Why Valeant's Medicis buy is positive for shareholders

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Stock jumps nearly 15 per cent as analysts see big payoff from drug maker's $2.6-billion offer for U.S. skin care company

Most analysts are applauding the move by Valeant Pharmaceuticals International Inc. to stake its future on wrinkles and pimples.

With Monday's proposed $2.6-billion (U.S.) acquisition of skincare company Medicis Pharmaceutical Corp., Valeant is poised to become one of the biggest players in the cosmetic end of the dermatology business. It's a potentially lucrative medical field not yet dominated by big drug companies or dependent on disbursements from penny-pinching government health-care plans.

At the consumer end, it's the money-making world of botox and anti-pimple creams, and investors reacted accordingly on Tuesday. The shares of the Montreal-based company were one of the biggest percentage gainers in a generally flat Toronto market, soaring $7.47 (Canadian) or 14.8 per cent to $57.94, their highest closing level in nine years.

Valeant, a drug company once known as Biovail Corp., is receiving plaudits from analysts for the new deal, based on projections that it will lead to a significant profitability boost.

A quick back-of-the-envelope calculation by Douglas Miehm, an analyst at RBC Dominion Securities, estimated that the acquisition could add 60 cents (U.S.) a share to Valeant's profits next year and $1.25 a share in 2014, when the company will have a full year of operations from the combined entity. Valeant is projecting earnings this year of about $4.55, indicating the large impact of the transaction on its bottom line.

"Our early view is positive," Mr. Miehm said in a note to clients.

At UBS, analyst Marc Goodman was equally upbeat, estimating the deal offers Valeant shares upside of about 10 per cent. He estimated the size of the earnings pickup in 2014 will be smaller than the one calculated at RBC, but still a very respectable 75 cents a share.

"Investors have continuously questioned when we would see the next material deal. Well, patience was finally rewarded with what looks to be another smart strategic accretive deal," Mr. Goodman said in a report.

The main factor making the deal a likely winner for shareholders is the opportunity it offers Valeant to cut costs after the acquisition by trimming overlapping sales forces, rationalizing distribution systems and other expense reductions.

Valeant CEO Michael Pearson reiterated on a conference call with analysts Tuesday that he expects more than $225-million annually in synergies, a figure he contended "is actually not that large a number. We are hopeful that we would find more, rather than less, once we actually get involved in the integration."

Given the compelling economics for Valeant in the transaction, Mr. Pearson had to deflect several questions on the analyst call about the possibility that rival bidders will swoop in to pluck up the savings.

Medicis shares vaulted higher, rising to $43.65, up 38.3 per cent, just below the $44 takeover price. Mr. Pearson is expecting the deal to close in the first half of next year, giving ample time for a competing bidder to emerge.

While investors cheered the proposed acquisition, credit rating firm Moody's Investors Service placed Valeant's debt, currently three notches into junk territory, under review for a possible downgrade.

The Medicis transaction is an all-cash deal that will be financed through debt. "The Medicis acquisition may push Valeant's leverage beyond Moody's tolerance level for the Ba3 rating, despite [a] solid strategic rationale," commented Michael Levesque, Moody's senior vice-president.

Many analysts have target prices for Valeant of more than $60 a share, but the company does have risk.

Valeant has been on an acquisition binge, making offers for herbal remedy makers, and pharmaceutical suppliers to Eastern Europe and Mexico, among just a few of about 36 takeovers since 2008. Debt has swollen to about $7.4-billion, according to the company's latest earnings release.

All the acquisitions make figuring out the company's underlying profitability difficult, according to ***Dimitry Khmelnitsky*** at ***Veritas Investment Research***, a Bay Street firm that isn't involved in underwriting and doesn't have a buy or sell opinion on the drug maker. ***Mr. Khmelnitsky*** said in a report earlier in the summer that Valeant's "multiple acquisitions across divergent geographical regions and ever-shifting product mix undoubtedly complicate the investment analysis" of the company.