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AbbVie acquisition of Shire almost certainly doomed

10-20-2014
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NORTH CHICAGO, Ill.—The IRS has claimed its first victory with anti-inversion rules, or perhaps its first victim depending on your perspective, in AbbVie with the scuttling of an intended acquisition by the company of Dublin, Ireland-based Shire plc.

It was just in August that, after months of wooing, AbbVie and Shire came to a roughly $55 billion agreement. And then, in late September, U.S. Department of Treasury proposed unilateral changes to the tax regulations designed to prevent or deter U.S. companies from re-domiciling in other countries—technically headquartering in those nations while often not actually moving any operations out of the U.S.—to reduce their tax burdens, a process known as inversion.

That got AbbVie to rethinking the deal and its potential profitability and, on Oct. 14, the company announced that its board of director would meet “to reconsider the recommendation made on July 18, 2014, that AbbVie stockholders adopt the merger agreement needed to complete the proposed combination of AbbVie and Shire” and “consider whether to withdraw or modify its recommendation.”

Some market-watchers had speculated that the deal would simply be modified, as both companies, particularly AbbVie, had been emphasizing their excitement about synergies between the company rather than the tax benefits to AbbVie. The theory was that AbbVie had too much of its reputation invested in the deal and would take a hit to its credibility if it backed off the acquisition.

Those analyses proved to be wrong when, just a day after the announcement that the board would reconsider the deal, AbbVie noted that Shire had waived a three-day notice period and the AbbVie board had made a “detailed consideration of the impact of the U.S. Department of Treasury’s unilateral changes to the tax rules” and recommended that shareholders reject the merger and acquisition (M&A) deal, as “The breadth and scope of the changes, including the unexpected nature of the exercise of administrative authority to impact longstanding tax principles, and to target specifically a subset of companies that would be treated differently than either other inverted companies or foreign domiciled entities, introduced an unacceptable level of uncertainty to the transaction. Additionally, the changes eliminated certain of the financial benefits of the transaction, most notably the ability to access current and future global cash flows in a tax efficient manner as originally contemplated in the transaction. This fundamentally changed the implied value of Shire to AbbVie in a significant manner.”

“AbbVie has always been financially disciplined and we have rigorous standards in place to ensure transactions are financially sound and deliver compelling stockholder returns,” said AbbVie Chairman and CEO Richard A. Gonzalez. “Although the strategic rationale of combining our two companies remains strong, the agreed upon valuation is no longer supported as a result of the changes to the tax rules and we did not believe it was in the best interests of our stockholders to proceed.”

Under the terms of the original acquisition deal, AbbVie will have to pay a break fee of approximately $1.64 billion, payable if either AbbVie stockholders do not approve the adoption of the merger agreement at an AbbVie stockholder meeting or such a meeting does not occur by Dec. 14, 2014.

While that is the third-largest fee on record to break an M&A deal, the sting might not be too painful for AbbVie in the end, as analysts have noted the fee—as well as many other related costs of the M&A negotiations and now breakup—are tax-deductible. A contributed article by Robert W. Wood on the Forbes website estimates that AbbVie could realize at least $650 million in tax savings and the injection of more than a billion dollars into Shire's coffers could make it more attractive to another potential M&A suitor. Some have speculated Shire may even go searching for an acquisition of its own.