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Ventana, Cytoc bids prescribe new value for Vision

Two US bids for an Australian diagnostics firm are good medicine for shareholders, writes **Bryan Frith**

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WHEN the US medical diagnostic group Ventana Medical Systems last month agreed on a \$450 million acquisition of Melbourne-based Vision Systems via a scheme of arrangement, there was consideration given to the possibility of a rival offer, which led to the insertion of a clause that Vision wouldn't announce a rival bid without first giving Ventana the opportunity to top it.

The MIA (merger implementation agreement) provided that Ventana would have two business days in which to submit a counter-proposal. If the Vision board considered it to be superior to the rival bid, then the target board must pursue Ventana's counter-proposal.

Yesterday, another US group, Cytoc Corp, announced a cash offer of \$2.35 a share - this was 22c a share, or 10 per cent, higher than Ventana's \$2.13 offer price, which lifts the value of Vision to \$497 million.

At first blush, it might be considered that Ventana was given the opportunity to counter the rival offer, but had declined, leaving the way clear for Cytoc.

That's not the case; Cytoc unilaterally announced its bid, which means that Vision didn't have the opportunity to consult with Ventana. It will now do so, and while the agreement refers to a two-day period, Vision considers that it is open to the company to allow Ventana more time in which to decide its position. Vision directors said yesterday that they were now discussing the Cytoc bid with Ventana.

The market is clearly speculating that an auction will develop. Yesterday, Vision's share price jumped 25c, or 11 per cent, to \$2.51 on a hefty turnover of 4.9 million shares. That's 16c, or almost 7 per cent, above Cytoc's offer price. At that price, Vision is capitalised at \$527 million.

To put the offer in context, the volume-weighted average price (VWAP) of Vision in the one month prior to August (when Vision obtained a trading halt ahead of announcing the Ventana offer) was \$1.56, and the VWAP for 12 months to August 9 was \$1.36. Cytoc's offer represents a premium of 84c, or 56 per cent to the one-month VWAP, and a whopping 99c, or 73 per cent, to the 12-month VWAP.

That suggests the market has either been undervaluing Vision, or that the US companies are overvaluing it.

Certainly, it suggests that the US bidders have a different concept of value than Australian investors. Twelve months ago, Vision was capitalised at just over \$200 million.

It's only weeks ago that Vision returned 40c a share to shareholders, via a capital reduction, following the sale of its non-core fire and security business for close to \$250 million. This was to enable the company to concentrate on its rapidly growing biomedical business.

Vision still holds cash of \$165 million, or 78c a share, which reduces the effective cost of the bids for the company.

The MIA contained "no shop" and the more restrictive "no talk" provisions, which meant that Vision could neither solicit a rival bid, nor enter into discussions in the event of an unsolicited bid, unless the directors considered that it was necessary to do so in order to fulfill their fiduciary duties.

The MIA also provided that Vision had to inform Ventana of any competing transaction and provide it with reasonable details of the proposal, subject to the directors not breaching their fiduciary duties.

It also provides for a break fee to Ventana of 1 per cent, or \$4.5 million, but, whereas many such agreements are payable if a higher bid is made, the fee is only payable once a rival bidder has obtained at least 90 per cent of Vision.

The target company and its adviser, Caliburn Partnership, have driven a hard bargain.

Ventana is being advised by Merrill Lynch; Cytyc is advised by Morgan Stanley.

Vision can terminate the MIA if a bona fide competing proposal is announced and the target directors consider that it's "more favourable" than the Ventana offer, and they have satisfied their obligation to give two days notice.

Vision directors have previously unanimously recommended Ventana's offer, in the absence of a superior offer and subject to independent expert Lonergan Edwards concluding that the scheme merger is in the best interest of Vision and its shareholders.

On that basis, Cytyc should expect that the Vision board will now recommend its bid, as it is higher, is less conditional, and provides for earlier payment. However, it's possible the Vision board will wait until Ventana has a chance to respond before revisiting its recommendation.

It's interesting to note that Ventana chose a scheme rather than a takeover bid. Takeovers offer more flexibility, but schemes provide lenders more certainty that the bidder will be able to access the target's cash-flow.

In this case, the scheme is still in the early stages. The explanatory memorandum is not due until the end of the month, with the scheme meeting to be held around November 2, and the final court hearing to approve the scheme scheduled for around November 10; so there's no impediment to Ventana boosting its bid price, if it wants to stay in the contest.

Cytyc's bid is unusual in that it is close to unconditional - there is neither a minimum acceptance condition, nor a financing condition - in fact, the only conditions are a MAC (no material adverse change) and the prescribed occurrences.

If the MAC were waived, Cytyc would normally be in a position to buy on the market - and a strategic stake could be handy to block the Ventana scheme. But Cytyc, as was Ventana, was allowed to conduct limited due diligence, which means that, now, it probably is in possession of some inside information and, therefore, unable to buy. It may also have had to give some undertakings in that regard before it was allowed to undertake due diligence.

Moreover, the market response has made the acquisition of a strategic stake unlikely at present, as Cytyc would have to at least match the highest price paid for any shares.

While acquisition of Vision would generate some synergy benefits, its bid has something of a defensive flavour to it. Vision and Ventana occupy the same space: both develop and manufacture medical diagnostic equipment which is used by pathology laboratories worldwide in the detection of cancer and infectious diseases.

Vision products are highly regarded. The company's sales jumped 48 per cent this year to \$116 million, and it has been taking market share from Ventana in the markets in which they compete.

Unlike Ventana, Cytoc is not a direct competitor to Vision. Cytoc provides diagnostic products to pathology labs which have applications for women's health, including cervical cancer. Cytoc has a much larger sales force than Vision and believes that this will enable it to drive greater sales growth than Vision could accomplish.

Institutional shareholders will decide Vision's fate. Investors Mutual owns 16 per cent of the capital, with hedge fund MM&E owning just on 6 per cent. Three nominees own a further 25 per cent - RBC (12.5 per cent), Westpac Custodians (7.4 per cent) and UBS Nominees (5.4 per cent).

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