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FNCE 174

Roche Case Study

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1. Why is Roche seeking to acquire the 44% of Genentech it does not own? From Roche's point of view, what are the advantages of owning 100% of Genentech? What are the risks?

Roche is seeking to acquire the other 44% of Genentech so that it can realize all of the competitive advantages of a merger without having to deal with the current conflicts of interest caused by the minority shareholders. The advantages of owning 100% of Genentech would be cutting costs and streamlining operations. They believe that they could obtain $750-$850 million in annual savings over the next five years. They also would be able to freely access Genentech’s increasing amount of cash that they have on hand. Also, Roche would gain access to the Genentech’s intellectual property, which would improve their research and development. Possible risks of owning 100% of Genentech would be a loss of key employees and managers that Genentech currently has and the possible loss of diversity with regard to research methods. Also, there is the risk of falling into financial trouble if they end up paying too much for the remaining shares.

1. As a majority shareholder of Genentech, what responsibilities does Roche have to the minority shareholders? (See “M&A Legal Context” below.)
   1. Why do minority shareholders need to be protected?

Because of potential conflicts of interest, Roche has to maintain an arm-length relationship with Genentech. This means that Roche cannot have access to Genentech’s intellectual property, create new agreements that would not be achievable on the open market, or have access to Genentech’s cash directly. Roche also has the responsibility to offer a fair price to minority shareholders in the event of a hostile takeover and cannot offer less than what would be offered during a tender offer. Minority shareholders need to be protected because they do not have always have a say on the board of directors and therefore cannot protected themselves form major changes that the company might make. It is important they are treated the same way as majority shareholders so that majority shareholders do not bully them to the point where they do not realize the full value of their shares.

1. As of June 2008, what is the value of the synergies Roche anticipates from a merger with Genentech? Assess the value of synergies per share of Genentech. Use a 9% weighted average cost of capital in your analysis.

The value of the synergies added per share of Genentech was $28.61. The value of the synergies added per share of Genentech that was dependent on the merger was $16.45.

1. Based on DCF valuation techniques, what range of values is reasonable for Genentech as a standalone company in June 2008? Please exclude synergies from your evaluation and use a 9% weighted average cost of capital. You can assume that as of the end of June 2008, Genentech held approximately $7 Billion in cash, which included investments in securities that were not needed in its daily operations. (Note: Exhibit 10 is a good starting point for this analysis.)

The range of values for Genentech as a standalone company in June 2008 would be between $71.96-$78.48 per share at an overall valuation of $75.7-$82.6 billion.

1. What does the analysis of comparable companies (exhibits 12, 13, and 14) indicate about Genentech's value within the range established in question 4?

Based on the ranged established in question 4, they would has similar one day premium of 13.4%, a slightly higher enterprise value / revenue ratio of 5.5x, and target price that fits well. Because of this the analysis of comparable companies indicated that Genentech’s currently is overvalued at $81.82 and should be more appropriately valued in the $70s.

1. How has the financial crisis affected Genentech's value? What changes in valuation assumptions occurred between June 2008 and January 2009?

The financial crisis did not strongly affect Genentech’s revenues and earnings, but it did cause their stock price to fall in line with the biotechnology industry. Changes in valuation assumptions because of the financial crisis included: slight decrease in revenue, slight decrease in EBIT, decrease in WACC, and increase in net working capital.

1. How did Genentech's board and management respond to Roche's offer of $89 per share?

Genentech’s board responded by forming a special committee to oversee the valuation process to make sure that there was no conflict of interest from board members who are current employees of Roche. This special committee sought outside financial and legal advice to evaluate Roche’s offer. After consulting with their outside help, the committee rejected the $89 offer and said that the offer unvalued Genentech. They did their own valuation of themselves and came to a conclusion that they are actually worth between $112-$115 per share.

1. What should Franz Humer do? Specifically, should he launch a tender offer for Genentech shares? What are the risks of this move? What price should he offer? Should he be prepared to go higher? How much new financing will Roche need to complete the tender offer?

Humer should launch a tender offer for Genentech shares. This is because the market brought the share price down to the low $70s which is very far off from the $112 per share value that the special committee made. This move does run the risk of losing key employees and managers to rival companies as Genentech employees would fear that the company culture would change. Also, this move runs the risk of Roche not gaining all of the shares to take over 100% of the company. Lastly, there is also a chance that the whole offer might not be properly funded. The price that he should offer would be $95 per share. This is the best offer he can make and should not be prepared to go higher. This is based off of the DCF valuation and the added synergies valuation. At this price, Roche would need $43.97 billion of new financing to complete the tender offer.