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NEWS ANALYSIS
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Pfizer-Warner: One Drug Merger That Might Just Deliver

The combo looks as if it will carry through with cost reductions, better marketing, and stronger R&D

Whenever pharmaceutical companies merge, there's often talk of huge cost-savings. That excites investors at first but later leaves them wondering: "Why did we believe that hype?" Case in point: Pharmacia's merger with Upjohn five years ago. The two companies trumpeted their belief that they would save $500 million annually for several years -- and then forgot to deliver. Within months, the merger became a mess, as squabbling broke out among disparate headquarters in four countries.

Now comes Pfizer's hostile takeover of Warner-Lambert, which is expected to take place before the middle of June. Analysts and money managers are saying that the merger will bring not only huge cost-savings but also huge marketing advantages over other companies. Hype? Maybe not this time. In fact, Pfizer may be underestimating the benefits, some believe. "We're talking about the creation of an extremely powerful drug company. I think investors are finally starting to grasp the size and scope of this merger," said Gruntal & Co. analyst Jeffrey Kraws. "This is about much more than cost-savings."

Above all, the merger is about Lipitor -- Warner-Lambert's blockbuster cholesterol-lowering drug, which Pfizer has been eyeing ever since merger talks began. Already, Pfizer takes nearly half the revenues from Lipitor in a co-marketing deal. The drug is poised to become the world's best-selling medicine, possibly as early as next year, surpassing Merck's Zocor and AstraZeneca's Prilosec, most analysts believe. Pfizer will soon have all Lipitor sales to itself in the combo -- more than $5 billion this year and $7 billion by 2002, according to Mehta Partners' Viren Mehta.

PREPARING THE HATCHET. What's more, Pfizer appears to be dead serious about cutting jobs and overhead costs in the consolidation. After all, it is a hostile takeover. Warner-Lambert's New Jersey headquarters will be folded into Pfizer's in New York. Only Warner-Lambert's over-the-counter business will remain in New Jersey. On May 12, Warner-Lambert's departing CEO, Lodewijk J.R. De Vink, told shareholders in his farewell address that the company should expect a 10% workforce reduction.

That may be aiming low, says Michael Krensavage of Brown Brothers Harriman. "The most important tool for achieving cost-savings in this merger will be a hatchet," he says. "This is no merger of equals. Pfizer is firmly in control."

Indeed, only a handful of top Warner-Lambert execs were given jobs at Pfizer. They include Peter Corr, who heads Warner-Lambert's Parke-Davis research labs, and S. Morgan Morton, chief of the consumer health-care division in New Jersey. The overwhelming majority have been let go.

INTEGRATION ADVANTAGES.. In all, Pfizer aims to save $1.6 billion in operating costs in as little as 18 months, with overall savings reaching $2.5 billion within three years, the company told analysts. What's interesting is that many believe the company could easily go for more. "Pfizer is low-balling the cost-cutting estimates," said Tim Ghriskey, senior portfolio manager for the Dreyfus Funds, which has been buying up Pfizer shares. "The company is remaining on the safe side."

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A look at the two companies' portfolios illustrates how they can save on operating costs: Pfizer makes Norvasc, a pill for high blood pressure that's expected to generate $3.5 billion in revenues this year, while Warner-Lambert makes Accupril, a $600 million blood-pressure drug with a different mechanism of action. After the merger, a slightly beefed-up Pfizer sales force can sell the two drugs at once, since doctors may prescribe both to patients with hypertension.

Integration on the research side will help, too, Krensavage argues. The two companies' research divisions are developing fledgling compounds for different diseases. Thus, a combination of R&D will create a company with hands in nearly twice as many drug categories. Pfizer sells Viagra for impotence and Zoloft for depression. Warner-Lambert makes Neurontin, a fast-growing epilepsy drug. Pfizer also co-markets Celebrex, a blockbuster arthritis painkiller made by Pharmacia. And marketing other companies' drugs remains Pfizer's bread-and-butter business, says analyst Hemant Shah. "Pfizer is sales-and-marketing-driven. Merck, by contrast, is research-driven."

"STRATEGIC REASONS." Then there's the merger's impact on Pfizer's market share. The company will have slightly more than 10% of sales in the domestic prescription-drug market. This will be the first time a drugmaker has ever held such a large position -- and that will likely make HMOs and other prescription-drug buyers nervous.

"A majority of other mergers in the past were financial mergers, done for cost reductions," says Martyn Postle of Cambridge Pharma Consultancy in Britain, which advises Pfizer but has no holdings in the company. "Pfizer did not need to do a financial merger. The company is doing this deal purely for strategic reasons -- for Lipitor, for the therapeutic enhancements Warner-Lambert brings, and for the sheer marketing clout that the merger gives the company." Postle says Pfizer's larger market share will give the company more influence over contracts with wholesale drug buyers. It is exactly the kind of influence a drug company needs in an increasingly hostile regulatory environment for the pharmaceutical industry, he says.

Despite the benefits for Pfizer, not everyone is convinced that the merger makes the company an attractive investment. With a price-to-earnings ratio of 54, Pfizer already stands as the most expensive stock among major pharmaceutical makers. Brown Brothers' Krensavage, for example, has a neutral rating on the stock. "I just don't see Pfizer as undervalued," he says.

WILD CARD. Indeed, the stock has shot up since the merger news, from a 2000 low of $30 in March to $44 on May 16. So any significant buying opportunity may have passed, some analysts think. And there's a wild card to consider later this year: Some drug-industry analysts have been arguing that if Al Gore is elected President in November, it could adversely affect drug company stock values. Gore has been a strong advocate for federal price controls on prescription drugs, while Republican George W. Bush has sidestepped the issue.

Still, Pfizer stock is expensive for good reason, most analysts who follow the company agree. Pfizer should produce earnings growth of 25% over the next three years, PaineWebber's Jeff Chaffkin says, with highly bankable drugs such as Viagra and Celebrex in its corner. By contrast, the drug industry as a whole will grow only about 15% annually, Chaffkin estimates.

With numbers like that, the Pfizer takeover of Warner-Lambert may result in what Gruntal's Jeffrey Kraws calls "one of the great defensive stocks." No matter what happens with higher interest rates, oil prices, or inflation, this combo may be more than just big talk and great expectations.

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