A Generic Merger: Amneal and Impax Combine To Fight For Survival In The Pharma Industry

Impax Laboratories, Inc. (IPXL:NASDAQ) – market cap as of 27/10/2017: $1.40bn

Introduction

On October 17, 2017, Amneal Pharmaceuticals and Impax Laboratories announced that they will merge in an all-stock transaction. Amneal will hold c. 75% of the combined entity, whereas Impax shareholders will own the remaining stake (c. 25%). These companies have been successful players in both the generic and specialty pharmaceutical sector, growing very rapidly especially in the last decade. The new company, to be named Amneal Pharmaceuticals, Inc., is expected to become the 5th largest company in the US in the generics sector and to achieve a pro-forma adjusted EBITDA of c. $600-650m.

About Amneal Pharmaceuticals LLC

Headquarted in New Jersey, Amneal is a privately-owned pharmaceutical company, with more than 5,000 employees and with operations in North America, Asia, and Europe. It was founded in 2002 by the two brothers Chirag and Chintu Patel, who currently hold the positions of co-chairmen and co-chief executive officers. The company operates in the generic drugs sector, with the aim of providing affordable high-quality medicine to patients. The company has an increasingly strong presence in UK, Germany, Ireland and India.

The company has always invested in quality manufacturing and new product development, and showed commitment to CSR policies. A combination of these factors, together with a lively acquisition track record, have led Amneal to become one of the fastest-growing global generics pharmaceutical manufacturers in the world. Indeed, the company can count on more than 10 executed M&A deals since 2007.

About Impax Laboratories, Inc.

Impax Laboratories is a California-based specialty pharmaceutical company founded in 1995. In 1999, the publicly traded Global Pharmaceutical Corporation and Impax Pharmaceuticals completed a reverse merger, forming Impax Laboratories. The merger allowed to combine the advanced drug delivery systems developed by Impax Pharmaceuticals, as well as its R&D expertise, with Global Pharmaceutical's sales, marketing and distribution capabilities.

The company has two divisions: Impax Generics and Impax Specialty Pharma. The Generic Pharma division covers a broad range of therapeutic areas and operates with technically challenging drug-delivery mechanisms and unique development formulations. The Specialty Pharma division is focused on proprietary branded pharmaceutical products for the treatment of central nervous system disorders and other specialty segments.

In FY2016 Impax has posted total revenues of $824m (down 4% YoY) and a net loss of $472m, as opposed to a profit of $39m in FY2015. The loss in FY2016 derives mostly from intangible assets impairment charges, after Impax's acquisition of a portfolio of generic drugs from Teva Pharmaceutical Industries.

Industry Overview

Pharmaceuticals companies are experiencing a wave of new challenges arising from the consolidation of providers, especially hospitals as they intend to achieve efficiency gains; the changing demands of patients, who seek greater knowledge and participation in their medical treatment; and increasing cost pressures. These forces are shifting the healthcare sector towards a more consumer facing industry, pricing for value rather than volume. Most pharma companies have always interacted with consumers thanks to clinical trials and thus have, to a limited extent, some experience with consumer oriented business models. Therefore, some firms are positioned to benefit from this new opportunity. In fact, these companies have begun adopting new technologies for data analytics so to manage and assess the results of personalized medical treatments and determine the direction of R&D investments for new products development. Moreover, these firms are also re-examining their pricing policies and distribution structures as they strive to improve their communication channel with patients.

The pharma industry is becoming predominantly consumer-focused, but not all companies will be successful in adapting to this structural change. The core issue consists of better communication systems with patients, especially given that many clients are sensitive about sharing personal information. However, PwC's Health Research Institute has recorded that most people are willing to inform pharma companies of their medical activities if this will lead to better care. Advances in digital and medical technology are improving pharmaceutical companies' communication systems. For instance, some groups have developed smartphone apps to survey patients in order to track the progression of a disease and help them better understand their needs. Since better quality medical treatments are spurred by individuals' habits and attitudes, pharma companies are starting to explore the realm of behavioral psychology to foster better patient decision making.

Another industry development is the rising importance of analytics. In the last 40 years, the volume and variety of medical information has expanded significantly due to innovations and large scale utilization of electronic medical records. Pharma companies have taken notice of the benefits from this evolution and are exploiting enterprise analytics. Implemented correctly, an enterprise analytics program can offer the following benefits: it can optimize R&D investments; help the company in making informed decisions regarding pricing, strategy, market access and identification of patients; monitor risks and allocates resources more efficiently, and improve supply chains by predicting risks and quantitatively assessing vendors performance. A smart way for pharma companies to exploit all this, is to build a specific team of data scientists focused on data analytics.

Regardless of some of the most important recent industry trends, the healthcare sector remains a non-cyclical sector experiencing stagnant growth (5.1% CAGR from 2013-2020). Due, to a limited extent, to its stagnant organic growth, M&A activity has been employed by all pharma companies as a main driver for growth. Mature and established incumbents acquire R&D intensive, high growth, early stage bio-tech /research companies with the hope of creating a new drug and obtaining a patent on it, in order to charge supra-marginal prices to consumers.

Deal Structure

The all-stock transaction has a total deal value, equal to the deal equity value, of $1.6bn. The combined company is expected to have a valuation of $6.4bn and c. $2bn in yearly revenues. Further, the companies expect c. $200m in annual cost synergies within three years, and they also expect the transaction to be accretive to Impax's adjusted EPS.

As result of the deal, a new publicly traded holding company, Amneal Pharmaceuticals, Inc., will be formed. Following the conversion, Amneal will hold approximately 75% of share capital while Impax will hold the remaining 25%. Amneal will nominate six BoD members, with Impax nominating five.

The combined entity has secured financing from JPMorgan Chase and Bank of America Merrill Lynch to refinance both companies' currently outstanding debt obligations. The transaction is expected to be close in H1 2018, after shareholder and regulatory approval.

Deal Rationale

The combined entity is expected to gain significant advantages in the highly competitive generics drug market, which displays strong price pressures. Indeed, the swift approval of generic drugs by regulators has increased competition in the sector.

The new company, the fifth-largest generic business in the US, will benefit from a wider range of products, which will result in a more diversified revenue stream. Its portfolio will contain approximately 165 different generic products and over 150 projects pending for ANDA (Abbreviated New Drug Application) approval in the United States and other 165 projects in active stages of development. Impax's specialty franchise products will sum up to the portfolio, adding stable cash flows to the company's revenues through its high margins products such as Rytary, Zomig Nasal Spray, Emverm and Albenza. Moreover, the combined company will have significant market advantages as it will achieve a top 1 or 2 position for many of its product families. The company's top 5 generic drugs will amount to c. 25% of its pro-forma net revenue in the first full year.

Another beneficial outcome of this merger will be their increased capability of investing in R&D projects for high-value products. It is expected that annual R&D investments will represent c. 10% of the combined company's pro-forma revenue.

The transaction is also financially compelling. The company has revealed to be expecting annual cost savings of $200m within three years, of which $80-120m projected for the first year after closing. The 2017 pro-forma net revenue of $1.75-1.85bn and pro-forma adjusted EBITDA of c. $600-650m in FY2017 and $700-750m in FY2018 will significantly contribute to the company's ability to pay down its debt and invest more intensively in R&D.

Market Reaction

On the day the deal was announced, October 17, Impax shares closed at $19.30, implying a 3% decline. However, by the end of the next day, the shares surged up again and closed at $21.45.

The markets initial negative reaction towards Impax shares has been attributed to the fact that Impax will only hold 25% of stocks of the new combined company, which does not represent enough voting power to control the company's strategic decisions. Nonetheless, some analysts believe the transaction can add value, particularly in the long term, since Impax has lacked operational efficiency in both generics and brands.

Advisors

Morgan Stanley and Bank of America Merrill Lynch advised Impax, whereas Amneal was advised by JP Morgan.

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