Perspective

[Chronology of a Transaction: Stryker Corporation, MAKO Surgical and Pipeline Biomedical Holdings]

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A bold, quick deal with high-stakes negotiations

Summary

The debate about whether **MAKO** Surgical (MAKO) has a sustainable, stand-alone company or business model is moot. **Stryker** Corporations' announced acquisition of MAKO is big, bold – and pricey – and comes with challenges. The transaction was done quickly – in less than seven weeks from first meeting of CEO's to announcement – and with some high-stakes negotiations. There were no other bidders.

Summarized below is: 1) an overview of the transactions, including MAKO of Pipeline Biomedical Holdings (Pipeline); 2) Overviews of each company and SYKs strategy behind the acquisition; 3) the chronology of events leading up to the announcement (info secured from MAKO's **Proxy Statement** ; 4) other points of interest; 5) comments from industry analysts; and 6) parting observations.

1. Overview of Transactions

SYK of MAKO

On September 25th, Stryker Corporation (SYK) announced that it was acquiring MAKO Surgical Corporation (MAKO) for $1.65 billion ($30 per share), which represented an 86% premium to the previous days closing price. SYK estimated the deal to be $0.10 to $0.12 dilutive to Earnings Per Share in the first year, neutral in the second and accretive thereafter.

The deal represented an approximate 14.7X multiple of MAKO's trailing twelve months revenues of $112.4 million (Canaccord Genuity) and an approximate 10.9X multiple of Canaccord Genuity analyst Bill Plovanic's revenue estimates of $150.8 million for MAKO in 2014.

MAKO of Pipeline

On October 2nd, MAKO Surgical announced the purchase of Pipeline Biomedical Holdings' (Pipeline) orthopedic devices and related instruments for use with both robotic devices and manual medical procedures for common stock and an initial down payment of $2.5 million.

2. Overview of MAKO and Pipeline; SYK's Strategy Behind the Acquisition

Overview of MAKO

The Company currently offers MAKOplasty – performed using its proprietary RIO Robotic Arm Interactive Orthopedic System – for partial knee and total hip arthroplasty. MAKO generates revenue from: unit sales of its RIO system; implants and disposable products; and maintenance services. As of mid-year 2013, MAKO had 164 MAKOplasty sites worldwide. About 29,000 procedures have been performed since the initial procedure was performed in 2006.

Overview of Pipeline

The Company has expertise in implant design and coatings and has been a supplier to MAKO. In 2012, Pipeline received 510k clearance for a cruciate-retaining knee system. In 2013, the Company received FDA clearances for the **Restoris PST** cups and **Restoris tapered stems** (with tantalum markers for RSA measurement of implant migration). Surgeons seem to prefer the Pipeline tapered stems to those provided to MAKO by its other supply partners.

SYK's Strategy Behind the MAKO Acquisition

SYK's President and CEO, when asked about the transaction and the premium paid, stated, "it will provide for better implant positioning, more consistent and reproducible outcomes and improve the surgeon experience. Yes, the price was fully valued in this deal, but we believe the potential is enormous and it can really provide significant differentiation for us. This is a long-term strategic bet".

3. The Chronology of Events Leading Up To the Announcement

(Note: Info Secured from MAKO's **Proxy Statement** Filed 10.16.13)

A) MAKO of Pipeline: May Thru October Events

- Under the terms of MAKO's strategic alliance with Pipeline, MAKO had the right to acquire the portion of Pipeline's business dedicated to the products pertaining to MAKO's business
- In May of 2013, the MAKO Board instructed management to make an acquisition of Pipeline a "high, near-term strategic priority"
- That same month, MAKO and Pipeline entered into a letter of intent outlining the principal terms of a transaction (including that the consideration for the acquisition would be not less than 3,953,771 shares of common stock of MAKO)
- In July, the MAKO Board reaffirmed that completing the Pipeline transaction, based on agreed outlined terms, should remain a high priority

- On October 2nd, MAKO announced that it entered into a definitive agreement to acquire Pipeline
- On October 8th, MAKO announced that it completed the acquisition of Pipeline – substantially on the previously contemplated terms

B) SYK of MAKO: August thru October Events
August 2013

- In early August, SYK's President and CEO (SYK CEO) contacted MAKO's President and CEO (MAKO CEO), to arrange a face-to-face meeting
- On August 12th, SYK CEO and MAKO CEO met and SYK CEO expressed an interest in having SYK acquire all of the issued and outstanding common stock of MAKO at a proposed price of $21 per share, in cash. MAKO CEO expressed doubt that MAKO would be interested in a transaction, especially given the price range; however, he confirmed that he would inform the MAKO Board – and requested that any further proposals be made in writing.
- On August 12th, following the SYK CEO meeting, MAKO CEO met with MAKO's Chairman of the Board to review SYK CEO's proposal
- On August 15th, MAKO received a letter from SYK proposing to acquire MAKO at a price in the range of $24-26 per share in cash, subject to negotiation of definitive agreements and completion of due diligence. The letter also suggested that SYK's valuation could change if the Company learned of any "additional opportunities or new product capabilities" during discussions with MAKO
- On August 16th and 19th, MAKO's Board conducted conference calls with their management, representatives of their financial advisor and their Corporate counsel to discuss and review SYK's proposal – and MAKO's standalone performance and prospects. The following was agreed:
- The MAKO Board directed management to engage (subject to SYK entering into customary confidentiality and standstill agreement) in further discussions and limited due diligence with SYK "with a view toward demonstrating to SYK additional opportunities and product capabilities that could enhance SYK's valuation of MAKO";
- The MAKO Board also said that "any delay or slowdown in negotiations with Pipeline would significantly jeopardize MAKO's ability to acquire Pipeline on the terms then under negotiation". The MAKO Board told management "to continue the Pipeline negotiations in parallel (with SYK) – and with high priority"
- On August 22nd, MAKO and SYK executed a confidentiality and standstill agreement.
- On August 26th, MAKO and SYK personnel met face-to-face to review MAKO's business and products – and attend a presentation by MAKO citing additional opportunities and future products. At the conclusion of the meeting, MAKO CEO informed SYK personnel attending that the MAKO Board was meeting the following week to discuss their proposal and that "if SYK intended to increase its proposal above the $24-26 per share range, it should do so before the MAKO Board meeting".

- On August 29th, SYK CEO informed MAKO CEO by phone that SYK was willing to increase the proposed purchase price to $30 per share, in cash. The following day, MAKO received a letter from SYK confirming – in writing – the new purchase price.

September 2013

- On September 4th, the MAKO Board met in-person, along with their financial advisor, Corporate counsel and newly appointed "special counsel". The Board concluded:
- "If a transaction with SYK could be achieved, at or above the price suggested by SYK, it would be more favorable to MAKO shareholders relative to the alternative of remaining independent. Based on SYK's complementary products and strategic positioning, SYK would be the potential transaction partner likely to pay the highest value for MAKO".
- The Board instructed MAKO CEO to contact SYK CEO "to confirm whether a higher price could be obtained". SYK CEO informed MAKO CEO that SYK's $30 per share price proposal "was near or at the limit of SYK's willingness to pay", but SYK CEO promised that the matter would be considered further internally.
- On September 5th, SYK CEO called MAKO CEO to confirm:
- SYK was willing to increase its proposed acquisition price to $31 per share, assuming satisfactory due diligence and negotiation of transaction documentation; and
- The $31 per share would be the maximum SYK would be willing to pay, regardless of results of further due diligence investigations – including with respect to Pipeline.
- Note: SYKs offer of $31 per share did not account for the issuance of additional shares of common stock as consideration of MAKO's acquisition of Pipeline
- On the same day, MAKO's Board held a special meeting and talked by phone about SYK's increased proposal. The Board informed management to proceed ahead with due diligence and negotiations for a transaction at the $31 per share price – subject to final approval by the MAKO Board.
- From September 6th thru 20th, SYK personnel continued their due diligence, including reviewing MAKO's relationship with Pipeline.
- On September 19th, SYK CEO called MAKO CEO and requested a face-to-face meeting the next day. On the 20th, SYK CEO met with MAKO CEO and select members of MAKO's management team. The following was discussed:
- SYK CEO informed MAKO CEO that SYK completed its due diligence process, and as a result of its findings, proposed to acquire MAKO for $29 a share (vs. the most recent $31 per share price); and
- SYK CEO confirmed that the lower share price was due to several business and performance related issues – and also said that SYK expected MAKO to enter into and complete its planned acquisition of Pipeline, which according to SYK CEO "would impose additional costs on SYK"
- On September 21st, the MAKO Board held a call with management and all support groups to discuss SYK's reduction in their proposed transaction price. The Board informed management that it should "continue negotiating with SYK to see if a better price could be obtained" – and that "the MAKO Board would not approve a transaction below $30 per share"

- On September 23rd, SYK CEO informed MAKO CEO that "he did not have authority from the SYK Board to exceed $29 per share (which implied an EV and cash cost to SYK of $1.6 billion, taking into account a MAKO acquisition of Pipeline) – and that the MAKO Board should make a decision on that basis". The MAKO Board then held a call, during which "special" legal counsel noted that "although legal discussions were not fully completed, it believed that such negotiations could likely be completed on satisfactory terms in a short amount of time assuming the parties were to reach agreement on price". However, the MAKO Board was unable to reach a unanimous determination to approve a transaction at a $29 share price. The Board directed MAKO CEO "to contact SYK CEO in advance of a SYK Board meeting on the 24th and obtain a proposal from SYK at a price of $30 per share, or more"
- On September 24th, SYK CEO called MAKO CEO and indicated that the SYK Board was willing to increase the transaction price to $30 per share of common stock in cash and had approved the transaction at that price – subject to satisfactory resolution of a small number of open legal points in the merger agreement. That same day, the MAKO Board, MAKO CEO and all MAKO support groups participated in numerous calls and meetings. The following was discussed:
- MAKO's financial advisor delivered an oral opinion (subsequently confirmed in writing) that "the $30 per share of common stock in cash……was fair from a financial point of view to the shareholders"; and
- The Board unanimously determined that the merger agreement, the merger and the other transactions contemplated by the merger agreement were advisable, fair and to and in the best interests of MAKO and its shareholders and recommended that MAKO's shareholders approve the adoption of the merger agreement
- On September 25th, MAKO, SYK and SYK's "merger sub" finalized and executed the merger agreement. MAKO and SYK issued press releases regarding merger agreement

4. Other Points of Interest Regarding the Transaction

- Since the announcement, MAKO, SYK, SYK's "merger sub" and members of MAKO's Board have been named as defendants in eight putative stockholder class action complaints challenging the transaction. The lawsuits generally allege "the individual defendants breached their fiduciary duties by, among other things, failing to obtain sufficient value for the MAKO stockholders in the transaction and agreeing to certain terms in the merger agreement that allegedly restrict the defendants' ability to obtain a more favorable offer. All plaintiffs seek a determination that their alleged claims may be asserted on a class-wide basis". MAKO believes the lawsuits are meritless.
- MAKO must pay SYK a termination fee of $61 million if SYK terminates the agreement because the MAKO Board changes its recommendation or fails to include the Board recommendation in favor of the required adoption of the merger agreement by MAKO's stockholders.

5. Comments from Industry Analyst’s (and SYK)

- Acquisition of MAKO benefits Stryker in several ways: (1) use of Stryker's implants on MAKO's system will increase adoption of MAKO; (2) MAKO's total knee application will help Stryker compete against new competitive knee platforms; (3) the MAKO robot can be sold via Stryker's MedSurg business; (4) Stryker should be able to leverage the international opportunity given its wider geographic footprint, noted WFS' analyst Larry Biegelson.
- WFS' analyst Biegelson reported that while Stryker is paying a hefty premium for MAKO, the MAKO robotic platform provides Stryker with a differentiated competitive advantage in the ortho space.
- The deal should address one of MAKO's major disadvantages - unproven implant designs - by pairing its established robotic technology with Stryker's established implants, according to Needham’s Michael Matson.
- The jury is still out on the success of robotics in orthopedics, noted Needham’s Matson. With 13% of the uni knee market, the hip market has been more challenging for MAKO, which has shown some early success with doubling of procedures this year off of a small base.
- Of all the ortho companies, Stryker is the best fit for MAKO given its large med-surg capital equipment business, reported the Needham analyst.
- Stryker's acquisition of MAKO is a bold and potentially risky move, opines Matson. If successful, significant market share could be gained from competitors (e.g., Zimmer). But if not, it could be a black-eye for Stryker's management. There is a place for robotics in orthopedics but Matson worries about overpaying for MAKO.
- 50% of non-users would be willing to use MAKO’s robotics if a Stryker implant were available for use with the system, according to results from Leerink Swann’s Q3 MEDACorp surgeon survey. Analyst Richard Newitter believes feedback suggests that MAKO technology with Stryker may be more widely accepted.
- The MAKO acquisition is a bold move on Stryker's part and one that could be disruptive for market share shifts in the hip/knee industry, which has been a relatively stagnant market, reported by Leerink Swan
- Stryker feels confident MAKO robotics will demonstrate superior patient and economic outcomes based on early data trends. The Company believes, in the short term, hospitals are attracted to the system by the potential to increase patient volume and improve payer mix.
- Wm Blair believes Stryker will use the MAKO robotic technology in multiple new applications longer term based on the premium paid for this acquisition.
- BMO expects Stryker to use the MAKO platform to drive procedural innovation including improved flow, and improve physician and patient experience and outcomes.
- Canaccord feels Stryker is better positioned to drive robotic systems placements past the first early adopters. Bill Plovanic expects the Company to leverage its strong balance sheet, large distribution network and deep implant offering to drive accelerated growth and utilization of already installed MAKO RIO systems.

6. Parting Observations

- The debate about whether MAKO has a sustainable, stand-alone company or business model is now moot. SYK is clearly in the best position of any strategic to make an acquisition of MAKO work. And as the MAKO Board noted, "based on SYKs complementary products and strategic positioning, SYK would be the potential transaction partner likely to pay the highest value for MAKO".
- For SYK, this deal is big, bold — and pricey: SYK's CEO continues to make innovative moves, and virtually all industry analysts and experts believe that this acquisition makes strategic sense. However, MAKO didn't come cheaply — on an Enterprise Value (EV)/ Sales basis, SYK will pay 12.4X 2013 sales estimate, per Larry Biegelsen of Wells Fargo. For comparison sake, Biegelsen confirmed that Medtronic acquired Kanghui for 11.6X EV/Sales and SYK purchased Trauson for 8.7X EV/Sales. Since Mike Matson of Needham proposed that the average orthopedic acquisition EV/Sales multiple is approximately 3.1X, investment bankers are hoping (and praying) that SYK has established a new watermark for value with the MAKO transaction!
- The transaction was done quickly and involved high-stakes negotiations. Although MAKO and SYK are publicly-traded companies and were likely on each other's radar screens, the MAKO deal was transacted in less than 7 weeks — from SYK CEO initial face-to-face meeting with MAKO CEO on August 12th, to deal announcement on September 25th. Even given highly motivated CEO's and Boards, that's pretty fast!
- Who were the other bidders? — Contrary to some industry speculation, there were no other bidders for MAKO.
- The Pipeline portfolio will help: Since it may take SYK up to two years to "move" its implants to the MAKO RIO robotics platform, the Pipeline portfolio will be a valuable asset for SYK – at least in the short term. However, SYK will likely need to build additional inventory for the Pipeline products to meet anticipated demand.
- The acquisition is not without its challenges: SYK must deliver on its post-deal promises regarding sales and cost synergies. In the short term,, SYK will need to integrate MAKO and Pipeline, leverage its own MedSurg (RIO capital equipment) and Orthopedic (implants) sales forces and continue to demonstrate meaningful value — from a clinical and economic standpoint – for the uni knee. In the mid-term, SYK will need to expand the MAKO platform for use in total hips, total knees and other applications – and deliver a value proposition for each which will be even more closely scrutinized in the future by surgeons, providers and payers.

For additional information about the MAKO/SYK transaction, please check MAKO Corp.'s **Form PREM14A** (Proxy Statement – Merger or Acquisition Preliminary) filed on 10.16.13 for the period ending 10.15.13.

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