Delaware officials concerned about AstraZeneca, DuPont threats

Jeff Mordock, **The News Journal**, February 22, 2015

(Photo: JIM GRAHAM / BLOOMBERG NEWS)

AstraZeneca Plc and DuPont Co. are facing threats that have the potential to cost Delaware hundreds of jobs. State officials say they are concerned.

Billionaire investor Nelson Peltz is making a play to install four new directors on DuPont's 13-member board. Peltz has vowed that if his director slate is elected to the chemical giant's board, they will lobby to split the company into three units.

Under Peltz's plan, DuPont will remain, but likely focus only on its core business of industrial biosciences. He would also spin off the company's agriculture and nutrition and health units, a proposal that would likely create job losses in those groups. Pressure from Peltz has already forced DuPont to spin off its performance chemical business, Chemours Co.

Meanwhile, AstraZeneca's 2014 earnings were characterized by analysts as disappointing. Net profits for last year stood at $1.23 billion, a roughly 24 percent decline from its 2013 net profit of $2.56 billion. The pharmaceutical company's 2014 earnings per share dropped to $4.28, an almost 18 percent decrease from $5.05 in 2013.

AstraZeneca's earnings slump along with the pharmaceutical industry's merger mania have led analysts to label the company as a potential acquisition target. The company rebuffed a $119 billion bid from Pfizer Inc. last year. Some analysts have said Pfizer or another company needing access to AstraZeneca's strong pipeline could be potential suitors for the company.

Pfizer was attracted to AstraZeneca because its principle headquarters was located in the United Kingdom. If the merger happened, Pfizer would have reincorporated in the United Kingdom to reduce its corporate taxes, a move referred to as "an inversion." At the time of Pfizer merger talks, Delaware's congressional delegation acknowledged the transaction would have cost the state jobs.

State officials say they are monitoring the situations with both companies, but cautioned it's too early to know if or when either scenario could come to fruition.

"Worried is not the appropriate term, but we are concerned," said Alan Levin, Director at the Delaware Economic Development Office.

In an interview with The News Journal, Gov. Jack Markell said he would use the word "hopeful" to describe how feels about the future of both companies. He said that the state officials regularly meet with executives from both companies to receive updates on issues affecting businesses.

"Anytime you are a small state, each job is meaningful," the governor said.

But others who follow the state's economy paint a different picture.

"If you are the state, I think you do worry," said James Butkiewicz, chairmain of the University of Delaware's Economics Department.

Republican State Sen. Greg Lavelle represents Sharpley, the legislative district that is home to AstraZeneca and a portion of DuPont's holdings, including the country club and the Experimental Station, the chemical company's primary research and development center.

"There are conversations to make these entities know that we want to have them in Delaware," Lavelle said. "We will do everything in our power, but our power is limited."

Threat of layoffs

Peltz owns $1.9 billion of DuPont stock through Trian Management Fund. He has lobbied to break up the company, including authoring two white papers arguing a leaner DuPont would generate better returns for shareholders. In an effort to achieve this goal, he has nominated four candidates, including himself to the company's board.

In a September letter to DuPont's board, Peltz claimed his plan to separate the company into three autonomously-managed business would eliminate an operational performance gap compared to its peers in the chemical industry. Although Peltz said last week his directors are open to keeping DuPont together, no one seriously believes his board members will not lobby split the company, if elected.

DuPont has opposed Peltz's plan. Dan Turner, a company spokesman, referred to DuPont's recent shareholder letter calling Peltz's breakup plan "misleading."

If Peltz is successful, the DuPont split could cause dual headaches for the state. The activist investor has a history of pressuring companies to lay off employees in an effort to reduce inefficiencies. He has already claimed DuPont has between $2 billion and $4 billion of excess corporate costs.

For example, when Trian assumed a 5.4 percent stake in ketchup maker Heinz, Peltz unveiled a turnaround plan calling for the company to reduce costs. Heinz responded with the elimination of 15 manufacturing plants and cutting 2,700 jobs, roughly 8 percent of its workforce.

Another concern is whether the spun off units will stay in Delaware. DuPont said Chemours will take over its former headquarters in downtown Wilmington. However, if Peltz splits the agriculture and nutrition and health units, another state may attempt to recruit the new entities or they could be acquired by a larger company.

Levin said the state is actively engaged with DuPont to ensure Chemours stays in downtown Wilmington, but could not provide specific information about those talks because of a nondisclosure agreement.

'Delaware could lose alot'

Unlike DuPont, no immediate AstraZeneca suitor has materialized, but analysts were discouraged with the company's full-year and fourth quarter earnings for 2014. A Barclays report issued after the pharmaceutical company released its earning statement said management "will be forced to acknowledge the current earnings base is untenable."

Kevin O'Neill, a program manager at The Cecon Group, a Wilmington company that offers consulting services in multiple industries, including life sciences and medical devices, agreed AstraZeneca's board may be compelled to consider an overture from an acquiring company.

“AstraZeneca’s financial performance makes them a target because they are under a lot of pressure to find a better return on shareholder investment,” O’Neill said. “If another party were to offer a slight premium on the stock price, AstraZeneca would have to look at that deal to create a better outcome than what they already have.”

But Joseph Fuhr, a professor of economics and adjunct assistant professor of pharmaceutical and healthcare business at Widener University, said even companies with strong earnings are merger targets in today’s market.

“Everyone in the drug industry is now a possible merger target because those companies are merging more and more,” he said.

In a statement released to the News Journal, AstraZeneca noted that its full revenue increased in 2014. The company’s full-year revenue inched up 3 percent at constant exchange rates to $26 billion last year from $25.7 billion in 2013. AstraZeneca also achieved a record six product approvals last year.

It is not clear if Pfizer will attempt another play for AstraZeneca. Earlier this month, Pfizer paid $17 billion to acquire Hospira, an Illinois manufacturer of generic versions of expensive biologic drugs. The acquisition was Pfizer’s first deal since the AstraZeneca transaction collapsed.

While the DuPont situation is more imminent, Butkiewicz said an AstraZeneca acquisition could potentially be more devastating to the state.

“I’m less concerned about DuPont than I am about AstraZeneca, he said. “With DuPont it’s not a takeover, but a restructuring. If a company takes over AstraZeneca they won’t have duplicate management. Delaware could lose a lot”

The Pfizer deal was so worrisome to Delaware that its federal representatives, U.S. Sens. Tom Carper and Chris Coons and U.S. Rep. John Carney, sent a letter to Pfizer CEO Ian Read. In the letter, the legislators said they were “mindful of the negative impact this merger could have on the thousands of dedicated AstraZeneca employees in our state.”

Although Pfizer walked away from the deal, they could return. Under British merger and acquisition laws, a company must wait six months before it attempts another merger with the same company. The six-month waiting period expired in November.

Levin said Markell was in constant contact with AstraZeneca when Pfizer was targeting the company. He said Pfizer had reached out to state officials, but Delaware refused to engage the company.

“Our allegiance was to our friends at AstraZeneca,” he said. “We thought an independent AstraZeneca was in Delaware’s best interest.”

Markell is hopeful

DuPont and AstraZeneca combine to employee roughly 9,600 people in the state. Although the companies account for roughly 2.2 percent of the state's 427,881 employed residents, they offer higher paying executive level jobs.

"A lot of people could lose good-paying jobs," Butkiewicz said. "The state won't get those jobs back, at least not on those levels. There is no obvious single source to offset the job loss that could happen in Delaware."

Job losses at either company will have a ripple effect on the greater Wilmington community because so many employees support shops and restaurants near their offices.

"You have to look at the benefit of these companies as more than just salaries," Butkiewicz continued. "Companies can say they are creating 50 jobs, but they are really creating 75 because those employees are buying things in the area."

Delaware's unemployment rate decreased to 5.4 percent in December, a full point from from October's 6.4 percent rate, according to state statistics. John Boyd is a principal of The Boyd Co. Inc., a organization that advises companies on relocation said Delaware's size makes it difficult to absorb job losses.

"DuPont is already leaving downtown Wilmington, so if AstraZeneca were to reduce their presence in the region, it would be a very dire situation for the greater Wilmington economy," Boyd said.

But Markell emphasized that he is positive about the future of both companies.

"(DuPont's) Ellen Kullman is a great leader who recruited two strong members to the company's board," he said. "I've been really impressed with (AstraZeneca CEO) Pascal Soriot. AstraZeneca's pipeline is better than it has ever been."

Credit card and banking hub

Delaware's unemployment rate in December 1979 was 6.9 percent, well above the national average of 5.8 percent, according to the Bureau of Labor Statistics. In an effort to improve the state's employment picture, the General Assembly passed the Financial Center Development Act, or FCDA. The legislation removed interest rate ceilings on banks. At that time, many banks located in New York had been frustrated with that state's law limiting interest rate increases. Delaware enacted the Consumer Credit Bank Act of 1983 two years later which allowed smaller and limited-purpose banks receive the same advantages of the FCDA.

The FCDA helped transform Delaware into a credit card and banking hub. A 1987 study by Delaware economist Eleanor D. Craig revealed that within six years, the legislation added 15,300 jobs and $554.6 million in additional personal income to the state. The study also concluded the banking jobs created a need for 90 retail establishments, increasing retail sales by $284.3 million per year.

But there is no 2015 version of the FCDA available to save Delaware if DuPont is split up and AstraZeneca is acquired.

“There is no obvious regulation changes that will make as big a difference as the FCDA did in 1981,” Butkiewicz said. “It’s a lot harder to do these things now because everyone is wise to it. Look at how other states have copied Delaware’s corporate charter.”

Boyd said the best thing Delaware can do to retain and keep jobs is keep taxes low and offer companies redevelopment incentives.

“Companies will need access to new incentives to customize new corporate investments,” he said. “The AstraZeneca facility was designed 30 years ago with 250 square feet per worker. Projects today require about 125 square feet per worker so economic development forces will need to address how to repurpose that vacant space.”

Lavelle agreed that low taxes are the key to attracting businesses to Delaware.

“Obviously, we need to be competitive with our tax rates,” he said.

Delaware officials should also be constantly marketing the state to companies located in other parts of the country. Boyd said right now Delaware should reaching out to the increasing number of New York companies that have investigated relocating to New Jersey.

“There is no reason Wilmington can’t present itself as an alternative to the prohibitively expensive New York City market,” he continued. “The governor should make the case to these companies that there is a greater cost savings in relocating to Wilmington instead of Bergen County. This is an area where governors can take the lead with economic development.”

Levin said the state is always looking to attract new businesses to Delaware.

Market conditions a factor

In the cases of AstraZeneca and DuPont, any structural changes would be influenced by market fluctuations. For example, DuPont’s shareholders will likely accept or reject Peltz’s proposal based on how the company is generating shareholder value at the time of the vote. If a suitor emerges for AstraZeneca, it would likely require a U.S. company seeking to do an inversion or company needing to infuse new products into a barren pipeline.

Delaware being held hostage to market conditions is nothing new. One of the reasons for Delaware's high unemployment rate in the 1970s was because the United States' manufacturing base began to erode and many of those jobs were based in the state.

"If you believe in capitalism, these things happen and we need to do what we can and keep our fingers crossed," Lavelle said.

Most recently, Markell and the state's federal legislature lobbied to tweak the Affordable Care Act to save 500 jobs at Cigna's Delaware office. Carney authored a bill allowing health insurance plans like Cigna to offer expatriate health insurance plans for people working outside their home country including foreign employees working in American or Americans working abroad. Cigna said it would be forced to lay off employees if an exemption was not created.

Since market conditions are often unpredictable, it makes it difficult for the state to go on the offensive to retain jobs if there is any kind of movement for either company.

"Until the DuPont splits actually happen, we are not prepared to put our cards on the table just yet," Levin said. "They just can't close these units down and move them to Ohio overnight. If there is a need to keep them we will be happy to sit down and discuss the future of DuPont."