

Viatis - What Should Phase 2 Capital Buy?

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Decision scope: Board rule for Phase 2 capital allocation and reinvestment gates

Case convention: This is an author-created board decision exercise based on information available on the cutoff date. Management estimates and announced transactions are labeled; no later outcomes are included.

The decision

On 7 November 2022, Viatis described a transition from “Phase 1,” focused on integration and debt reduction, to a “Phase 2” portfolio intended to support growth. It expected \$8-9 billion of gross, pre-tax proceeds from announced and planned divestitures by the end of 2023 or shortly thereafter. Management also estimated that the assets leaving would remove about \$2.1 billion of revenue and \$700 million of adjusted EBITDA, while research and development expense would rise by approximately \$300 million. [P1], pp. 3-5, lines 55-79, 99-102.

Management proposed a framework for at least \$2.3 billion of annual Phase 2 free cash flow: roughly half for dividends and share repurchases, and the other half for organic and inorganic reinvestment. It presented this as an intended allocation, not a formula already tested against the post-divestiture portfolio. [P1], p. 6, lines 104-106.

Assignment: As a hypothetical board member, recommend a Phase 2 capital-allocation rule. Should the board retain the approximate 50/50 framework, and what evidence and gates should determine how the reinvestment pool is used? Address internal R&D, acquisitions and shareholder returns while preserving the stated debt-reduction and investment-grade objectives. The task is to set a decision rule, not to re-decide the announced divestitures.

What “cash” means in this decision

Viatis defined Phase 2 free cash flow (FCF) as U.S. GAAP net cash provided by operating activities less capital expenditures. FCF is a non-GAAP measure. The \$2.3 billion annual amount was a management forecast, stated to exclude transaction costs and taxes. The filing did not provide a quantitative reconciliation of that outlook to projected GAAP operating cash flow because significant items could not reasonably be predicted. It was not reported as an achieved annual run rate. [P1], p. 6, lines 104-106; non-GAAP definitions, lines 194-202.

The \$8-9 billion divestiture estimate is a separate pool: gross, one-time, pre-tax proceeds expected from announced and planned transactions, including the biosimilars transaction. Management separately estimated \$5-6 billion from other planned divestitures. These amounts should not be added together, treated as after-tax cash, or confused with annual FCF. Timing, transaction costs, taxes, working capital and stranded costs could affect net cash available. [P1], pp. 3-5, lines 55-79, 99-102.

Phase 1 constraints and Phase 2 objectives

For Phase 1 (2021-2023), management had stated goals including at least \$1 billion of cost synergies, at least \$6.5 billion of debt paydown, a 3.0x gross-leverage target and preservation of investment-grade ratings. As of the update, Viatris reported \$4.2 billion in debt repaid since the start of 2021 and said it was on track for the \$6.5 billion goal. These are dated management statements; the update does not establish rating headroom or a debt-repayment schedule after Phase 1. [P1], pp. 1-2, lines 7-22.

The 3.0x gross-leverage target had a stated 2.8x-3.2x range and was defined as a forward-looking non-GAAP measure using targeted notional gross debt divided by targeted adjusted EBITDA. Viatris explicitly said this target was not Company guidance and did not quantify future amounts. It should be treated as a management objective, not a forecast or covenant. [P1], lines 208-209.

The company forecast 2-3% annual erosion in its Phase 2 base business before pipeline effects, while expecting its internal pipeline to more than offset erosion and support 1% long-term organic top-line growth. Including two announced ophthalmology acquisitions, it targeted approximately 3% revenue CAGR, 4-5% adjusted EBITDA CAGR and mid-teens adjusted EPS CAGR. These were management forecasts, not demonstrated outcomes or guidance beyond 2022. [P1], pp. 5-6, lines 87-102.

Management's growth priorities included ophthalmology, gastrointestinal and dermatology. It said future acquisitions should be value-creating, financially accretive bolt-ons that fit those areas. Viatris also described its shares as significantly undervalued and repurchases as attractive. Those are management views; the public update does not provide independent valuation evidence or a project-by-project pipeline return analysis. [P1], pp. 2, 6, lines 31-32, 104-118.

A live test of the reinvestment rule

Viatris had announced acquisitions of Oyster Point Pharma and Famy Life Sciences for an approximately \$700-750 million cash package. At the cutoff these acquisitions were pending. Oyster Point consideration was \$11 per share upfront plus a non-tradeable contingent value right (CVR) of up to \$2 per share, conditional on specified 2022 performance metrics. Closing was subject to customary conditions, regulatory approval and tender acceptance. [P2], paragraphs 2-9, lines 134-143.

Management said the acquisitions could establish an ophthalmology franchise by combining its global commercial, regulatory and supply capabilities with Oyster Point's marketed product and Famy's Phase III-ready pipeline. It projected at least \$1 billion in sales and \$500 million in adjusted EBITDA by 2028. Those were forecasts, not realized sales, validated returns or a probability-adjusted valuation. The public materials did not provide an independent product forecast bridge, integration budget, CVR valuation or detailed pipeline probabilities. [P2], lines 139-144.

Exhibit 1. Separate capital pools and claims

Item	Amount / definition	Status and scope
Phase 2 annual FCF	At least \$2.3bn; GAAP operating cash flow less capex	Management forecast; non-GAAP; excludes transaction costs and taxes; no quantitative reconciliation to projected GAAP operating cash flow. [P1]
Intended allocation of Phase 2 FCF	Approximately 50% to dividends/repurchases; 50% to organic/inorganic reinvestment	Management's proposed framework; open for board analysis. [P1]
Divestiture proceeds	\$8-9bn gross, pre-tax, from transactions including biosimilars	One-time aggregate estimate; timing and net proceeds uncertain. Not annual FCF. [P1]
Removed assets / increased R&D	~\$2.1bn revenue and ~\$700m adjusted EBITDA leaving; ~\$300m higher R&D expense	Management's estimated Phase 2 portfolio bridge, not an audited pro forma. [P1]
Gross leverage objective	3.0x target; 2.8x-3.2x range	Non-GAAP forward-looking measure; expressly not Company guidance. [P1]
Oyster Point / Famy	~\$700-750m cash package; Oyster Point \$11/share upfront plus up to \$2/share CVR	Announced and pending; CVR contingent on specified 2022 performance metrics. [P2]

The figures refer to different concepts, timing and accounting bases. They should not be summed into one pool of immediately distributable cash.

Exhibit 2. Board choices to examine

Capital-allocation posture	Potential benefit	Main concern
Keep the approximate 50/50 rule: fund shareholder returns and reinvestment at the announced proportions	Predictability and balance between current distributions and portfolio renewal	A fixed percentage may not fit cash volatility, a weak opportunity set or the business's revenue/EBITDA transition
Tilt toward internal reinvestment: prioritize pipeline and capability development until erosion and R&D needs are addressed	Could replenish the portfolio and support differentiated growth	Internal projects may have uncertain timing and returns; reduced distributions may weaken investor confidence
Return more cash / emphasize balance-sheet capacity: use dividends, repurchases or debt actions when projects fail defined hurdles	Can avoid overpaying for growth and reinforce financial resilience	May underfund a viable pipeline or leave the portfolio exposed to continued erosion; buybacks depend on valuation judgment
Keep 50/50 as a starting rule with gated reinvestment: allocate by percentage but release investment in stages against explicit hurdles	Combines a stable framework with project discipline and the option to redirect funds	Gates can become either rubber stamps or excessive delay; the framework still needs a rule for uncommitted cash

These are analytical choices, not management's subsequent actions. A strong recommendation specifies the rule, the treatment of one-time proceeds, the return and leverage constraints, and how the board will change course if forecasts or opportunities disappoint.

Questions for discussion

1. Is the roughly 50/50 allocation robust to the forecast loss of revenue and adjusted EBITDA, higher R&D expense and expected base-business erosion?
2. How should the board evaluate internal pipeline funding versus acquisitions, repurchases, dividends or debt actions?
3. What hurdles and stage gates should govern use of the reinvestment pool? Which evidence would validate therapeutic fit, capability advantage and financial return?
4. How should the board treat the pending Oyster Point/Famy acquisitions in its capital-allocation framework, including the CVR and management's 2028 projections?
5. How should the board use the 3.0x gross-leverage objective and investment-grade commitment without treating the target range as company guidance?

Sources and conventions

P1. Viatriis, "[State of the Union](#)" [strategic-update script](#), Form 8-K Exhibit 99.2, 7 November 2022. Phase 1, pp. 1-2; divestitures, pp. 3-5; Phase 2 outlook and capital allocation, pp. 5-6; FCF definition/reconciliation, lines 194-202; leverage target and range, lines 208-209.

P2. Viatriis, "[Viatriis Announces Two Acquisitions to Create What it Expects to be a Leading Ophthalmology Franchise](#)", 7 November 2022, paragraphs 2-10, lines 134-144.

Management forecasts, stated valuation views, transaction terms and strategic rationales are attributed. The 50/50 rule remains open to analysis. No academic effect size is used to forecast Viatriis outcomes; no post-cutoff closings, proceeds or operating results are included.