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Concordia: A tough pill to swallow

by Benjamin Lye

Concordia International Corporation (Concordia) is an international specialty pharmaceutical company that focuses on the acquisition of "legacy", or older, pharmaceutical products and orphan drugs. It is the market leader in the development stage biotech industry according to Bloomberg classification. The company's three main operating segments consist of Concordia North America, Concordia International and Orphan Drugs, which contributed 33.4%, 65.4% and 1.23% to total revenue, respectively. Since 2013, the firm has spent almost USD 5bn on acquisitions which were funded by a high level of debt. Concordia acquired Amdipharm Mercury, currently known as Concordia International (Jersey), for USD 3.5bn in October 2015, a strategy that granted Concordia additional access to more than 190 off-patent molecules and an international sales channel to wholesalers, hospitals and pharmacies in over 100 countries. However, due to more competition, an increasing number of cheaper substitutes and a volatile foreign currency from its international operation, Concordia's control over drug prices has reduced and this has hurt its profitability and placed it in a risky credit position.

The RMI-CRI 1-year Probability of Default (PD) for Concordia exceeded the mark of 50bps for the first time in August 2015 and surged to 2,542bps as of Aug 12, 2016. This coincided with the sharp fall of the firm's market capitalization in light of the increased scrutiny due to Valeant's drug price hike crisis, an increased in the number of generic drug approvals by the FDA, the rescinding of their buyout offers by two private equity firms, a disappointing second quarter result as well as Brexit uncertainty weighing on its international segment.

Figure 1: RMI-CRI 1-year PD (LHS) and market cap (RHS) of Concordia. *Source: RMI-CRI, Bloomberg*

Valeant Pharmaceuticals International's price hike on prescription medicine has drawn increased scrutiny on drug prices from political party and pharmaceutical benefit managers (PBMs). Drug prices had gone up by more than 10% in the past two years and this has created much public discontent. PBMs, such as CVS Health are replacing drugs that have experienced egregious price increases with cheaper alternatives for their clients, which include Concordia's prostate cancer drug Nilandron and blood-pressure treatment Dutoprol at the start of 2017. With the removal of the drugs from the market next year, Concordia's once predictable revenue stream would be affected. This will place Concordia in a tough spot as it focuses on legacy products and has no intention to increase its R&D expenditure substantially from current levels. The firm's on-going strategic review has not yet yielded any result.

Concordia's significant exposure to the United Kingdom is a major headwind for the firm. Out of its total revenue, more than 45% came from the United Kingdom in Q2 2016. The depreciating British Pound and the increase in Pound volatility could weigh on Concordia's credit profile, which reports its earnings in USD. Bloomberg estimated that a 5% depreciation of GBP can drag Concordia's EBITDA down by 1%.

Additionally, uncertainty regarding the laws (which could take up to two years to finalize), ranging from finance, trade, intellectual property rights, safety and health could force Concordia to incur a higher compliance cost as it needs to fulfill a different regulatory framework for the United Kingdom.

(USD mn)	FY 2013	FY 2014	FY 2015	Q1 2016	Q2 2016
Revenue	40.45	104.94	394.22	228.54	231.71
Net Income/Net Profit (Losses)	2.43	11.59	-31.57	-5.16	-570.46
Long Term Debt	5.10	230.04	3,302.58	3,280.31	3,228.48
Total Debt to Total Equity (%)	33.70	100.46	287.26	304.43	887.10
Free Cash Flow	49.76	5.43	71.95	58.17	40.00

Table 1: Financial metrics for Concordia International Corp. *Source: Bloomberg*

The unfavorable business performance is also reflected in Concordia's financial profile. The increase in Concordia's revenue in 2015 was primarily a result of its growth by acquisition strategy, and its long term debt skyrocketed from 2014 to 2015, a more than 14 fold increase. Net income had also been negative since 2015 and Concordia recorded its worst performance in Q2 2016, recording USD 570.46mn in net losses. This was due to competitive pressures in its North America segment that triggered USD 567mn asset impairment and drove up its net losses and debt to equity ratio.

In light of the accelerating competitive drug business environment, increased regulatory scrutiny, a higher generic drug approval rate and large exposure to the UK, a heavily debt-laden Concordia faces an uncertain future prospect. The market cap of Concordia has dropped by 82% from its peak in September 2015 to August 12, 2016. These, coupled with Concordia's unresolved strategic review had made Concordia a tough pill for investors to swallow.

Credit News

National Australia Bank cash profit falls 3% as bad debts rise

Aug 15. National Australia Bank's Q3 profit fell 3% amid rising expenses incurred by bad debts and provisions for mining and agricultural loans, symbolizing the most challenging reporting season for lenders in the recent six years. The unaudited cash profit from continuing operations for the Melbourne-based lender declined to AUD 1.6bn in the quarter ended June 30, corresponding to the rise in bad debt charge by 21% to AUD 228mn. The escalating provisions for bad loans are not the only drag on big Australian banks, which are also facing declining loan margins due to a regulatory clampdown on mortgages to counter soaring housing prices. (Bloomberg)

Dark clouds over UK insurers disperse as Brexit concerns ease

Aug 12. The UK's life insurers have suffered a great deal from the Brexit, as there are increased concerns about a long-term recession, which would put people off investment products and damage their holdings of corporate bonds. During the week after the referendum, the FTSE 350 UK life insurance index had lost a fifth of its value. However, since the insurers reported good half-year figures over the past weeks, the clouds have lifted. Many of the insurers, including Prudential and Standard Life, beat expectations. Their capital ratios under the new Solvency II rules produced no big shocks. Most importantly, dividends increased almost across the board. (FT)

Abengoa reaches deal with creditors to avoid bankruptcy

Aug 11. The renewable energy and engineering company Abengoa SA declared that it had reached a restructuring deal with some major creditors to avoid becoming Spain's largest-ever bankruptcy. A group of investors have agreed to inject EUD 1.17bn into the debt-laden company. In exchange, investors and creditor banks are set to own between 90% and 95% of Abengoa, depending on whether Abengoa meets certain targets. It is still noteworthy that Abengoa did not clarify whether 75% of creditors had agreed to the restructuring deal, as required by Spanish bankruptcy law. (WSJ)

Fox & Hound restaurant owner files for bankruptcy protection

Aug 10. Last Call Guarantor LLC, a Dallas-based holding company which operates 48 Fox & Hound restaurants, 23 Champps locations and 9 Bailey's restaurant, had filed for chapter 11 bankruptcy protection. Last Call Guarantor LLC had listed debt between USD 100mn and USD 500mn. The recent filing was the second time that the restaurant chain owner had filed for bankruptcy protection since late 2013, with the previous bankruptcy filing attributed to deterioration in sales and heightening costs amid the economic downturn which results in less spending by diners. (WSJ)

Chinese central bank eyes liquidity tools

Aug 9. The People's Bank of China (PBOC), had expressed its commitment towards the use of liquidity tools besides further cuts to interest rates or the percentage of deposits banks must hold as reserves. A commentary published by a newspaper under the PBOC underscored the use of "Innovative monetary tools" such as its medium-term lending facility (MLF) and standing lending facility (SLF) to improve the effectiveness of it monetary policy. Earlier, the PBOC stated in a report that frequent interest rate cuts and banks' required reserve ratio would induce excessive liquidity into the financial system and could raise expectations of a depreciating yuan. (Straits Times)

Soaring debt has US companies as vulnerable to default as 2008 (Bloomberg)

South Korean growth will rise to 3% in 2017, IMF says (Bloomberg)

Noble Group sacrifices profit in pursuit of cash after loss (Bloomberg)

Regulatory Updates

Half of big banks unprepared for accounting shake-up

Aug 14. According to a Deloitte survey, many banks are unprepared for IFRS 9 - an accounting standard that requires lenders to state loan provisions in terms of expected losses rather than actual losses. 46% of the survey's respondents said a lack of resources may hinder them from implementing the required changes by the 2018 deadline. In addition, respondents expect IFRS 9 to result in a 25% increase in total impairment provisions, which is likely to weaken their capital ratios. The new accounting standard was conceptualized during the last financial crisis which requires banks to adopt a common forward-looking loss framework across all jurisdictions. (FT)

UK regulator delays publishing findings of asset management review

Aug 14. The Financial Conduct Authority (FCA) has postponed the publication of a widely anticipated investigation into the asset management industry. The report was due to be published in July but delays in the processing of information has resulted in a new publication date in 2017. The outcome of the Brexit vote and the subsequent departure of Martin Wheatley, the former chief executive in charge of financial services companies, have also created a question mark over the outcome of the investigation. Even though the FCA is a self-governing institution, their modus operandi is clearly affected by the political atmosphere in Westminister. (FT)

PwC sued for USD 5.5bn over mortgage underwriter TBW's collapse (FT)

China regulator to strengthen rules on capital guarantee funds (Reuters)

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