailed explanation of the

accounting, and explains that most US multinationals don't use the same accounting treatment. ATF adds that Pfizer had as much as $148 billion parked overseas and untaxed in the US. At least that explains where they get the money to pay off their shareholders and keep Wall Street happy.

Let's just ignore the claim of Frank D'Amelio, Pfizer's CFO, that half the tax savings will go to shareholders as dividends. Pfizer has shut down a bunch of R&D facilities after each of its recent mergers.

> Writing in Nature, former Pfizer R&D executive John LaMattina noted that the company's three largest buyouts—Warner-Lambert, Pharmacia and Wyeth—resulted in sweeping research cuts and site closures, leaving more than 20,000 scientists out of work. And those who stick around were saddled with major R&D delays, LaMattina wrote, as integrating two large companies involves a painstaking review of assets that can slow development down to a crawl. Even more difficult to quantify is the effect on productivity, he wrote, as word of potential layoffs spreads fast throughout a large company and distracts workers from their projects.

After the merger the number two man, Brent Saunders of Allergan will oversee operations, including R&D. Here's Saunders in August, 2015, discussing his vision of R&D with Randall Pierson of Reuters.

> Saunders said discovery research, where researchers test ideas and compounds in test tubes and animals, typically eats up about 30 percent of pharmaceutical company research budgets, although only about one of every 20 such products that enters human trials succeeds and is approved.

> “Discovery is where the industry has its lowest return on investment,” he said, “and not a good (use) of Allergan’s research dollars.”
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> Instead, he said Allergan will acquire products from companies that have already done the research spadework, and then itself develop the medicines and submit them for regulatory approvals.

In other words, Saunders and Read like the business of buying other people’s research and then doing some tests and filling out the paperwork for drug approvals. This gets them a patent/monopoly, and a fat tax deduction for all the paperwork. Then they can sell the drugs for a profit that is taxed (if at all) at capital gain rates, and if a US company buys it, the US company gets to treat the price it paid as a fully deductible R&D expense. Sweet.

Remember that Read is magnificently compensated for running this business, but what does he bring to the table? It has nothing to do with drug creation and manufacture. His contribution is measured by how little Pfizer pays in taxes, and how well he engineers earnings, and certainly not by any contribution to the well-being of humans.

We don’t have to allow this business model to flourish with tax cuts and benefits. It’s corrupt to the bone.