Evaluate Vantage

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Shire finds its fourth way

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Shire's $750m purchase of Advanced BioHealing (ABH) adds a fourth therapeutic business unit which the specialty player had been working on for some time (*EP Vantage Interview – Shire seeking a fourth way, September 17, 2010*). The deal is primarily for ABH's Dermagraft, a regenerative skin substitute for diabetic foot ulcers, a $3bn market in which Dermagraft grabbed a 5% share last year.

For ABH and its investors the deal is an unexpected bonus, having been on the verge of launching a $200m IPO this week - Shire's offer represents a 25% premium to ABH's implied value of $600m if the flotation had achieved its target price, a big if in today's IPO climate. Shire will use up nearly all of its available cash reserves to fund the deal, indicating the extent to which the company is reinvesting for future growth instead of hanging around for inevitable bidders to emerge, if market rumours are to be believed.

Strategic fit

Established in 2004, ABH acquired the rights to Dermagraft from Smith & Nephew in 2006. The product had already gained FDA approval, but Smith & Nephew struggled to make it a commercial success, partly due to manufacturing issues. ABH took over the reins, upgraded the manufacturing facility and re-launched the product in early 2007.

Sales of Dermagraft reached $146.7m last year and $44.2m in the first quarter of this year. Based on current run rates, sales should exceed $500m by 2016, making it Shire's fifth biggest selling product. However, this is likely to be the minimum sales target and Shire will doubtless be aiming considerably higher, by drawing on its greater manufacturing capacity and commercial expertise.

Aside from growing Dermagraft's share of the diabetic foot ulcer market, a pivotal trial is ongoing in treating venous leg ulcers, another significant market opportunity which ABH estimates at $3bn. Recruitment is complete, headline data should be available by the end of the year and a regulatory filing in the US is expected in the first quarter of 2012.

Although regenerative cell-based products is a completely new therapeutic area for Shire – there is little cross over to its three existing businesses of ADHD, human genetic therapies (HGT) and gastrointestinal (GI) – the deal certainly fits the company's track record of identifying and making the most from under-penetrated specialist markets.

Investors certainly seemed comfortable with this deal – after some initial weakness, shares gained 3% in afternoon trading to £19.59, close to a record high of £19.78 reached last Friday. A perennial takeover target – M&A speculation was rife just last week - Shire is now valued at an impressive £10.8bn ($17.5bn), a price which might take it out of range of some big pharma companies.

M&A track record

Shire is funding the purchase from existing cash reserves, which were $712m at the end of March, having generated $155m in net cash during the first quarter. As such, while the deal will burn a significant hole in current cash on the balance sheet, the company will quickly replenish its reserves and the transaction will not affect prior financial guidance.

One of the likely reasons why investors seem happy with the use of this cash is Shire's decent M&A track record, particularly the transformational deals for New River Pharmaceuticals in 2007 and Transkaryotic Therapies in 2005, purchased for $2.6bn and $1.6bn respectively.

However, Shire's more recent deals - $537m for Movetis in 2010 and $455m for Jerini in 2008 – do not yet appear to be quite so beneficial. The key products acquired are so far struggling to make the headway expected, particularly Jerini's Firazyr (*Shire needs Firazyr to stand out in HAE crowd, March 2, 2011*).

Investors will therefore be hoping that Advanced BioHealing provides the handsome return on investment that New River and Transkaryotic secured, rather than the more questionable recent deals.