

DIABETES CLOSE UP

Diabetes Close Up, V3, #1
January 13, 2004
Abbott Buys TheraSense

1. **MediSense Plus TheraSense = A Lot of Sense:** More below on why Abbott's \$1.2 billion acquisition of TheraSense is smart both strategically and tactically for both companies.
2. **Diabetes Close Up commercial!** DCU's *Diabetes 2003 – 04: Diabetes Close Up* will publish its first annual diabetes/obesity roundup in early February ~ details below.

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1. **MediSense Plus TheraSense = A Lot of Sense, Super Acquisition Sense, Common Sense ...**
 - a. **Early this morning, Abbott announced it would purchase TheraSense for \$1.2 billion in cash, a 33% premium to yesterday's closing price.**
 - i. **Based on projected 2003 revenues of \$210 million for TheraSense, this represents a 5.7x multiple on trailing sales.**
 - ii. **In our opinion, this is a clear win for Abbott. TheraSense has been on a serious roll and has had a knockout last few months,** beating Q3 sales expectations, achieving its first profitable quarter, carrying off a brilliant product launch for Flash, and submitting its continuous glucose sensor, Navigator, to the FDA.
 - iii. **TheraSense reports full year 2003 sales later this month. Given the recent topline financial success in particular,** it would not be surprising to see the company outperform stated expectations, which would lower the multiple a bit, closer to the 2003 Roche/Disetronic 5.1x multiple.
 - iv. **Interestingly, the ~5.7x multiple represents roughly the same multiple that Abbott paid for MediSense in its \$876 million 1996 purchase,** though below multiples seen in other recent diabetes deals¹. The purchase price provides an excellent ROI by most measures for many investors (certainly the companies early investors and employees), and probably also represents disciplined negotiating from Abbott's perspective.
 - v. **We believe the success of this deal rests on Abbott's ability to retain and motivate key personnel as well as on the ultimate success of the Navigator –** if it's a hit, we believe the acquisition "works" – if not, it could be a costly purchase of market share. Still, this puts MediSense back in the game ...
 - vi. **More details after Abbott reports this Friday morning.**
 - b. **We see this as a technology, marketing, and momentum play for Abbott,** who gains:
 - i. **Robust technology and product pipeline:** In addition to impressive technology behind FreeStyle and Flash, Abbott now has a clear continuous monitoring strategy, via TheraSense's Navigator, submitted to the FDA in 2003². Notably, Abbott also gains substantial R&D brainpower through its purchase.
 - ii. **Excellent product portfolio, brand, and general momentum behind FreeStyle and FreeStyle Flash:** The TheraSense marketing team deserves kudos for FreeStyle and Flash performance to date. With TheraSense market share now approaching the 10% mark, the combined market share will significantly boost Abbott's share above Bayer's who they've been competing

¹ If you would like our M&A spreadsheet of diabetes deals, please write kclose@closeconcerns.com.

² Since MediSense's agreement with SpectRx was dissolved last year, the company hasn't appeared to have a clear strategy in this area, although it's also fair to say there's undoubtedly a lot going on in this area that remains under the public radar screen.

- with for a distant third place for some time, behind heavyweights J&J/LifeScan and Roche.
- iii. **Managed care leverage:** Payors will no doubt welcome the enhanced product portfolio, which gives Abbott much better critical mass.
 - iv. **Increased marketing resources:** TheraSense spent ~\$80 million in SG&A in the first three quarters of 2003. Although Abbott doesn't disclose MediSense spending, we can assume with Abbott's only recently-lifted consent decree, resources have been more scarce.
 - v. **Potential for increased profitability.** Although the blood glucose industry has had a tough year (pricing pressure caused by competition, product diversion, etc.), the newly combined MediSense/TheraSense entity should have enhanced profitability potential compared to what MediSense had alone. Although plans are unclear, opportunities for cost reduction in overhead functions will likely emerge. However, because Abbott will keep the Precision brand, at least for now, we assume manufacturing facilities will not be combined where otherwise some savings might be netted. We will look forward to hearing more on details that will tell us more about cost savings, such as sales force plans, headquarters location (we assume there will ultimately be only one), and ultimate product portfolio.
 - vi. **Energy:** TheraSense has been the clear growth player in blood glucose monitoring in 2003 (basically they're on a tear) and has historically played a real pioneering role in bringing new technologies to market.
- c. **Too, we see this as a real positive for TheraSense.** The company has executed extremely well in 2003, coming back impressively by every measure after a disappointing 3Q02. Abbott will bolster TheraSense in a range of respects, including:
- i. **Strong global presence:** As noted on the conference call, TheraSense sells direct only in the UK and Canada, while Abbott has substantially broader reach.
 - ii. **Key relationships:** Abbott brings valuable Fortune 50 kind of company experience in areas such as reimbursement and government affairs etc. This will gain importance as the combined entity moves forward on the continuous and other technological fronts. TheraSense did very heavy lifting in developing Navigator – nice for them to have some help in the next critical stretch of the product development. Although to date, Abbott has lagged J&J and Roche on the managed care front, we believe MediSense has key contracts that will undoubtedly welcome the broader portfolio.
 - iii. **Strong hospital presence:** The hospital market has been a tough market from a profitability perspective, which is likely why TheraSense has stayed out of it to date. The timing couldn't be better, however, as we believe this market will gain importance as a result of the recent ACE conference in mid-December. We'll be publishing a summary of this meeting later this month, but in short, the meeting presented indisputable evidence that glucose management needs dramatic improvement in-patient settings. Implications are many, but favor those with strong hospital relationships like Abbott and J&J.
 - iv. **Can the R&D engine keep running?** It will be imperative for Abbott to retain key personnel, especially the scientists that have been such a force to date.
- d. **Other musings:**
- i. **Good for the industry overall:** Clearly this underscores Abbott's commitment to diabetes and we assume they will continue to develop more drugs and nutritional products that can ultimately be co-marketed with their expanded product portfolio. We see this announcement as a signal to small diabetes companies that focusing on technology is the way to go ~ onward!
 - ii. **Other winners:** Besides the two companies and the industry, it seems to be other winners are the five research analysts that currently cover TheraSense, particularly Thom Gunderson of Piper Jaffray who upgraded the stock to Strong

Buy at \$12.50 in late October (historical ratings available on Yahoo)³ following a mid-July update to Outperform.

2. **Diabetes Close Up commercial!** DCU's *Diabetes 2003 – 04: Diabetes Close Up* will publish its first annual diabetes/obesity roundup in the coming weeks! Ordering information to follow on this volume, which contains information/features noted below. Please let us know if you are interested by e-mailing info@closeconcerns.com. The volume will contain:
- a. Detailed notes on 20 conferences in 2003, including ADA, AADE, EASD/IDF, NAASO
 - b. Top ten research articles of 2003
 - c. Ten great talks of 2003 (and how to get the tapes)
 - d. Top diabetes/obesity themes we saw in 2003
 - e. Diabetes/obesity forecast, 2004
 - f. Key conferences in 2004
 - g. DCU High Five Awards – the best products of 2003

Diabetes Close Up is a newsletter highlighting notable information and events related to selected companies with diabetes/obesity businesses. This newsletter is put forth as an unbiased commentary on the industry. If you have any suggestions or comments regarding content, please contact info@closeconcerns.com. If you would like to 1) unsubscribe; 2) receive a monthly digest rather than real-time updates; 3) add a name to the DCU mailing list; or 4) offer any suggestions or comments regarding content, please contact info@closeconcerns.com.

Disclosure: Kelly L. Close is a specialized consultant to the medical technology/pharmaceutical/biotech industries. Companies 1) in which Kelly Close has a personal investment; 2) that are clients of Close Concerns, Inc.; and/or 3) on which Kelly Close serves on a speaker's bureau, including Abbott, Animas, Amylin, Aventis, Johnson & Johnson, SimpleChoice, and TheraSense. All observations expressed are the opinions of Close Concerns alone and should not be viewed as recommendations to investors on any companies in the industry.

³ Other analysts covering TheraSense include Lynn Pieper of Thomas Weisel, Sara Michelmores of SG Cowen, Sam Chang and Phil Nalbhone of RBC Capital Markets, Al Kildani of CE Unterberg Towbin (the latter two initiated coverage in 2003).