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**Grifols seeks infusion of Talecris for future growth**

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Today’s announcement that Grifols will be acquiring Talecris Biotherapeutics shows that size does matter, at least when it comes to blood products. The rationale for the deal appears to be the increasing competition in the blood plasma world, and, as such the companies that can drive economies of scale should stand a better chance of succeeding.

Grifols will be paying $3.2bn for Talecris in a mixture of cash and shares, with the $26.16 per share price tag being made up of $19 in cash and the rest in non-voting shares. Investors, however, reacted negatively to the empire expanding move pushing shares in Grifols down by 7% by late afternoon trading to €8.61.

**Stretching multiples**

The deal does, however, look a little on the expensive side given that the premium to the share price stands at a chunky looking 64% to the closing share price of Talecris last Friday of $15.91 before the deal was announced. It also looks rather pricy given that shares in the US company had fallen by 27% over the last three months over wider concerns about the blood products market ( Shares in plasma companies bleeding value over slowdown fears, April 26, 2010 ).

It also looks like a big stretch for Grifols, which itself has a market cap of $2.68bn and is already carrying debt of $1.13bn. This could explain why the number of banks involved in the financing of the deal, who provided loans and long-term bond arrangements, totaled six. This makes for a very complex deal and one that will leave Grifols highly leveraged.

But it is risky for Grifols to be taking on this kind of debt, which will amount to $2.5bn, which is expected to push up its debt to underlying profit ratio from 2x to 5x, a high multiple given that cash flow generation in blood products tends not to be that strong.

**Little movement**

The acquisition itself does not really propel the new group that far up the rankings of the blood product companies, it will remain at number three, taking over Talecris’s position, but it will move pro forma annual sales up to $2.8bn, which compares with $2.92bn for CSL in 2009 and $3.84bn in blood product sales only for Baxter International in the same year.

This lack of movement up the blood product chart should, however, help the two groups avoid the anti-trust issues that derailed Talecris’s proposed tie up with CSL last year, which ran foul of the US Federal Trade Commission (FTC) ( CSL’s reality check sinks Talecris deal, June 9, 2009 ).

It is also highly likely that given the dismal outcome of that deal the two group’s have already done more than enough homework on whether the acquisition was likely to get past the competition regulator.

A combined Talecris and Grifols group will claim 30% of the IVIG market and 23% of the albumin market in the US, but according to investment bank UBS this is still below the 32% and 34% respectively that market leader Baxter commands.

Speaking on a conference call today Victor Grifols, chief executive of Grifols expressed his confidence that the deal was unlikely to hit significant problems with the FTC. “Our approach is different, if Grifols and Talecris merge we will have a third player that is bigger, but still third. I think this is an important point that the FTC will see that the three players remain three and Grifols is not disturbing the fundamentals of the US market,” he said.

Mr Grifols added that even with the tie-up there would not be a single combined product that would reach critical market share according to the FTC’s point of view.
Deal rationale

In terms of a rationale for the deal in an increasingly competitive world Talecris has historically not priced its products at a premium, which means that it is in a good position to help Grifols expand globally and win more market share, but what this might do to group margins is debatable.

Also Talecris’s growth was previously expected to be capped in the medium term by manufacturing constraints. This is in stark contrast to Grifols, which has plenty of manufacturing capacity, making the deal look sensible on this front.

There should also be plasma pricing synergies from the deal with the increased scale. At present buying in raw plasma is estimated to be about 60% of cost of goods for Talecris, which should be dramatically reduced by the combination of Grifols’ 80 collection centres.

It will also address concerns about Grifols’ over capacity, with many estimating that the company could be carrying 13 months of plasma supplies rather than more normal inventory levels of seven to eight months, resulting in higher working capital and costs.

Grifols is hoping to wring out $230m in cost savings from the deal over the next four years. These cuts should come at a one off cost of $100m, but they do look rather ambitious.

Timing

The deal does not come at an ideal time for Grifols to be issuing new shares to pay for the acquisition given that the stock has fallen recently over concerns about future growth in the sector. However, as previously mentioned Talecris stock too has fallen, which could have been the incentive for Grifols to strike now.

In the short-term there are bound to be questions over the price of the deal and a sharp eye will be kept on Grifols' future cash generation, which will hold the key to the group meeting its own ambitious targets to getting it earnings-to-debt ratio down.

If there are any hiccups or stumbles in this then the stock, which has already suffered today as analysts work through the sums, could fall and fall hard.

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