Lemelson Capital Says Ligand Pharmaceuticals’ (NASDAQ: LGND) $225M Debt Issuance Solidifies Company’s Insolvency, Substantially Raises Specter of Bankruptcy

Lemelson Capital short stake built as share price collapses on insolvency and bankruptcy risk

Rev. Father Emmanuel Lemelson, Founder and President of the Lantern Foundation and Chief Investment Officer of Lemelson Capital Management, appeared yesterday on Benzinga's Pre-Market Prep show in which he addressed recent geopolitical and global market developments and the firm’s existing long and short investment positions, including Lemelson Capital’s short position in Ligand Pharmaceuticals (NASDAQ: LGND), which the firm first announced on June 16, 2014. Lemelson Capital has continued to sell the stock short even as its share price has collapsed over the last six weeks.

Lemelson told Benzinga yesterday that Ligand’s recent August 11, 2014 announcement that it would assume $225 million in convertible debt to finance a $200 million share repurchase further deepens the already significant concerns about Ligand’s imminent insolvency and the company’s substantial risk of bankruptcy.

Lemelson’s August 13 Benzinga interview, including his comments on Ligand, can be heard here.

Lemelson Capital’s previous research reports (PDF versions) on Ligand can be found here, here and here.

Lemelson Capital today raises several new points and concerns regarding Ligand’s recently announced issuance of $225 million in convertible senior debt, including:

1. **July 17, 2014 announcement**: On July 17, Ligand announced that the company had authorized a $10 million share repurchase. At that time, the company’s cash position was a mere $12.98 million and its current portion of long term debt totaled $5.77 million. When Ligand announced its Q2 2014 earnings on August 4, however, the company had not repurchased any shares under this authorization.

2. **Debt issuance and large shareholders’ sale of stock**: Less than four weeks later, on August 14, 2014, the company announced it intended to assume $225 million in convertible notes to purchase, with proceeds from the debt, roughly $200 million of shares of its stock. Included in the release was the following statement:
Ligand intends to use a portion of the net proceeds from the offering of the notes to pay the cost of certain convertible note hedge transactions, taking into account the proceeds to Ligand of certain warrant transactions and to repurchase up to $45 million of shares of Ligand's common stock in privately negotiated transactions...

“LIGAND ANNOUNCES PROPOSED OFFERING OF $225 MILLION OF CONVERTIBLE SENIOR NOTES AND ANNOUNCES $200 MILLION SHARE REPURCHASE PROGRAM,”
AUGUST 12, 2014

3. **Tangible equity**: On August 4, 2014, Ligand released their Q2 earnings report and financial statements in which the company boasted that it was debt free. Prior to this August 4 release, the company's liabilities exceeded tangible assets, meaning the company was insolvent. With the August 4, 2014 earnings release and its updated financials, the company presented tangible equity of just $21,000 upon which rested an extraordinary market capitalization of approximately $1.1 billion.

4. **Debt service expense and prospective dilution likely to increase exponentially**: On August 11, the company announced that they would be taking on $225 million in new debt, vis-à-vis a new convertible debt offering. If the bond offering succeeds, the company's liabilities will again far exceed its assets, and the company will be technically insolvent once more. This means that the debt-free financial condition that Ligand boasted on August 4 will have lasted, according to its publicly-available financial reports, less than two weeks.

   - Hypothetically, a reasonable coupon on the bond would be 5.5 percent, meaning debt service on the proposed notes should be roughly $12 million. Under this hypothetical scenario, the addition of $12 million in interest payments would be payable with the company's average net earnings from continuing operations over the last ten years of minus $23.74 million. During the last twelve month alone, the company's EPS has declined some 76 percent. Trailing twelve month EPS through June was just $7.52 million. The increased debt service will dramatically intensify going concern risk, which the company discussed at length in its 2013 annual report, and its prospects for bankruptcy.

5. **Real cost of debt disguised in up-front derivative hedge**: On August 13, two days after its announcement that it intended to assume $225 million in convertible note debt to repurchase $200 million worth of its shares, the company announced that merely $40 million of the debt proceeds would be used to repurchase shares. It announced further that the convertible notes had been priced at 0.75 percent interest. However, this pricing is misleading because (as the company had
failed to note in its August 11 release) the company has been further required to insure the $225 million debt offering with $33.5 million in convertible hedge transactions, apparently in order to insure the debt issuers.

Convertible option of notes, if exercised, will substantially further dilute common shareholders. As Ligand stated in its announcement yesterday:

"Holders of the notes will have the right to require Ligand to repurchase all or some of their notes at 100% of their principal amount, plus any accrued and unpaid interest, upon the occurrence of certain corporate events."

“This creates a real debt cost to Ligand and its shareholders of an extraordinary 15 percent in upfront fees (a percentage higher than most consumer credit card debt). This is before the 0.75 percent interest payment becomes due and reflects the real risk premium demanded by Ligand's new lenders who have incorporated a call feature that would force the company to potentially repurchase the notes at 100 percent of their principle amount plus interest. If triggered, as it could be, this would likely force the company into bankruptcy.

- The real purpose of the transaction appears to be to enable large institutional Ligand shareholders to unload large numbers of shares in private transactions that will not negatively affect the prices of the shares traded in public markets. The proof of this is that the company has already acknowledged that $45 million of the $225 million will be used immediately for this purpose.

- Large, institutional common equity holders are trading in unsecured securities for secured debt instruments, which have an upfront payment of 15 percent. Between the derivative hedge transaction ($33.5 million), the private transaction ($45 million), and the $40 million repurchase, $118.5 million of the $225 million, or 53 percent, will be used immediately, therefore making it impossible for the company to make “repurchases up to a total of $200 million” as it had stated in its press release just two days previously.

- While the vast majority of the $118 million will not benefit the common shareholder, the common shareholder will be left with the tangible costs of the full $225 million in new debt and its associated risks.
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