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JP Morgan Healthcare Conference 2014 – Valeant's success sees others copy the tax trick

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If imitation is the sincerest form of flattery then Valeant Pharmaceuticals should be feeling pretty good about itself right now.

This week's JP Morgan conference in San Francisco saw no shortage of mid-sized speciality pharma companies extolling the benefits of debt-funded acquisitions and tax inversions – including Endo Health Solutions and Forest Labs. This is exactly the strategy Valeant has employed so successfully to become Canada's biggest pharma company.

Of course, use of debt is not a novel funding mechanism. But a domicile outside the US is what Valeant was really the first to exploit – its merger with Biovail gave it a more tax-friendly base in Canada.

Others are now cottoning on. Jazz's move on Azur, the Actavis and Warner Chilcott combination, Perrigo's acquisition of Elan and more recently Endo's takeover of Paladin were all driven by a desire to take on the foreign home occupied by the target – in most cases Ireland, though Paladin is also Canada-based.

And those who have yet to make the move offshore are keen to follow suit: Forest's new chief executive, Brett Saunders, fresh from the $2.9bn takeover of Aptalis, has made no secret of his desire to pursue an inversion – whereby a company becomes the subsidiary of another company in another, tax-friendly, country.

Teva or Pfizer biz?

For Valeant's deal-hungry chief executive, Michael Pearson, the M&A spree is driven by a desire to become one of the five most valuable pharma companies – by market cap – by 2016. This means more deals, perhaps including a "merger of equals".

With Valeant's market value approaching $50bn, not many groups fit the bill, however. The most obvious target would be Teva, which is suffering from a boardroom spat, and now would be a natural time to strike (*Teva gets a chance to start again – again, December 2, 2013*).

The unit that Pfizer is getting ready to hive off would also perhaps provide a good fit, but while speaking to investors at the conference this week Mr Pearson would not be drawn on his interest.

"It depends. I would have to analyse it. And it depends on the price. If they gave it to me I'd take it," he said. His chief financial officer, Howard Schiller, quickly brought the speculation to an end with a "no comment".

Mr Pearson is clearly not afraid of the big deal, and believes that there are more opportunities to find savings in bigger companies. And Valeant's truly decentralised operations – only finance is run centrally – helps pare costs right back.

Still, Mr Pearson's list of potential targets is likely to be much longer than one compiled by those focusing on the public markets. "There are loads of [Bausch & Lomb] type companies out there, [which are] private equity-owned," he said.

The M&A strategy has resulted in a fivefold rise in Valeant's share price over the past three years, in the wake of a string of well-received, debt-funded deals that have bolstered the company's earnings and ability to generate cash.

"We are very disciplined when we do a deal. People can get over-excited, particularly when you use bankers," Mr Pearson said. Valeant is famous for its quick internal due diligence processes and refusal to use an investment bank, although Mr Schiller, a former Goldman Sachs executive, is something of an in-house banker, albeit with aligned priorities.

Buying a foreign home

Also at JP Morgan was Endo's Rajiv De Silva, a former Valeant executive, extolling the virtues of his company's new Irish domicile. The ability to run future deals through the region will bring substantial tax benefits, he said, and an infrastructure is being built in Ireland to facilitate this.

Even smaller players know the benefits; Alkermes, which acquired an Irish domicile with its acquisition of Elan's Drug Technologies unit, has deals in mind to take advantage of bringing its tax rate down below 20%.

How long this chase for inversion will continue is unclear; there are limited targets to acquire to achieve an overseas domicile, and deals also have to make sense strategically.

And not everyone is convinced that the trend will gather pace. Some fund managers *EP Vantage* spoke to at the conference described inversion as more of a "fad" that is unlikely to be jumped on by many firms, many of which in any case are unlikely to be able to capitalise on the advantages.

Nevertheless, consolidation by the industry's speciality pharma players is expected to continue apace this year, and Valeant has proved itself a very efficient operator.

"Our strategy is simple to copy, but it's hard to do," says Mr Pearson. "If we do fail, it would be through overpaying or through poor execution. But we don't plan on screwing up."

Given his track record, few would bet against him. And those looking for inspiration would do well to heed his words.

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