



Valeant's Pursuit of Allergan: Go Big or Go Home

Description

Valeant Pharmaceuticals (TSX: VRX)(NYSE: VRX) recently made a cash and share offer of around \$46 billion to the shareholders of the pharmaceutical company, **Allergan** (NYSE: AGN). At the time of the offer this equated to \$154 per Allergan share, which represented a premium of over 20% compared to the previous day trading price or 27% compared to the trading price over the preceding few weeks.

Pershing Square Capital Management, under the leadership of Bill Ackman, has partnered with Valeant to pursue the acquisition and is now the single largest shareholder in Allergan with a holding of 9.7%.

The Allergan board rejected the initial offer without engaging in formal discussions with Valeant. They offered a number of reasons for the rejection, including an observation that the offer undervalued Allergan and that it created risks and uncertainties for Allergan shareholders. They also pointed to their own track record of producing consistent growth and solid results over time and outlined a 20% per annum profit growth target through 2019.

The Valeant board indicated on May 13 that it would improve the offer and make an announcement during a scheduled webcast on May 28, when it will discuss details of its plans for the Allergan merger.

What is Allergan worth to Valeant?

Valeant and Pershing are of the opinion that a merged and streamlined operation could create substantial shareholder value. The combined entity would, in the first instance create a strong portfolio of leading products in ophthalmology, dermatology, and aesthetics. They feel the transaction would enhance cash profits by 15-20% over the medium term, mainly through reducing the combined entity's general and research and development cost by 30% or \$2.7 billion.

There will also be additional benefits through a lower effective tax rate for the combined entity as well as revenue synergies from the combined product offering.

The current offer for Allergan values the company at a 2014 EV/EBITDA ratio of 17.3 times. This is already considerably higher than the valuation of a representative peer group which trades on an

estimated 11.5 times multiple. Based on Valeant's calculated \$2.7 billion savings through a business combination, the offer multiple could drop to an estimated 12.9 times, which will only represent a modest premium to the peer group valuation.

Given the considerable execution risks to Allergan shareholders and perceptions of an inflated Valeant share price and unsustainable business model, the Valeant board may have to increase the previous offer considerably – perhaps by 10-15% for a new value of around \$169- 176 per Allergan share.

On the higher price, the revised offer raises the EV/EBITDA valuation multiple to 14 times, including the \$2.7 billion synergies. This will be a 47% premium over the pre-offer Allergan price, a 20% premium to the 2014 valuation of the peer group and at a premium to the rejected “final” offer made by **Pfizer** to **AstraZeneca** shareholders.

Valeant will also have to consider raising the \$48 per share cash component of the offer, given the actual and perceived risks attached to the Valeant share price. Valeant already carries high debt levels and may be constrained to raise more cash than the \$15 billion already committed by major banks. Should Valeant be able to find the cash resources to raise the cash component from the original 32% to say 40%, or \$70 per share, the maximum cash requirement will increase by around \$6 billion.

What next?

Valeant has indicated that it will announce an increased offer during a webcast on May 28. Meanwhile, Bill Ackman wrote to the lead independent director of Allergan requesting a full engagement with Valeant regarding the offer pointing to the responsibilities of directors to act in the best interest of shareholders.

In my view, Valeant will have to raise the offer considerably to make it attractive enough for the Allergan board and shareholders to find it appealing.

CATEGORY

1. Investing

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1. NYSE:BHC (Bausch Health Companies Inc.)
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