

The financial profile of a Basel pharmaceutical group

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The financial profile of a large research-based pharmaceutical company differs markedly from that of a bank or an industrial manufacturer. Its revenues are generated by a limited number of patented products with high gross margins, which produce strong and fairly predictable operating cash flows for as long as patent protection lasts. Research and development absorb a large share of revenue every year, typically somewhere between a fifth and a quarter of sales in the case of Roche and Novartis. Because the outcome of individual research projects is highly uncertain, the companies prefer to finance research from current cash flow and to keep borrowing for acquisitions, where an identifiable asset with a measurable value is being purchased.¹

A second characteristic is the importance of the patent cliff. When a blockbuster medicine loses exclusivity, its sales can fall by a large proportion within a few years because generic or biosimilar competitors enter the market. Roche experienced this after 2018 with its three large cancer antibodies Herceptin, Avastin and MabThera, whose combined sales had been one of the foundations of its profitability. Novartis went through a comparable phase earlier with Diovan and Gleevec. A finance function that serves such a business must ensure that the balance sheet can absorb several years of declining revenue in a particular franchise while research spending continues and acquisitions are made to replenish the pipeline.²

A third element is the international distribution of cash flows. Both groups generate the larger part of their sales outside Switzerland, with the United States as the single largest market, while a significant share of their costs, including research, headquarters functions and part of production, is incurred in Swiss francs. Profits accumulate in subsidiaries in many jurisdictions and have to be moved to the parent company in Basel in the form of dividends, licence fees, service charges or intra-group loans. The

design of these flows falls within the domain of tax planning, which is discussed in the next chapter, although it also shapes the treasury organisation that this chapter examines.³

1 Notes

1. On the share of research and development in the revenues of Roche and Novartis, see the annual reports of Roche Holding AG and Novartis AG for recent financial years. Percentages vary from year to year and are to be verified. ↩
2. On the loss of exclusivity of Herceptin, Avastin and MabThera/Rituxan and the effect of biosimilar competition on Roche's revenues from about 2018, see the Roche annual reports 2018–2021. On the patent expiry of Diovan and Glivec/Gleevec at Novartis, see the Novartis annual reports 2012–2016. To be verified. ↩
3. On the geographical distribution of sales and the share of the United States in the revenues of Roche and Novartis, see the segment information in their annual reports. On transfer pricing and intra-group flows in a tax context, see Part G, Chapter III. To be verified. ↩

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