

## Endo engineers Paladin into a return for all



Jacob Plieth

With pharmaceutical asset prices increasingly testing the limits of affordability, deal bankers will be relieved that it is still possible to structure a takeover that generates an immediate return for everyone.

Endo Health Solutions' use of a paradoxically strong share price has enabled it to pay way over the odds for Paladin Labs but still please its investors, which in turn has boosted Paladin's value even further. Structuring the deal through a new Irish-domiciled entity, releasing hidden value by spinning out a key product and reporting a good third quarter are the secrets of its success.

Paladin, a Canadian speciality pharma business, boasted a share price that had risen 53% this year to an all-time high of CDN\$63.91 (\$61.17) before Endo announced its bid. The rise had been driven by revenues climbing at a CAGR of 31% over eight years to \$192m in 2012, and by consensus forecasts seeing sales growth of 8% a year over the next six.

But with a market cap 17 times last year's pretax profit the group was looking expensive, and had reached the top of several sellside target prices. Nevertheless, through a smart deal Endo was able to offer Paladin investors an immediate 18% premium.

### Strong stock

The takeover is being made largely in Endo stock, with a small cash element intended to provide some guarantee against an undue fall in the acquirer's share price, and Endo has been fortunate that a restructuring had helped its own shares climb 66% this year.

This is despite some serious internal problems, such as plummeting sales of its two biggest products, the anaesthetic Lidoderm and the analgesic Opana ER, which are facing generic competition.

But perhaps Endo's cleverest move is to route the acquisition via a new Irish entity. Ireland's tax-friendly status has spurred previous takeovers of Ireland-domiciled businesses, and the Paladin move simply takes this logic a stage further.

Endo said the Irish domicile would yield a blended tax rate of just 20% – down from the current 28%. Meanwhile, operational and tax savings would amount to at least \$75m a year, and this plus an expectation-beating third quarter pushed Endo's stock up 29% yesterday.

The knock-on effect was of course that Paladin investors got even more under the deal.

| Trading in tandem: the benefits of Endo's acquisition of Paladin   |                |                |
|--|----------------|----------------|
|  | At Nov 4 close | At Nov 5 close |
| Paladin share price (CDN\$)  | 63.91          | 95.50          |
| Endo share price (US\$)  | 43.64          | 56.22          |
| <i>What Paladin investors get:</i>   |                |                |
| Endo shares for each Paladin share held  | 1.6331         | 1.6331         |
| Value of Endo shares (CDN\$)*  | 74.12          | 95.49          |
| Cash per Paladin share held (CDN\$)**  | 1.16           | 1.16           |
| <i>What the deal is worth:***</i>  |                |                |
| Per Paladin share (CDN\$)  | 75.28          | 96.65          |
| Total value (CDN\$m)   | 1,553          | 1,994          |
| Premium vs Paladin's Nov 4 closing price   | 17.8%          | 51.2%          |
| <i>*Exchange rate of CDN\$1.04 per US\$1 is applied.</i>   |                |                |
| <i>**Cash element will rise to a maximum of \$223m, if Endo stock falls by more than 7% over a set period.</i> |                |                |
| <i>***Holders of each Paladin share will also receive one share of a new company, Knight Therapeutics.</i>     |                |                |

And there were other reasons for Endo shareholders to celebrate. The group has been an active deal-maker, and has done no less than \$4.7bn of takeovers in the past four years, including acquisitions of American Medical Systems and Qualitest Pharmaceuticals.

This has left it carrying \$2.6bn of long-term debt, against \$594m of third-quarter cash – equivalent to a net gearing of almost twice forecast 2013 Ebitda. But Paladin is debt-free, and Endo says it will deleverage quickly after completing the deal next year.

This means that further acquisitions are on the cards, and the group said it would continue to look at deals in the \$250-500m range.

### **Icing on the cake**

The spin-out of Paladin's leishmaniasis drug Impavido is the icing on the cake for Paladin investors, who will also receive a share in Knight Therapeutics, a new company that will hold this asset. Impavido is marketed in several countries, and received a US advisory panel endorsement last month; an FDA approval decision is due by December 19.

Paladin employs 127 people and generates 66% of its sales in Canada from prescription and OTC products. Pipeline projects include Canadian rights to Zohydro ER, the chronic pain treatment that recently gained a surprise US approval, though Endo cites its footprint in South Africa and Latin America as a particular benefit.

True, emerging markets are attractive, but nothing is quite as pleasing as a deal that results in both acquirer and acquired adding 25% of market value overnight.

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