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Perspective

Chronology Of A Transaction: Zimmer And Biomet

By Don Urbanowicz, Urbanowicz Consulting
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A mega-deal that will disrupt the orthopedic industry.

In late April, Zimmer entered into an agreement to acquire Biomet, the #4 market share player in the global orthopedic reconstructive industry, for $13.35B in a deal that will be financed with $10.35B in cash (via debt) and $3.0B in Zimmer shares. The combined entity creates a strong #2 player in the global market with $7.8 billion of revenues and $2.8 billion of adjusted EBITDA in 2013. Post-deal, Zimmer shareholders will own 84% and Biomet 16% of the combined company.

The transaction was done quickly – four months from the initial call from Zimmer's CEO to Biomet's CEO, to the joint press release – and with the usual drama and high stakes negotiations.

- On the Zimmer side, the final purchase price reflected an ~11% increase in valuation from Zimmer's "higher-end", initial non-binding, verbal offer of $11B to $12B – and a 4.7% increase from its "counter-offer" of $12.75B.
- On the Biomet side, the $13.35B was slightly less than the $13.5B to $14.0B the Company had hoped for, but in-line with its "best and final offer" to Zimmer.

On the regulatory front, EU antitrust regulators are conducting an in-depth probe into the deal stating that the "proposed acquisition may substantially lessen competition in the markets for hip, knee, elbow and shoulder implants, as well as for other products, such as bone cement, bone cement accessories and pulse lavage". A final decision is due by March 11, 2015 (excruciatingly close to the 2015 AAOS which runs from March 24 thru 28). However, Zimmer remains confident that the transaction will close by the end of Q115. A potential regulatory resolution may include divestitures – most likely in the unicompartmental knee and shoulder areas – given the relatively high shares for the combined companies.

Interestingly, Zimmer was not Biomet's first choice. While reviewing its strategic alternatives, including an initial public offering (IPO) – and prior to its involvement with Zimmer – Biomet reached out to an un-named orthopedic company to discuss a potential business combination transaction. However, less than 30 days following its involvement with Zimmer, the un-named orthopedic company declined to engage in further discussions. Industry experts opine that the un-named company was either

Stryker (SYK), Smith & Nephew (SNN), Johnson & Johnson (JNJ) or Medtronic – with Stryker and SNN being "most likely".

Summarized below is information pertaining to: 1) What's Behind Current Orthopedic M&A, 2) What Zimmer Says Is Behind Its Megadeal, 3) A Look At the Combined Company, 3) The Chronology of Events Leading Up to the Announcement (info secured from Zimmer's S-4 Registration Statement), 5) What Analysts Have Said About the Acquisition, and 6) Parting Observations.

1. What's Behind Orthopedic M&A?

The orthopedic sector has been consolidating as companies like JNJ, SYK and Zimmer seek additional size, economies of scale and growth opportunities in new business areas.

2. What Zimmer Says Is Behind Its Megadeal?

The opportunity to combine the two businesses – and move Zimmer more firmly into the # 1 position in the global knee and hip markets, and into a solid # 2 position in the overall orthopedic market behind Johnson & Johnson (while leap-frogging Stryker) – was a major driver behind the deal.

According to Zimmer executives:

- "The combination is certainly about growth, together the combined company will be more competitive in our knee and hip franchises with a more diverse revenue base to increase scale and faster growing markets in adjacent categories";
- "We will also gain meaningful entry into sports medicine and we will have a research and development teams that will power and enhance innovation";
- "Our success will be in our ability to leverage the combined experience and capabilities of both companies. To offer more personalized solutions that benefit patients across the continuum of care";
- "Our combined company will be supported by a research and development spend capability of approximately $360MM and will immediately benefit from a combined portfolio of innovative solutions as well as efficiencies gained from combining each companies respective R&D efforts";
- "This includes game changing solutions in categories such as early intervention and joint preservation, personalized devices, intelligent instrumentation as well as value based offerings for emerging markets";
- "We will have enhanced diversification and strong scalable platforms in faster growing sports medicine, extremities and trauma product categories";
- "This together with enhanced scale and other categories will benefit the full spectrum of our key constituents and address current market demands while also growing the market in other category such as knees, hips, surgical spine and dental"; and,

- “Both companies have strong sales force teams to achieve cross selling opportunities as early as day one”.

3. What Are the Multiples, What Does the Combined Company Look Like, And What Will It Be Valued at?

- Acquisition price translates to a trailing 12-month sales multiple of 4.2x (based on Biomet’s quarterly revenues [ending 2.28.14] of $3.2B) and a trailing 12-month adjusted EBITDA of 12.6x (based on Biomet’s quarterly EBITDA [ending 2.28.14] of $1.1B)
- The 2013 combined calendar year revenues of Zimmer and Biomet total approximately $7.8B, with combined adjusted EBITDA of $2.8B.
- Zimmer expects to achieve net annual synergies of approximately $270MM (~5-7% of the combined cost base) by the third year following the closing of the transaction, with approximately $135MM anticipated in the first year.
- The transaction is expected to be double-digit accretive to Zimmer's adjusted diluted earnings per share in the first year following the closing.
- Market analysts suggest that the equity in the new combination will be valued at roughly $20B – or about 17x earnings, while Zimmer/Biomet will operate with a net debt position of around $10-$11B.

4. The Chronology Of Events Leading Up The Announcement

(Note: Info Secured from Zimmer’s S-4 Registration Statement Filed August 26, 2014)

December 2013

December 13: The Zimmer board of directors (Zimmer board), select members of Zimmer’s senior management team and Zimmer’s financial advisor met internally to discuss: a potential business combination transaction with Biomet; strategic combinations in the healthcare industry generally; and the proposed initial public offering by LVB (Biomet) of LVB common stock. The board authorized the Zimmer President and CEO (Zimmer CEO) to contact the Biomet President and CEO (Biomet CEO) to gauge Biomet’s interest in a potential transaction between Zimmer and Biomet.

On the same day, the LVB board of directors (LVB board), along with Biomet’s senior management and financial advisor, met to review a number of strategic alternatives, including: a potential business combination transaction with an un-named orthopedic company and the strategic benefits of such a transaction and the financial advisors preliminary consideration of an initial public offering (IPO) of LVB common stock. The board confirmed its support of Biomet management continuing to investigate a potential business combination with the un-named orthopedic company as well as the potential IPO.

December 23: The Biomet CEO met with the CEO of the un-named orthopedic company to discuss exploring a potential collaborative opportunity between companies.

January 2014

1st Week Of January: The Zimmer CEO contacted the Biomet CEO to gauge Biomet's interest in a potential transaction – and requested an in-person meeting.

January 9: The Zimmer and Biomet CEO's met and discussed:

- LVB's IPO, including methodologies that might be applied to value shares of LVB common stock;
- Matters related to integration in the event Zimmer and Biomet pursued a transaction; and,
- The form of merger consideration that might be paid by Zimmer

The Biomet CEO indicated that LVB might be willing to engage in discussions and provide due diligence information, subject to Zimmer's providing an acceptable valuation proposal – including assumptions behind Zimmer's valuation of Biomet.

January 19: The Zimmer board met to secure an update from the CEO. Following discussions, it was agreed that Zimmer would be willing to acquire Biomet in an all-cash transaction for $11B to $12B – a valuation range consistent with the range Zimmer's board previously reviewed with its financial advisor and Zimmer's senior management.

January 21: The Zimmer CEO contacted the Biomet CEO and made an indicative, non-binding proposal to acquire Biomet on a cash-free, debt-free basis for a total enterprise value consideration in the range of $11B to $12B – conditioned on Biomet agreeing to enter into exclusive negotiations with Zimmer for 60 days. The Biomet CEO responded that he would discuss proposal with his board, but felt his board remained confident in Biomet's future as an independent company and that the Zimmer proposal significantly undervalued Biomet.

January 23: The Biomet CEO met with his senior management, the board and financial advisor. The board instructed Biomet CEO to inform the Zimmer CEO that they were not willing to engage in further discussions with Zimmer based on Zimmer's proposal. In addition, the board noted that even if Zimmer and Biomet were able to reach agreement on valuation, the LVB board would only pursue a transaction that provided Biomet with a significant certainty of closing.

January 24: The Biomet CEO called the CEO of the un-named orthopedic company and was told that the un-named company "had several internal projects on the horizon for 2014 and was not at this time prepared to engage in discussions regarding a potential business combination transaction".

That same day, the Biomet CEO called the Zimmer CEO and indicated that Biomet would not be interested in continuing discussions at the valuation range proposed by Zimmer. However, the Biomet CEO added that the company's financial advisor would be contacting Zimmer's financial advisor to discuss potential valuations per share of LVB common stock that the planned IPO might yield.

February 2014

1st Week of February: The financial advisor's of Biomet and Zimmer met to review potential valuations. The Biomet advisors implied that an enterprise value for Biomet in the range of $13.5B to $14.0B – and proposed that Zimmer bear all the risk of obtaining regulatory approvals in any such transaction.

February 28: The Zimmer board met with the Zimmer CEO and financial advisor. It was decided that Zimmer would be willing to acquire Biomet based on a total enterprise valuation of $12.75B, consisting of $9.75B cash and $3B in shares of Zimmer common stock.

March 2014

March 5: The Zimmer CEO contacted the Biomet CEO and made a revised, non-binding proposal subject to, among other things: completion of due diligence; negotiation of mutually acceptable definitive transaction documents; and a 60-day exclusivity.

March 7: Biomet filed a registration statement on Form S-1 with the SEC in connection with its planned IPO.

March 9 thru 14: Following face-to-face and telephonic meetings between the Biomet board, Biomet CEO and financial advisor, the Biomet CEO was authorized to make a best-and-final offer to engage in further discussions with Zimmer – in which Zimmer would acquire Biomet for $13.35B in total enterprise value consideration, consisting of $10.1B of cash (less Biomet's net debt) and $3.25B of Zimmer common stock (based on a fixed exchange ratio).

March 16: The Biomet and Zimmer CEO's met and discussed Biomet's best-and-final offer, the parameters of a limited due diligence review process, an integration planning process and the timeframe for executing a definitive agreement. The Biomet CEO added the following "expectations":

- Biomet would be treated as a public company for the purposes of the merger agreement; and
- LVB's sponsors would be afforded the right to participate on the Zimmer board following a transaction

The Biomet CEO also stated that Biomet would be willing to grant Zimmer an exclusive period to conduct due diligence and negotiate and formalize a definitive agreement if Zimmer met Biomet's valuation and other expectations.

March 20: The Zimmer board, along with the Zimmer CEO and senior leaders, financial advisor and outside counsel, met to discuss Biomet's terms. The board concurred with Zimmer management's proposal to acquire Biomet for $13.35B , including $10.35B in cash and $3B in shares of Zimmer common stock.

March 21: The Zimmer CEO contacted the Biomet CEO and made a revised non-binding proposal. The Zimmer CEO expressed confidence in arranging the necessary financing. In addition, he emphasized that exclusivity was critical to Zimmer and said that Zimmer would not proceed without a 35-day period of exclusivity.

The Biomet CEO requested a response to other key transaction terms and the Zimmer CEO responded that there was general alignment. The Zimmer CEO also sent the Biomet CEO a draft non-disclosure and exclusivity agreement.

March 22: The LVB board met with the Biomet CEO and instructed him to convey the following to the Zimmer CEO: Although the board appreciated Zimmer's efforts to bridge the valuation gap, Zimmer would need to confirm that it was willing to pursue a transaction on the basis of certain key transaction terms LVB had proposed.

March 23: The Biomet CEO called the Zimmer CEO and shared the latest board instructions. In addition – in the interest of time – he instructed outside counsel to provide comments on the proposed non-disclosure and exclusivity agreement, which was forwarded that day to Zimmer's counsel.

March 23 thru 30: Both CEO's had telephonic and face-to-face meetings to discuss the due diligence process and the process for analyzing regulatory risk. The LVB board authorized the Biomet CEO to proceed with due diligence and enter into exclusive negotiations with Zimmer.

In addition, legal representatives from both companies met, negotiated and agreed to terms of the non-disclosure and exclusivity agreement (effective until April 30th). Finally, Biomet was permitted to pursue a potential IPO.

April 2014

March 26 thru April 6: Representatives from Zimmer and Biomet – and their respective advisors – met in person and had telephonic conference calls as part of Zimmer's due diligence review.

April 2: Biomet's outside-US legal counsel and Zimmer and Biomet's US counsel entered into a joint defense agreement in connection with the regulatory risk analysis. Thereafter, US and OUS counsel performed regulatory due diligence on Zimmer and Biomet to assess regulatory risk.

April 5: Zimmer legal sent Biomet legal a draft merger agreement.

April 6: Biomet's legal team summarized the terms of draft merger agreement with the LVB board, noting that there was significant departure from the key transaction terms Biomet had proposed. The board instructed the Biomet CEO to terminate discussions with Zimmer until Zimmer was able to assure Biomet CEO that it was willing to move forward on key transaction terms.

April 7: The Biomet CEO informed the Zimmer CEO of his boards' instructions. Biomet's financial advisors informed Zimmer's financial advisors of the same. Zimmer's CEO confirmed that he was willing to pursue a transaction generally on the basis of the key transaction terms – other than LVB's request for representation on Zimmer's board – which the Zimmer CEO said he would need to discuss with the Zimmer board.

April 8: The LVB board informed the Biomet CEO to re-commence due diligence and negotiations with Zimmer.

April 9 thru 24: Each party made available to the other party and its respective advisors certain legal, business and financial documents as part of continuing due diligence review.

April 9: The LVB board approved several matters relating to a potential IPO.

April 10: The Zimmer board expressed willingness to appoint two representatives of LVB's sponsors to the Zimmer board of directors upon completion of the merger. Zimmer's counsel sent an updated draft of the merger agreement to Biomet's counsel.

April 14: LVB filed an amended registration statement on Form S-1 with the SEC for a potential IPO.

April 15 thru 24: Both parties, their legal teams and financial advisors negotiated terms of the merger and stockholders agreements.

April 23: The LVB board – following critical review of the terms of the merger agreement (including financial terms, antitrust covenants, closing conditions, remedies provisions, and employee benefits provisions) – met and adopted and approved the merger and recommended that the LVB shareholders do the same.

That same day, the Zimmer board met – and following a similar critical review of the terms of the merger agreement (including termination fee) – adopted and approved the merger agreement.

April 24: The merger agreement was executed by Zimmer and LVB. Before the NYSE opened on the 24th, Zimmer and LVB issued a joint press release announcing the execution of the merger agreement.

5. What Analysts Have Said About The Zimmer Deal?

Med-tech industry analysts have offered the following:

- “With consolidation happening across the healthcare industry, management teams seem to believe bigger is better. Bigger medical device firms have cost advantages and are able to bundle products putting smaller companies (particularly those undifferentiated technologies) at a disadvantage” (Matson/ Needham).
- "In healthcare, being a larger company that has a broader product offering seems to be the way that things are evolving. You're selling to hospitals as opposed to individual surgeons and having that larger footprint is believed over time to be important" (Denhoy/Jefferies).
- “Consolidation in the $45 billion global orthopedics market was a long time coming. In hips and knees there are five pretty large players all competing for the business of the hospital and the surgeon and most people looking at the industry……would say the economics work better for everyone if there were fewer" (Miksic/Piper Jaffray).
- “The deal was even more important for Biomet, as hospitals look to shore up profit by consolidating vendors. There are a lot of orthopedic makers out there right now and the smaller ones were at great risk of being left behind. So for Biomet to hook up with one of the larger players, it really saved their business over the long haul" (Wang/Morningstar)

6. Parting Observations

- For Zimmer, the deal is the largest in its history and makes strategic sense – especially as the Company looks to more effectively compete against JNJ and SYK in becoming a one-stop-shop for orthopedic appliances sold to increasingly large, price-sensitive healthcare providers.
- Given its size and scope, the transaction was done quickly -- in four months. Consistent with other mega-deals, it involved high-stakes negotiations, including Biomet’s insistence on Zimmer accepting its “best and final $13.35 billion offer” and having Zimmer appoint two representatives (of LVB sponsors) to the Zimmer board upon completion of the merger.
- Zimmer wasn’t Biomet’s 1st choice as a “potential business combination partner”. When considering strategic alternatives (including an IPO) and partners, Biomet reached out to another un-named orthopedic company – who passed on the opportunity.
- Deal closing by March 31, 2015 will be very tight – especially given EU regulator’s in-depth probe and proposed final decision on March 11, 2015.
- After closing, Zimmer will have its challenges. The Company must deliver on its post-deal promises regarding sales and cost synergies.

- The Biomet integration will also be significantly more challenging for Zimmer than Centerpulse. The number of moving global parts, including various divisions/ locations, product portfolio's/pipelines, employees/sales forces, surgeon/hospital customers, and potential divestitures, etc., will make this a complex and potentially disruptive integration – much to the advantage of competitors.
- Although the Zimmer/Biomet merger further strengthens the Company's hip, knee, and trauma portfolios, Zimmer will still lack a significant presence in spine (combined 5% share), lower extremity (combined 7% share) and soft tissue fixation (combined 7% share). Due to the significant debt it has incurred, Zimmer will likely focus on reducing leverage – and may be constrained in successfully concluding other material transactions in these segments, at least in the short term.
- Although Zimmer may be required to divest parts of its uni knee and shoulder portfolio's to resolve potential anti-trust issues, it will be interesting to see if the Company also considers divesting its combined dental business – in an effort to secure a "more focused" orthopedic portfolio and pay off debt.

For additional information about the Zimmer/Biomet transaction, please **click** for Zimmer Holdings Form S-4 Registration Statement filed on August 26, 2014.

Don Urbanowicz is Principal of Urbanowicz Consulting, an advisory firm with a musculoskeletal focus seeking to enable clients to achieve strategic and transaction-related goals by capitalizing on market opportunities. UC offers a unique perspective on how large global companies approach strategy, valuation, negotiations, due diligence and integration, and a thorough understanding of achieving success throughout all phases of the transaction process.

Please learn more online at www.urbanowiczconsulting.com, and contact Don Urbanowicz at durbanowicz@du-llc.com.