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Debt, Equity Markets Heat Up As Pharma M&A Soars

By **Chelsea Naso**

Law360, New York (May 20, 2015, 4:04 PM ET) -- With pharmaceutical companies continuously peppering the market with multibillion-dollar deals, the hunt for attractive acquisition financing has lifted corporate debt offerings, equity offerings and even commitments from third-party lenders to new highs, experts say.

The latest deal to rock the market is Endo International PLC's $8.05 billion bid for generic-drug maker Par Pharmaceutical Cos. Inc., joining the flood of deals that includes megamergers like Valeant Pharmaceuticals International Inc.'s $15.8 billion acquisition of Salix Pharmaceuticals Ltd. and AbbVie Inc.'s $21 billion deal for Pharmacyclics Inc.

Financing trends for deals are driven in large part by the cost of capital to the acquirer, which has sent many to the debt and equity capital markets, explained Brandon Parris, a Morrison & Foerster LLP partner and co-head of the firm's global corporate department.

"As companies do acquisitions, they look to their balance sheet to see if they have the funds or if they need to get financing. It really all comes down to what a company's cost of capital is," he said. "Companies don't always have the luxury of having a nice cushion of cash on their balance sheet and have to look to other sources."

Here, Law360 takes a look at financing trends taking shape as the pharmaceutical industry continues to consolidate.

Corporate Debt Offerings Reach Astronomical Heights

Corporate debt offerings have become the go-to options for pharmaceutical companies looking to fund deals, especially among the headline-grabbing series of megamergers inked so far this year.

Low interest rates have investors hungry for a place to put their cash to work, helping to fuel the liquid debt capital markets in the U.S. and offering companies a strong alternative to equity offerings and bank financings, explained Will Fogg, a Cravath Swaine & Moore LLP securities partner and co-head of the firm's corporate practice.

"The debt markets are extremely deep and liquid in the U.S. It's a huge pool of capital and very easy to access. Interest rates are low, so companies can get long-term money without diluting shareholders," he said.

The volume of global acquisition-related debt offerings across all industries for the year as of May 14 hit $159.4 billion, more than double the amount seen during the same period of 2014 and the highest amount on record, according to Dealogic.

Pharmaceutical companies have accounted for a large chunk of that debt issuance, with $60.98 billion worth of acquisition-related debt sold through 36 transactions so far this year, according to Dealogic. The volume of corporate acquisition-related debt stemming from the pharmaceutical industry in 2015 so far has dwarfed the $4.94 billion raised during the same period of 2014.

Two of the largest debt capital markets offerings to price during 2015 so far were rolled out by pharmaceutical giants AbbVie and Actavis PLC, according to Dealogic. Earlier this month, AbbVie priced a $16.7 billion bond offering to help finance its $21 billion acquisition of cancer-drug maker Pharmacyclics. In March, Actavis raked in a whopping $21 billion in a bond offering to support its $65.7 billion acquisition of Allergan Inc.

The record-setting debt offerings were far from anomalies. March also saw Canadian drug giant Valeant price an upsized bond offering, raising $10.1 billion to back its acquisition of Salix.

Equity Remains a Strong Yet Tricky Currency

Follow-on offerings of common stock have also helped buoy several pharmaceutical deals, supplementing corporate debt offerings and credit facilities with an infusion of capital. Pharmaceutical companies have also pooled their own shares, handing over the new stock to the target company as currency.

The stock market has proved strong, and already-public companies with proven track records have been able to return to the market to fund mergers and acquisitions and to shore up balance sheets. Issuing equity can also be a smart option for highly leveraged companies, but issuers need to time their offering just right, explained Parris.

“Equity financing may be the way to go if they are highly leveraged or if they don’t have a great credit rating, because in that case debt might be too expensive for them,” he said. “Going to the capital markets can be a little tricky, only because you need to make sure you time it correctly and access it quickly while the window is open. There is a lot of risk associated with that.”

Companies have to be careful not to issue too much equity, however, or they risk diluting current stockholders. Finding the right ratio of debt to equity is essential to maintaining strong credit, noted Fogg.

“Many of the big pharmaceutical companies are investment grade. They want to keep their investment-grade rating among other reasons because they want counterparties to their commercial agreements to know they have good credit,” he said. “So there is a limit to how much debt they can take on.”

So far this year, pharmaceutical companies have floated $9.09 billion worth of shares to help fund current or future acquisitions, a steep increase from the $818 million raised in acquisition-related stock offerings during the same period of 2014, according to data tracked by Dealogic.

Actavis is one of the 21 pharmaceutical companies that have tapped the public equity markets to help fund a deal so far this year. In February, the pharmaceutical giant raked in $8.4 billion through a simultaneous common stock and convertible share offering, adding to the series of historic financings that together will fund Actavis' acquisition of Allergan.

Valeant also capitalized on the strong stock market to supplement the financing for its Salix bid with a $1.45 billion stock offering. The March stock offering saw 7.3 million shares price at $199 a pop.

Endo plans to use its equity to help fund its $8.05 billion acquisition of Par, which includes shelling out about 18 million shares, worth roughly $1.55 billion, and funding the rest of the deal with cash.

Endo also plans to use a permanent capital structure to back its deal, according to a statement. Although the drugmaker has not outlined any specific plans regarding a potential permanent capital structure, one possibility is that Endo could opt to take a portion of Par, or a portion of a holding company for Par, public.

Bank Lending Grows Despite Regulatory Challenges

While corporate debt provides favorable interest rates and a strong stock market is fueling follow-on offerings and the use of equity as currency, the use of loans has not dwindled, a factor that speaks to the monstrous amount of M&A activity in the pharmaceutical space.

So far this year, pharmaceutical companies have locked down $42.8 billion worth of acquisition-related loans, compared with just $19.35 billion in loans during the same period of 2014, according to Dealogic.

Endo plans to hand over $6.5 billion in cash to Par and its private equity backers and has already locked down secured, fully committed financing from Deutsche Bank AG and Barclays PLC to back the cash portion of the deal, the drugmaker said.

Other blockbuster acquisitions, like Actavis' takeover of Allergan, have also turned to bank financing to buoy deals. The Irish drugmaker in December secured $35.4 billion in borrowings — the largest health care acquisition-related syndicated loan on record globally, according to data compiled by Dealogic.

The sky-high loan volumes come even as banks face much stricter leveraged-lending guidelines and are tightening up their practices, explained Fogg.

"It's getting harder and harder to get highly leveraged, high-yield credit deals done with big banks because of recent regulatory developments. That pushes money out of leveraged lending into other places," Fogg said.

Borrowing cash from a third party can also have a higher cost of capital, but having a commitment from a bank, even if it is never drawn upon, acts as insurance to the target that the cash promised will be available when it comes time to close the deal, noted Fogg.

"More often than not, those commitments are not intended to be drawn upon. The reason you get those commitments is that if the markets fall you have a source of capital to pay the purchase price," he said.

--Editing by John Quinn and Edrienne Su.