

# M&A Spotlight: Takeda Pharmaceutical and Shire Pharmaceutical

15.10.2018 | Antonio Meroni, Pengana Absolute Return Asia Pacific Fund

The Fund Manager of the Pengana Absolute Return Asia Pacific Fund discusses the M&A deal between Takeda Pharmaceutical and Shire Pharmaceutical.

## Company Overview:

- Takeda Pharmaceutical is the largest pharmaceutical company in Japan and Asia, it is headquartered in Osaka and entered the US pharmaceutical market in 1977.
- Shire Pharmaceutical is a speciality biopharmaceutical company, headquartered in Ireland and listed on the London stock exchange in 1996.
- Takeda Pharmaceutical announced a takeover offer for Shire Pharmaceutical (SHP) for USD \$30.33 in cash, and \$0.839 in new shares in Takeda.
- Takeda's 5<sup>th</sup> proposal to the Board of Shire Pharmaceutical was formally recommended by the Board to shareholders on 8<sup>th</sup> May.

We initiated a long position in shares of SHP (1% exposure) and Takeda (2% exposure) post announcement. The key rationale is to capture a very attractive deal spread of approximately 15% absolute return to deal completion, and a potential sharp re-rate in the shares of Takeda. The perceived uncertainty and consecutive deal re-negotiation were key factors that have heavily weighed on the share price of Takeda, as well as fears over a large capital raising to fund the deal. In addition, some big M&A investors setup the M&A spread by going long SHP and short Takeda, further impacting the Takeda share price.

## Rationale:

The market currently prices a 55% probability of deal completion for SHP, due to the vote risk at Takeda's upcoming shareholder meeting. If the SHP deal fails, we believe SHP will trade approximately -15% lower. However, this is not the first time that SHP have shopped around, and we believe there could be other counterbidders emerging.

In addition, if the acquisition ultimately falls through, it could be an opportunity for the Takeda shares to make up lost ground in excess of 20% since the acquisition proposal was first announced. This would result in a net gain of our investments.

Conversely, if the acquisition with SHP completes, not only would we capture the current attractive M&A deal spread but also an upside re-rate in Takeda shares.

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The substantial cash flow generation expected to result from the acquisition will enable the combined group to de-lever quickly from around five times net debt/EBITDA (earnings before interest, taxes, depreciation and amortization) following completion of the deal. Takeda intends to maintain its investment grade credit rating with a target net debt /EBITDA of two times in the next 5 years.

With the SHP deal, Takeda Pharma's core EPS would be highly accretive, particularly in the outer years, in excess of >70%.

From a strategic fit perspective, SHP would add to two of Takeda's three core competencies, gastroenterology and neuroscience, whilst from a pipeline perspective it complements the pipeline of early and late-stage programs.

The new Takeda Pharma FY19e core P/E is 12.2 times, which marks it a discount to the FY19E consensus of 13.3 times for the major global pharma companies. In view of limited downside risk, due to the Company's current dividend yield of 4.1%, we see the stock's risk-return profile appealing and skewed to the upside from current depressed levels.

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