The Economist

Valeant

Shop ’til you drop

An acquisitive pharmaceutical company announces its biggest deal yet

Jun 1st 2013 | NEW YORK |From the print edition

An eye for deals

MANAGEMENT consultants have long given advice to troubled pharmaceutical firms. In 2008 a consultant decided to run one instead. Michael Pearson, who led the drugs practice at McKinsey, has transformed Valeant Pharmaceuticals by snapping up company after company. On May 27th he announced the $8.7 billion acquisition of Bausch + Lomb, an American eye-health giant. It is the latest extension of Mr Pearson’s strategy for success: to be a thriving drug company, don’t create new drugs.

With this approach, Valeant avoids an old problem for the pharma industry. Research and development is notoriously risky. The number of new drugs for every billion dollars of R&D has dropped about 80-fold since 1950, according to a report in *Nature Reviews Drug Discovery*, a science journal. Companies have tried to fill their pipelines by buying young firms or signing royalty deals with them. But most large pharma companies still invest in R&D, too.

Valeant handled the problem of falling returns on R&D differently, by all but eliminating it. Its R&D spending is just 2% of revenue this year, according to Morgan Stanley, a bank. “Valeant is not a drug company in the classic sense,” says Ronny Gal of Sanford C. Bernstein, a research firm. Instead, it is a pragmatic shopper. It snapped up 25 companies last year. Valeant avoids countries with too much price pressure or competition from Big Pharma, such as western Europe, Japan, India and China. Targets must have a strong cashflow, with a stable of products on the market or close to being so. The most appealing products are those paid for largely in cash—these are less vulnerable to the whims of public health-insurance schemes.

Last year, for example, Valeant bought Medicis, a dermatology company, for $2.6 billion. Its main products include Restylane, used to fill wrinkles and “provide fullness and definition to the lips”, according to Valeant’s annual report.

Such deals may not cure humanity’s most deadly ills, then, but they are likely to be profitable. Add to this lean management and a low tax rate—Valeant, headquartered in Canada, books much of its revenue in Bermuda, Ireland, Luxembourg and Switzerland—and Mr Pearson has a formula for growth. Valeant’s shares have risen by 800% since 2008.

Bausch + Lomb is Valeant’s biggest deal by far, purchased from investors led by Warburg Pincus, a private-equity firm. The eye-health market pits Valeant against big pharma companies such as Novartis. But the deal is an extension of Valeant’s model, not a departure. As with dermatology, many patients pay for Bausch + Lomb’s products with cash. Bausch + Lomb has nine products close to launch, including a new type of contact lens. This means less R&D risk for Valeant.

It is unclear when the pace of deals will subside. Valeant’s annual revenue in 2012 was $3.5 billion. Earlier this year Mr Pearson said he wanted to reach revenues of $10 billion-20 billion “in the foreseeable future”. This is clearly ambitious. ***Dimitry Khmelnitsky*** of ***Veritas***, another research firm, argues that Valeant’s meagre organic growth will force it to seek more deals. But integrating all these acquisitions will be a lot of work. To carry them off, Valeant will also need to keep its borrowing costs down, which may be tricky given that its debts are already high. And as with Apple and other tech firms, its offshore tax structure may come under scrutiny.

The main challenge, perhaps, will be to keep finding target firms with interesting products. One good place to look, the company said recently, is cosmetic dentistry.

From the print edition: Business