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Sacrificial creditors

The $46 billion bid for Allergan Inc. that Valeant Pharmaceuticals International Inc. lodged on April 21, with a helping hand from the investor William Ackman, was widely described as "hostile." It was likely seen as such by the holders of Allergan's single-A-plus-rated, 3 3/8% notes of Sept. 15, 2020, which dipped to par and change from 103. Nor was it likely welcomed by the Allergan workforce. The serially acquisitive Valeant, whose shares and debt have lately been in the *Grant's* crosshairs, has a well-earned reputation for payroll lightening and cost removal, especially of R&D costs.

We here reiterate by reference our observation that Valeant's debt-financed expansion strategy has not produced measurable improvements in the operating results of the companies brought into the Valeant corporate fold; those acquired seem rather to shrink. Insofar as Valeant adds value, it does so through cost-cutting and tax-avoidance (*Grant's*, March 7, April 4).

The day after the bid was unsheathed, the Valeant CEO, J. Michael Pearson, announced the goal of reducing Allergan's operating expenses by more than $2.7 billion—in terms of 2013 results, by 60% of operating expenses or 149% of operating profit. Middle management would have to go; also, the people in lab coats. Valeant has no use for company-financed scientific discovery.

"As you may be aware," Pearson wrote to the board of Allergan last week, "since 2008 and over 100 transactions, Valeant has never failed to exceed its preannounced cost synergies in any acquisition." The McKinsey & Co. alumnus set the goal of achieving 80% of these cuts within the first six months of the deal closing and the balance in the following year. When all is said and done, Pearson vowed, the post-Allergan Valeant will generate free cash flow of over $6 billion. This would be quite a leap from the stand-alone Valeant, which turned out $927 million in free cash flow last year, and Allergan, which generated $1,524 million in free cash flow.

Last Friday, investors pushed Pearson for evidence that Allergan was overspending to the tune of $2.7 billion. "Have you been to their golf course – have you seen it?" Pearson replied, BMO Capital Markets analyst David Maris reported in an April 29 note. "He repeated this assertion and went on to describe how it is things like this that show how Allergan is a fat cat ripe for cost cutting," Maris continued. "The problem with this 'evidence' is that, according to Allergan, Allergan does not own a golf course." Responding to an inquiry from *Grant's*, an Allergan spokesman insisted that there is, indeed, no golf course (nor do Allergan's public filings show the existence of one). Maybe Pearson was thinking of the employees' bathrooms or of closing the office for Christmas or of on-site retirement parties at which free soft drinks are passed around in company-procured paper cups.

If the deal closed, Valeant's net debt would soar to $30 billion from $17 billion. This contingency the company's creditors have not so much as flinched at. On Tuesday, the Valeant single-B-rated 6 3/8 senior unsecured notes of Oct. 15, 2020, changed hands at 107 and change, a price to yield 5.02% to maturity or 4.17% to the Oct. 15, 2016, call. The price is virtually unchanged since the Valeant-Ackman bid bomb dropped. For the note holders, what's the conceivable upside?

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