cube
LEARN | DISCUSS | INVEST

**Research on Takeda Pharmaceuticals - 4/14/19**

**Description:** Was founded in 1781 and is headquartered in Tokyo, Japan. Takeda engages in the research, development, manufacturing, and marketing of pharmaceutical products, over-the-counter medicines and quasi-drug consumer products, and other healthcare products. The company provides medicines in various therapeutic areas comprising gastroenterology, oncology, and neuroscience; and vaccines. It operates in Japan, the United States, Europe and Canada, Russia/CIS, Latin America, Asia, the Middle East, Oceania, and Africa. The company has a collaboration agreement with Lupus Therapeutics Inc. to evaluate the investigational biologic TAK-079 as a potential new therapy for Lupus in a Phase 1 trial.

Ticker: TAK
Price: $19.04
Market Cap: $60.1B
Performance: +13.20% YTD

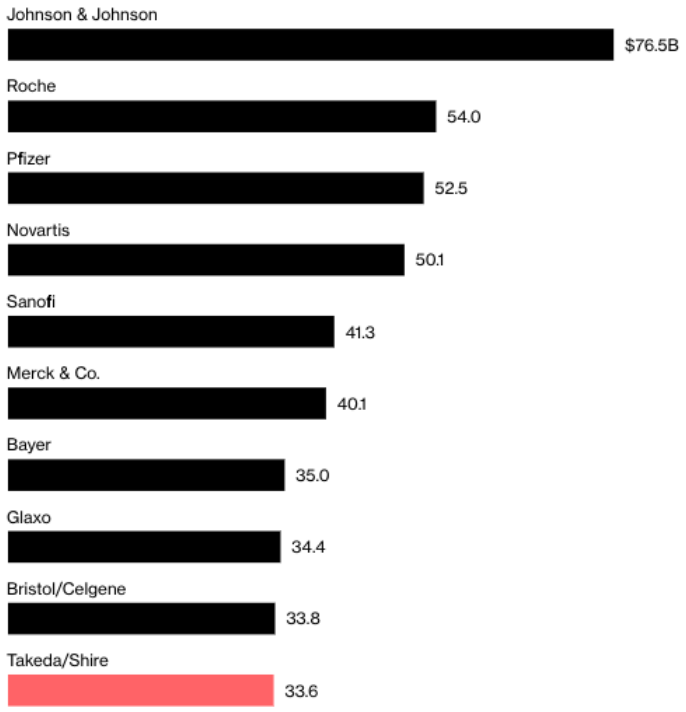
Analysis

Takeda Pharma is now a worldwide juggernaut in the pharmaceutical space since announcing they were acquiring Shire PLC for a whopping $62B last year. The deal was closed and finalized on January 8th of this year. This was one of the largest deals recorded in 2018 and is something we are becoming very familiar with as consolidation in the pharma space is becoming very common. For example:

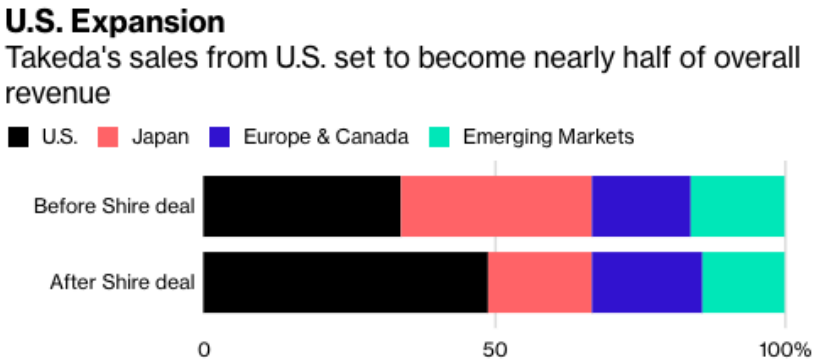
2015: Shire acquisition Baxalta for $32B
2016: Bayer's acquisition of Monsanto for $66B
2017: Gilead's acquisition of Kite Pharma for $12B
2018: Sanofi's acquisition of Bioverativ for $11.6B
2019: Bristol-Myers Squibb's acquisition of Celgene for $74B

2019: Roche acquisition of Spark for $5B

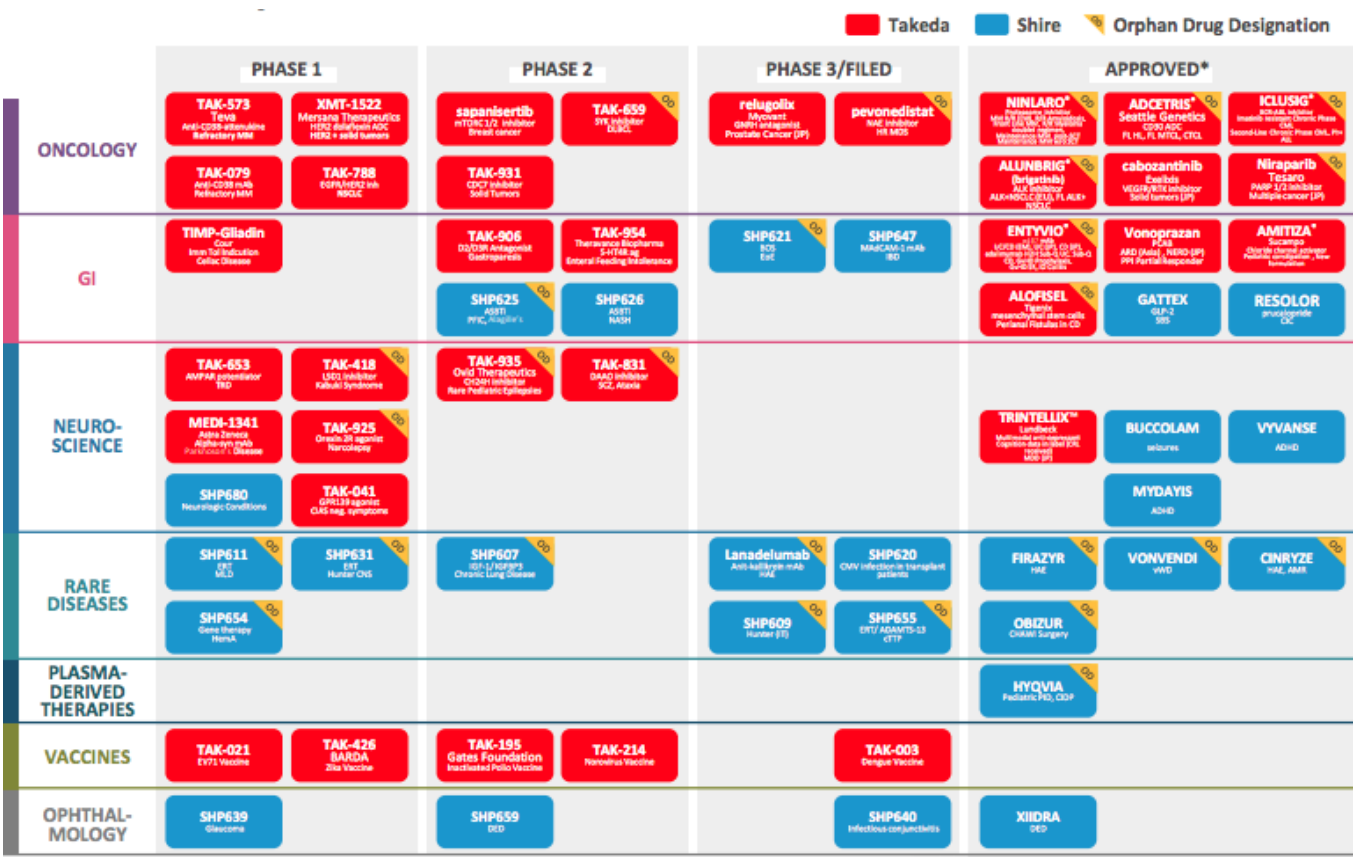
In today's changing marketplace we believe this frequency of consolidation will only continue and the strongest will be the survivors. TAK's acquisition of Shire now places them in the top 10 for largest revenues for pharmas. Notice, a lot of these companies are in the mergers list above and this is obviously not a coincidence.




What makes TAK's merger with Shire even more appealing aside from all the synergies is that it gives TAK a strong foothold globally. View the image below and you'll see that TAK is now going to bring in a lot more revs from the United States.



Adding to the image above, one downside we could pull from it is that TAK's revenue stream is actually less diversified now as nearly 50% of revenues are coming from the United States. TAK makes up for this greatly though by adding a ton of diversity to their pipeline (view image below):

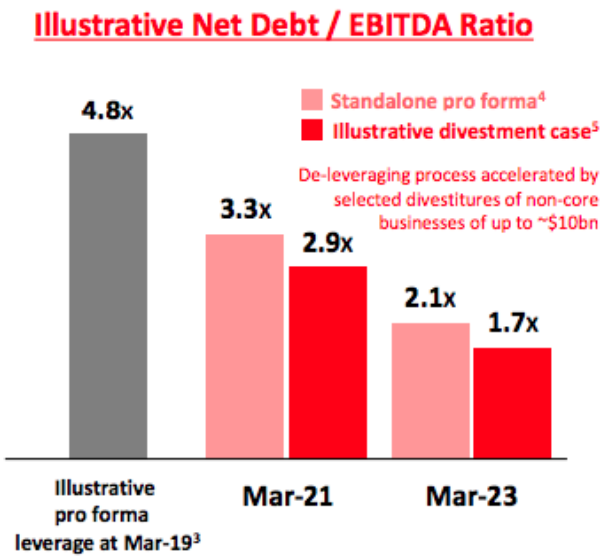



Shire is now adding completely new product lines like that of Rare Diseases, Plasma-Derived Therapies, Ophthalmology alongside stacking their already large assortments of medicines in GI and Neuroscience.

TAK alone has a ton of medicines in the pipeline awaiting approval but what the acquisition with Shire does is place a lot more towards the tail end in Phase 3 and even more so with their approved drugs.

Now that we covered a lot of the good things from this merger we also have to discuss some of the bad/not so good.

Takeda took on a lot of debt to get this deal done – approximately $30B worth on tap of the debt it already has on its books making the total nearly $48B of debt.




According to TAK's presentation on the deal, the company is currently standing at a 4.8x net debt (pulling the cash out)/ EBITDA (earnings before interest, tax, depreciation & amortization). This is extremely high but the company believes after synergies are met between the companies and future drugs rollout as well as certain assets sold they can get it down to 1.7x by 2023. If they are unable to divest some of their assets that ratio will get down to 2.1x, which is still pretty high but much healthier than the current 4.8x.

We were looking through some fine print on the financial statement and believe the divestitures have already begun, which is a good sign. We were unable to copy and paste but here is the excerpt:

The Company has decided to newly establish a wholly owned subsidiary ("Subject Company") of Takeda Pharmaceutical Real Estate Co., Ltd. ("TPRE"), a wholly owned subsidiary of the Company; to have the Subject Company succeed a part of the respective real estate businesses of the Company and TPRE through company splits as of March 11, 2019; and to transfer all of the issued shares of the Subject Company held by Takeda and TPRE as of March 22, 2019, which will be allocated as considerations of the company splits. On January 28, 2019, Takeda entered into an agreement on the share transfer.

After the transaction, the transferee will hold 21 properties, including the Takeda Osaka Headquarters (Takeda Mido-suji building). Takeda will record a gain on sale of shares arising as a result of the transfer of about 38.0 billion yen (before taxes) for the year ended March 31, 2019. Business activities of the Company at the Osaka Headquarters (Takeda Mido-suji building) and other places will continue after the completion of the transaction.

Moving forward, let's talk about TAK's most recent quarter and 9 month's results that was released in February:

- Solid Underlying Revenue growth of +4.8%, with continued strong momentum from Takeda's Growth Drivers (Gastroenterology, Oncology, Neuroscience and Emerging Markets), which grew +10.5%.
- Key growth products
    - Entyvio (+35.1%
    - Ninlaro (+36.6%)
    - Trintellix (+19.5%)
    - Iclusig (+26.0%)
    - Alunbrig (+151.4%)
- Every region grew their prescription drug portfolio versus prior year
    - U.S. +8.5%
    - Japan +4.9%
    - Europe & Canada +4.9%
    - Emerging Markets +5.1%
- Revenue grew +0.8% year-to-date to 1,380 billion yen, despite the negative impact from foreign exchange rates (-1.1pp) and divestitures (-3.0pp)
- Underlying Core Earnings +32.3% year-to-date, with margin +530 basis points driven by business momentum and execution of the Global Opex Initiative
- Underlying Core EPS was up +34.2% year-to-date
- Reported EPS declined -32.0% to 210 yen per share, impacted by divestitures, Shire related costs, and loss of associates accounted for using the equity method due to an impairment charge recognized by Teva Takeda Pharma Ltd

Overall, the results were decent but these numbers do not include Shire as the results were for the period ending December 31, 2018 and the deal officially closed on January 8, 2019.

Without knowing exactly what the financials are going to look like, let's examine some stats for the U.S. healthcare market – especially now that TAK's revenues will be comprised of nearly 50% from this region.

- According to the Centers for Medicare & Medicaid Services (CMS), U.S. healthcare spending is expected to rise 5.5% each year over the next decade, reaching ~$6T by 2027 (19.4% of GDP).

- Medicare spending is expected to rise 7.4% per annum over the same period, above 5.5% for Medicaid and 4.8% for private insurance plans.
- Medicare enrollment should peak at 2.9% this year.
- Prescription drug spending is forecasted to rise 5.6% per year between 2018 and 2027 as is hospital spending.
- By 2027, federal, state and local governments are projected to fund 47% of national healthcare spending (45% in 2017).

With this in mind, we think TAK will benefit greatly from getting more U.S. exposure. Despite seeing tons of benefits from the merger we are still hesitant about the company, though. Right now, our whole concern is cash flow and whether TAK can get this pile of debt down that almost equates to a majority of the market cap of the company.

In addition, even though TAK's product line is very diverse it is still a pharmaceutical company that possesses a ton of regulatory risk as we've seen it hurt the likes of Biogen and many others in recent history.

We'd wait to see how TAK's first quarter with Shire's financials included look before doing anything here as there are so many variables. It truly is a tough call as there is data and figures that support TAK will benefit greatly from this merger but at the same time there are legitimate concerns about TAK's capital structure over the medium to long-term.

Technically speaking, TAK is looking oversold here. From the chart below, you'll notice the stock has broken below its 50 day moving average, 200 day moving average, and lower Bollinger band. In addition, it has broken into oversold territory on the Williams %R and MFI. The next area of support looks like it will be $18.47 as it has also broken below all of its resistance points when looking at the fibonnaci retracement levels.

Overall, we'd hold off on owning TAK short-term as right now there are too many question marks as to what the financials are going to look like and we also believe the stock is caught in a pretty bad downtrend despite being oversold. If you're adamant on holding the company, we'd wait for a little more downside in the name and would also remind you that this is a long-term bet on the company if you want to see some substantial upside in TAK. It's going to take time for the companies to synergize, get more products to market, and get down the debt in a healthcare environment that is currently very unpredictable.

cube
LEARN | DISCUSS | INVEST