



Life Sciences & Healthcare Sector Forecast



July 2010

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In association with

**Rodman
& Renshaw**

EPSTEIN BECKER GREEN



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Foreword

Welcome to the Life Sciences & Healthcare Sector Forecast, published by mergermarket in association with Epstein Becker & Green, P.C. (EpsteinBeckerGreen) and Rodman & Renshaw LLC. Based on interviews with over 75 healthcare investors in the US, this report offers valuable insight into emerging trends in investment activity, as well as a detailed forecast for specific subsectors, including biotechnology and pharmaceuticals; medical devices; healthcare providers and payors; and healthcare services.

Respondents to this survey unanimously agree that healthcare M&A activity will either increase or remain at its current level over the next 12 months. The biotechnology and pharmaceuticals subsector and the healthcare services subsector are particularly likely to witness a significant increase in M&A during this time, according to 87% and 83% of respondents, respectively.

Investment patterns are likely to vary according to industry over the next 12 months. Strategic buyers are likely to be most active in the biotechnology and pharmaceuticals subsector, following on a recent wave of large-cap deals including the US\$68bn Pfizer-Wyeth merger and the US\$44bn Roche-Genentech merger. Financial buyers, on the other hand, are likely to focus their attention on the healthcare services space, where recent private equity buyouts include TPG Capital's US\$5.3bn acquisition of IMS Health.

The private sector will also play an important role in financing healthcare research and development. PIPE investors are expected to be especially active in this respect, focusing primarily on drug research and development firms with strong product pipelines. PIPEs will offer these firms much-needed liquidity in a market where access to other financing sources is still fairly limited. PIPEs will also appeal to investors seeking to acquire shares at discounted prices.

When investing abroad over the next 12 months, 41% of respondents plan to focus on China, where an expanding middle class and a growing pharmaceuticals market are just two of the many factors drawing US-based investors to the country. Western Europe will also see significant inbound investment from the US, according to 30% of respondents, as will the South American region, where many respondents believe investors will seek growth opportunities in various emerging markets.

In the US, healthcare sector consolidation will be determined in part by healthcare reform. The large majority of respondents believe reform will trigger consolidation among healthcare payors and providers (83%) and among healthcare services companies (75%), and more than half of respondents believe reform will spur consolidation in the medical device subsector and the biotechnology and pharmaceuticals subsector. Specific initiatives, including an increase in federal funding for information technology infrastructure, could influence M&A among technology-focused healthcare firms including electronic medical records (EMR) companies.

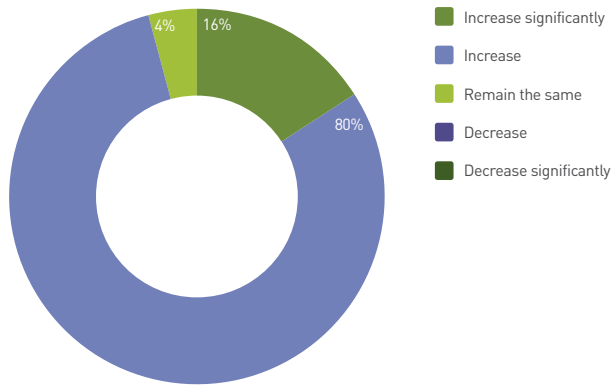
In addition to the above findings, this report offers insight into financing trends, legal issues and a wide range of factors influencing deal flow in the healthcare sector today. We hope you find this survey both interesting and informative and as always, we welcome your feedback.

Methodology

In the second quarter of 2010, mergermarket interviewed 75 healthcare investors in the US on their outlook for the healthcare industry over the next year, including macroeconomic developments and subsector-specific deal drivers. Respondents are anonymous and results are presented in aggregate.

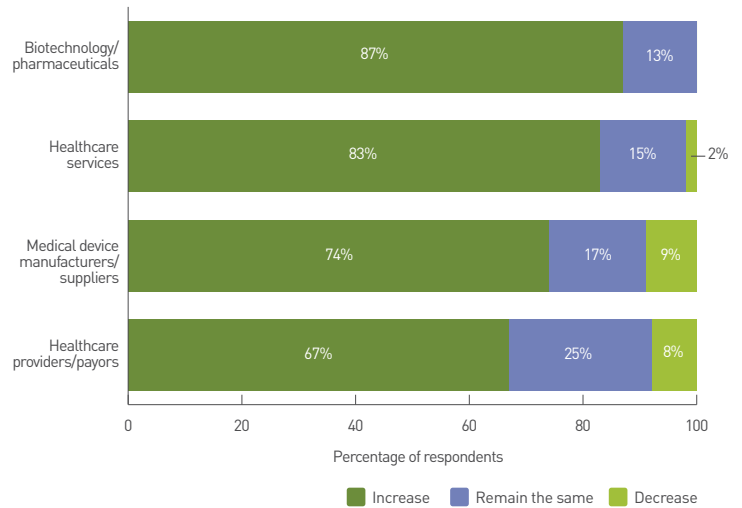
Survey results

What do you expect to happen to the overall level of M&A activity in the Life Sciences & Healthcare sector over the next 12 months?



- Respondents unanimously agree that M&A activity in the healthcare sector will either increase or remain at its current level in the upcoming year. Even those respondents who do not foresee an increase in activity acknowledge that deal volume has already been on the rise over the course of the past 12 months in all segments of the healthcare market.
- This bullish response is not necessarily surprising, as the healthcare sector as a whole is facing an increasingly competitive climate as well as increased demand. Healthcare services companies throughout the US are responding to the growing needs of an aging population; biotechnology and pharmaceutical firms are preparing for heightened generic competition as lucrative drug patents expire; and healthcare companies across the board continue to look to M&A as a vehicle for expansion in emerging markets.

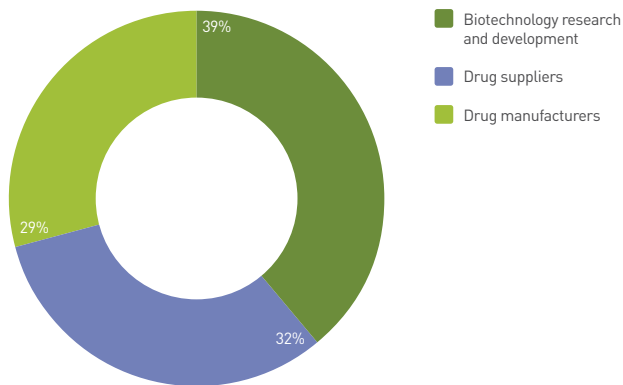
In each of the following subsectors, do you expect M&A activity to increase, decrease or remain the same over the next 12 months?



- All healthcare subsectors are expected to see an increase in M&A activity, but this increase is likely to be most pronounced in the biotechnology and pharmaceuticals industry, where 87% of respondents expect an increase in M&A. One respondent with experience in the industry says an uptick in M&A will stem largely from increased competition resulting from recent large-cap mergers, including the US\$68bn Pfizer-Wyeth merger and the US\$44bn Roche-Genentech deal. The healthcare services sector is also favored by a significant majority of respondents (83%).

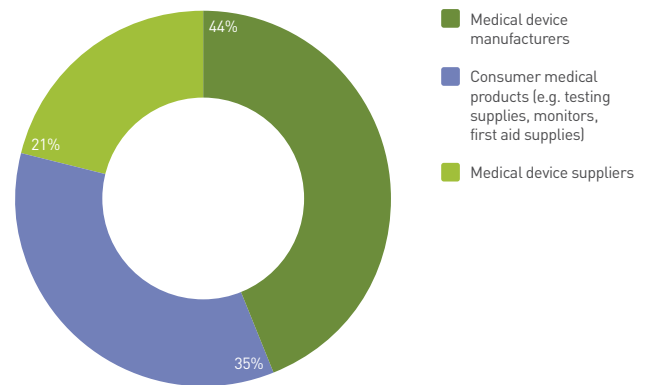
In each of the following subsectors, where do you expect to see the most consolidation over the next 12 months?

Biotechnology/pharmaceuticals:



- Respondents expect all industries within the biotechnology and pharmaceuticals space to witness considerable consolidation this year. The largest percentage of respondents (39%) believe biotech research and development firms will see the most consolidation, while respondents are nearly evenly split between the drug suppliers and drug manufacturers industries with 32% and 29%, respectively.
- All three of these markets have generated significant M&A activity over the past two years, and the largest of these deals have involved major international players merging with US entities. Most notably, 2009 began with the cross-border merger of Switzerland-based Roche Holding and US-based Genentech Inc., valued at US\$44bn, and 2010 saw the US\$6.8bn merger of Germany-based Merck and Millipore Corporation, the US-based therapeutic drug developer.

Medical device manufacturers/suppliers:

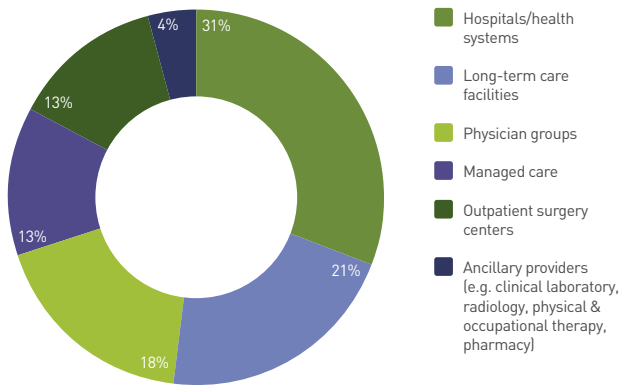


- There is a somewhat similar distribution for the medical devices subsector, where 44% of respondents expect the manufacturing industry to see the most consolidation, followed by one-third of respondents who expect consumer product companies to consolidate most this year.

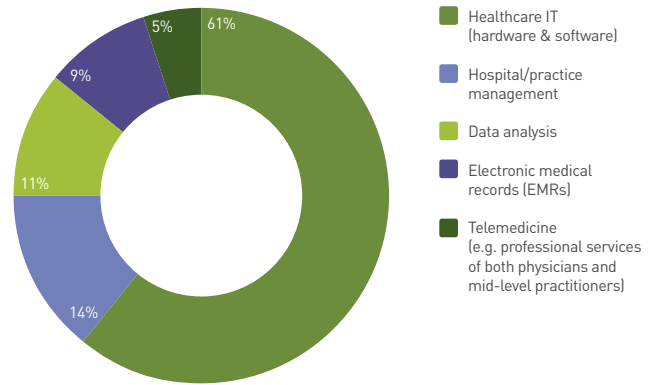
“M&A activity in the medical device space looks healthy over the next 5-10 years. The growth should be facilitated by structural changes in the healthcare landscape, entry into emerging markets and a need to reduce marginal costs. We believe the line between device and pharma companies will blur increasingly given favorable cross-selling opportunities. Finally, we believe average premium for takeovers will decrease over time given increased systematic risks.”

Suraj Kalia, Managing Director, Rodman & Renshaw, LLC

Healthcare providers/payors:



Healthcare services:



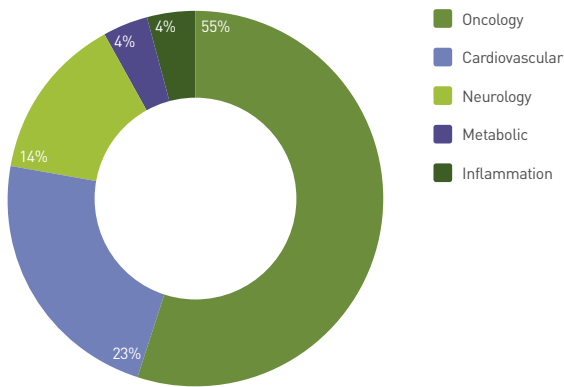
- Hospitals and health systems will likely witness the highest levels of consolidation this year, according to 31% of respondents, while other respondents are divided fairly evenly across long-term care facilities and physician groups. One respondent points out that many of these fields have a high concentration of distressed companies across the US, which could contribute to distressed M&A activity. One such deal includes the US\$235m acquisition of Stayton SW Assisted Living, the assisted living facility operator in the midst of restructuring, which was recently acquired by a joint venture involving US-based private equity firm Blackstone Group Holdings and Emeritus Corporation.

- 61% of respondents believe healthcare IT companies will see the most consolidation this year, significantly more so than other services industries including practice management and data analysis. This could be due to the push for stronger IT infrastructure to support the rising demand being placed on the healthcare sector as a whole. One respondent points out that the need for a more comprehensive IT system is reflected, too, in the demand for more dependable medical record systems, which he says could lead to an impressive amount of investor interest in electronic medical records (EMRs) companies in the upcoming year.

“The drive toward accountable care in both the public and private sectors opens up a new range of strategic imperatives for all providers and payors. This will trigger a new round of mergers, acquisitions, joint ventures and other collaborative arrangements, not the least of which will be the formation of accountable care organizations.”

Doug Hastings, Chair and Member, EpsteinBeckerGreen, Washington, DC

In the biotechnology/pharmaceuticals subsector specifically, which of the following therapeutic areas is likely to see the most interest from investors over the next 12 months?

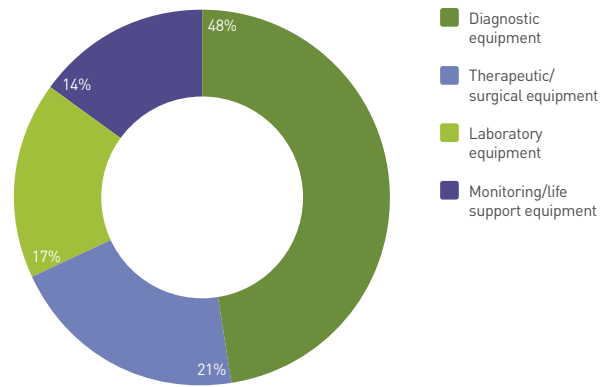


- The majority of respondents (55%) identify oncology as the primary focus for biotechnology and pharmaceutical industry investors this year, which is not necessarily surprising given the push for research in this particular field. Indeed, oncology has been central to biotechnology companies' acquisition strategies in recent years. Johnson & Johnson's US\$818m acquisition of Cougar Technologies, a deal aimed at strengthening each company's oncology research and development efforts, was followed closely by Bristol Myers-Squibb's US\$2.1bn acquisition of Medarex Inc., a cancer-focused life sciences research and development firm, announced in July of 2009.

"Smaller manufacturers with potentially successful oncology products have typically been rather attractive buyout targets for larger pharma with aging portfolios. At the other end of the spectrum, cardiovascular products have a number of significant patent losses on the horizon that may drive down prices in this (already fairly crowded) class, and, thus, make them possibly less attractive to investors."

Kathleen Peterson, Member, EpsteinBeckerGreen, Washington, DC

In the medical device subsector specifically, which of the following areas is likely to see the most interest from investors over the next 12 months?



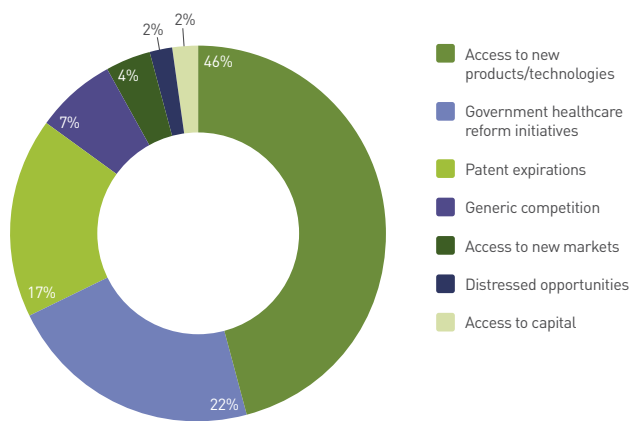
- Diagnostic equipment is identified by the largest percentage of respondents (48%) as the area that will see the most interest from investors this year, followed by over one-fifth of respondents who believe therapeutic or digital equipment will see the most significant interest. The demand for all types of medical equipment in the US will likely continue to rise in the years ahead, in response to the needs of an aging population. This, in turn, will undoubtedly influence the appetite of US-based healthcare investors.

"There is no one subsector within the medical device sector that is of particular interest. There is, however, a lot of excitement with mobile health products that help consumers stay healthy and help patients communicate information to physicians and payors. The big question is how the FDA intends to regulate these types of products without creating a chilling effect on innovation."

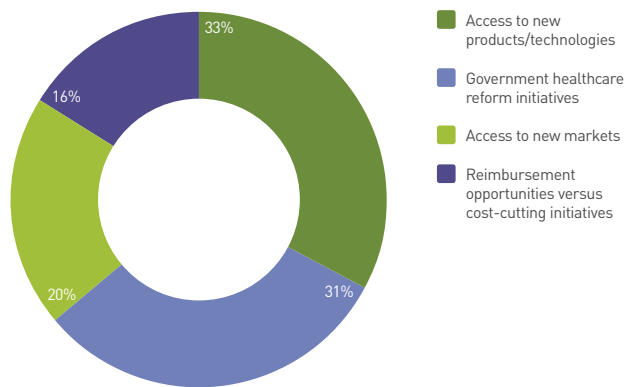
Lynn Shapiro Snyder, Senior Member, EpsteinBeckerGreen, Washington, DC

In each of the following subsectors, which factor will have the greatest impact on M&A activity over the next 12 months?

Biotechnology/pharmaceuticals:



Medical device manufacturers/suppliers:



- Nearly half of respondents (46%) believe biotechnology and pharmaceutical companies' appetite for new products or technologies will be the most important driver of M&A activity in the subsector. An additional 22% of respondents believe government healthcare reform will drive consolidation and outweigh issues that are unique to the biotechnology and pharmaceutical markets, including patent expirations (17%) and generic competition (7%).

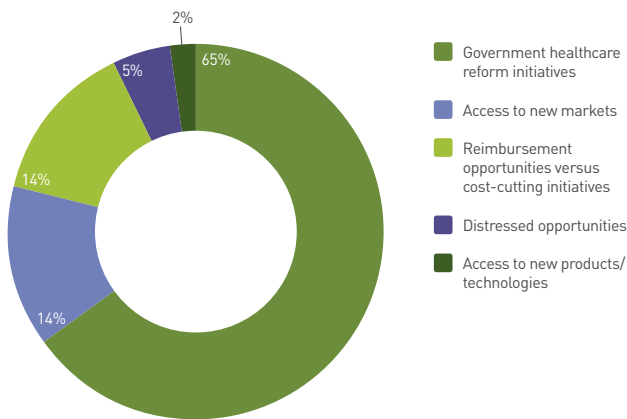
- One-third of respondents believe access to new products and technologies will be the primary driver of M&A activity in the medical device industry, followed closely by the 31% of respondents who believe pending healthcare reforms will have the greatest influence on deal flow. Many of the respondents who expect reform to affect medical device M&A, however, point out that the impact will be secondary, as the impact of healthcare reform on device companies will depend largely on how reform impacts the companies they supply.

“While the need for new products and platforms will always drive M&A activity, the increasing wave of patent expirations... at an unprecedented level in 2012, will in my estimation be the primary driver for the increased M&A activity we’ll see in the near-term.”

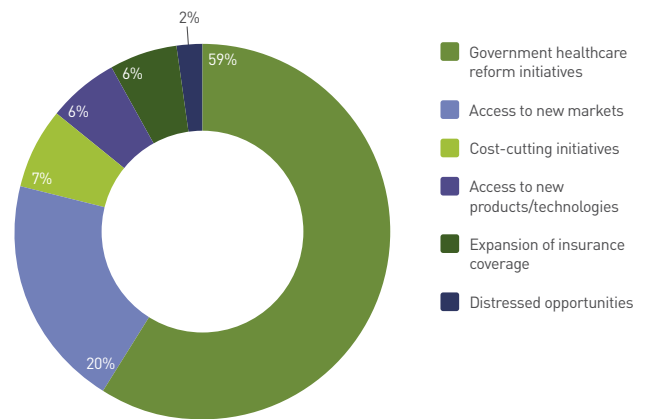
Michael Higgins, Managing Director, Rodman & Renshaw, LLC

In each of the following subsectors, which factor will have the greatest impact on M&A activity over the next 12 months? (Continued)

Healthcare providers/payers:



Healthcare services:



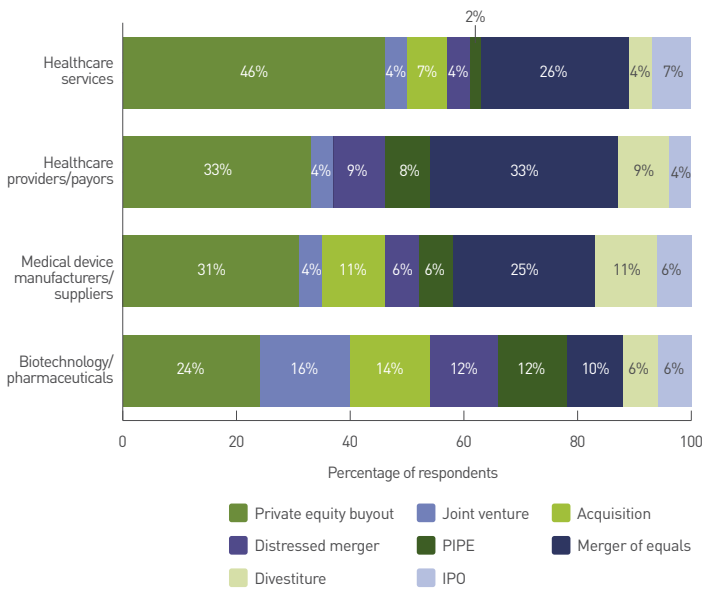
- Not surprisingly, of all the segments of the healthcare sector, healthcare providers and payors are expected to be most heavily influenced by government healthcare reform initiatives, according to 65% of respondents. Reimbursement opportunities and expansion strategies may also drive deal activity, each according to 14%. One respondent comments: "Healthcare providers and payors will definitely be impacted by a reform bill, however a lot of the revisions do not start until 2013 and as late as 2018 so the effects may be a long way off."

- The majority of respondents (59%) believe M&A involving healthcare services companies will depend primarily on healthcare reform in the US. One-fifth of respondents believe access to new markets will be the key determinant of M&A activity in the year ahead, which many respondents believe will stem from US-based companies' appetite for expansion in emerging markets including China and Latin America.
- The more traditional M&A drivers, including cost-cutting measures and companies' appetite for new products or technologies, are expected to be secondary to broad-sweeping healthcare reform initiatives in the US, as these potential initiatives could have a material impact on companies' bottom lines as well as their expansion strategies.

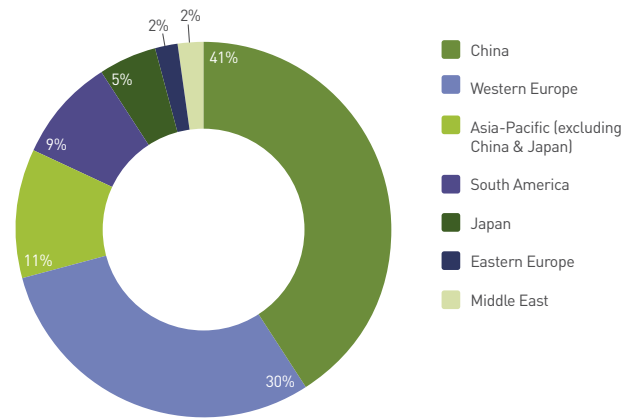
"The clear intent of PPACA is to spur provider collaboration. From hospital acquisitions of physician practices (with physicians then becoming employees of the hospitals), at one extreme, to the formation of large accountable care organizations comprising a wide variety of independent health care providers and provider groups, at the other extreme – and all manner of provider mergers and joint ventures in between – we are likely to see an unprecedented era of collaboration and consolidation among those who provide health care services."

Robert Berg, Member, EpsteinBeckerGreen, Atlanta, GA

In each of the following subsectors, which transaction type do you expect to be most common over the next 12 months?



In which of the following foreign countries/regions do you expect US-based Life Sciences & Healthcare investors to be most active?



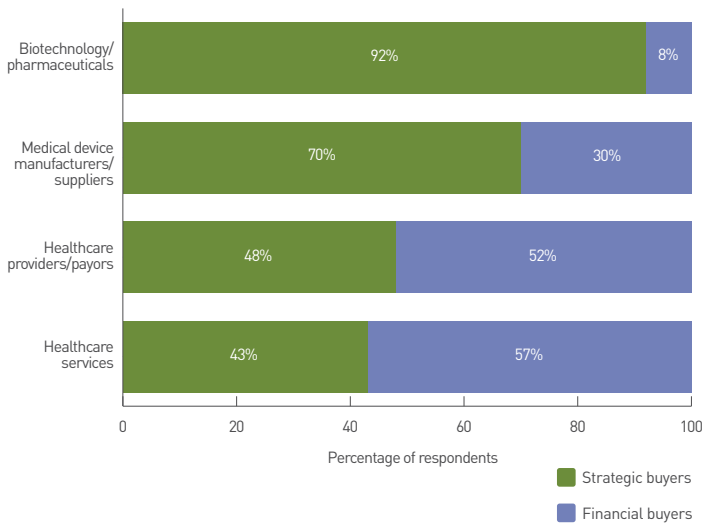
- Overall, private equity buyouts are favored by the largest percentage of respondents as the most common deal structure in the healthcare sector over the next 12 months, particularly in the healthcare services subsector. Mergers of equals are also expected to be common in the healthcare services, healthcare providers and medical devices subsectors.
- Biotechnology and pharmaceuticals companies are expected to see the greatest distribution of transaction types this year. Joint ventures, acquisitions, distressed mergers and PIPEs are all identified by respondents as common deal structures to expect in the upcoming year, and it is worth noting that PIPEs are considerably more likely to occur here than in any other subsector.

- When investing abroad, US-based healthcare investors will be focusing primarily on China. Respondents refer to China’s growing middle class and its attractive pharmaceuticals market as just two of the many factors that US-based investors will be drawn to in the years ahead. According to one respondent, “drug manufacturers will move to China for the cost benefits,” benefits which another respondent says have “already caused major investments in the Chinese pharmaceutical industry.”
- Western Europe will also field significant interest from US-based healthcare investors, according to 30% of respondents. Commenting on this particular region, one respondent explains that potential synergies with Western European companies in the region will be a major draw for US firms: “Western Europe has all the major markets and therefore will continue to be most attractive. US-based companies might be able to leverage their position in this region back into the US.” Interestingly, other respondents believe the potential to enhance US operations through acquisitions in Asia will drive cross-border M&A in the broader Asia-Pacific region and the South American region, which are identified by 11% and 9% of respondents, respectively, as the most active markets for inbound investments from the US.

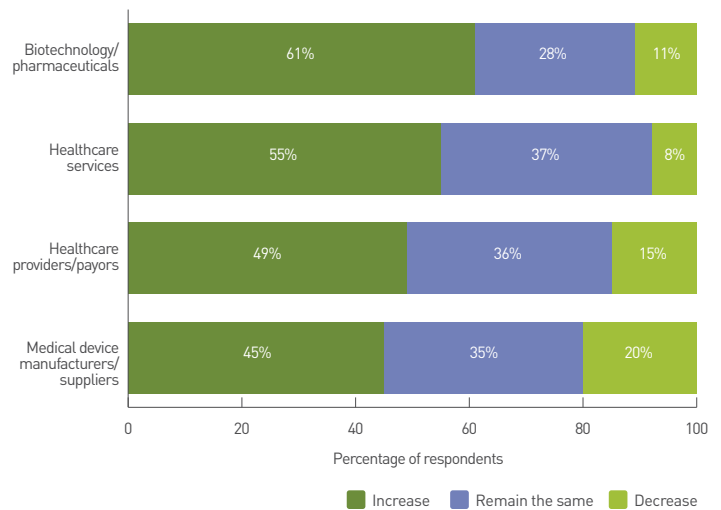
“I expect acquisitions by strategic buyers and private equity investments to be the most common type of transaction over the next 12 months, as many companies will need size and economic strength to survive the Patient Protection and Affordable Care Act.”

Steven Epstein, Founding Member, EpsteinBeckerGreen, Washington, DC

In each of the following subsectors, do you expect to see more M&A activity from strategic buyers or financial buyers over the 12 months?



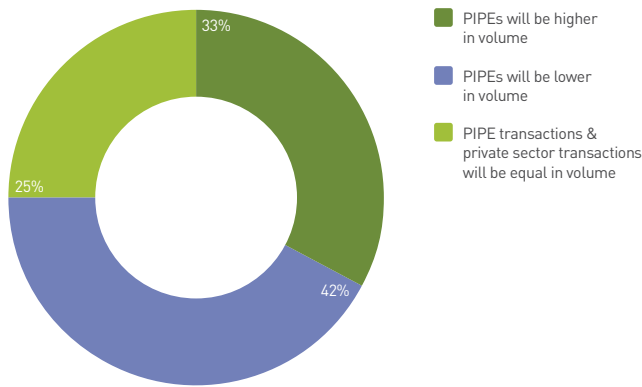
In each of the following industries, what do you expect to happen to the volume of PIPE transactions over the next 12 months?



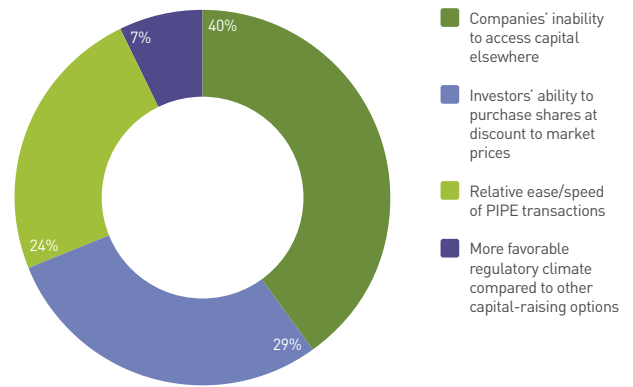
- The distribution of financial and strategic deals will likely vary according to specific healthcare industry subsectors this year. In the biotechnology and pharmaceutical space, an overwhelming 92% of respondents expect strategic buyers to be more active than financial buyers, and a significant majority (70%) expects the same for the medical devices industry. Healthcare providers and healthcare services companies, on the other hand, will likely be favored by financial buyers, according to 52% and 57% of respondents, respectively.
- Healthcare services companies have already proved to be attractive targets for financial buyers, with recently announced buyouts including that of healthcare information solutions provider IMS Health, acquired by Canada Pension Plan Investment Board and US-based private equity firm TPG Capital for US\$5.3bn in November of 2009. As for biotechnology and pharmaceuticals firms, recent large-cap consolidation will likely pave the way for more strategic mergers.

- The outlook for PIPE activity is fairly bullish sector-wide. Sixty-one percent of respondents expect PIPE activity to increase in the biotechnology and pharmaceuticals industry, where PIPE investors tend to focus most of their attention. One respondent points out that biotechnology research firms in need of capital are most likely to lean toward PIPEs in the year ahead as venture capital funding is no longer a viable option in many cases. The healthcare services industry, which covers technology-focused companies including electronic medical room (EMR) developers, is also likely to witness an increase in PIPE activity this year, according to 55% of respondents.

How do you expect the volume of PIPE investments in the Life Sciences & Healthcare sector to compare to the volume of other private sector transactions, including private equity and venture capital investments?



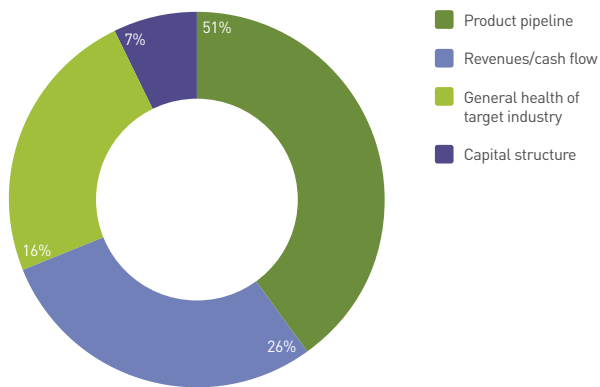
What do you expect the primary driver of PIPE activity in the Life Sciences & Healthcare sector to be in the next 12 months?



- Respondents are somewhat divided on how PIPE transactions will compare to other private sector deals in terms of volume. The largest percentage of respondents (42%) believe PIPE investments will be outnumbered by private equity, venture capital or other private sector deals, while one-third of respondents expect PIPE activity to be higher. A significant one-quarter minority expects these deals to be equal in volume.
- Respondents in all three of these groups were quite vocal as to the specific factors influencing all private sector transactions this year. One respondent says private equity firms will outpace PIPE investors because “buyout groups have more money on the sidelines for new deals.” But another respondent believes that while private equity firms might have “more capital” at their disposal, companies will favor PIPE investments as PIPEs are less likely to attract public scrutiny.

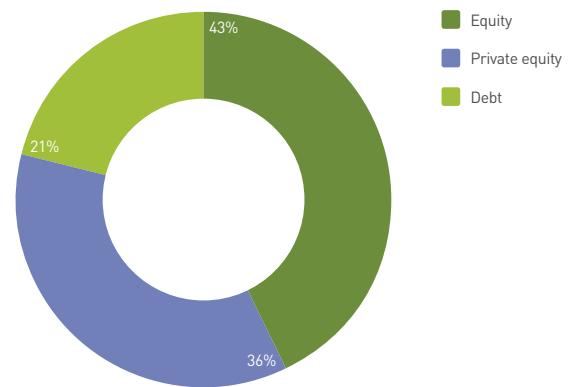
- PIPE activity will likely receive a boost in the next 12 months as issuers and investors will be drawn to this deal structure for very specific reasons. The largest group of respondents (40%) believe companies' need for capital will be the primary driver of PIPEs, as companies may find it difficult to tap other sources of capital in the current market. Investors' desire to take advantage of discounted share prices will also be a significant driver of PIPE transactions in the upcoming 12 months, according to 29% of respondents.
- Other features of PIPE transactions are identified by significant portions of respondents as well. Nearly one-quarter of respondents believe the relative ease and speed of closing PIPE deals will boost activity this year, and in a similar vein, other respondents believe a more favorable regulatory climate for PIPE transactions will be appealing for all parties involved.

For PIPE investors, which of the following will be most important when evaluating a potential target in the Life Sciences & Healthcare sector?



- PIPE investors will focus primarily on potential targets' product pipelines, according to 51% of respondents. Many respondents attribute this to the fact that PIPE investors are often particularly active in the biotechnology space, where drug research and intellectual property tend to be key determinants of long-term success.
- Of course, these companies' financials are also critical. Close to one-quarter of respondents say revenue and cash flow figures will be the central focus of investors' evaluations, while 16% of respondents believe investors will be most concerned with the overall health of the target's industry.

Which of the following financing sources do you expect to be used most for M&A transactions in the Life Sciences & Healthcare sector over the next 12 months?

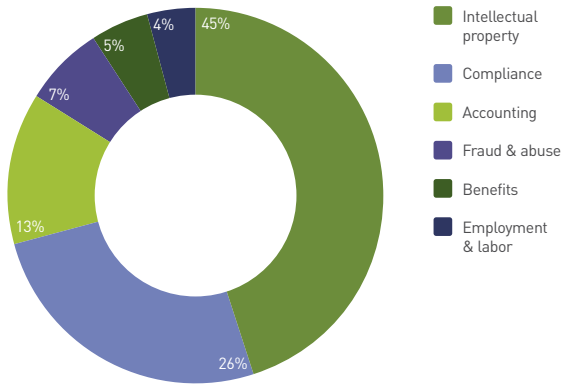


- While the largest percentage of respondents (43%) expect most M&A transactions to be financed with equity, over one-third of respondents believe private equity firms will provide most financing for new deals in the sector this year. One-fifth of respondents believe debt will be the primary M&A financing source during this period. One respondent comments that strategic transactions will rely most heavily on equity this year, and will generally outnumber deals involving private equity buyers.
- At the same time, other respondents believe private equity firms will be at an advantage this year. One respondent mentions that private equity firms have recently raised funds to deploy in the near-term and will be more active than venture capital firms, which are "tapped out" of financing and "naturally smaller" than their private equity peers. Another respondent explains, "Volatility and market risk of public finance is very high. Companies will be better off with private transactions."

"Especially in the life sciences sector (drug, device and bio), the company's value is based significantly on its intellectual property. Therefore, if the IP is not as strong as the seller describes or represents, then there is a strong likelihood that a buyer might turn away from a transaction."

David Matyas, Member, EpsteinBeckerGreen, Washington, DC

In which of the following areas are risks and liabilities identified during due diligence most likely to affect the outcome of potential M&A transactions in the Life Sciences & Healthcare sector?

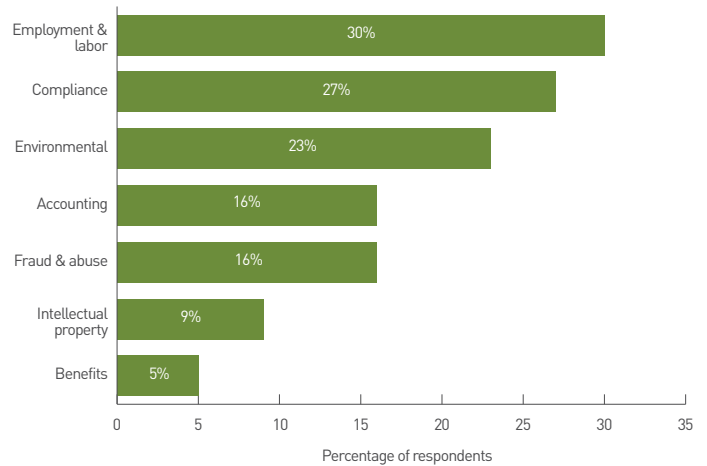


- Intellectual property risks and liabilities are identified by the largest portion of respondents (45%) as most likely to impact the outcome of potential deals in the healthcare space, and many of the respondents within this group say the rapid development of new technologies in all industries—particularly medical devices and pharmaceuticals—will make intellectual property a major priority. Compliance issues follow behind intellectual property issues with close to one-quarter of respondents expecting this area to have the greatest influence on healthcare deals this year.

“In recent years, I have seen numerous instances where litigation resulted because parties acquiring hospitals had not made the proper arrangements to renegotiate the presently existing managed care contracts. In doing due diligence, it is important to identify all the contracts that need to be renegotiated or canceled and to get an early jump on resolving such items appropriately by reaching out to all affected parties.”

Damian Capozzola, Member, EpsteinBeckerGreen, Los Angeles, CA

In which of the following areas are potential risks and liabilities most likely to be overlooked during due diligence in the Life Sciences & Healthcare sector?

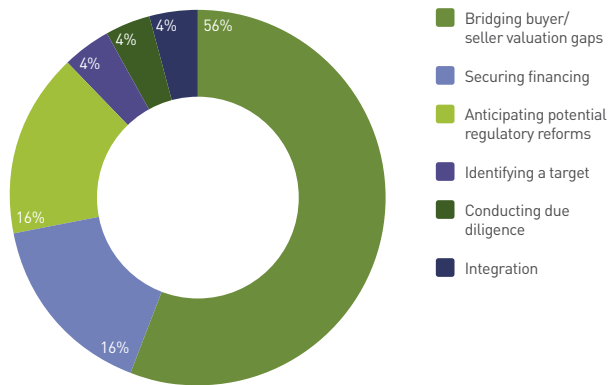


- Potential risks and liabilities are most likely to be overlooked during due diligence in the employment and labor area, according to 30% of respondents, while more than one-quarter of respondents say that due diligence is most likely to fail to uncover compliance-related issues. Several respondents make clear that the tendency to overlook issues in these specific areas depends largely on the industry, as potential risks facing patients and consumers may make certain practices more susceptible to public scrutiny.

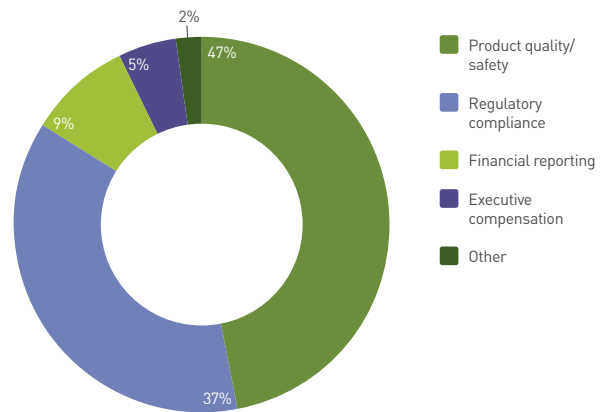
“One significant liability that often is overlooked during a regulatory due diligence of a life science company is a review and determination of whether a company-sanctioned, off-label marketing scheme exists. In order to evaluate the risks associated with potential non-compliance with the Food, Drug, and Cosmetic Act’s promotional rules, due diligence must consist of more than a review of policies and procedures regarding product promotion and the related training.”

Wendy Goldstein, Healthcare Practice Chair and Member, EpsteinBeckerGreen, New York, NY

Which of the following stages of the M&A process is going to be most challenging over the next 12 months?



Which of the following corporate governance issues will be the greatest priority for Life Sciences & Healthcare companies over the next 12 months?



- The demand for healthcare products and services is not likely to suffer directly from poor economic conditions, but the lingering impact of the financial crisis and uncertainty in the financial markets will affect the sector’s M&A landscape. Indeed, the gap between buyer and seller expectations will pose the most significant challenge to healthcare M&A transactions over the next 12 months, according to 56% of respondents, while a significant 16% minority says securing financing for new transactions will be most difficult. The same percentage of respondents says uncertainty surrounding regulatory reform will make the M&A process particularly challenging this year.

- Product quality and safety is identified by nearly half of respondents (47%) as the highest priority within healthcare companies’ corporate governance practices this year, while a comparable 37% of respondents believe regulatory compliance will be the greatest priority. Also, in the wake of the financial crisis, a heightened public awareness of financial transparency and executive compensation practices has triggered a reevaluation of these areas for most companies, and healthcare companies are no different. However, financial reporting and executive compensation are considered less of a concern for healthcare companies as they “deal more with the ‘human factor’ and are more concerned with compliance and safety,” according to one respondent.

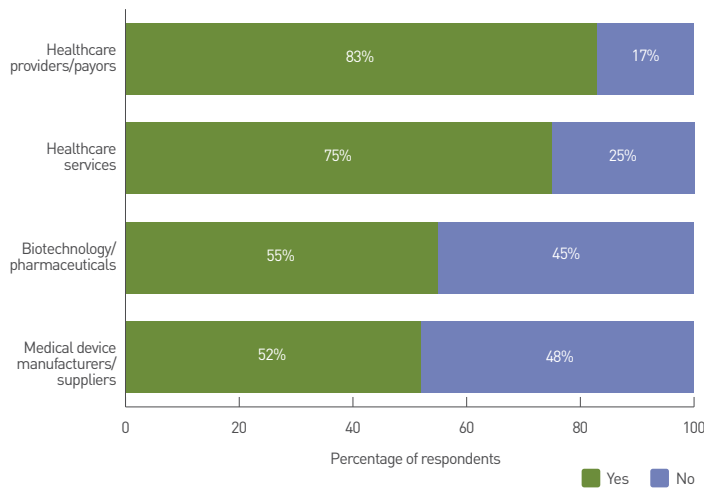
“This potential M&A activity is likely to continue to produce a valuation disparity between the profitable life science companies over \$1 billion in market cap and those under \$1 billion. Also, the \$1 billion to \$10 billion life science companies may consider leveraging their valuations by acquiring smaller companies with earlier-stage assets.”

Michael Higgins, Managing Director, Rodman & Renshaw, LLC

“Knowledge of all the relevant business implications arising from the Patient Protection and Affordable Care Act and related federal and state health care reforms should be the highest priority for members of boards of directors at the various types of healthcare companies being impacted... The ramifications of health insurance reform and entitlement reform included in these laws will require companies to consider ‘change management’ as the norm for the next three to four years.”

Lynn Shapiro Snyder, Senior Member, EpsteinBeckerGreen, Washington, DC

Do you expect the passage of a healthcare reform bill to trigger consolidation in each of the following sub-sectors?



- Healthcare reform will likely trigger consolidation in all facets of the healthcare industry, according to the overall majority of respondents. The largest majority (83%) believes consolidation of healthcare providers and payors will be influenced most heavily by healthcare reform, while a significant 75% majority of respondents believe healthcare services companies will see the most significant consolidation as a result of the reform bill.
- Respondents believe reform will also influence consolidation activity in the biotechnology and pharmaceuticals space (55%) and the medical device space (52%), but for the most part, companies on the manufacturing and supply side of the sector are considered less likely to be influenced by healthcare reform than service providers.

“Survival in healthcare is contingent upon reimbursement and regulatory requirements and, in general, larger companies have a better chance to survive the changes resulting from the Patient Protection and Affordable Care Act. Smaller companies may find it harder to absorb these changes, which will probably result in more consolidation.”

Steven Epstein, Founding Member, EpsteinBeckerGreen, Washington, DC

“In the biotech/pharmaceuticals space... organizations are looking to diversify product lines and product portfolios to minimize the impact from numerous domestic and international legislative and regulatory changes that have an effect on operations and revenues. Also, there is a need for organizations to replace revenue that will be lost due to patent expirations of commercial products. Certain organizations may be more creative than others with respect to how they diversify their business to incorporate potential new product or service lines.”

Wendy Goldstein, Healthcare Practice Chair and Member, EpsteinBeckerGreen, New York, NY

The impact of health reform on M&A activity in the healthcare sector

The Patient Protection and Affordable Care Act (as modified by the Health Care and Education Reconciliation Act) (collectively referred to as "Health Reform") was signed into law in March 2010.¹ This legislation represents the most comprehensive reform of the healthcare system in the last 50 years and it promises to affect healthcare and life science companies in every corner of the industry.

Nowhere is the impact of Health Reform more noticeable than in the context of mergers and acquisitions. Recent deal flow suggests that companies in various segments of the healthcare sector have been anticipating the impact of this type of legislation and a number of healthcare companies began developing unique strategies to adjust to expected rules and regulations well before President Obama signed the Health Reform legislation into law. Furthermore, in terms of corporate combinations, movement among healthcare providers and manufacturers suggests that many opportunities are available for healthcare industry members who want to attain a competitive edge and initiate a strategic response to Health Reform.

1. Healthcare Providers

Many post-acute care providers and hospitals have been engaging in mergers and acquisitions in anticipation of changes to the current fee-for-service pay structure. Some entities have used corporate combination strategies to enhance their suite of service offerings, while others (often in financial distress) have looked to mergers and acquisitions to defray reimbursement cuts and improve their financial positions and overall performance.

a. Post-acute and Long-term Care Consolidation

Section 3023 of the Patient Protection and Affordable Care Act directs the Secretary of Health and Human Services to develop a national, voluntary pilot program by January 1, 2013 encouraging hospitals, doctors, and post-acute care providers to improve patient care and achieve savings for the Medicare program through bundled payment models. This National Pilot Program on Payment Bundling ("Pilot Program") will test a bundled payment model which, unlike the current fee-for-service model, offers a single bundled payment for a continuum of healthcare services. The bundled payment will see a patient through an entire episode of care, from inpatient and outpatient acute care through post-acute care, including home health, skilled nursing and rehabilitation.

Given the establishment of this pilot program, Health Reform has the potential to dramatically change how healthcare providers are paid for their services. The Secretary is only required to establish the initial pilot program for a five year period, but should the pilot program improve quality and reduce costs, the Secretary has the authority to expand the program.

Potentially in anticipation of the establishment of a more bundled payment program, some post-acute care providers have been proactive in pursuing corporate combinations to take advantage of the bundled payment model. By focusing on vertically integrating an array of long-term care services, these post-acute care providers appear to be positioning themselves to stretch (i.e., maximize) bundled payments, thereby increasing their return.

The proposed merger of Odyssey HealthCare (a hospice care provider) and Gentiva Health Services (a hospice and home health care provider) in May 2010 exemplifies this type of behavior among post-acute care providers. The merger, pegged at \$1 billion, will create the largest healthcare provider focused on home health and hospice services in the United States.² The combined entity will boast \$1.8 billion in annual revenue, 60 percent of which is expected to be generated from home healthcare and 40 percent of which is expected to be generated from hospice care.

However, while the Odyssey-Gentiva deal has received the most attention, several other post-acute care providers have also used acquisitions as a means to increasing their home health and hospice operations. On May 24, 2010, Idaho Home Health and Hospice entered into a definitive agreement with Louisiana-based LHC Group Inc, which is expected to enhance LHC Group's array of post-acute healthcare services, including its home-based division and its facility-based division.³ The announcement of this transaction follows LHC's acquisition of Oregon-based Salem Hospital Home Care in March 2010.⁴

¹ Patient Protection and Affordable Care Act of 2010, Pub. L. No. 111-148, 124 Stat. 119 [2010]; Health Care and Education Reconciliation Act of 2010, Pub L. No. 111-152, 124 Stat. 1029 [2010].

² See Press Release, Gentiva Health Services, Gentiva Health Services to Acquire Odyssey HealthCare, Creating A Leading US Hospice Care Provider (May 24, 2010), available at <http://investors.gentiva.com/releasedetail.cfm?ReleaseID=472656>.

³ See Press Release, LHC Group, LHC Group Signs Definitive Agreement with Idaho Home Health and Hospice (May 24, 2010), available at <http://investor.lhcgroup.com/releasedetail.cfm?ReleaseID=472644>.

⁴ See Press Release, LHC Group, LHC Group Signs Definitive Agreement to Acquire Salem Hospital Home Care (Mar. 10, 2010), available at <http://investor.lhcgroup.com/releasedetail.cfm?ReleaseID=450712>.

The impact of health reform on M&A activity in the healthcare sector

The Ensign Group, Inc. appears to be pursuing a similar strategy. In May 2010, Ensign announced plans to acquire Horizon Home Health and Hospice.⁵ The acquisition was among a litany of deals recently conducted by Ensign outside the hospice space; Ensign announced in May that it would acquire both the Heritage Gardens Healthcare Center and the Silver Springs Healthcare Center, two Texas-based nursing home operations.⁶ Furthermore, these acquisitions came on the heels of Ensign's acquisitions of Emmett Care & Rehabilitation Center and Parke View Rehabilitation & Care Center in January 2010.⁷ Moreover, it does not appear that Ensign has any plans to slow down as it has expressed a commitment to actively pursue both well-performing and struggling long-term care targets. This type of behavior suggests that the frequency of mergers and acquisitions among post-acute care providers will remain high for the near future.

b. Non-Profit & For-Profit Hospitals

Health Reform may also spur corporate combination activity because of its affect on the hospital industry.

For example, Section 9007 of the Patient Protection and Affordable Care provides new requirements applicable to non-profit hospitals. Among these requirements, a non-profit hospital loses its status as a Section 501(c)(3) Charitable Hospital Organization unless it conducts a periodic "Community Health Needs Assessment" which "takes into account input from persons who represent the broad interests of the community served by the hospital facility, including those with special knowledge of or expertise in public health." The non-profit hospital must also "adopt an implementation strategy to meet the community health needs identified through the [Community Health Needs Assessment]."

Furthermore, Health Reform imposes more transparency requirements on non-profit hospitals. Section 9007 requires non-profit hospitals to develop written financial assistance policies and "widely publicize the policy within the community to be served by the organization."

These, and other requirements imposed on hospitals under Health Reform, may be burdensome for some non-profit hospitals that are already experiencing capital shortages. To survive, non-profit hospitals may seek to merge with (or be acquired by) their peers. Indeed, smaller players may not have the resources to address new guidelines and potential financial penalties for noncompliance.

Consequently, many non-profit players have been targeted for acquisition. In fact, in June 2010, Vanguard Health Systems, Inc. signed a purchase agreement to acquire the eight-hospital system of non-profit Detroit Medical Center ("DMC").⁸ Under the terms of the agreement, Vanguard will purchase DMC for approximately \$417 million in cash, which will enable DMC to retire its debt. In addition, Vanguard has committed to providing DMC with \$350 million for on-going capital needs and at least \$500 million for new capital investment over the next five years. The deal represents the single largest private sector investment in Detroit's history and it epitomizes the struggle hospitals across the country are facing. However, the combination is expected to help Detroit Medical Center better manage the financial difficulties associated with serving a large urban community.

Another example of M&A activity among non-profit and for-profit hospitals is that in June 2010, for-profit hospital operator LifePoint Hospitals, Inc. was granted judicial approval to acquire Sumner Regional Health Systems of Tennessee, which had filed for bankruptcy in late April.⁹ LifePoint offered to purchase Sumner for \$145 million cash and provide \$60 million of additional capital over the next decade, which will give Sumner the capital it needs to address its debt burden, finance its daily operations, and update its facilities.

Joint ventures are another viable option for non-profit hospitals that need capital but do not want to give up complete operational control. Saint Joseph's Hospital of Atlanta, a non-profit hospital with \$400 million in reported annual revenue, and Piedmont Healthcare, Inc., another non-profit hospital with \$1.1 billion in annual revenue, signed a letter of intent to enter into exclusive negotiations to create

⁵ See Press Release, The Ensign Group, The Ensign Group Acquires Idaho Home Health and Hospice Agency (May 3, 2010), available at <http://investor.ensigngroup.net/releasedetail.cfm?ReleaseID=465720>.

⁶ See Press Release, The Ensign Group, The Ensign Group Acquires Two Texas Skilled Nursing Facilities (May 3, 2010), available at <http://investor.ensigngroup.net/releasedetail.cfm?releaseid=465719>.

⁷ See Press Release, The Ensign Group, The Ensign Group Acquires Two Idaho Skilled Nursing Facilities (Jan. 4, 2010), available at <http://investor.ensigngroup.net/releasedetail.cfm?ReleaseID=433817>.

⁸ See Press Release, Detroit Medical Center, Detroit Medical Center Purchase Within Reach; Purchase Agreement with Vanguard Signed; AG Review Next Step (Jun. 11, 2010), available at <http://www.dmc.org/news/?sid=1&nid=178>.

⁹ See Press Release, Sumner Regional Medical Center, Court Approves Lifepoint Hospitals' Purchase of Sumner Regional Health Systems (Jun. 11, 2010), available at <http://www.sumner.org/news/news-releases/court-approval.html>.

¹⁰ See Press Release, Saint Joseph's Hospital Saint Joseph's and Piedmont Healthcare Announce Letter of Intent to Form Joint Operating Company (Apr. 8, 2010), available at <http://www.stjosephsatlanta.org/news/04-08-10-JOC.html>.

¹¹ See Urvaksh Karkaria, *Rival Hospital Deal Could Spell New Owner for Saint Joseph's*, ATL. BUS. CHRON., Apr. 9, 2010, available at <http://www.bizjournals.com/atlanta/stories/2010/04/12/story3.html?b=1271044800%5E3162421>.

a joint operating company.¹⁰ Should the joint operating company come to fruition, it would allow both parties to reduce their costs and increase the quality of provided medical care. The deal is estimated to reduce annual expenses by \$20 million for Saint Joseph's Hospital and \$10 million for Piedmont.¹¹

2. Life Sciences and Medical Devices

While corporate combinations among hospitals and other healthcare providers have been—and will continue to be—driven largely by changes in reimbursement mechanisms and reporting requirements, M&A activity in the life sciences industry (i.e., biotechnology, pharmaceutical and medical device companies) may be motivated by several of Health Reform's provisions supporting new input and competing technologies, as well as new tax provisions.

a. Biotech and Pharmaceutical Consolidation

Competition from generic manufacturers is not a new challenge for existing members of the biotechnology and pharmaceutical industries. However, with the passage of Health Reform, generic competition may become a more significant player.

Section 7002 of the Patient Protection and Affordable Care Act provides for a "biosimilars pathway," which establishes a process under which the Secretary of Health and Human Services is required to license a biological product that is shown to be "biosimilar to" or "interchangeable with" a licensed biological product (i.e., a reference product). A biological product is "biosimilar" to a reference product if it is "highly similar to the reference product notwithstanding minor differences in clinically inactive components" and "there are no clinically meaningful differences between the biological product and reference product in terms of the safety, purity, and potency of the product." A biological product is "interchangeable" with a reference product (meaning it can be substituted for the reference product without the intervention of the healthcare provider who prescribed the reference product) if it is "biosimilar" and "can be expected to produce the same clinical results as the reference product."

The Secretary of Health and Human Services has yet to issue guidance regarding the approval process for biosimilars, and Section 7002 does prohibit approval of an application for "biosimilarity" or "interchangeability" for twelve years from the date on which the reference product was first approved for license.

However, it is clear that these and other provisions of Health Reform are paving the way for an increase in the use of generic products. Consequently, many biotechnology and pharmaceutical firms in the United States are pursuing strategies involving new corporate combinations to either diversify their product offerings or gain access to the generics in their respective fields.

In May 2010, Abbott Laboratories announced a definitive agreement with Piramal Healthcare Limited to acquire full ownership of Piramal's Healthcare Solutions business for an up-front payment of \$2.12 billion, plus \$400 million annually for the next four years.¹² Mumbai-based Piramal Healthcare Solutions has a comprehensive portfolio of branded generics with annual sales expected to exceed \$500 million next year in India, and market-leading brands in multiple therapeutic areas, including antibiotics, respiratory, cardiovascular, pain and neuroscience. The deal exemplifies one pharmaceutical manufacturer's strategy to reinforce its position in branded generics, strengthen its presence in new markets, and complement its proprietary pharmaceutical offerings and pipeline.

Smaller firms also are engaging in corporate combination activity as well. On June 3, 2010, Sandoz, Inc. completed its acquisition of Oriol Therapeutics, Inc., a privately held pharmaceuticals company based in the United States that focuses on developing respiratory products with known pathways as generic alternatives to patented drugs for asthma and chronic obstructive pulmonary disease.¹³ As a result of the deal, Sandoz will gain exclusive rights to Oriol's portfolio of generic drug candidates in addition to certain technologies for the inhalable respiratory drug market. In announcing the deal, Sandoz cited industry estimates that approximately 50 percent of the \$32 billion global market for asthma and chronic obstructive pulmonary disease medicines will lose patent protection by 2016.

b. Medical Device Manufacturers Respond

Section 1405 of the Health Care and Education Reconciliation Act imposes an excise tax equal to 2.3 percent of the sales price on the sale of medical devices by a manufacturer or importer, effective on December 31, 2012,¹⁴ and it is expected to provide the federal government with \$20 billion over the next 10 years. Though gauging the impact of this specific provision on merger and acquisition activity among medical device manufacturers is difficult, it is conceivable that many device manufacturers are seeking to offset this future reduction in net income through synergies realized as a result of corporate combinations. Furthermore, recent activity

¹² See Press Release, Abbott Laboratories, Abbott to Become No. 1 Pharmaceutical Company in India with Acquisition of Piramal's Healthcare Solutions Business (May 21, 2010), available at http://www.abbott.com/global/url/pressRelease/en_US/60.5:5/Press_Release_0861.htm.

¹³ See Press Release, Sandoz, Inc., Sandoz Completes Acquisition of Oriol Therapeutics, Strengthening Potential for Global Leadership in Respiratory (Jun. 3, 2010), available at http://www.sandoz.com/site/en/media_room/press_releases_news/100603.shtml.

¹⁴ HCERA, § 1405, 124 Stat. 1066.

suggests that some medical device manufacturers are preparing for the impact of the upcoming excise tax by using mergers and acquisitions to cut costs, expand service offerings, and/or prioritize core operations.

As a result of Section 1405, Medtronic, Inc., one of the leading medical device manufacturers in the United States, is expected to lose \$150 million to \$200 million in profit annually.¹⁵ Perhaps in anticipation of the tax (and in an attempt to offset it), Medtronic has made a string of strategic acquisitions. Most recently, on April 29, 2010, Medtronic and ATS Medical, Inc., a leading developer, manufacturer and marketer of products and services focused on cardiac surgery, signed a definitive agreement under which Medtronic will acquire ATS Medical in a transaction valued at \$370 million.¹⁶

This past May, CareFusion Corporation, a medical device provider, completed the acquisition of Medegen LLC from the private equity firm Nautic Partners LLC for \$225 million in cash.¹⁷ Medegen manufactures and markets disposable intravenous therapy products and also provides contract manufacturing to other medical device manufacturers and pharmaceutical companies. The acquisition complements CareFusion's current research and development efforts and enables both companies to expand their respective product lines and customer bases. CareFusion is also simultaneously focusing on slimming down its operations. On April 29, 2010, eResearch Technology, Inc., which provides services and technology for collecting, analyzing and distributing information about clinical-trial participants, agreed to acquire the research services division of CareFusion Corporation for \$81 million in cash.¹⁸

Elsewhere, companies are making similar moves to shed their non-core businesses. On April 26, 2010, Thoratec Corporation, a leader in device-based mechanical circulatory support therapies to save, support and restore failing hearts, signed a definitive agreement to sell its International Technidyne Corporation ("ITC") division to Danaher Corporation for \$110 million in cash and an earn-out expected to total \$26 million over three years.¹⁹ In the press release announcing the deal, Thoratec stated the sale enabled Thoratec to focus its attention and resources on the fast-growing Ventricular Assist Device business and the cash generated by the transaction facilitated new investments in Thoratec's existing product pipeline.

Conclusion

While many of the repercussions of the passage of Health Reform have yet to be realized, companies throughout the U.S. Life Sciences & Healthcare sector are already preparing for a costlier and more burdensome regulatory environment. As part of these preparations, some organizations have streamlined their operations, while others have aligned with complementary providers in an attempt to raise revenue or cut costs. Health Reform will inevitably touch every individual of every company from the entire spectrum of the healthcare sector, and those who consider strategic alliances now may find themselves uniquely positioned to take advantage of the Act's many provisions when they do come into effect over the next four years. From changes in reimbursement models to new taxes and regulatory requirements, Health Reform has proven—and will continue—to be an important driver of corporate combination activity.

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¹⁵ See Medtronic Statement On Impact of Health Care Reform Bill (March 22, 2010), available at <http://www.medtronic.com/Newsroom>.

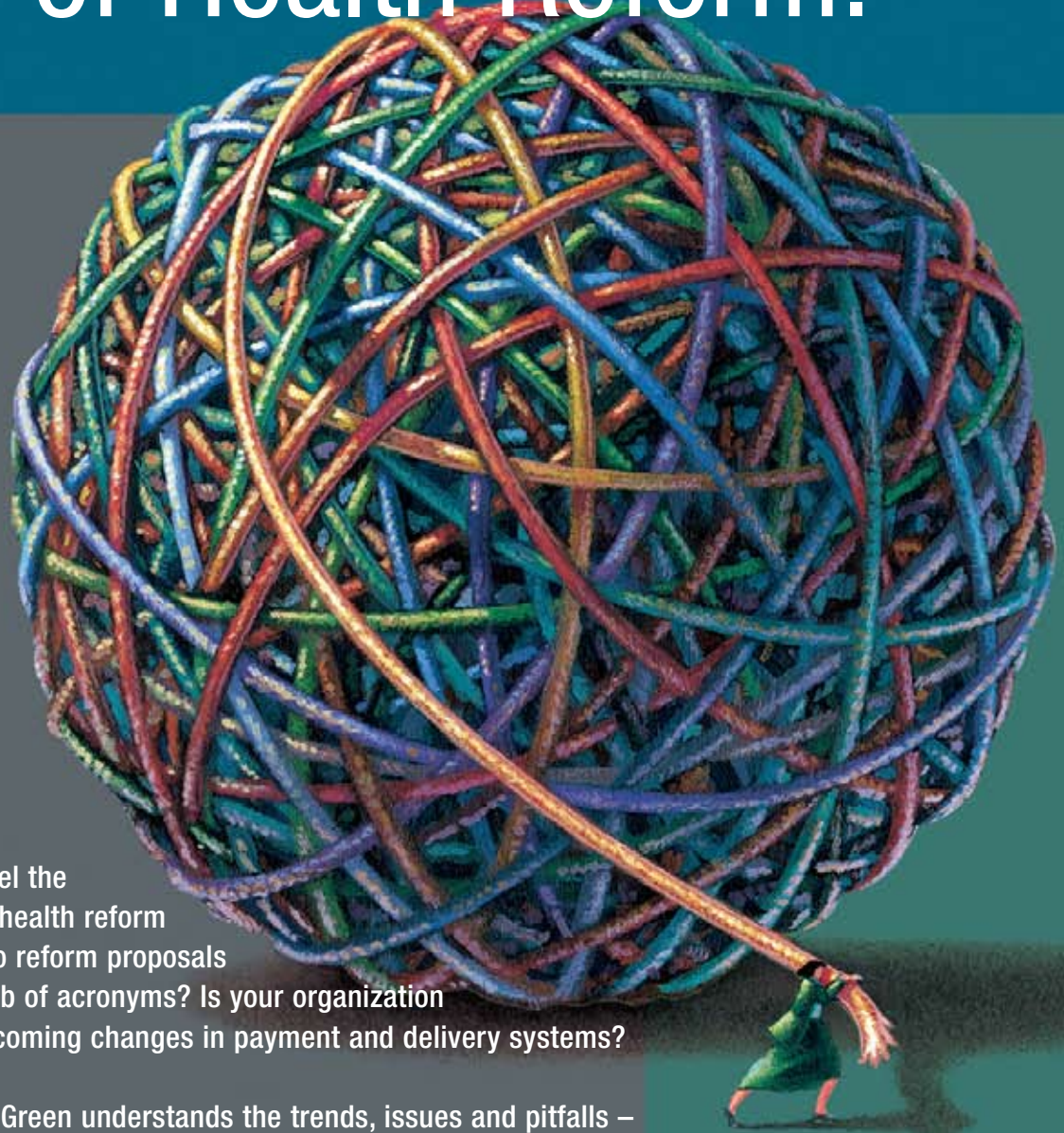
¹⁶ See Press Release, Medtronic, Inc., Medtronic Signs Agreement to Acquire ATS Medical (Apr. 29, 2010), available at http://www.medtronic.com/Newsroom/NewsReleaseDetails.do?itemId=1272541176428&lang=en_US.

¹⁷ See Press Release, CareFusion Corporation, CareFusion Completes Medegen Acquisition (May 17, 2010), available at <http://media.carefusion.com/index.php?s=43&item=63>.

¹⁸ See Press Release, eResearch Technology, Inc., ERT Agrees to Acquire the Research Services Division of CareFusion (Apr. 29, 2010), available at <http://ert.investorroom.com/index.php?s=43&item=377>.

¹⁹ See Press Release, Thoratec Corporation, Thoratec Announces Sale of ITC Division to Danaher Corporation for \$110 Million (Apr. 26, 2010), available at <http://phx.corporate-ir.net/phoenix.zhtml?c=95989&p=irol-newsArticle&ID=1417652&highlight=>

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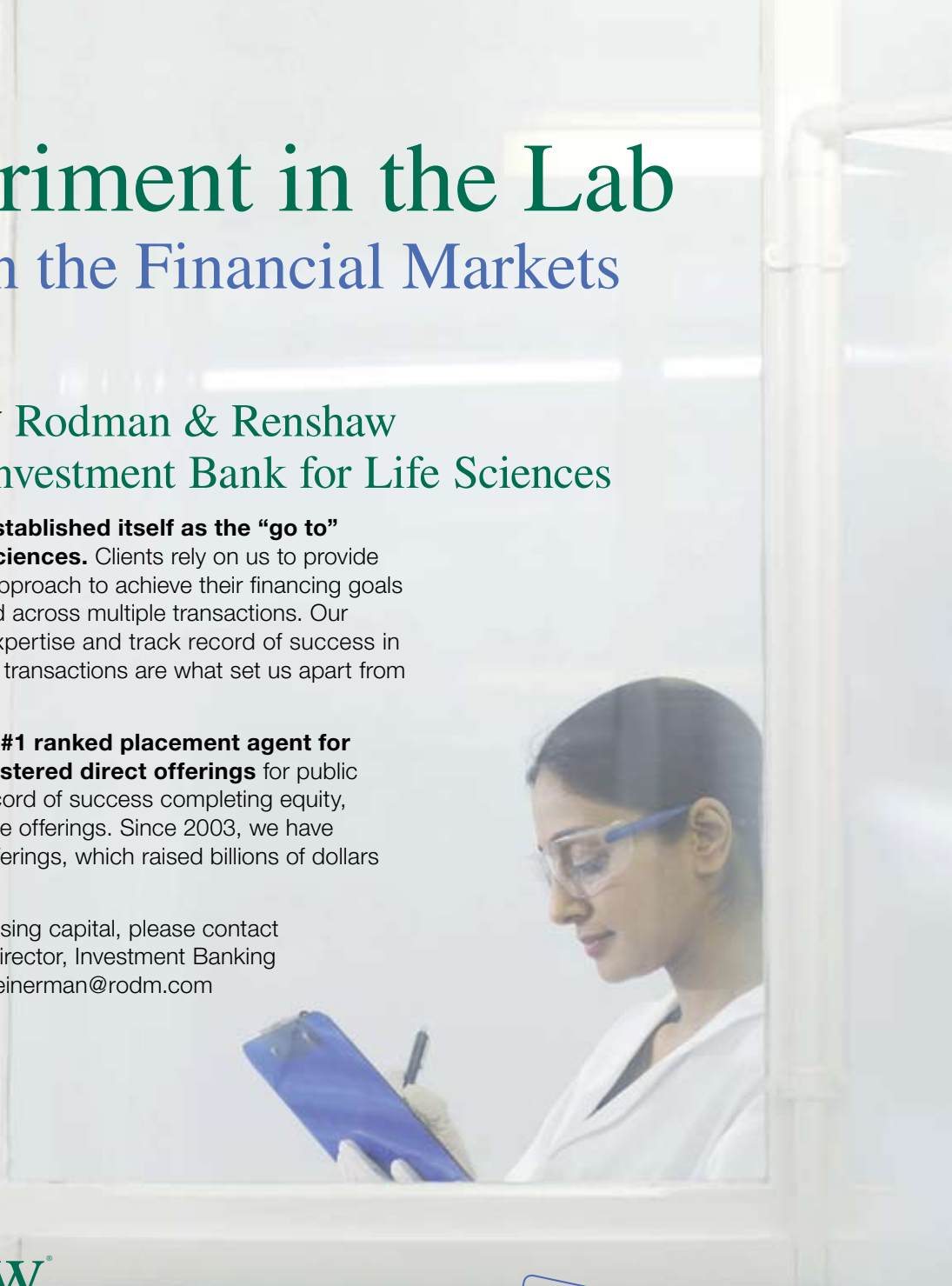
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March 1, 2010



Consistent PIPE Leadership

Top 10 Agents by Number of Deals

January 1, 2010–March 31, 2010

Rank	Placement Agent	Deal Count	USD Amount
1	Rodman & Renshaw, LLC	24	\$359,076,456
2	Roth Capital Partners, LLC	16	\$269,225,750
3	Chardan Capital Markets	10	\$117,794,053
4	RBC Capital Markets, Inc.	6	\$318,364,702
5	Lazard	6	\$194,250,000
6	Needham & Company, Inc.	6	\$142,089,363
7	Canaccord Adams, Inc.	5	\$121,835,165
8	Merriman Curhan Ford & Company	5	\$ 97,894,985
9	Robert W. Baird & Co.	4	\$155,114,995
10	Thomas Weisel Partners, LLC	4	\$ 64,853,564

Source: Sagient Research Systems, Inc. Totals from 01/01/10 through 03/31/10.

Placement Agency Ranking Summary 2005–2009 YTD

January 1, 2005–December 31, 2009

Year	Rank	Deal Count	Placement Agent
2009	1	77	Rodman & Renshaw, LLC
2008	1	44	Rodman & Renshaw, LLC
2007	1	52	Rodman & Renshaw, LLC
2006	1	49	Rodman & Renshaw, LLC
2005	1	29	Rodman & Renshaw, LLC

Source: Sagient Research Systems, Inc. Totals from 01/01/05 through 12/31/09.



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