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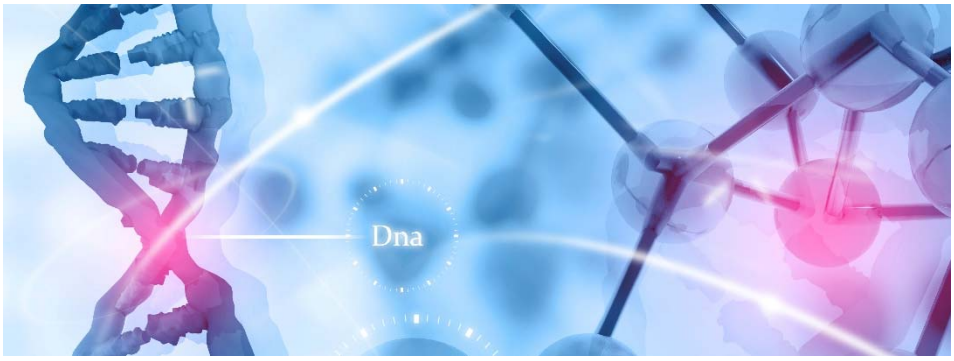

Valuation of Goodwill and Intangibles in 2015 BioPharmaceutical Transactions

The Financial Accounting Standards Board (FASB), the Public Company Accounting Oversight Board (PCAOB) and the Securities and Exchange Commission (SEC) have all consistently emphasized the importance of accurate business combination accounting. In this context, we have reviewed the accounting for purchase price allocations with a focus on goodwill, intangible assets, and earn-outs for BioPharmaceutical companies.

What Needs Fair Value

Contingent Consideration
Developed Technology
Marketed Products
In-Process R&D

While no two acquisitions are the same, common themes in the valuation of intangibles and goodwill can be found along industry lines. Biopharmaceutical companies, with their focus on drug development, rely on such identifiable intangible assets as developed technology, in-process research and development (in-process R&D), and marketed products. In addition, fair value analysis may be required for less common assets such as non-compete agreements and trade names.

Contingent considerations, or earn-outs, often account for a substantial portion of the purchase consideration. They are recorded as liabilities. Fair value assessments are performed upon initial recognition and at the end of each subsequent reporting period. Similarly, in-process R&D has to be valued (or tested for impairment) each reporting period until reclassified into developed product or abandoned.

Relative valuations of goodwill and identifiable intangibles are also consistent within the biopharmaceutical industry. It is common to find a significant portion of excess consideration to be ascribed to goodwill. Marketed products, developed technology and in-process R&D will be dependent on the state of the therapeutic product pipeline, the platform technology and the extent of commercial operations. Note that customer relationships and tradenames are rarely reported even if the target generates substantial revenues.

Selected Transaction

We utilized CapitalIQ to obtain all available 2015 transactions i) with purchase prices greater than $10 million, ii) completed by US publicly traded acquirers, and iii) where targets were classified under Pharmaceutical or Biotechnology industry. We excluded transactions where iv) SEC filings did not provide sufficient purchase price allocation details, and v) those with recognized customer relationship assets. These criteria led to a selection of 42 transactions.

Observation #1

The universe of observed intangible assets is mostly limited to technology-related assets. In-process R&D commonly represents pipeline therapeutics. Many observers consider marketed products to be technology-related because technology, e.g. the chemical structure of a single small molecule and its associated patent protection, carries the business. Patients are attached to the drug, not the company that sells it. FDA approved therapeutics may convert from indefinite-lived in-process R&D to amortizable marketed product.

Developed technology often identifies platform technology rather than a specific therapeutic product. Many transactions involving platform technologies are licenses that do not necessitate purchase accounting. Contingent consideration, a part of the purchase consideration, is commonly attached to the performance of certain clinical trials. Its valuation may resemble that of the underlying product.

Because both in-process R&D and contingent consideration are continuously tested and revalued following the initial purchase accounting, fair value challenges can persist for a number of years following the transaction.

Components of Allocation	% of Excess Consideration			Observations
	[1st Quartile]		[3rd Quartile]	
Transactions Reviewed				42
Goodwill	22%	-	40%	29
In Process R&D	17%	-	74%	28
Marketed Products	46%	-	78%	12
Developed Technology	52%	-	71%	6
Contingent Consideration	7%	-	42%	12

Observation #2

Both developed technology and marketed product intangibles can represent developed therapeutic products. Patent expirations limit useful lives of technology-related assets. Therapeutic products often exhaust a substantial portion of their patent life during the clinical development process; platform technologies are less subject to this effect. As a result, developed technology often features longer useful life.

Supported by a single patent, or limited set of patents, the useful lives of marketed products are easier to determine than those of platform technologies where a larger group of patents may be involved. Functional and technological obsolescence factors also complicate useful life determination for some developed technologies.

Components of Allocation	Useful Lives	Observations
	[Years]	
Transactions Reviewed		42
Marketed Products	11 – 14	20
Developed Technology	14 – 20	6

Observation #3

Asset acquisitions, as defined by US GAAP, are rare in most other industries, but not with drug developers. Asset acquisition accounting precludes Goodwill from being recognized.

In-process R&D is expensed when the asset does not offer any alternative use, e.g. a single-shot-on-goal pipeline therapeutic. Technologies that can be used across multiple development programs are capitalized and tested for impairment at each subsequent reporting date.

In over 80% of asset acquisitions contingent considerations were part of purchase considerations, albeit fair values were not disclosed. Even when no valuation of that single intangible is required, the purchase price cannot be determined without calculating the fair value of the contingency.

Components of Allocation	Asset Acquisitions	Observations	Business Combinations	Observations
	[Median]		[Median]	
Transactions Reviewed		11		31
In-Process R&D (Booked)	100%	3	47%	25
In-Process R&D (Expensed)	100%	7	na	na
Marketed Products	100%	1	57%	11
Developed Technology	71%	1	66%	5
Contingent Consideration	na	8	21%	5

For more information, please contact:

Max Fonarev, M.Sc., MBA, CFA
Principal, Fair Value Advisory
Sorbus Advisors LLC

1101 5th Avenue, Suite 350
San Rafael, CA 94901

1.415.506.9830
max@sorbusadvisors.com

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