

High-yielding Biovail races clock to get new product in pipeline

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Late last year, **Biovail Corp.** dressed up its dividend to buy its stock some time. Now, eight months later and with its pipeline for new products clogged by regulatory delays, that time could run out, analysts say.

With full generic competition for the company's flagship Wellbutrin XL antidepressant coming some time next year, analysts wonder whether Biovail will be able to maintain its generous dividend payments, which were tripled to an annual rate of \$1.50 (U.S.) a share last December. The dividend, which generates a yield of about 9 per cent at the current stock price, has become the main attraction to the stock while investors await new products to replace the anticipated deep declines in revenue and cash flow from Wellbutrin.

"Biovail's value is being supported by the dividend, which we believe is unsustainable," analyst **Anthony Scilipoti** of **Veritas Investment Research Corp.** said in a recent report.

"Armed with one drug, a stable of declining generics and legacy product lines, the company will be hard pressed to maintain its dividend past the end of 2007."

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The prediction is simple arithmetic. Biovail will pay out about \$240-million this year in dividends, which amounts to a generous 86 per cent of projected distributable cash (cash flow after capital expenditures). But **Mr. Scilipoti** projects that full generic competition could reduce Wellbutrin XL's cash flow contribution by more than \$150-million, leaving Biovail without enough cash generation to cover the dividend payments next year.

"Unless a new golden goose is found, [2008 operating cash flow] will be 30 per cent lower than [2007 estimates]," he said, adding that based on the current operating model, "Biovail will be short roughly \$60-million to pay its dividend."

That new golden goose was expected to be a new antidepressant that Biovail had hoped to launch before the end of this year. But last month the U.S. Food and Drug Administration (FDA) rejected one of the company's studies for a once-a-day formulation of bupropion, a key component of the new product - potentially setting back the launch by as much as a year.

The news wiped out 20 per cent of Biovail's stock value in a single day. Since then, the stock has continued to slide, closing at \$18.28 (Canadian) on the Toronto Stock Exchange yesterday, down 31 per cent from its levels before the FDA announcement.

For many investors, last December's dividend increase was seen as a stop-gap measure to keep them interested in the stock during a lull in Biovail's product pipeline, temporarily converting the stock into a yield play until new products could come on line and return the stock to its more traditional profile as a growth play. Indeed, Biovail spokesman Nelson Isabel said the company expects to have "10 major development projects under way" by the end of this year.

But the question, in light of the FDA news, is how far away those prospects are - and whether the dividend can survive the wait.

First Albany Capital analyst David Lickrish said last year's dividend increase "was actually quite a clever idea," succeeding in lifting Biovail's stock in the first half of this year even as sales and earnings shrunk. But now, with the new-product outlook clouded and investors relying increasingly on the dividend, "they've painted themselves into a corner."

Biovail stated shortly after the FDA announcement that it had no intention of cutting its dividend - a position Mr. Isabel reiterated yesterday.

"As investors begin to appreciate what's in the pipeline ... I think they will begin to have confidence in what we have and in the growth of the company," chief executive officer Douglas Squires said recently.

Mr. Lickrish added that the company remains optimistic that it can clear the FDA hurdles for its new antidepressant before Wellbutrin becomes fully open to generic competition some time next year.

A major institutional shareholder of the stock noted that the company does have roughly \$500-million of cash on hand to bolster its payments if cash flow does fall short of covering the dividend payout.

Mr. Scilipoti said Biovail might be able to reduce R&D spending to free up cash, and it has enough cash and unused credit lines to finance a modest-sized acquisition that could generate additional cash flow. But both of those strategies would go against the strategic focus management adopted last December, geared to developing and manufacturing new home-grown products.

Biovail's Mr. Isabel said the company is "actively evaluating" several possible acquisitions "of all sizes," but declined to elaborate.

The dividend and new-product question marks, coupled with continuing regulatory investigations into Biovail's accounting practices in the early part of this decade, have depressed the company's stock valuation. Biovail is trading at under 10 times its forward 12-month earnings estimates - compared with better than 18 times for the S&P/TSX health care subindex as a group.

That does present a buying opportunity for anyone patient enough to see if the company's growth story can return.

"The problems the company has had and the negative press it has received have created a stock that is quite undervalued," the institutional investor said. "There's an opportunity for value creation here."

Biovail

Highest yielding common stocks in the S&P/TSX composite

Company	Price Aug. 22	Yield	YTD price ch'ge
Biovail	\$18.50	9.40%	- 24.8%
Russel Metals	\$28.03	6.40%	5.00%
Rothmans	\$21.82	5.50%	0.30%
Manitoba Tel.	\$48.68	5.30%	4.90%
Norbord	\$7.82	5.10%	- 12.2%
Emera	\$19.63	4.60%	- 13.1%
National Bank	\$56.85	4.20%	- 13.7%
Bank of Montreal	\$66.01	4.10%	- 4.3%
TransCanada	\$36.13	3.80%	- 11.0%
Torstar	\$19.40	3.80%	- 1.1%

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