Thermo Fisher to Buy the Binding Site Group

Introduction

On October 31st, Thermo Fisher Scientific [TMO: NYSE], one of the global leaders in the supply of scientific instrumentation, announced that it had entered a definitive agreement to acquire The Binding Site Group, a Birmingham-based specialty diagnostics firm. European private equity firms Nordic Capital and Five Arrow Principal Investments, owners since 2011, exited The Binding Site in an all-cash transaction, valued at $2.6bn (£2.25bn). The acquisition will allow Thermo Fisher to further expand its specialty diagnostics segment and its share in the clinical diagnostic market, which is expected to grow at a compound annual growth rate of approximately 6.1% during the forecast period 2022-2027. Once the transaction is completed, expected to be sometime in the first half of 2023, the new addition is expected to add $0.07 to Thermo Fisher's adjusted earnings per share for the first full year following the deal's close.

About Thermo Fisher Scientific

Born in 2006 from the merger of analytical instrument provider Thermo Electron and laboratory supply firm Fisher Scientific, Thermo Fisher Scientific provides scientific instrumentation, reagents and consumables, as well as software services. With a revenue of approximately $40bn in FY2021, the company has reported a net income of $7.7bn, resulting in a 21% year-on-year increase in both. It operates through four segments: Analytical Instruments, Laboratory Products and Services, Life Science Solutions and Specialty Diagnostics.

Analytical Instruments include a variety of instruments, consumables, software and services employed by customers in the pharmaceutical, biotechnology, academic, government, environmental and research-related industries. Laboratory Products and services contribute to 33% of the total revenue and include unique combinations of produced and supplied products sold to laboratories with a wide range of outsourced services, including clinical trial logistics. Life Sciences Solutions, the largest of the company's segments, contributes 38% to the total revenue and offers reagents, equipment and consumables utilized in biomedical research, drug development and manufacture, as well as infection and disease diagnostics. It involves clients from the agricultural industry, healthcare, academics and government industries. Specialty Diagnostic has been the second fastest growing segment for Thermo Fisher in the past two years, especially as the COVID-19 pandemic urged patients to self-test. As a matter of fact, this division provides diagnostic test kits, reagents and tools to support clients in healthcare, clinical, pharmaceutical, and food safety laboratories. After the acquisition of The Binding Site Group, this segment could expand from diagnostic kits for viruses and allergies to instruments for the diagnosis and management of blood cancers and immune system disorders.

The Binding Site is only the last of almost 40 acquisitions since Thermo Fisher itself was formed by a merger in 2006. M&A is, as a matter of fact, a key growth strategy for the American giant to expand across emerging markets. Although the field of the acquired companies is broad– ranging from genomics to pharmaceutical research- they all offer products focused on the same areas: diagnostics, therapies, and lab productivity. Spending exclusively on life sciences research was combined with management's willingness to take the risk, such as when, in 2013, the firm acquired Life Technologies Corporation for $13.6bn, more than its annual revenue at the time. Since then, Thermo Fisher has spent over $15bn in acquisitions, favored by the boom of the life sciences market, whose compound annual growth rate is predicted to be 14.9% between 2022 and 2030. Other key growth strategies are innovation, with $1.5bn spent on R&D annually, and creating unique value for customers through comprehensive biopharma services and high-impact, innovative products, as well as a yearly updated capital deployment strategy.

It must be considered, however, that the market is highly competitive and the leading companies other than Thermo Fisher are Bruker Corporation [BRKR: NASDAQ], Agilent Technologies [A: NYSE], and Eppendorf.

About The Binding Site Group

The Binding Site Group is a global specialist diagnostic company engaged in the research, development, manufacture and distribution of innovative tests used to detect blood cancers and immune disorders. Born at the University of Birmingham in 1986, it has been growing around 10% annually and is expected to deliver more than $225m (£190m) of revenue in FY2022.

At the roots of The Binding Site is protein analysis, which involves the extensive interpretation of the structure and functions of proteins. This technology allowed the company to develop its three main products: Optilite, Hevylite and Freelite. The first is an analyzer designed for mid to high volume laboratories and is meant to consolidate a laboratory's workload by simplifying otherwise complex analytical processes; Hevylite offers a unique test for light and heavy isotype analysis, while Freelite is specifically meant to be employed in the diagnosis and monitoring of myeloma and related diseases. Moreover, the company provides a data management software, DataSite, which is said to enhance the laboratory's efficiency when used in conjunction with the diagnostic analyzers. Finally, it offers a vast selection of immunoassay tests, able to measure the concentration of an analyte in a solution through an antibody or antigen and used to detect diseases or assess vaccine responses.

The company operates in the clinical diagnostics market, which was valued at around $70bn in FY2021 and is expected to grow over 6% in the next five years, due to increasing incidence of infection and chronic diseases and the increasing adoption of automated platforms. The Binding Site currently serves 3,000 customers in over 100 countries and it generated over $190m (£160m) in revenue in FY2021. Its strategy is centered around three pillars: patients, colleagues and the planet. As a matter of fact, the company aims to improve the lives of its patients through innovation and an ethical approach, fosters collaboration by working in an inclusive environment and commits to the net-zero operations goal. The acquisition by Thermo Fisher will allow The Binding site to implement this strategy and establish itself in the highly competitive market of clinical diagnostics.

Deal Rationale

One of the main objectives of Thermo Fisher with the deal is to enhance their specialty diagnostic portfolio, which includes equipment for testing allergy and autoimmune diseases and for monitoring transplant-related biomarkers. That segment alone accounted for 10% of Thermo Fisher's revenue on the second quarter, nearly $1.1bn. The Binding Site is most respected for their pioneering diagnosis and monitoring solutions for multiple myeloma and their strong R&D culture. Hence, with patient care shifting to early diagnosis and monitoring using regular testing, it should become an even more profitable segment, one that Thermo Fisher had until now low exposure to. Both revenue and cost synergies are expected. According to Thermo Fisher, upon completion, the deal is expected to be accretive to adjusted earnings per share by $0.07 for the first full year of ownership. Moreover, the cost synergies, somewhat frequent in Healthcare M&As, arise from the consolidation of overlapping R&D efforts.

Further, the acquisition of Binding Site is line with the company's past M&A activity. As part of the Massachusetts-based company's recent capital deployment strategy, the company has been performing strategic acquisitions, having spent over $50bn over the last decade. According to analysts at Credit Suisse [CSGN: SWX] earlier this year, the company has been effectively using its COVID cash flow to create shareholder value, increasing its exposure to faster growing businesses. In efforts to combat the pandemic, the company developed various types of diagnostic kits. Thermo Fisher is currently the biggest player in the PCR market, having generated over $9.3bn in overall testing revenues last year. Nonetheless, the company has faced a smaller demand this year, expecting around $2.8bn in revenues.

Despite the challenging macroeconomic backdrop, Binding Site's sale was highly celebrated by its former shareholders. The firm was originally part of Nordic Capital Fund VII portfolio, whose term expired in December 2017, but was transferred to a 5-year-term continuation vehicle to maximize the value creation potential. The diagnostic company was their best-ever exit, yielding a 19x multiple of invested capital and a gross internal rate of return of around 35%. To thank is the resilience of the pharmaceutical and diagnostic businesses, which unlike other sectors, such as tech, haven't seen a steep decrease in their comparables.

Deal Structure

The deal valued Binding Site at £2.25bn ($2.6bn at the current exchange rate) in an all-cash transaction and is set to be the third largest deal of the year in the pharmaceuticals & medical devices industry. The value represents 11x of the diagnostic company's 2023 expected sales, which is in fact substantially higher than 6x sales Thermo Fisher paid for Phadia, a similar diagnostic company, in 2011. Further, it represents around 1.25% of Thermo Fisher's market capitalization. Upon completion, The Binding Site will become part of Thermo Fisher's Specialty Diagnostics segment. The transaction is expected to be completed in the first half of 2023, but is nonetheless subject to customary closing conditions, including regulatory approvals. Moreover, the transaction could indicate a resurgence of the M&A market in Europe, whose volumes have been almost at record low levels. Specifically, due to a relative strong dollar, US-based buyers, such as Thermo Fisher, could benefit when paying for pound- or euro-denominated assets.

Market reaction

Thermo Fisher's stock remained somewhat stable as the market opened, going down by 0.2%, and closing the day near $513, slightly higher than the $504 opening price. Nonetheless, it traded upwards for the following two weeks, gaining 7%. The Massachusetts-based company also posted its quarterly results a week before the deal was announced. The company beat the market expectations, exceeding analyst estimates regarding both revenue, which increased 18% compared to 3Q21, and EPS which only fell 21% compared to 3Q21. However, the year-over-year decline in revenues in the Life Science Solutions and Specialty Diagnostics segment concerned the market. Moreover, the company reported lower profit margins led by higher expenses, which suffocated any possible gains.

Both the stock and the Life Sciences industry are down 24% this year, whereas the S&P 500 only fell 18%. The underperformance of the industry in the stock market may be a consequence of the inflated prices left by the higher revenues during the pandemic, which led the stocks of the industry to their all-time high.

Tags: Healthcare, Diagnostics, Life Sciences, M&A, Private Equity

