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Carlyle's bid for Johnson & Johnson fixer-upper bucks market trends

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A boom in US healthcare assets has not provided fertile ground for private equity, which as a rule tends to snap up under-appreciated companies near the bottom of the cycle.

Carlyle Group, whose $4bn purchase of Johnson & Johnson's Ortho-Clinical Diagnostics division was finally agreed yesterday, seems to be the exception to the rule. The private equity group has now obtained a shrinking business in an otherwise accelerating sector, but with time and effort the division will doubtless do better as a standalone concern that in did under the J&J umbrella.

Bluntly, Ortho is in trouble. In vitro diagnostics is the biggest segment in medtech, and with a CAGR of 5.1% it is growing fast. Ortho is doing the opposite. Its technology, focused on blood screening and typing, is a long way from the flashier disciplines of companion diagnostics and genetic sequencing, and without intervention will see its market share shrink from 4.7% in 2012 to 3.6% in 2018, *EvaluateMedTech* forecasts show.

If J&J's reasons for selling are clear, Carlyle's decision to buy, and to buy now, is more opaque. Private equity deal volume in healthcare was reported to have plummeted 65% last year – neatly coinciding with the biggest US biotech bull market for years.

Carlyle certainly has form. It participated in buyouts of the CRO Pharmaceutical Product Development for $3.9bn in 2011, and Healthscope, an Australian hospital group, for $2.0bn a year earlier.

Overall, the group says it has injected $6.3bn of equity into healthcare transactions since inception in 1987, and was apparently outbid on a couple of huge deals recently. Clearly it sees in Ortho a moribund asset in need of a shakeup – private equity's natural domain; lack of trade buyer interest could signify antitrust issues.

Cheap debt

Even so, the Ortho deal is bold, as shown by Carlyle doing it alone rather than as part of a syndicate. It has no doubt been emboldened by central bank monetary policies that have led to the ongoing availability of cheap debt financing.

When contacted by *EP Vantage* Carlyle would not reveal details of the debt that has been raised to finance the Ortho acquisition, but debt reportedly makes up 80% of the $4.15bn price. Low interest rates mean that even for a severely leveraged buyout like this there is plenty of scope for private equity to make a healthy return.

Of course, this will not happen without a push, and a major restructuring for Ortho is surely on the cards – Carlyle's assurances that it will invest in R&D and manufacturing notwithstanding. The division has been on the block for a year, so the axe probably needs to be swung.

And the price? Unfortunately Johnson & Johnson releases limited information specifically about Ortho, but the division accounts for the vast majority of its diagnostics business, which also includes a much smaller unit, Janssen Diagnostics.

In 2012 diagnostics revenue fell 4% to $2.1bn, and after nine months of last year sales were off another 8%. In comparison, the market leader, Roche, saw sales of 8.2bn in 2012 and by this measure a further six companies, including Abbott and Danaher, also lead Ortho.

The J&J unit's earnings before interest, tax, depreciation and amortisation (Ebitda) were reported to amount to $475m in 2012, but given the falling sales must have narrowed considerably last year.

Even so, the $4.15bn price tag implies an undemanding multiple, perhaps closer to 10x than 15x Ebitda. This might not herald the start of a private equity buyout boom in healthcare, but the availability of cheap debt should spur continued appetite for distressed assets, even in a bull market.

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