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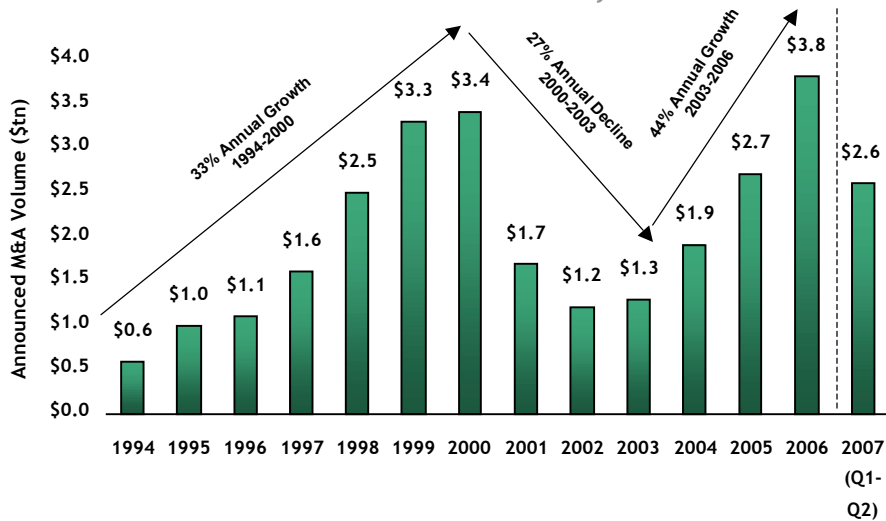
Merger and Acquisition Developments
 Alan C. Smith
 September 27, 2007



- LONDON
- MILAN
- MOSCOW
- PARIS
- ROME
- TAIPEI
- TOKYO
- NEW YORK
- SAN FRANCISCO
- SILICON VALLEY
- LOS ANGELES
- WASHINGTON DC
- SACRAMENTO
- PACIFIC NORTHWEST
- ORANGE COUNTY

M&A Activity Increased Across Industry Sectors

Volume of M&A Activity

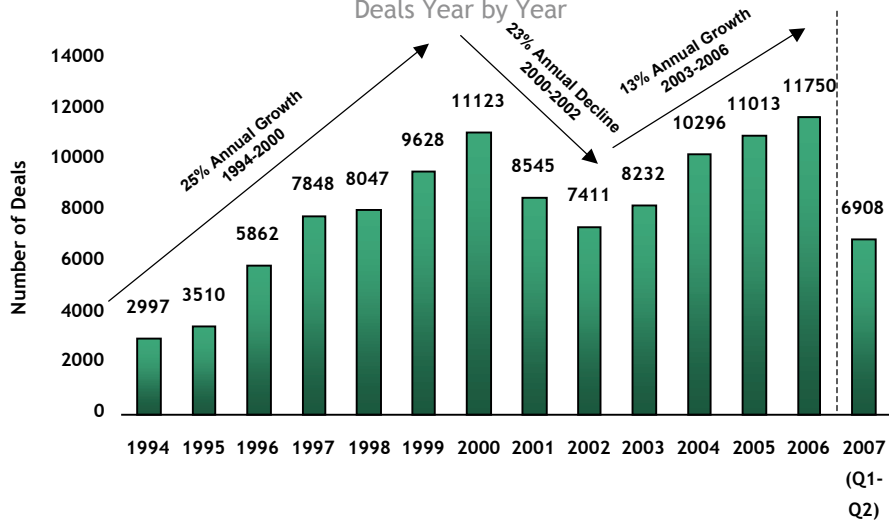


Source: Thomson Financial Securities Data



Due to Recovery, Volumes Exceeded Historical Levels

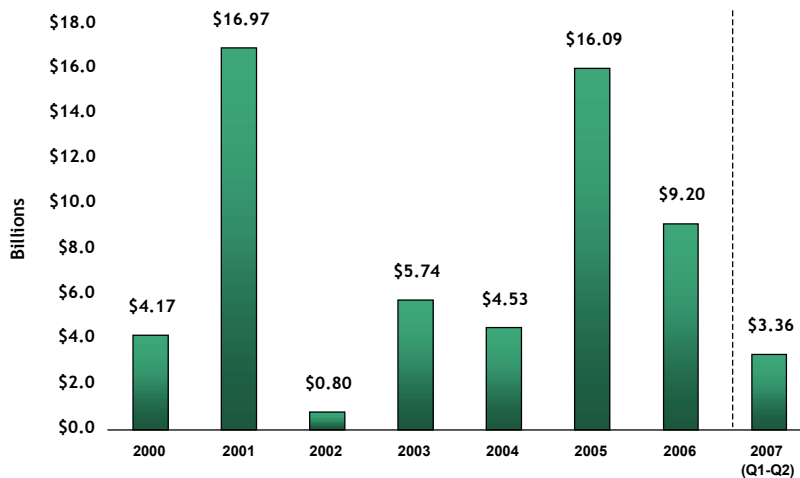
Volume of M&A Activity
Deals Year by Year



Source: Thomson Financial Securities Data

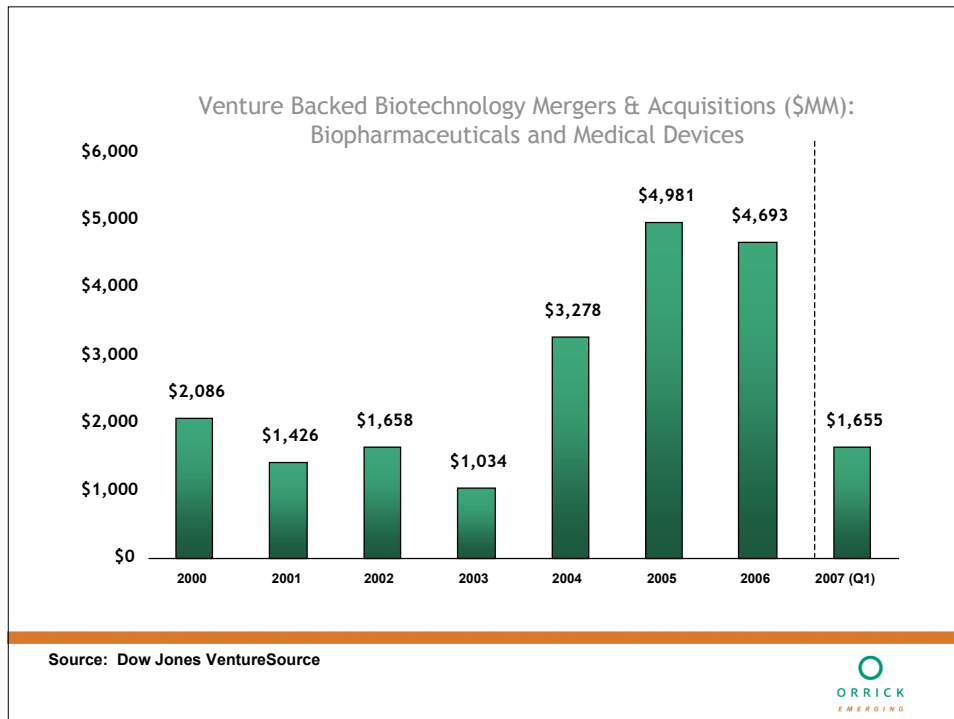


Biotech Industry M&A Activity Has Fallen



Source: Mergermarkets.com






Biotech Industry 2006 M&A Activity

Some Notable Deals (Big Pharma/Biotech)

- Abbott Laboratories paid \$78 per share for Kos Pharmaceuticals Inc. for a total of \$3.7 billion
- Eli Lilly and Co. bought out ICOS Corp. for \$2.1 billion
- Merck & Co. Inc.'s acquisition of Sirna Therapeutics Inc. for \$1.1 billion



Biotech Industry 2006 M&A Activity

Some Notable Deals (Biotech/Biotech)

- Gilead Sciences Inc.'s acquisition of Myogen Inc. for \$2.5 billion
- Genentech Inc.'s takeover of Tanox Inc. for \$919 million
- Illumina Inc.'s acquisition of Solexa Inc. in a \$600 million stock swap
- Genzyme took over AnorMED Inc. for \$580 million
- Gilead Sciences Inc.'s acquisition of Corus Pharma, Inc. for \$365 million



Drivers of Consolidation

Product-Lean Pharma

- Many “blockbuster” products are nearing the end of their patent lives
- Despite rising R&D spending, the number of new drugs and biologics submitted to the US FDA has steadily decreased in recent years
 - The number of new drug approvals by the FDA remained sluggish during 2006 with only 18 “new molecular entities” cleared for the US market, compared to an average of 26 new drugs during the past 6 years



Drivers of Consolidation

M&A Increasing in Popularity

- Biotechnology companies searching for new exit strategy, IPOs increase in difficulty
- Big Pharma needs to fill diminishing product pipeline



Trends

- Cash is king - trend toward cash deals
- Premium levels remain more moderate
- Some pickup in hostile activity
 - 2005 was the highest percentage (14%) of M&A activity since 1999

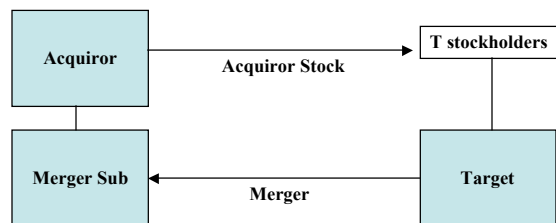


Alternative Private Company Acquisition Structures

- Statutory Merger
- Stock Purchase
- Asset Purchase



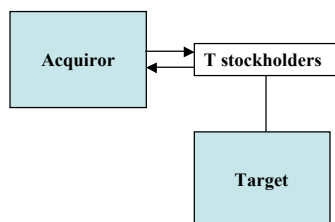
Statutory Merger



- Direct v. Subsidiary (Shareholder approval by Acquiror)
- Reverse v. Forward (Contracts and Tax)
- Merger v. Stock or Asset Purchase
 - Certainty of acquiring 100% ownership
 - Statutory procedures and approvals can be cumbersome



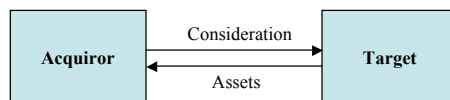
Stock Purchase



- Acquiror buys shares directly from each Target stockholder
- Stock Purchase v. Merger
 - Relatively simple
 - Chain of title critical
 - Must get every shareholder to sign



Asset Purchase



- Acquiror buys assets directly from Target; Target may subsequently liquidate and distribute consideration
- Shareholder approval required if assets constitute “all or substantially all” of Target’s assets
- Asset Purchase v. Merger or Stock Purchase
 - Allows certain liabilities to be excluded from the deal (subject to successor liability)
 - Stepped up tax basis for buyer in assets
 - Buyer need not be as concerned about equity ownership issues
 - Many contract consents likely required
 - Complex to transfer legal title to all separate assets
 - Awkward to use unregistered stock



Chronology of Private Company Acquisition

- Timing highly variable; Can take anywhere from 7 to 125+ days
- Negotiate and execute definitive agreement; simultaneous sign and close if possible (7 to 21 days)
- Termination of HSR Waiting Period, if necessary (30 days from filing)
- Fairness Hearing, if necessary (30 to 60 days from execution)
- Effectiveness of S-4 (55 to 125 days from execution)
- Stockholder Meeting or Consent and Closing (Up to 20 days from mailing)

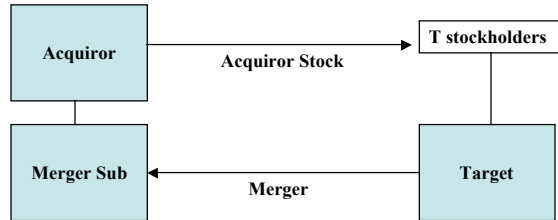


Alternative Public Company Acquisition Structures

- **Stock Transactions**
 - Stock-for-Stock Merger
 - Share Exchange Offer Followed by Cleanup Merger
- **Cash Transactions**
 - Cash Merger
 - Cash Tender Offer Followed by Cleanup Merger



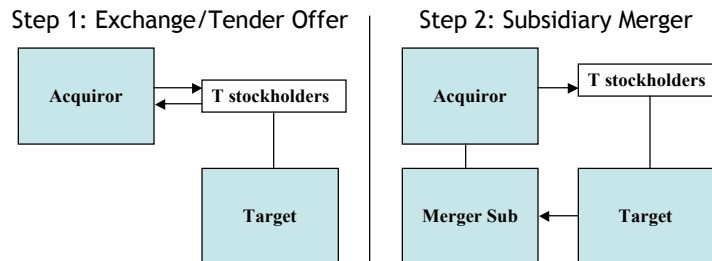
Statutory Merger



- More often direct (merger of equals)
- No shareholder approval by Acquiror shareholders, subject to Nasdaq rules
- Requires Form S-4



Exchange/Tender Offer



- Acquiror offers to exchange cash and/or Acquiror's shares for shares of Target held by Target stockholders
- After closing of offer, Target merges into subsidiary of Acquiror through standard or "short-form" merger, cleaning up any remaining Target shares
- May be faster than merger due to SEC review commitment
- Requires Schedule TO, Schedule 14D-9 and Form S-4 (exchange only)



Chronology of a Public Company Acquisition

Pre-Execution Chronology (All Structures)

- Execute Confidentiality/Standstill Agreement
- Agree on key terms
- Due diligence
- Hold Board of Directors' meetings
- Negotiate and execute definitive agreement
- Announce transaction
- Pre-execution process can be completed in 10 to 15 days



Chronology of a Public Company Acquisition

Stock-for-Stock Merger (55 to 125 Days)

- T = Execute Definitive Agreement
- T + 10 to 20 days - File Form S-4 Registration Statement
- T + 20 to 90 days - No review determination or complete SEC Review/Go Effective (review of 40 to 70 days likely)
- T + 25 to 95 days - Mail Stockholder Proxy Materials
- T + 55 to 125 days - Stockholder Meeting and Closing (20 business days required)
- Contingencies: SEC review, Stockholder Approval, HSR



Chronology of a Public Company Acquisition

Share Exchange Offer (49 to 59 Days)

- T = Execute Definitive Agreement
- T + 10 to 20 days - Commence Exchange Offer/File Schedule TO, S-4 Registration Statement and Schedule 14D-9
- T + 14 to 21 days - Receive SEC comments due to expedited review
- T + 48 to 58 days - Close Exchange Offer (not less than 20 business days from commencement)
- T + 49 to 59 days - Complete Short-Form Merger and Close Transaction
- Contingencies: SEC review, Response to Exchange Offer, HSR



Chronology of a Public Company Acquisition

Tender Offer (36 to 46 Days)

- T = Execute Definitive Agreement
- T + 5 to 10 days - Commence Tender Offer/File Schedule TO and Schedule 14D-9
- T + 35 to 45 days - Close Tender Offer (not less than 20 business days from commencement)
- T + 36 to 46 days - Complete Short-Form Merger and Close Transaction
- Contingencies: Response to Tender Offer, HSR



Option Structure

- Uncommon outside of Biotech
- Can be a valuable tool
 - Critical contingency
 - Strategic Partnership
- Exercise great caution
 - Complexity!!!
 - Surrendering Upside
 - Risk of Nonenforceability



Structure of Option Transaction

- Fiduciary Duty Issues
- Board Duties Remain Until Shareholder Approval
- Sequencing Critical Under Delaware Law
 - First, Board Approval
 - Second, Sign Agreement
 - Third, Shareholder Approval



Structure of Option Transaction

- Documentation Structure
 - One agreement - two time periods
 - Option Agreement & Merger Agreement
 - Issues
 - Timing of Accuracy of Reps - Closing Condition
 - Accuracy of Reps - Liability
 - Covenants



M&A Negotiations & Strategy Are You a Seller?

Corporate Cleanup

- Start by working off of a form of diligence list for a comparable transaction (seller's legal and financial advisors can provide helpful forms)
- Put the corporate house in order (articles, bylaws, minutes, capitalization records, securities exemptions and filings)
 - Verify that all corporate actions, particularly stock and option issuances, have all been fully documented and properly approved by Board and, if applicable, shareholders
- Employment terms
 - Are there employment agreements? Offer letters with severance provisions or bonuses? Options with acceleration provisions?
 - Were all required approvals received
- Material agreements
 - The basics—identify material agreements and make sure you have complete, fully executed copies of the agreements with all exhibits and attachments
 - Review material agreements for assignment provisions, termination features



M&A Negotiations & Strategy Are You a Seller?

- Simple and familiar capital structures
 - Model liquidation preference and financial impact across a range of potential scenarios before beginning transaction process
- Avoid non-accredited shareholders
- Recognize and mitigate due diligence issues
 - Accounting and revenue recognition issues
 - IP ownership issues, including compliance with terms of any licenses
 - Tax issues
 - Litigation risks
- Assemble data room
 - Consider a virtual data room, particularly if running a multiple bidder process or working with multiple locations of the same buyer



M&A Negotiations & Strategy Are You a Seller?

Agreements in Advance of Negotiations

- Confidentiality Agreement - Before providing any nonpublic information or beginning serious negotiations
- Standstill Agreement - To protect negotiating leverage
- No-hire/Nonsolicit Agreement - To protect key employees
- Exclusivity Agreement - If Acquiror seeks agreement providing for period of exclusive negotiations, Board will need to evaluate this proposal in light of proposed acquisition terms, including price, and fiduciary considerations



M&A Negotiations & Strategy Are You a Seller?

Confidentiality and Disclosure

Ramifications of Inadvertent Disclosure

- Puts company in play
- Run-up in Target stock price may eliminate premium and/or derail negotiations
- Negotiations now conducted in a “fishbowl” atmosphere
- Possible disruption of relations with employees, customers and suppliers
- Possible stockholder litigation



M&A Negotiations & Strategy Are You a Seller?

Confidentiality and Disclosure

Practical Measures to Protect Confidentiality

- Remind directors and officers early and often about importance of confidentiality
- Prohibit trading by those with knowledge of discussions until discussions end or until advised otherwise by General Counsel or other appropriate officer
- Assemble a small team at the company to assist in providing due diligence and negotiating documents; inform others only on a need-to-know basis
- Use code names for transactions and parties in all communications (beginning immediately)
- Establish secure channels of communication that are not accessible to others (e.g., public area fax machine)
- Hold meetings off-site



M&A Negotiations & Strategy Are You a Seller?

Engaging an investment bank

- Engage Bank before any material discussions begin
- Bank will:
 - Conduct auction process, if desired
 - assist with negotiations and valuation determination
 - provide fairness opinion for Board and in stockholder proxy materials
- Portion of compensation will be contingent on success of transaction; typically ranges from 1.5% to 4% of deal value, depending on deal size
- Compensation for fairness opinion usually not contingent



M&A Negotiations & Strategy Are You a Seller?

Executive Agreements/Severance

- Acquirer may request employment and/or consulting agreements with management team
- Review existing employment and change of control arrangements
- Must be careful in structuring change-of-control payments to avoid loss of deduction and additional 20% tax on employee under section 280G



M&A Negotiations & Strategy Are You a Seller?

- Antitakeover protections
 - Poison Pill
 - Staggered board
 - Procedures for calling special meetings
 - Nomination and removal of directors
 - Lookout for “work arounds”
 - Institutional shareholder issues



M&A Negotiations & Strategy Are You a Seller?

- Auction process
 - Enhance premium in right context
 - Key is coordination and timing
 - Data room/data site
 - Form agreement



M&A Negotiations & Strategy Are You a Seller?

- Anticipating litigation
 - Fiduciary duty litigation very common
 - Importance of process
 - Importance of structure of decision-making (independence)



M&A Negotiations & Strategy Are You a Buyer?

Load the warchest

- Anticipatory financing
- Authorized unissued capital stock
- Shelf registration statements
 - Financing
 - Acquisition



M&A Negotiations & Strategy Are You a Buyer?

Consider shareholder approval rules

- Issuance of >20% outstanding requires shareholder approval
- Can slow or prevent an otherwise “private deal
- Cash is king



M&A Negotiations & Strategy Are You a Buyer?

Develop M&A SWAT Team

- Finance/tax
- Legal
- Intellectual Property
- Clinical/regulatory
- Investment bank
- Outside counsel
- Independent auditor



Closing Thoughts