



Contingencies and Intangibles in Biopharmaceutical Acquisitions

Accounting Standard Codification Topic 805 (“ASC 805”), *Business Combinations*, was designed to provide additional transparency in purchase accounting. The biopharmaceutical industry is a clear beneficiary. With significant contingent payouts, the purchase considerations paid for pre-revenue drug development companies are extremely difficult to assess. Under ASC 805, financial statements provide much better information about the values of future milestone payments and of the distinct clinical candidates acquired. We studied how acquisitions of development stage biopharmaceutical companies were reported in the SEC filings.

While no two acquisitions are the same, deal structures and acquired intangibles are often similar within the same industry. In-process research and development (“IPR&D”) is typically the dominant identified intangible asset owned by a drug development company. It represents the value of distinct drug candidates in various stages of development. Other less common identified intangibles include royalty streams and collaborative agreements.

Biopharma Intangibles

IPR&D
Royalty Streams
Collaborative Agreements
Goodwill

Contingent considerations appear consistently in biopharmaceutical acquisitions. Beyond Up-front Cash, future milestones and royalties (“Future Cash”) can be significant but contingent upon clinical or regulatory outcomes. Press releases, news media reports, and some professional databases routinely include all potential milestones and royalties as part of the Total Transaction Value, often overstating the true economic value a seller receives and an acquirer pays in a transaction. Fair Value reporting helps clarify the picture.

We utilized CapitalIQ to obtain all available 2009 and 2010 transactions: i) with total transaction values greater than \$100 million, ii) completed by US-based, publicly traded companies, iii) where acquired companies were classified under Pharmaceutical or Biotech as their primary industry, and iv) acquired companies were pure-play, pre-revenue drug developers. Our analysis below is based on the information available in the SEC filings.

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The table below summarizes our findings. A number of observations can be made from the data:

- Future Cash as a percent of the Total Transaction Value ranged between 1% and 92%, with median 67%
- The Total Transaction Values were often poor indicators of the purchase prices. In our sample, fair value of all potential milestones and royalties ("FV Earnout") as a percent of nominal future milestones and royalties ranged between 11% and 77%, with median 31%
- IPR&D and Goodwill were the dominant intangibles with Goodwill ranging between 19% and 72%, with median 30%, of the total excess consideration

Important factors for financial reporting professionals to consider:

- Both IPR&D and Contingent Consideration require sophisticated valuation analyses
- Beyond initial recognition, both require ongoing valuation adjustments to reflect milestones achieved over time
- Acquirers, in conjunction with their auditors, will have to develop a policy around types of events that warrant IPR&D or Contingent Consideration fair value adjustments

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Target	Buyer	Date	Total Transaction Value	Transaction Value Breakdown		FV Earnout as % of Future Cash	Percent of Excess Consideration			
				Upfront	Future Cash		Goodwill	IPR&D	Other	
Proteolix, Inc.	Onyx Pharmaceuticals, Inc.	10/10/2009	\$ 850	32%	68%	35%	31%	69%	0%	
Avid Radiopharmaceuticals, Inc.	Eli Lilly & Co.	11/08/2010	836	34%	66%	11%	28%	72%	0%	
Gloucester Pharmaceuticals, Inc.	Celgene Corporation	12/07/2009	639	53%	47%	77%	26%	48%	27%	
Neurimmune, Immunotherapy	Biogen Idec Inc.	12/20/2010	428	8%	92%	21%	19%	81%	0%	
Calixa Therapeutics, Inc.	Cubist Pharmaceuticals Inc.	12/12/2009	409	24%	76%	33%	25%	75%	0%	
Arresto Biosciences, Inc.	Gilead Sciences Inc.	12/19/2010	225	99%	1%	NA	53%	47%	0%	
CuraGen Corporation	Celldex Therapeutics, Inc.	05/28/2009	144	61%	39%	NA	24%	31%	45%	
CGI Pharmaceuticals, Inc.	Gilead Sciences Inc.	06/23/2010	120	76%	24%	38%	72%	28%	0%	
ZyStor Therapeutics, Inc.	BioMarin Pharmaceutical Inc.	08/17/2010	119	17%	83%	17%	32%	68%	0%	
LEAD Therapeutics, Inc.	BioMarin Pharmaceutical Inc.	02/04/2010	87	21%	79%	30%	32%	68%	-	
				Max	99%	92%	77%	72%	81%	45%
				Median	33%	67%	31%	30%	68%	0%
				Min	8%	1%	11%	19%	28%	0%

(\$ in millions)