Why Bill Ackman and Valeant Are Bidding for Allergan

Description

The management team, board members, and shareholders of multi-specialty healthcare company **Allergan** (NYSE:AGN) certainly have a lot to think about. Canada-based **Valeant Pharmaceuticals** (TSX: VRX)(NYSE: VRX) has teamed up with hedge fund Pershing Square (led by activist investor Bill Ackman) to bid for the company.

The total value of the bid is $47 billion, approximately $153 per share, with 30% of that being paid in cash, and the rest in stock. The offering price is a 30% premium to Allergan's closing price back on April 10, when Pershing Square ratcheted up its purchases of Allergan stock. Yet the market still expects the offer to be sweetened; the shares currently trade in the mid-$160s (all figures in USD).

Valeant and Pershing have been prepping for this day for months. Valeant has already lined up funding from **RBC** and **Barclays**. Meanwhile, Pershing has accumulated a 9.7% stake in Allergan. Pershing is also committed to being a long-term shareholder in Valeant should the transaction close.

The numbers are compelling

Mr. Ackman and Valeant see lots of opportunity to add value by buying Allergan. They have estimated that a combined company would generate at least $2.7 billion in annual cost synergies, with "significant" revenue synergies as well. The transaction also allows Valeant to apply its low tax rate to Allergan's earnings. Altogether Mr. Ackman and Pershing expect earnings accretion of 25-30%.

From there, the company should expect to see organic revenue growth in the high single digits, with cash EPS growing by 15-20% per year.

How will this be done?

Of the $2.7 billion in cost synergies, two-thirds will come from general corporate expenses. For example, the corporate and regional headquarters will be rationalized. Other redundant functions will be eliminated.

The other third will come from reduced R&D spending. Valeant is well-known for this, as the company prefers to acquire products rather than develop them in-house. Meanwhile, Allergan has a mixed track record when it comes to R&D, to put it mildly. As pointed out by Mr. Ackman and Valeant, Allergan has spent $9.5 billion on R&D since 1998 – yet ~80% of the company's 2013 revenue came from acquired products.

Mr. Ackman and Valeant pointed out other deficiencies in Allergan's operating model, promising to wring cost savings simply by applying Valeant's strategy to Allergan's business. Mr. Ackman stated that he believes no other company can rationally make a higher bid for Allergan's shares than he and Valeant just did.

So what happens next?

This is really just the beginning of the process. The acquirers still need to discuss the transaction with Allergan, as well as pitch the deal to the company's shareholders. And Valeant's shareholders will get a chance to voice their opinion too. But the latter group already seems on board; Valeant's shares have risen by nearly 8% in response to the news.

Foolish bottom line

So far, this appears to be a match made in heaven. But we have not heard Allergan's side of the story yet, and if the company's board opposes this transaction, things could get ugly very quickly. Stay tuned for more developments.

CATEGORY

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