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Mallinckrodt pays through the nose for popularity


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Cadence Pharmaceuticals might be a pedestrian, loss-making, one-trick pony with a massive price tag, but Mallinckrodt’s 12% stock rise yesterday shows just how desperate the latter’s investors were for an acquisition at any cost.

In reality, Mallinckrodt had little choice; competition for speciality pharma assets is fierce, and management was under pressure to avert a serious business downturn. By taking advantage of cheap debt, and adding the promise of a tax break into the mix, it has seemingly pulled a rabbit out of the hat.

In buying Cadence for $1.3bn, Mallinckrodt’s C-suite can show that it has not been sitting on its hands since the business was spun out of Covidien last year (*Covidien aims for AbbVie mk II with Mallinckrodt spinout, May 8, 2013*).

A quick look at Mallinckrodt’s forecasts shows just how desperate was the need to act. Sales of its leading contrast agents Optiray and Optimark fell last year, as did those of its acetaminophen and oxycodone products; consensus forecasts see a group revenue dip this year, with pretax profits falling 22%.

Hospital-use acetaminophen

Cadence’s only drug is Ofirmev, an injectable acetaminophen used in hospitals to treat pain and reduce fever. Cadence expects to have sold $111m of it last year, and consensus is for revenue to rise to $168m in 2014, though the group has yet to turn a profit from it.

Last November Cadence defeated a generic challenger in court, and has been successful in settling other cases, resulting in analysis expecting Ofirmev to retain market exclusivity until 2020. It is quite possible that the patent win provided the trigger for Mallinckrodt.

However, the $1.3bn price tag is steep. Just how steep can be illustrated by the fact that it is exactly equal to the net present value of Ofirmev’s sales – not profits – in the seven years’ market exclusivity it hopes to enjoy, if a 12.5% discount rate is applied.

Naturally, the product has a cost of goods, and Cadence employs a 130-strong sales force that Mallinckrodt expects to retain, so Ofirmev’s actual contribution to the bottom line will be far lower. “We can’t quite figure out how to get paid back and get a good return in seven years,” UBS analysts wrote yesterday, recommending that clients sell Mallinckrodt on the stock’s strength.

Mallinckrodt certainly knows this market, and has in fact supplied acetaminophen to Cadence since Ofirmev’s 2011 launch. The acetaminophen-containing project Xartemis XR is one if its own key internal pipeline hopes.

But at $1.3bn the deal’s benefits are not obvious, and its rationale probably owes a lot to Mallinckrodt’s ability to use Cadence’s losses to offset some of its own tax – the group is already domiciled in Ireland – and raise debt at rates that it calls “very attractive”.

Mallinckrodt's balance sheet detail ($m)	
Cash at 27 Dec 2013	(287.8)
Capital lease obligations	2.9
3.50% notes due April 2018	299.9
9.50% debentures due May 2022	10.4
8.00% debentures due March 2023	8.0
4.75% notes due April 2023	598.2
Cadence acquisition cost	1,300.0
Pro forma net debt	***1,931.6***

Mallinckrodt’s own balance sheet is hardly a picture of health, and adding in the $1.3bn acquisition cost will give the group, capitalised at $385m, a net debt position of $1.9bn. Even if Ofirmev becomes profitable next year, and annual cost savings amount to around $25m, this is still equal to almost 6x expected 2014 pro forma operating profit.

That said, whether anything near $1.3bn can be wrung out of Ofirmev by the time 2020 rolls around might be irrelevant if just doing the deal helps Mallinckrodt end up itself in the hands of an equally deal-hungry, highly leveraged, speciality pharma business.

Over to Valeant, Actavis and Perrigo.

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