

United States Senate

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Committee on Homeland Security and Governmental Affairs

Rob Portman, Chairman

**IMPACT OF THE U.S. TAX CODE ON THE
MARKET FOR CORPORATE CONTROL AND
JOBS**

MAJORITY STAFF REPORT

**PERMANENT SUBCOMMITTEE ON
INVESTIGATIONS**

UNITED STATES SENATE



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EXECUTIVE SUMMARY

The Senate Permanent Subcommittee on Investigations recently examined the effect of the U.S. tax code on the market for corporate control of American companies. The United States has the highest corporate tax rate in the industrialized world, and (alone among its peers) has retained a worldwide system that taxes American companies for the privilege of repatriating their overseas earnings. Meanwhile, most other nations with advanced economies have adopted competitive tax rates and territorial-type tax systems. As a result, U.S. firms too often have a significant incentive to relocate their headquarters overseas. Corporate inversions may be the most dramatic manifestation of that incentive, but the far greater part of the story concerns other more common forms of cross-border mergers and acquisitions.

Through a detailed review of several important cross-border transactions, our investigation found that the increase in after-tax profits created by escaping the U.S. tax net can (i) contribute significantly to foreign corporations' ability to acquire American firms; and (ii) create powerful incentives for American firms that merge with foreign corporations to locate their new combined headquarters abroad. Both phenomena can lead to a significant loss of American jobs, business headquarters, and tax revenues.

First, the Subcommittee examined three major acquisitions of U.S. companies by Valeant Pharmaceuticals, a successful, serial acquirer headquartered in Quebec. Since merging with a Canadian firm and relocating to Canada, Valeant has achieved a single-digit cash effective tax rate; according to its longtime CFO, that rate has “turbocharged” Valeant’s expansion by acquisition,¹ making it the sixth-largest OECD-based foreign acquirer of U.S. companies in terms of deal price, according to third-party data compiled by the Joint Committee on Taxation. When evaluating an acquisition, Valeant considers many factors but focuses on two key deal targets: the projected internal rate of return it can expect, and the “payback” period of the acquisition—the time it will take Valeant to recover its investment. As a guideline, Valeant generally seeks deals projected to achieve a 20% internal rate of return and a payback period of 6 years or less.

¹ Subcommittee Interview of Howard Schiller, Corporate Dir., Valeant Pharm. Inc. (July 24, 2015). Schiller elaborated: “I think the clear answer is that what really distinguishes Valeant is its ability to create value [through its business model]. . . . But its tax rate has augmented its growth. There is no question that we would not be in the same place we are in today if we had a higher tax rate. We have been able to plow that [after-tax profit] back in at very high rate of return.”

To understand the role of tax considerations in Valeant’s deals, PSI reviewed Valeant’s recent multibillion-dollar acquisitions of three U.S. companies: Mediciis, Bausch & Lomb, and Salix. Valeant’s primary valuation of target companies was based on an assumed U.S. tax rate of 36%—close to the U.S. target companies’ actual or projected rates. In each transaction we reviewed, however, Valeant performed a pre-acquisition tax analysis to determine the lower tax rate that could be achieved by integrating its U.S. target into Valeant’s corporate group headquartered in Canada. Applying that new, lower tax rate to the U.S. company’s future cash flow, Valeant evaluated the deal along the two key guidelines mentioned above—whether it could meet (or approximate) its targeted 20% return and 6-year payback period. In each case, Valeant’s ability to hit or approximate those targets depended to a large extent on its ability to lower the target company’s tax rate. In other words, tax savings helped justify the price that Valeant was able to pay while hitting its ambitious financial goals. Valeant’s projected post-acquisition tax savings for Bausch & Lomb alone exceeded \$3.6 billion over 10 years, and its projected tax savings for Salix exceeded \$560 million over 5 years. And although Valeant did not project specific tax savings for Mediciis, we estimate the potential savings at approximately \$680 million over 10 years.

It is important to note that none of these acquisitions were “tax-motivated” in the sense that Valeant was aiming to reduce its own tax liabilities. Instead, they illustrate that foreign acquirers that hail from more favorable tax jurisdictions are able to create value *simply* by restructuring the affairs of the U.S. target companies to improve their tax profile. In Valeant’s case, those tax savings significantly enhanced the deal along the key metrics that Valeant uses to decide whether to undertake an acquisition.

Second, the Subcommittee examined a major transaction that can be thought of as a “merger of equals”: Burger King’s \$11.4 billion merger with the Canadian restaurant business Tim Hortons. Our review showed that Burger King had clear business reasons to team up with Tim Hortons. But when deciding where to locate the headquarters of the combined firm, tax considerations flatly ruled out the United States from the outset. Burger King calculated that pulling Tim Hortons into the worldwide U.S. tax net, rather than relocating to Canada, would destroy up to \$5.5 billion in value over just five years. Far better, executives concluded, to put the new company in a country that would allow it to reinvest overseas earnings back in the U.S. and Canada without incurring new taxes.

Finally, the Subcommittee conducted a limited review of the tax and employment consequences of InBev’s 2008 acquisition of Anheuser Busch. Through

that deal, InBev was able to integrate a U.S. company with a pre-acquisition worldwide effective tax rate of approximately 39% into a worldwide corporate group with an effective tax rate of 19%. It is clear from the record that a significant number of U.S. jobs were lost following that acquisition. From 2007 to 2015, the number of U.S.-based employees of AB InBev declined by about 30%, while the number of employees based in Leuven, Belgium and the State of São Paulo, Brazil rose by 34%. In particular, the company's U.S. headcount was reduced from 18,345 in 2007 to 12,938 in 2015. That 30% reduction is significantly higher than the 10% to 15% decrease that Anheuser-Busch announced before the merger as part of its restructuring plan.

* * *

The lesson policymakers should draw from our findings is straightforward: The high U.S. corporate tax rate and worldwide system of taxation are competitive disadvantages that make it easier for foreign firms to acquire American companies. Those policies also strongly incentivize cross-border merging firms, when choosing where to locate their new headquarters, not to choose the United States. The long term costs of these incentives can be measured in a loss of jobs, corporate headquarters, and revenue to the Treasury.

BACKGROUND

To place the case studies that follow in context, we begin by briefly outlining the basic elements of the U.S. corporate tax code. We then turn to an overview of recent empirical research and academic commentary concerning the effect of the U.S. tax code on the ability of U.S. businesses to grow by acquisition, along with the tax advantages enjoyed by foreign acquirers in the market for corporate control. Finally, we describe the means by which foreign acquirers are often able to reduce the tax burden on U.S. firms.

The U.S. Corporate Tax System

America's approach to taxing corporate income is an outlier among industrialized nations. The United States has the highest statutory corporate tax rate among Organization for Economic Co-operation and Development (OECD) countries—a 39% combined state and federal rate,² well above the OECD average of

² *Table II.1. Corporate Income Tax Rate*, OECD.STAT (2015), <http://stats.oecd.org//Index.aspx?QueryId=58204> (last visited July 27, 2015).

25%.³ Even with a panoply of tax preferences that narrow the U.S. tax base, the average effective tax rate paid by U.S. corporations is still seven points higher than the OECD average effective rate.⁴

The United States is also one of few nations that has not yet adopted a territorial system of taxation.⁵ Instead, U.S. corporate income taxes apply worldwide. For financial accounting purposes, U.S. corporations can defer recording U.S. tax expense for the overseas earnings of their foreign subsidiaries by declaring such earnings to be permanently reinvested. As a consequence, apart from certain passive income subject to immediate taxation and cross-border related party sales and services income,⁶ U.S. corporations can defer U.S. tax on their overseas earnings indefinitely, both for tax and financial accounting purposes. These earnings are then effectively “locked out” of the U.S., due to the interaction of tax law and accounting standards.⁷ As of this year, U.S. corporations have accumulated approximately \$2.1 trillion dollars in locked-out overseas earnings—a sum increasing at an annual rate of about 8%.⁸

In contrast to the U.S. system, most of our major trading partners—including every other G-7 nation—have adopted territorial tax regimes, meaning that they tax business income earned within their borders but largely exempt business income earned outside their borders. Canada, for example, does not tax the overseas earnings of Canadian-owned businesses, so long as the earnings are derived from an active business in a country with which Canada has an income tax treaty or other qualifying agreement. As a result, unlike U.S. businesses, Canadian firms doing business abroad can simply pay taxes owed in the countries where they

³ *Id.*

⁴ See DUANJIE CHEN & JACK MINTZ, TAX FOUND., THE U.S. CORPORATE EFFECTIVE TAX RATE: MYTH AND FACT, 7 (Feb. 2014), available at <http://taxfoundation.org/sites/taxfoundation.org/files/docs/SR214.pdf>.

⁵ We use the shorthand “territorial” to describe systems of taxation that exempt foreign business income from resident-country taxation.

⁶ Subpart F of the tax code requires immediate taxation of most passive income, such as income and royalties. Subpart F income forms the principal exception to the deferral regime that governs most overseas income.

⁷ The Senate Finance Committee’s International Tax Reform Working Group recently released a report that provides a fuller treatment of the U.S. taxation of foreign earnings. See Senate Fin. Comm., Int’l Tax Reform Working Group: Final Report 15–55 (July 2015), available at http://www.portman.senate.gov/public/index.cfm/files/serve?File_id=923a866b-9c71-429a-a655-5dd0adef2caa.

⁸ *Id.* at 78.

operate, and then repatriate those earnings to Canada without incurring additional tax.⁹

Taxes and the Market for Corporate Control

Businesses buy and merge with other businesses primarily because of “ownership advantages”—the means by which an acquirer expects to create new value.¹⁰ Those advantages may take a number of forms. An acquirer might believe it can boost a target company’s profits through cost-cutting, improve sales through better marketing, or enhance productivity by integrating complementary technologies. An acquirer expects that its ownership advantages will increase the target firm’s future cash flow, thus “enabling the acquirer to outbid the reservation price of the initial owner[s] and increase the likelihood that the deal takes place.”¹¹ In other words, ownership advantages allow the acquirer to pay a premium—more than the target firm is valued by the market as a whole.

There is a growing body of evidence that simply being a non-U.S. acquirer—with access to a lower corporate tax rate and territorial system of taxation—has become a significant ownership advantage. In a recent paper, Professor Andrew Bird of Carnegie Mellon University reported strong empirical evidence that “U.S. based potential acquirers for U.S. targets are losing out to foreign acquirers who are tax-favored”—that is, foreign acquirers headquartered in countries with a territorial regime and a low corporate tax rate.¹² Bird found that the ability to access “locked-out” foreign earnings of U.S. firms drives foreign acquisition, and that the effect is strongest for foreign acquirers who have access to a territorial system:

If U.S. firms retain greater levels of foreign earnings overseas as a result of the U.S.’s worldwide tax system and the related financial reporting rules, these U.S. firms become more attractive targets for foreign buyers as the foreign buyers enjoy

⁹ ERNST AND YOUNG, CANADA-HONG KONG TAX TREATY ENTERS INTO FORCE 1 (Oct. 30, 2013), *available at*

[http://www.ey.com/Publication/vwLUAssets/Tax_Alert_2013_No_50/\\$FILE/TaxAlert2013No50.pdf](http://www.ey.com/Publication/vwLUAssets/Tax_Alert_2013_No_50/$FILE/TaxAlert2013No50.pdf).

¹⁰ THOMAS BELZ ET AL., TAX AVOIDANCE AS A DRIVER OF MERGERS AND ACQUISITIONS 1 (December 23, 2013) (unpublished manuscript), *available at*

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2371706.

¹¹ *Id.*

¹² Andrew Bird et al., *Does the U.S. System of Taxation on Multinationals Advantage Foreign Acquirers?* 35 (Rotman Sch. of Mgmt., Working Paper No. 2550819, 2015), *available at*

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2550819.

a tax-advantage resulting from the acquisitions. The tax-advantage is created by two primary factors. First, foreign acquirers have a tax-advantage related to locked-out past earnings of the U.S. multinational targets. Through the merger or acquisition a foreign acquirer may be able to free the multi-national's foreign subsidiaries' past earnings from the U.S. worldwide tax system by accessing those past earnings through 'out-from-under' strategies. Second, the foreign acquirer can exploit an additional tax-advantage on a go forward basis. With appropriate tax planning, future foreign (e.g., non-U.S.) earnings of the new entity could avoid or lower U.S. repatriation taxes that would exist under the old corporate structure.¹³

Based on a sample of more than 4,500 acquisitions of U.S. corporations from 1996 through 2010, Bird determined that “the baseline likelihood of an acquirer of a U.S. corporation being foreign is 17%,” but it rises to 23% if the U.S. target has foreign earnings/operations.¹⁴ In a related 2014 study, Bird found evidence that the more profitable a U.S. target firm is, the more likely it will be acquired by a foreign corporation rather than a U.S. firm. Bird explained that “the empirical results show that foreign acquirers systematically target more profitable firms for acquisitions,” and “[a]s would be expected if this observation is driven by tax differences, the results are strikingly larger for tax haven-resident acquirers.”¹⁵

Other researchers have reached similar conclusions. In 2009, economists at Tilburg University conducted an analysis of cross-border M&As involving the United States, Japan, and several European countries from 1985-2004.¹⁶ They found that “countries can attract additional parent companies by lowering international double taxation, either through lower tax rates or through more generous double tax relief”—that is, through reducing taxes on repatriation of

¹³ *Id.* at 4.

¹⁴ *Id.*

¹⁵ Andrew Bird, Domestic Taxes and Inbound Acquisitions 35 (July 6, 2015) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2627367. Bird also reported that U.S. firms with access to greater domestic tax deductions are less likely to be the target of inbound foreign merger and acquisition activity. *Id.* at 35–36.

¹⁶ See Harry P. Huizinga & Johannes Voget, *International Taxation and the Direction and Volume of Cross-Border M&As*, 64 J. OF FIN. 1217 (June 2009) available at <http://onlinelibrary.wiley.com/doi/10.1111/j.1540-6261.2009.01463.x/full>.

foreign earnings.¹⁷ Their study notes that high repatriation taxes decrease the likelihood that a nation will host the corporate headquarters of a domestic firm that merges with a foreign one. In the same vein, a related 2009 study concluded that multinational corporations that face high repatriation taxes, like U.S. businesses, are significantly more likely to relocate through merger and acquisition. The study's author urges policymakers to "consider that firms may vote with their feet and relocate headquarters" if their home-country system of taxation remains uncompetitive.¹⁸

As many industrialized nations have reformed their tax codes in recent years, experts have evaluated the effect of those reforms on the ability of businesses to grow by acquisition. A 2013 study by scholars at the Centre for European Economic Research examined the impact of Japan's 2009 decision to switch from a worldwide to a territorial system of taxation.¹⁹ The results were striking. Based on a large sample of cross-border mergers and acquisitions, the study found that Japan's reform "increased the number of foreign acquisitions by Japanese firms by 31.9%."²⁰ The study also simulated the effects of a U.S. transition to a territorial system and concluded that it would "increase . . . the number of international mergers and acquisitions with U.S. acquirers by 17.1%."²¹ The study's authors explained that "[r]epatriation taxes to be paid on a target's profits" reduce the valuation of the target and, consequently, "the bid price of U.S. investors is relatively lower than that of an identical investor from a [territorial] country."²²

Most recently, a 2015 study prepared by Ernst & Young for the Business Roundtable attempted to estimate the impact that a lower corporate tax rate would have on U.S. businesses' ability to grow by acquisition. From 2004–2013, U.S. companies were the acquirers in 20% of cross-border M&A activity by value and the

¹⁷ *Id.* at 1237.

¹⁸ Johannes Voget, *Headquarter Relocations and International Taxation 2* (Oxford Univ. Ctr. for Bus. Taxation, Working Paper No. 10/08, 2009) available at http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Working_Papers/Series_10/WP1008.pdf.

¹⁹ See Lars P. Feld, *Effects of Territorial and Worldwide Corporation Tax Systems on Outbound M&As 1* (Ctr. for Econ. Studies & Ifo Inst., Working Paper No. 4455, 2013) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2353329.

²⁰ *Id.* at 20.

²¹ *Id.* at 2.

²² *Id.* at 1. Other scholars have focused on a related investment distortion caused by the U.S. tax system's lock-out effect: ["Edwards et al. (2014) and Hanlon et al. investigate the effect of cash trapped overseas on U.S. multinational corporations' foreign acquisitions and find that firms with high levels of trapped cash make less profitable acquisitions of foreign target firms using cash consideration."]

target in 23% by value. Based on a review of 24,000 cross-border M&A transactions across 34 OECD countries, the report found that the United States would likely have been a net acquirer—rather than a net target—if the corporate rate were 25% (the OECD average).²³ Specifically, “[w]ith a 25% tax rate, US companies would have acquired \$590 billion in cross-border assets over the past 10 years instead of losing \$179 billion in assets (a net shift of \$769 billion in assets from foreign countries to the United States).”²⁴ The report also estimated that a 25% corporate tax rate would have “kept 1,300 companies in the U.S. over the last 10 years.”²⁵

Tax-based distortions of the market for corporate control raise serious economic concerns. Ownership of a business is, of course, “an important determinant of its productivity.”²⁶ Professor Bird explains that “if some potential acquirers have a purely tax-derived comparative advantage in acquiring certain assets, they may be able to outbid other potential acquirers that could make more productive use of the assets.”²⁷ In other words, tax distortions can produce inefficiencies, driving U.S. businesses into the hands of those best able to reduce tax liabilities, rather than those best equipped to manage and grow them—and thereby create jobs and increase wages. Bird notes that “[s]ince an acquirer’s post-deal tax savings are completely offset by government revenue losses at the global level, such a situation represents a clear deadweight loss, as the real productivity of the stock of assets is not maximized.”²⁸

Post-Acquisition Tax Planning

The tax advantages available to acquirers from other OECD nations derive principally from their comparatively lower domestic corporate tax rates and territorial systems of taxation. Those advantages do not, however, automatically transfer to the U.S. target company after an acquisition. Even if a U.S. target’s new parent is headquartered abroad, the U.S. target company itself remains a tax resident of the U.S., and the U.S. target’s foreign subsidiaries are still members of a U.S. corporate group. Consequently, a foreign acquirer must engage in some

²³ ERNST AND YOUNG, BUYING AND SELLING: CROSS-BORDER MERGERS AND ACQUISITIONS AND THE US CORPORATE INCOME TAX i (March 2015), *available at* <http://businessroundtable.org/sites/default/files/reports/EY%20BRT%20Cross-border%20MA%20report%202015%2003%2010.pdf>.

²⁴ *Id.*

²⁵ *Id.*

²⁶ Bird, *supra* note 12, at 1.

²⁷ *Id.*

²⁸ *Id.*

combination of tax planning and business reorganization to significantly reduce the tax burden on an acquired U.S. company.

On a long-term basis, a foreign acquirer can reorganize a U.S. firm so that “future foreign earnings of the pre-existing U.S. foreign subsidiaries are no longer subject to U.S. tax.”²⁹ That can be achieved through essentially “freezing” the value of the U.S. target firm’s foreign subsidiaries and the transferring of assets to non-U.S. affiliates of the foreign parent.³⁰ This so-called “out-from-under” planning is “highly fact specific and different strategies are used depending on the attributes of the firms involved.”³¹ The effect, however, is to incrementally pull the target firm’s non-U.S. business activity out from under the U.S. tax net, thereby freeing its overseas income from repatriation taxes.

Foreign acquirers can use other common tax-planning tools to more quickly reduce tax rates on U.S. firms after an acquisition. Foremost among them is the transfer of intellectual property to lower-tax jurisdictions and the use of intercompany debt. Post-acquisition transfers of intellectual property—whether by sale or license—result in taxable income for the acquired U.S. firm. Under section 482 of the tax code, a business that transfers intellectual property to a related party (*e.g.*, a foreign affiliate) must be compensated at an arms-length rate—one based on the property’s estimated market value. The effect of such intellectual property transfers, however, is to move important income-generating assets *out* of the U.S. group and into affiliates located in low-tax jurisdictions. Although the U.S. group will be compensated for the intellectual property as it was valued at the time of transfer, the foreign acquirer can source future income on that intellectual property outside the U.S. tax net—including income from business improvements that increase the value of the transferred intellectual property.

In addition, the Subcommittee reviewed a number of transactions in which the foreign acquirer has used acquisition debt to reduce the tax base of the U.S. target firm. Typically, the foreign firm will borrow from third-party banks at the foreign-parent level, and then push down some or all of that debt onto the balance sheet of the U.S. target company through an intra-group loan. The U.S. target is then able to make significant deductible interest payments to the foreign parent (or to a low-taxed subsidiary of the foreign parent)—subject to little or no U.S. federal withholding tax, depending on treaty arrangements. This strategy reduces the U.S.

²⁹ Bird *supra* note 12, at 15.

³⁰ *Id.*

³¹ *Id.* at 14.

target’s tax base in a high-tax jurisdiction, while allowing the foreign acquirer to earn interest income subject to little or (in some cases) no tax.³²

CASE STUDIES

As part of our investigation, the Subcommittee reviewed two types of cross-border transactions. First, through a series of briefings, interrogatories, and document requests, the Subcommittee reviewed more than a dozen recent significant foreign acquisitions of U.S. companies. We selected the Canadian-based drugmaker Valeant Pharmaceuticals International—a successful, serial acquirer—as an illustrative case study. *See* Part I, *infra*. To better understand how Valeant’s advantageous tax domicile has affected its expansion by acquisition, the Subcommittee focused on Valeant’s three largest acquisitions to date: Medicis Pharmaceutical Corporation (2012); Bausch & Lomb Holding Incorporation (2013); and Salix Pharmaceuticals, Ltd. (2015). The information in these case studies is drawn from more than 1,800 pages of key deal-related documents produced voluntarily by Valeant at the Subcommittee’s request, in addition to four rounds of detailed interrogatories and two staff interviews with Valeant executives.

Second, the Subcommittee also reviewed several “merger of equals” transactions in which a U.S. company combined with a foreign counterpart and chose to place the combined company’s headquarters abroad. In this report, we describe the 2014 merger of Burger King Worldwide with Tim Hortons, Inc., which combined to form the Canada-based Restaurant Brands International (RBI). *See* Part II, *infra*. The information in the RBI case study is drawn from more than 500 pages of key deal-related documents produced voluntarily at the Subcommittee’s request, in addition to two rounds of interrogatories and three staff interviews with RBI executives.

In addition to being reflective of broader trends, both the Valeant transactions and the Burger King transactions are economically significant. At the Subcommittee’s request, the Joint Committee on Taxation used the Zephyr database published by Bureau van Dijk to compile a list of the top twenty OECD-based buyers of U.S. target companies by deal value over the past decade. Valeant ranks sixth. The ranking also puts the \$11.4 billion value of the Burger King/Tim

³² Current law provides certain rules and limitations associated with interest expense on intra-group and third party financing of domestic companies operating abroad (i.e., subpart F and foreign tax credit limitation) and on intra-group financing of foreign companies operating in the U.S. (i.e., section 163(j) deduction limitation).

Hortons merger in context; had the Bureau van Dijk classified it as an inbound acquisition, the transaction would have made the top-twenty list.

| Top OECD-Based Buyers of US Targets by Value of Deals, 2006-2015 | | | |
|---|----------------|-------------------------|-------------------------------|
| Foreign Company Name | Country | Deal Value (\$B) | Number of Transactions |
| ACTAVIS PLC | IE | 95.4 | 3 |
| MEDTRONIC HOLDINGS LTD | IE | 60.7 | 1 |
| ROCHE HOLDING AG | CH | 60.4 | 12 |
| INBEV SA | BE | 52.0 | 1 |
| TEVA PHARMACEUTICAL | IL | 28.2 | 8 |
| VALEANT PHARMACEUTICALS | CA | 27.2 | 9 |
| AERCAP IRELAND LTD | IE | 26.4 | 1 |
| SANOFI-AVENTIS SA | FR | 25.2 | 4 |
| LIBERTY GLOBAL PLC | GB | 24.0 | 2 |
| BASELL BV | NL | 20.0 | 1 |
| NEW MOON BV | NL | 18.8 | 1 |
| TORONTO-DOMINION BANK | CA | 18.7 | 6 |
| ASTRAZENECA PLC | GB | 17.8 | 5 |
| SUNTORY HOLDINGS LTD | JP | 16.0 | 1 |
| ZF FRIEDRICHSHAFEN AG | DE | 13.5 | 1 |
| ALCATEL SA | FR | 13.4 | 1 |
| NESTLE SA | CH | 12.0 | 4 |
| NATIONAL GRID PLC | GB | 11.8 | 1 |
| BANCO BILBAO VIZCAYA ARGENTARIA SA | ES | 11.7 | 4 |
| REYNOLDS GROUP HOLDINGS LTD | NZ | 10.9 | 4 |

Source: Zephyr published by Bureau van Dijk and JCT Calculations.³³

After reviewing the Valeant and Burger King transactions in Parts I and II of this report, we conclude in Part III with a brief description of one of the most famous inbound acquisitions in recent history—InBev’s 2008 acquisition of Anheuser-Busch—with particular focus on the potential U.S. employment effects.

A preliminary note on tax terminology is in order. In the analysis that follows, we refer to *GAAP* effective tax rates, *non-GAAP* effective tax rates, and *cash-based* effective tax rates. For clarity, the GAAP effective tax rate is prepared

³³ The Joint Committee on Taxation used third-party data that prices deals slightly differently than the method used by Valeant, as described in Part I. As a result, Valeant’s estimate of the total value of its U.S. acquisitions is higher than the estimate reflected in the table above.

on an accrual basis of accounting; it is the rate that is publicly disclosed in Securities and Exchange Commission filings. For management purposes, however, companies commonly maintain their tax rate on a non-GAAP basis or cash basis. A non-GAAP effective tax rate is an accrual-based tax calculation (similar to GAAP), but has typically been adjusted to exclude the tax effect of certain non-recurring items. It typically represents the accrual-based tax rate on management income. A cash-based effective tax rate reflects only cash taxes paid, including certain one-time tax benefits that are not typically reflected in GAAP-based reporting.

In analyzing the transactions we studied, we adopted the rate calculation used by the acquiring firm. For example, Valeant uses a cash-based effective tax rate for management purposes and in analyzing acquisitions. Accordingly, we primarily rely on cash rates in our discussion of the Valeant acquisitions, and where possible we have drawn comparisons to this cash-based rate. By contrast, Burger King Worldwide relied primarily on GAAP effective tax rates in its acquisition-related analysis. We followed suit in that case study.

I. Valeant Pharmaceuticals: Successful Foreign Acquirer

Valeant Pharmaceuticals International, Inc., is a Canadian-based multinational specialty pharmaceutical company. With \$8.3 billion in revenues last year and market capitalization of more than \$81 billion,³⁴ Valeant has seen remarkable growth since its predecessor firm was formed through the 1994 consolidation of four smaller pharmaceutical companies with \$500 million in combined annual sales.³⁵ The company has operations across six continents, with activity in both developed and emerging markets. Its products include both over-the-counter and prescription drugs, with a focus in dermatology, eye health, neurology, gastrointestinal medicine, and consumer health care.³⁶ Among dozens of

³⁴ *Valeant Pharmaceuticals Reports Fourth Quarter And Full Year 2014 Financial Results*, VALEANT PHARMACEUTICALS INTERNATIONAL, INC. (Feb. 22, 2015), <http://ir.valeant.com/investor-relations/news-releases/news-release-details/2015/Valeant-Pharmaceuticals-Reports-Fourth-Quarter-And-Full-Year-2014-Financial-Results/default.aspx>.

³⁵ ICN Pharm., Inc., Annual Report (Form 10-K) (Dec. 21, 2001); *ICN Pharmaceuticals Merging With Affiliates*, N.Y. TIMES (Aug. 3, 1994), <http://www.nytimes.com/1994/08/03/business/company-news-icn-pharmaceuticals-merging-with-affiliates.html>. The combined corporation was renamed Valeant in 2003.

³⁶ *Description Valeant Pharmaceuticals International Inc.*, WALL ST. J., <http://quotes.wsj.com/VRX/company-people> (last visited July 28, 2015).

other medicines, Valeant's portfolio includes drugs such as Wellbutrin XL, used for the treatment of depression, and Ativan, used for the treatment of anxiety.³⁷

Originally a U.S. corporation based in California,³⁸ Valeant merged with Canada's largest publicly traded drugmaker, Biovail Corporation, in 2010, with Biovail surviving as the parent. The Biovail deal was a merger-of-equals transaction, with Biovail (market cap. \$2.6 billion) acquiring Valeant (market cap. \$3.5 billion)³⁹ and the combined entity renamed Valeant Pharmaceuticals International.⁴⁰ The combined company moved its global headquarters to Ontario, Canada before relocating to Quebec in 2012.⁴¹ After the acquisition, former Biovail shareholders owned 50.5% of the new firm, while former Valeant shareholders received 49.5%, along with an additional cash dividend.⁴² The companies touted the merger as an opportunity to expand their presence in the U.S. and Canada and build on their core strengths in neurology, dermatology, and branded generic drugs.⁴³ Valeant CEO J. Michael Pearson also noted the collateral tax advantages of placing the combined company in Canada: "We had to do this sooner rather than later from a standpoint of gaining this tax rate."⁴⁴ Market analysts commented that the deal was "tax efficient, given that the corporate tax rate in Canada is between 10–15% compared with the 35% Valeant was expected to pay [in 2010]."⁴⁵ Through the merger, Valeant effectively stepped out of a tax regime with a 35% statutory rate

³⁷ *Home » Operational Expertise » Valeant United States*, VALEANT PHARM. INT'L, INC., <http://www.valeant.com/operational-expertise/valeant-united-states> (last visited July 28, 2015).

³⁸ Valeant was known at the time as Valeant Pharmaceutical International.

³⁹ Phil Serafino, *Valeant, Canada's Biovail to Combine in Stock Deal*, BLOOMBERG BUS. (June 21, 2010), <http://www.bloomberg.com/news/articles/2010-06-21/valeant-pharma-canada-s-biovail-corp-agree-to-merge-in-stock-transaction>.

⁴⁰ Andy Georgiades, *Biovail Says Valeant Deal Rockets Company into the Future*, WALL ST. J. (June 21, 2010, 1:54 PM), <http://www.wsj.com/articles/SB10001424052748704895204575320350568757726>.

⁴¹ Richard Blackwell, *Drug Giant Valeant Moving Global Head Office to Montreal Region*, GLOBE AND MAIL (Apr. 03, 2012, 10:53 AM), <http://www.theglobeandmail.com/globe-investor/drug-giant-valeant-moving-global-head-office-to-montreal-region/article4097610/> (last modified Sept. 06, 2012, 12:59 PM).

⁴² *Id.*; Pav Jordan and Esha Dey, *Drugmaker Biovail to Buy Valeant in \$3.3 Billion Deal*, REUTERS (June 21, 2010, 5:03 PM), <http://www.reuters.com/article/2010/06/21/us-biovail-valeant-idUSTRE65K1LA20100621>.

⁴³ Andy Georgiades, *Biovail Says Valeant Deal Rockets Company into the Future*, WALL ST. JOURNAL (June 21, 2010, 1:54 PM),

<http://www.wsj.com/articles/SB10001424052748704895204575320350568757726>.

⁴⁴ Pav Jordan & Esha Dey, *Drugmaker Biovail to buy Valeant in \$3.3 billion deal*, REUTERS (June 21, 2010, 5:03 PM), <http://www.reuters.com/article/2010/06/21/us-biovail-valeant-idUSTRE65K1LA20100621>.

⁴⁵ SeekingAlpha, *A Closer Look at the Biovail – Valeant Merger*, NASDAQ (June 23, 2010, 3:34:39 AM). <http://www.nasdaq.com/article/a-closer-look-at-the-biovail-valeant-merger-cm26039#ixzz3gY9bopYq>.

and worldwide system of taxation with deferral and opted into a tax regime with a 27% statutory rate and territorial system of taxation.⁴⁶

Since the merger, Valeant has achieved single-digit cash effective tax rates on both its U.S. and worldwide income. Its GAAP effective tax rate has varied widely due in part to its acquisition activity, but it appears to have reached a steady rate in the mid-teens.⁴⁷ Valeant uses a cash-based effective tax rate for management purposes and in analyzing acquisitions. Accordingly, we primarily rely on cash rates, and where possible, we have drawn comparisons to this cash-based rate.

| Valeant – Tax Rates ⁴⁸ | | | | | | | |
|-----------------------------------|--------|--------------------|-------|-------|-------|--------------------|-------|
| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
| Worldwide cash effective tax rate | 5.9% | 4.5% | 2.8% | 3.1% | 3.3% | 3.3% | 3.9% |
| U.S. cash effective tax rate | 0% | 0.6% | 0.6% | 0% | 0.8% | 177% ⁴⁹ | 10.1% |
| Worldwide GAAP effective tax rate | 11.9% | 986% ⁵⁰ | 70.6% | 34.3% | 16.5% | 17.4% | 14.6% |
| U.S. GAAP effective tax rate | -10.5% | 48% ⁵¹ | 34.6% | 27.4% | 4.4% | — | — |

⁴⁶ See PRICEWATERHOUSECOOPERS, TAX FACTS AND FIGURES: CANADA 2011 (2011), available at <https://www.pwc.com/ca/en/tax/publications/tax-facts-figures-2011-en.pdf>.

⁴⁷ In general, Valeant’s cash tax rate is lower than its GAAP rate because certain tax benefits that cannot be recognized in the rate for GAAP accounting purposes can be recognized in the cash-based rate. In general, these include (but are not limited to) the benefit of acquired net operating losses, acquired tax credits, and certain benefits related to stock option deductions.

⁴⁸ Valeant’s U.S. GAAP effective tax rate was 27.4% in 2013 and 4.4% in 2014. Letter from Valeant to PSI (July 7, 2015), 6 (“Valeant Resp. II”). Valeant’s worldwide GAAP effective tax rate was 34.3% in 2013 and 16.5% in 2014, and it is projected to be 17.4% in 2015 and 14.6% in 2016. Letter from Valeant to PSI (June 10, 2015), 4 (“Valeant Resp. I”). As explained above, the Majority Staff has focused on cash effective tax rates.

⁴⁹ Valeant’s U.S. cash tax rate spiked in 2015 due to “the timing of items with respect to which the company previously recorded a deferred tax liability for future book expenses that are not deductible for federal tax purposes.” Valeant Resp. II, 5.

⁵⁰ Valeant’s 2011 worldwide GAAP effective tax rate spiked due to the jurisdictional mix of where Valeant earned its profits and losses. Due to the fact that the company does not record benefits for all its tax losses for U.S. GAAP purposes, the large losses generated in jurisdictions such as Canada contributed to a lowered denominator, and thus resulted in a higher GAAP effective tax rate.

⁵¹ Valeant’s U.S. GAAP effective tax rate spike in 2011 was due to the jurisdictional mix of where Valeant earned its profits and losses. Valeant Resp. II, 5. “[L]arge losses in jurisdictions including Canada reduced its operating income, thus resulting in a higher effective rate.” *Id.*

Howard Schiller, Valeant’s Chief Financial Officer from 2011 through June 2015, told the Subcommittee that Valeant’s low tax rate, made possible by the merger with Biovail, has “turbocharged” Valeant’s expansion by acquisition.⁵² Indeed, Valeant has experienced a recent period of rapid growth, fueled largely by the acquisition of U.S. businesses. Since 2010, Valeant has completed acquisitions with a total value of approximately \$36 billion, including \$30 billion in acquisitions of U.S. corporations.⁵³ As noted above, Valeant is now the sixth-largest foreign acquirer of U.S. companies in terms of deal value.⁵⁴ *Forbes* summarized the thinking of many market observers: “When it comes to value-oriented stock investors, many are looking for the Valeant Pharmaceuticals in every sector: serial dealmakers that use tax advantages to consolidate entire industries, wrenching out billions in synergies, transforming from also-rans into global powerhouses.”⁵⁵

Valeant considers many factors in evaluating and pricing a potential acquisition, but two key metrics predominate.⁵⁶ First, Valeant looks to the “projected internal rate of return to understand the overall magnitude of the capital allocation opportunity.”⁵⁷ Valeant also considers an acquisition’s “payback period”—the projected time period it will take to fully recover Valeant’s investment—“to understand speed of return and forecast risk.”⁵⁸ To determine whether a new acquisition is worth the contemplated acquisition price, Valeant generally seeks deals projected to achieve a 20% internal rate of return and a payback period of 6 years or less.⁵⁹ In his written testimony to the Subcommittee,

⁵² Subcommittee Interview with Schiller (July 24, 2015). Schiller elaborated: “I think the clear answer is that what really distinguishes Valeant is its ability to create value [through its business model]. . . . But its tax rate has augmented its growth. There is no question that we would not be in the same place we are in today if we had a higher tax rate. We have been able to plow that [after-tax profit] back in at a very high rate of return.” *Id.*

⁵³ Data gathered from publicly available Valeant announcements. *See* Valeant Pharmaceuticals Investor Relations News Releases: <http://ir.valeant.com/investor-relations/news-releases/2014/default.aspx>.

⁵⁴ *See* Table 1, *supra*.

⁵⁵ Antoine Gara, *Could Avago Become the Valeant Pharmaceuticals of the Semiconductor Sector?*, FORBES (May 28, 2015, 2:24PM), <http://www.forbes.com/sites/antoinegara/2015/05/28/could-avago-become-the-valeant-pharmaceuticals-of-the-semiconductor-sector/>.

⁵⁶ Subcommittee Interview with Howard Schiller, *supra* note 1.

⁵⁷ Valeant Resp. II, 3.

⁵⁸ Valeant Resp. II, 3.

⁵⁹ Written Statement of Howard Schiller, Corporate Dir., Valeant Pharm. Int’l, Inc. (July 24, 2015); Briefing with Howard Schiller & Jeremy Lipshy, Corporate Dir. & Dir. of Int’l Tax Planning, Valeant Pharm. Int’l, Inc. (April 10, 2015). Mr. Schiller later noted that, when seeking to acquire large public

Mr. Schiller described Valeant’s strategy as a “financially disciplined approach” and explained that Valeant’s “financial guidelines have allowed us to stay disciplined in our acquisition strategy, and we are proud that—while not every acquisition has paid off—overall our strategy has succeeded, and on the whole we have surpassed these financial targets.”⁶⁰ As a result, the “majority of [Valeant’s] transactions are delivering above our targeted 20 percent internal rate of return.”⁶¹

In each of the acquisitions reviewed by the Subcommittee, Valeant relied on the ability to achieve lower tax rates in order to meet those key goals. Valeant’s primary valuation of target companies is based on an assumed tax rate of 36%. In the transactions we reviewed, however, Valeant performed a pre-acquisition tax analysis to determine the potential effective tax rate that could be achieved by integrating the target into its worldwide corporate group headquartered in Canada. Applying that new, lower tax rate to the target company’s future cash flow, Valeant evaluated key deal metrics, including internal rate of return and payback period. In each case reviewed by the Subcommittee, Valeant’s ability to hit or approximate the targets of 20% return and 6-year payback period appears to have largely depended on its ability to lower the target company’s effective tax rate.

A. The Medicis Acquisition

Valeant’s first major purchase after the Biovail merger was its December 2012 acquisition of Medicis, a pharmaceutical company headquartered in Scottsdale, Arizona. Valeant paid \$2.6 billion (or \$44 per share) in an all-cash deal. The \$44 price per share paid by Valeant represented a 39% premium on Medicis’s closing share price before the acquisition was announced. Valeant explained the acquisition primarily as a means of expanding its reach and offerings in dermatology.⁶²

Valeant and its target had dramatically different tax profiles. Before the acquisition, Medicis had a U.S. cash effective tax rate of 30.3% in 2010 and 25% in

companies, Valeant does not always expect 20% return. *See* Subcommittee Interview with Howard Schiller, *supra* note 1.

⁶⁰ Written Statement of Howard Schiller, Corporate Dir., Valeant Pharm. Int’l, Inc. (July 24, 2015).
⁶¹ *Id.*

⁶² *See Valeant Pharmaceuticals International, Inc. Agrees to Acquire Medicis Pharmaceutical Corporation for \$44.00 Per Share in Cash*, VALEANT PHARM. INT’L, INC. (Sept. 03, 2012), <http://ir.valeant.com/investor-relations/news-releases/news-release-details/2012/Valeant-Pharmaceuticals-International-Inc-Agrees-To-Acquire-Medicis-Pharmaceutical-Corporation-For-4400-Per-Share-In-Cash1130/default.aspx>.

2011.⁶³ Medicis had no significant non-U.S. income. By contrast, Valeant had a U.S. cash effective tax rate of 0% and 0.6% in 2010 and 2011, respectively, and a worldwide cash effective tax rate of 5.9% and 4.5% in 2010 and 2011, respectively.⁶⁴

As part of its due diligence, Valeant reviewed Medicis’s recent tax returns and determined that it was possible to reduce Medicis’s effective tax rate by integrating the company into Valeant’s worldwide corporate group. In an August 2013 presentation to the Valeant board, Valeant executives forecasted that it would be possible to achieve a “20% effective tax rate post acquisition” on legacy Medicis profits.⁶⁵ Using a preliminary model, Valeant compared the economics of the Medicis acquisition using two potential tax rates: 36%, the applicable statutory federal and state corporate tax rate; and 20%, the worldwide cash tax rate Valeant thought it could achieve through post-acquisition tax planning.⁶⁶ Not surprisingly, the analysis showed that the tax advantages available to Valeant made the Medicis acquisition significantly more attractive along key deal metrics.

| Medicis Acquisition Base Case Projections (at \$44/share) | | | | |
|--|--------------|---------------|-----------------|--------------------------------------|
| | Valeant Goal | 36% Tax Rate | 20% Tax Rate | <i>Tax Differential⁶⁷</i> |
| Net Present Value of Deal Gains | — | \$981 million | \$1.721 billion | <i>\$740 million</i> |
| Internal Rate of Return | 20% | 14% | 17% | <i>3%</i> |
| Payback Period | 6 years | 9.1 years | 7.2 years | <i>1.9 years</i> |

As the table above illustrates, Valeant projected that it could significantly enhance its return on the Medicis acquisition by integrating it into a corporate group based in Canada. When evaluated at a tax rate close to the U.S. statutory rate, the net present value of the Medicis deal gains (at the ultimate acquisition price of \$44/share) was \$981 million.⁶⁸ That value increased by 75% (or \$740

⁶³ Valeant Resp. I, 3.

⁶⁴ Valeant Resp. I, 4.

⁶⁵ App. 51 (VRXPSI-01-0087).

⁶⁶ App. 52-53 (VRXPSI-01-000092-93).

⁶⁷ It is important to note that what we term the “tax differential” derives both from anticipated tax savings and expected return on reinvestment of those savings in Valeant’s business.

⁶⁸ Specifically, as calculated by Valeant, deal gains is the difference between the “synergized” net present value of the target—that is, the value of the target after accounting for profit-boosting reforms planned by Valeant—and the cost of the deal—that is, the aggregate purchase price of the

million) to \$1.72 billion when viewed through the lens of a foreign acquirer capable of reducing the target company’s cash effective tax rate to 20%. Similarly, the internal rate of return on the Medicis acquisition rose from 14% to 17% when Valeant’s tax planning advantages were accounted for. And Valeant determined that its investment in Medicis would pay for itself faster—within 7.2 years rather than 9.1 years—at a 20% tax rate.

Significantly, the only scenario that met or exceeded both of Valeant’s key targets—a 20% internal rate of return and 6-year payback period—was the company’s “upside” scenario at the projected lower tax rate, as displayed in the table below.⁶⁹ With the benefit of a 20% tax rate, Valeant projected the deal would yield an impressive 23% internal rate of return and would pay for itself in 5 years.⁷⁰ Without those tax benefits, the deal missed the mark.

| Medicis Acquisition Upside Case Projections (at \$44/share) | | | | |
|--|--------------|----------------|-----------------|-------------------------|
| | Valeant Goal | 36% Tax Rate | 20% Tax Rate | <i>Tax Differential</i> |
| Net Present Value of Deal Gains | — | \$2.28 billion | \$3.364 billion | <i>\$1.06 billion</i> |
| Internal Rate of Return | 20% | 19% | 23% | <i>5%</i> |
| Payback Period | 6 years | 6.2 years | 5 years | <i>1.2 years</i> |

Valeant “anticipated that its effort to integrate [Medicis into Valeant] would yield significant savings,” but it did not specifically quantify the savings.⁷¹ Post-acquisition tax savings, however, can be approximated based on Valeant’s projection of the achievable effective tax rate for Medicis done as part of the deal analysis. Assuming a cash effective tax rate of 20% post-acquisition compared to a 36% rate,

target. “In other words, it represents the excess of the company’s estimate of the synergized value of the business being acquired over the amount expected to be paid to acquire that business.” Letter from Valeant to PSI (July 21), 3 (“Valeant Resp. III”). Valeant states that it does not rely on NPV when evaluating potential acquisition transactions, but that figure features very prominently in its Board presentations alongside what the company describes as key deal metrics. *See* App. 50, 52, 53 (VRXPSI-01-0000081, 92, 93); *see also* App. 62, 65 (VRXPSI-01-0000613, 624).

⁶⁹ App. 53 (VRXPSI-01-000093).

⁷⁰ *See* App. 52-53 (VRXPSI-01-000092-93).

⁷¹ Valeant Resp. I, 9.

the acquisition by Valeant could yield approximately \$680 million in tax savings over 10 years.⁷²

1. Intellectual Property Transfers

Before the acquisition, all of Medicis’s intellectual property was held in the United States, and all royalties were earned in the United States.⁷³ Within four months of the acquisition, Valeant transferred Medicis’s intellectual property portfolio to low-tax foreign jurisdictions, with the exception of products that Valeant had sold or discontinued.⁷⁴ It achieved this through a multi-step process. To simplify, the newly acquired Medicis granted Valeant-Canada⁷⁵ a license to all its intellectual property. Valeant-Canada sub-licensed that newly transferred Medicis intellectual property to other entities, ultimately consolidating the rights to Medicis’s patents in Valeant’s Irish subsidiary (Valeant Holdings Ireland or VHI) and (for a short time) Valeant’s U.S. group.⁷⁶

The object of these intellectual property transfers was to shift abroad the upside of any future appreciation in the value of Medicis’s property. To understand why, it is important to note that transferring intellectual property outside the country does have a cost. Under section 482 of the tax code, Valeant’s foreign affiliates were required to compensate Valeant’s U.S. group for the intellectual property transfer at an arms-length rate—which results in taxable income in the United States. To simplify, that transaction must be priced to reflect the value of the intellectual property at the time of the transfer. But as a consequence, if the transferred intellectual property later appreciates in value, the *accretion* will be taxed at the lower foreign rate. If the intellectual property unexpectedly depreciates, the guarantee royalty payment mandated by section 482 will cause a loss.

Here, Valeant essentially placed a bet that transferring Medicis’s intellectual property overseas would be worth the upfront tax cost. To comply with section 482,

⁷² This estimate assumes a 10-year operating income of \$4.26 billion from 2013 through 2022 based on Medicis’s projected income in 2013, 2014, and 2015, and further assuming that its income held steady from 2015 to 2022. *See* App. 85 (VRXPSI-02-000086). Medicis’s analyst-projected future tax rate was 39.5%. *Id.*

⁷³ Valeant Resp. II, 3.

⁷⁴ “[T]wo legacy Medicis products were sold to unrelated parties in separate transactions, and five legacy Medicis products were discontinued or abandoned.” Valeant Resp. II, 8.

⁷⁵ Where necessary for clarity, we refer to the Canadian parent company, Valeant Pharmaceuticals International, Inc., as “Valeant-Canada.”

⁷⁶ *See* Valeant Resp. I, 6.

when Valeant transferred Medicis’s intellectual property abroad, it set up tiered royalties payments (at rates between 20% to 35% depending on the level of net sales for each product) that Valeant’s non-U.S. affiliates must pay to Valeant’s U.S. group in exchange for the transfer; those payments are taxable in the United States.⁷⁷ Since 2013, Valeant’s non-U.S. affiliates have paid \$156 million in U.S.-taxable Medicis royalties to the U.S. group.⁷⁸

But Valeant concluded that it was worth the price. Valeant’s pre-acquisition Board presentation predicted that additional taxes on Valeant’s transfer of Medicis intellectual property would be offset by the fact that “[i]ncreased profits attributable to synergies will be taxed at less than 4%.”⁷⁹ Through the intellectual property transfers, Valeant ensured that (except for the tiered royalties described above) future income derived from Medicis’s intellectual property would be earned by entities outside the United States. In the first full year following the acquisition, while it *received* the inbound royalty payments described above, Valeant’s U.S. group also *paid* significant royalties to Valeant Pharmaceuticals Luxembourg (VPL) and Valeant-Canada for use of transferred Medicis intellectual property.⁸⁰ Those outbound royalty payments are then taxed at the lower Canadian or Luxembourg rates.

After the 2013 Bausch & Lomb acquisition, however, those outbound payments ceased because Valeant further restructured its intellectual property portfolio. As described in greater detail below (*see* I.B.1 *infra*), in 2013, Valeant consolidated much of its worldwide intellectual property in a single principal company—Valeant Holdings Ireland—and converted its U.S. entities into essentially limited-risk distributors and contract manufacturers.⁸¹ Under that arrangement, VHI contracts with Valeant affiliates (including some U.S. entities) to manufacture Medicis products. A member of Valeant’s U.S. group, VPNA, then buys the finished product from VHI and handles product sales, marketing and distribution in the U.S.⁸² As a result, apart from the return on those services and the tiered royalties required under section 482, Valeant’s Irish subsidiary now

⁷⁷ Valeant Resp. II, 7.

⁷⁸ Valeant Resp. I, 15, 9-D2.

⁷⁹ App. 54 (VRXPSI-01-0000104).

⁸⁰ Valeant Resp. I, 14. In the first two full years following the acquisition, Valeant-U.S. received related-party royalties of \$22.9 million in 2013 and \$63 million in 2014 in combined royalties from the non-U.S. Valeant corporate group.

⁸¹ Valeant Resp. II, 8.

⁸² VPNA operates under a buy-sell arrangement pursuant to which it purchases inventory and earns a return on its sales, marketing and distribution activities.

earns substantially all the income on worldwide sales of Medicis products; Valeant's U.S. group shares in part of those profits through its equity interest in VHI.

2. Intercompany Debt

In its Board presentation, Valeant forecasted that it would use acquisition debt to “further erode [Medicis’s] tax base.”⁸³ Accordingly, “[i]n connection with the Medicis acquisition, VPI Delaware [a Valeant subsidiary] issued an aggregate \$2.75 billion in debt financing to support the acquisition by VPI Delaware of Medicis.”⁸⁴ Since the acquisition, VPI has made significant deductible interest payments to third party lenders—thereby reducing the U.S. group’s tax base. The Medicis acquisition debt was not issued by the Valeant-Canada parent, and consequently it has not resulted in significant outbound interest payments to low-tax jurisdictions. Valeant’s non-U.S. affiliates did, however, guarantee the Medicis acquisition debt. As a result Valeant’s U.S. group makes significant outbound guarantee fee payments. In 2013 and 2014, Valeant’s U.S. group made \$19.5 million in guarantee fee payments to non-U.S. related parties in connection with the Medicis acquisition debt, and those payments will continue for the life of the corresponding loans.⁸⁵ The outbound guarantee fees are deductible for U.S. federal tax purposes.⁸⁶

B. The Bausch & Lomb Acquisition

On August 5, 2013, Valeant acquired Bausch & Lomb, one of the world’s largest producers of eye health products. The acquisition was completed for \$8.7 billion in cash, with \$4.5 billion paid to the target’s owner, the private equity firm Warburg Pincus, and the remaining \$4.2 billion used to pay down the target’s outstanding debt. Headquartered in Rochester, New York,⁸⁷ Bausch & Lomb initially filed to go public before Valeant acquired it, reporting \$3.03 billion in annual sales in 2012.⁸⁸ By further expanding Valeant’s ophthalmology offerings and facilitating an expansion into China, Valeant anticipated the acquisition would

⁸³ App. 54 (VRXPSI-01-0000104).

⁸⁴ Valeant Resp. I, 19.

⁸⁵ Valeant Resp. II, 12-13, Table 8-D1.

⁸⁶ Valeant Resp. II, 3. Likewise, inbound guarantee fees are includible in income for U.S. federal tax purposes.

⁸⁷ *Worldwide Locations*, BAUSCH + LOMB, http://www.bausch.com/our-company/worldwide-locations#.VZF11qPD_5I (last visited July 24, 2015).

⁸⁸ WP Prism Inc., Registration Statement (Form S-1) (Mar. 22, 2013), *available at* http://www.sec.gov/Archives/edgar/data/1416436/000119312513122167/d502777ds1.htm#rom502777_8.

create a “global eye health platform with estimated pro forma 2013 net revenue of more than \$3.5 billion.”⁸⁹

Prior to the acquisition, Bausch & Lomb boasted a significant international presence, the company had manufacturing in nine countries and sales in more than 100.⁹⁰ In 2012, more than 60% of its revenue was from outside the United States, and the company’s growth plans contemplated expansion in new markets, including Argentina, India, and Japan.⁹¹ At the time of the acquisition, Bausch & Lomb had \$187 million in unrepatriated overseas earnings.⁹² With a projected 32% worldwide effective tax rate at the time of the acquisition, Bausch & Lomb’s future tax burden stood in sharp contrast to Valeant’s single-digit worldwide rate and ability to repatriate international earnings without additional taxes.⁹³

In evaluating the acquisition, Valeant again analyzed the extent to which it could reduce rates on Bausch & Lomb’s worldwide income by integrating the company into Valeant’s Canada-based corporate group.⁹⁴ In a May 2013 presentation to the company’s Board, Valeant executives presented the results of that analysis. Valeant compared the economics of the Bausch & Lomb acquisition using two potential tax rates: 36% (close to Bausch & Lomb’s projected steady-state rate) and 20% (the worldwide cash tax rate Valeant believed it could achieve post-acquisition). Again the analysis showed that the tax advantages available to Valeant would make the Bausch & Lomb acquisition significantly more attractive along several key deal metrics.

⁸⁹ Valeant Pharm. Int’l, Inc. & Bausch & Lomb, *Press Release: Valeant Pharmaceuticals International, Inc., To Acquire Bausch & Lomb for \$8.7 Billion*, SEC.GOV (May 27, 2013), <http://www.sec.gov/Archives/edgar/data/885590/000119312513242429/d546764dex991.htm>; *see also* Richard Blackwell, Sean Silcoff, & Bertrand Marotte, *Valeant Pharmaceuticals Eyes China with Bausch & Lomb Deal*, HSBC GLOBAL CONNECTIONS (Aug. 8, 2013), <https://globalconnections.hsbc.com/canada/en/articles/valeant-pharmaceuticals-eyes-china-bausch-lomb-deal>.

⁹⁰ App. 58 (VRXPSI-01-0000311).

⁹¹ App. 70 (VRX-PSI-01-0000666).

⁹² Valeant maintained a deferred tax liability on these earnings for financial accounting purposes.

⁹³ Before the acquisition, Bausch & Lomb had a U.S. cash effective tax rate of 2.8% and -1.6% in 2011 and 2012, respectively, and a worldwide cash effective tax rate of 1062.9% and 471.4% in 2011 and 2012, respectively. Those unusual tax rates were due to the company’s significant losses in the United States and significant tax liability outside the United States. Valeant Resp. II, 5-6. Bausch & Lomb projected, however, that its non-GAAP effective tax rate would stabilize to approximately 32% in 2013-2014. App. 71 (VRXPSI-01-0000693); *see* App. 63 (VRX-PSI-01-0000614).

⁹⁴ App. 64, 65 (VRXPSI-01-0000618, 624).

| Bausch + Lomb Acquisition | | | |
|---|---------------|--------------|-------------------------|
| Valeant's Base Case Projections (at \$8.5B purchase price) | | | |
| | 36% Tax Rate | 20% Tax Rate | <i>Tax Differential</i> |
| Net Present Value of Deal Gains | \$1.6 billion | \$4 billion | <i>\$2.4 billion</i> |
| Internal Rate of Return | 12% | 15% | <i>3%</i> |
| Payback period | 9.7 years | 8 years | <i>1.7 years</i> |

The table above illustrates how Valeant believed it could enhance the economics of the Bausch & Lomb acquisition by integrating it into a corporate group with a lower tax rate. Although neither tax-rate scenario hit Valeant's targets of a 20% internal rate of return and 6 year payback period, the low-tax scenario came much closer. When evaluated at a tax rate close to the U.S. statutory rate, the net present value of the deal gains was \$1.6 billion.⁹⁵ But that value jumped by \$2.4 billion (or 28% of the acquisition price) when viewed through the lens of a foreign acquirer capable of reducing the target company's cash effective tax rate to 20%. Similarly, the internal rate of return on the Bausch & Lomb acquisition rose from 12% to 15% when the tax advantages of having a Canadian parent were accounted for. And Valeant determined that its investment in Bausch & Lomb would pay for itself in a shorter time period—8 years rather than 9.7 years—at a 20% tax rate.

In financial models prepared prior to the acquisition and reviewed by the Subcommittee, Valeant analyzed available tax planning in greater detail.⁹⁶ The company ran three alternative tax planning scenarios through its proprietary model. The most tax-efficient scenario was labeled "Alt 6." The Alt 6 scenario contemplated a transfer of all intellectual property to Valeant Holdings Ireland through a guaranteed license, as well as a "push down" of \$3.5 billion in debt to Valeant's U.S. group. Valeant projected that the Alt 6 strategy would reduce Bausch & Lomb's average cash effective tax rate to 17.1% through 2023 and achieve a cash effective tax rate of 9.9% for the combined entity. Valeant projected that the "status quo" for Bausch & Lomb would result in a 10-year tax bill of \$5.13 billion, while integration into Valeant would reduce that tax bill to \$2.99 billion—for a tax savings of \$2.13 billion. Those projected tax savings rise to \$3.6 billion when

⁹⁵ App. 65 (VRXSI-01-0000624).

⁹⁶ This information is drawn from Valeant's financial models. The Majority Staff has not included those models in the Appendix.

deductions attributable to Valeant's intercompany acquisition debt are accounted for.⁹⁷

Valeant does not track whether it is on pace to achieve its projected tax savings "because the projections did not take into account all possible effects, and because the company does not track what its taxable income might have been had it not integrated the two businesses."⁹⁸ Based on data available, however, Valeant's tax planning appears to have had a significant effect on Bausch & Lomb's tax profile. The target company was integrated into a corporate group with a U.S. cash effective tax rate of 0.8% and worldwide cash effective tax rate of 3.3% in the first year following the acquisition. Post-acquisition tax rates for Bausch & Lomb are not available because the target company was entirely integrated into Valeant rather than transformed into a subsidiary. The effect of Valeant's integration of Bausch & Lomb, however, is reflected to some extent by a comparison of Bausch & Lomb's projected non-GAAP tax rate of 32% (2013 and 2014) with Valeant's post-acquisition cash tax rates. Valeant's U.S. cash effective tax rate remained under 1% in the first full year following the acquisition, and its worldwide cash effective tax rate ticked up from 3.1% to 3.3%.⁹⁹

1. Intellectual Property Transfers

Before the acquisition, approximately 75% of Bausch & Lomb's intellectual property was located in the United States.¹⁰⁰ Within five months of the acquisition, Valeant moved Bausch & Lomb's entire intellectual property portfolio to Ireland. It achieved this through a multi-step process. *First*, Valeant transferred and consolidated its ownership interests in VPL, Bausch & Lomb S.a.r.l. (a Luxembourg subsidiary), and certain other non-U.S. entities into its Irish subsidiary VHI. *Second*, Valeant's U.S. entities (including Bausch & Lomb U.S.) granted two U.S. Valeant holding companies a fully paid-up exclusive license to their entire intellectual property portfolio, in exchange for shares in the holding companies. *Third*, the two Valeant U.S. holding companies, in turn, granted VHI a fully paid-up exclusive license to their intellectual property, in exchange for equity in VHI. Because that equity in VHI served as compensation for the transfer of intellectual

⁹⁷ This information is drawn from Valeant's financial models. The Majority Staff has not included those models in the Appendix.

⁹⁸ Valeant Resp. I, 9.

⁹⁹ Valeant Resp. I, 4. Valeant stated that it has no specific plans to access Bausch & Lomb's \$187 million in accumulated earnings. *See* Valeant Resp. I, 9; III, 4.

¹⁰⁰ Valeant Resp. III.

property to a related party, Valeant was required under section 482 of the tax code to ensure the interest corresponded to the arms-length value of the transferred intellectual property at the time of the sale. Going forward, Valeant's U.S. holding companies receive a share of worldwide income earned by VHI, and that income is taxable in the United States.¹⁰¹

As in the case of Medicis, the practical result of these transfers is that all income on non-U.S. sales of Bausch & Lomb products is earned outside the U.S. tax "net," except for the U.S. share of VHI income. In addition, the income from U.S. sales of Bausch & Lomb products is now limited to the routine return on product sales, marketing, and distribution in the U.S. and manufacturing (to the extent it is performed in the U.S.), plus the U.S. share of VHI income. Bausch & Lomb's U.S. entities now function essentially as a "contract manufacturer, providing manufacturing services to other members of the Valeant group."¹⁰² VPNA (a U.S. Valeant subsidiary) serves as a limited-risk distributor which purchases finished product from other members of the Valeant group for distribution in the United States.¹⁰³ Consequently, all income generated by Bausch & Lomb's intellectual property is sourced and taxed abroad, with the exception of the U.S. shares of VHI income described above and the fees for contract manufacturing and distribution functions.

It is important to note that Valeant Holdings Ireland is now the company's principal "risk taker" with respect to intellectual property. VHI bears the risks and costs associated with the ongoing development and exploitation of the licensed Medicis and Bausch & Lomb intellectual property. But VHI also will earn the rewards. If Valeant is successful in its plans to enhance the profitability of Medicis and Bausch & Lomb's intellectual property, the lion's share of those increased or "synergized" profits will flow to VHI.

2. Intercompany Debt

In connection with the Bausch & Lomb acquisition, Valeant pushed down \$2.4 billion of the acquisition debt from its foreign affiliates to a Delaware subsidiary (VPI-Delaware), thereby creating a stream of deductible interest

¹⁰¹ Valeant Resp. I, 8-9; Valeant Resp. II, 7-8.

¹⁰² Valeant Resp. II, 8-9.

¹⁰³ Valeant Resp. II, 9. As part of this restructuring, "the licenses of intellectual property by other members of the Valeant group to VPNA were cancelled. VPNA ceased being a licensee of intellectual property and thus stopped paying royalties to other members of the Valeant group." Valeant Resp. II, 8.

payments that have significantly reduced Bausch & Lomb's U.S. tax base. Specifically, Valeant-Canada issued an aggregate \$7.3 billion in debt financing from third-party banks. Valeant-Canada then made an interest-free loan of \$3.1 billion to a Luxembourg subsidiary, Biovail International S.a.r.l., which in turn made an interest-bearing loan (at 6%) of \$2.4 billion to VPI-Delaware.¹⁰⁴

The result of this intercompany lending is evident in the rise in Valeant-U.S.'s tax-deductible, outbound related-party interest payments. In the two years preceding the Bausch & Lomb acquisition, Valeant's U.S. group made an average of \$219,000 per quarter in related-party interest payments. In the first full year following the acquisition, those payments swelled to \$59.9 million per quarter—a 273-fold increase.¹⁰⁵ To date, Valeant's U.S. group has made \$320.2 million in interest payments on the Bausch & Lomb acquisition debt to Biovail International S.a.r.l. and projects another \$375 million in interest payments through the first quarter of 2017; those payments will continue through the life of the loan.¹⁰⁶ The interest payments are fully deductible in the U.S. and subject to no U.S. federal withholding taxes.¹⁰⁷ Only a portion of the interest income received by Valeant in Luxembourg is taxable—at single-digit tax rates.

C. The Salix Acquisition

Founded in 1989, Salix Pharmaceuticals was a North Carolina-based pharmaceutical company specializing in gastrointestinal health. In 2013, the company had \$933.8 million in revenues¹⁰⁸ and a market capitalization of more than \$5.47 billion.¹⁰⁹ With an effective tax rate hovering in the high 30s to low 40s,

¹⁰⁴ Valeant Resp. I, 21.

¹⁰⁵ See Valeant Resp. I, 12-13.

¹⁰⁶ See Valeant Resp. II, 11-12. Those outbound interest payments were offset to a minor degree by inbound guarantee fees. Because one of Valeant's U.S. entities was one of several guarantors of the Bausch & Lomb and Salix acquisition debt, Valeant's Canadian parent paid guarantee fees to VPI-Delaware from 2012 through 2014 totaling \$22.5 million. Those payments increased Valeant's taxable income in the United States. See Valeant Resp. II, 11.

¹⁰⁷ Valeant notes that "some deductions were limited pursuant to section 163(j)," but as of December 31, 2014, those previously limited deductions have been allowed. Valeant Resp. III, 3.

¹⁰⁸ Salix Pharm., Annual Report (Form 10-K) (Feb. 28, 2014), available at http://www.salix.com/assets/pdf/investors/2013_10K.pdf?id=790422.

¹⁰⁹ See *Id.*; *Salix Pharmaceuticals Ltd. (SLXP)*, YAHOO FINANCE, <http://finance.yahoo.com/q/hp?s=SLXP&a=11&b=30&c=2013&d=00&e=2&f=2014&g=d> (last visited July 28, 2015) (calculated using stock price from Yahoo Finance on Dec. 31, 2013 and outstanding shares as indicated in Salix 10-K).

however, the company actively sought opportunities to relocate to a lower-tax jurisdiction.¹¹⁰

On July 9, 2014, Salix announced that it had agreed to buy an Irish subsidiary of the Italian-based pharmaceutical firm Cosmo Pharmaceuticals SpA for \$2.7 billion in stock. The planned deal was to be structured as an inversion, placing the combined company's headquarters in Ireland.¹¹¹ If the transaction were approved, Salix shareholders would own slightly less than 80% of the new firm; that ownership percentage shielded the deal from one of the anti-inversion provisions contained in section 7874 of the tax code, which treats inverted corporations as domestic corporations when shareholders of the U.S. company own 80% or more of the new entity.¹¹² Salix Chief Executive Officer Carolyn Logan specifically noted that the deal would "greatly enhance" the company's ability to compete for new acquisitions.¹¹³

On September 22, 2014, the U.S. Treasury Department issued new guidance designed to tighten anti-inversion rules. The guidance applied to inversions in which a U.S. company's shareholders would own more than 60% or more of the combined company, as legacy Salix shareholders would have.¹¹⁴ On October 3, 2014, citing a "changed political environment [that] has created more uncertainty regarding the potential benefits [Salix] expected to achieve" through the Cosmo deal, Salix announced that it had decided to terminate the proposed transaction.¹¹⁵

Valeant and other interested acquirers then stepped in. Within months, in February 2015, Valeant announced that it had agreed to acquire Salix for \$158 per share. The companies later revised the terms to \$173 per share, for a total enterprise value of approximately \$15.8 billion. The acquisition price represented a

¹¹⁰ Salix's 2013 U.S. GAAP effective tax rate was 31.9%; its 2012 U.S. cash effective tax rate was 41.6%. Valeant Resp. I, 10.

¹¹¹ Simeon Bennett & Alex Wayne, *Salix to Merge with Cosmo in Latest Tax Inversion Deal*, BLOOMBERGBUSINESS (July 9, 2014, 4:13 PM), <http://www.bloomberg.com/news/articles/2014-07-08/salix-to-merge-with-cosmo-in-latest-tax-inversion-deal>.

¹¹² See 26 U.S.C. § 7874 (2012).

¹¹³ Bennett & Wayne, *supra* note 111.

¹¹⁴ Treasury Notice 2014-52.

¹¹⁵ Chip Cummins, *Salix, Cosmo Cancel Merger Agreement*, WALL ST. J. (Oct. 3, 2014, 4:22 AM), <http://www.wsj.com/articles/salix-cosmo-cancel-merger-agreement-1412319533>.

greater than 40% premium over Salix’s share price before the acquisition was announced.¹¹⁶

The tax profiles of Salix and Valeant differed sharply. Before the acquisition, Salix projected that its U.S. cash effective tax rate would level out at 38% in 2017 and beyond;¹¹⁷ market analysts similarly expected Salix’s future effective tax rate to hover in the “mid/high 30% range.”¹¹⁸ By contrast, Valeant had a U.S. cash effective tax rate of 0% and 0.8% in 2013 and 2014, respectively, and a worldwide cash effective tax rate of 3.1% and 3.3% in 2013 and 2014, respectively.

| Salix Acquisition | | | | |
|---|--------------|--------------|-------------|-------------------------|
| Valeant’s Base Case Projections (at \$160/share)¹¹⁹ | | | | |
| | 36% Tax Rate | 10% Tax Rate | 5% Tax Rate | <i>Tax Differential</i> |
| Internal Rate of Return | 15.6% | 21.4% | 22.4% | <i>up to 6.8%</i> |

Valeant again evaluated the deal in light of potential tax savings. It assumed the applicable 36% statutory rate applied to the Salix acquisition. But because Valeant was uncertain precisely what rate it could achieve post-acquisition, it evaluated the deal based on two possible achievable tax rates, 5% and 10%. As the table above illustrates, Valeant projected that it could significantly enhance the economics of the Salix acquisition by drawing on its non-U.S. tax profile. Once again, Valeant projected that the only way to hit its goal of 20% internal rate of return was by reducing the target’s tax rate through integrating it into a Canada-based corporate group. Assuming a share price of \$160, Valeant projected that its internal rate of return would be 15.6% at a 36% tax rate, which would jump to a 22.4% return at a 5% tax rate.

Valeant estimated that the “aggregate tax savings” from its post-acquisition tax planning “would be approximately \$562 million over five years” in nominal

¹¹⁶ David Crow & James Fontanella-Khan, *Raised Offer from Valeant Knocks Endo out of Salix Race*, FIN. TIMES (March 16, 2015, 6:29 PM), <http://www.ft.com/intl/cms/s/0/f8c8bf1c-cbdd-11e4-beca-00144feab7de.html#axzz3gvVXLsaKaxzz3hCYKiRZZ>.

¹¹⁷ App. 76 (VRXPSI-01-0001047).

¹¹⁸ App. 73 (VRXPSI-01-0000867).

¹¹⁹ Valeant evaluated the acquisition as a purchase price ranging from \$140 per share to \$160 per share. See App. 80, 81 (VRXPSI-01-0001112, 1113). The final purchase price was \$173 per share. Valeant considered the rate of return under two base cases; the table above reflects the upside case (“Base Case 1”).

dollars.¹²⁰ The immediate tools for achieving those savings entailed the transfer of intellectual property outside the U.S. tax net and the use of intercompany lending.

1. Intellectual Property Transfers

Prior to the acquisition, all but an insignificant portion of Salix's intellectual property was held in the United States. Valeant now plans to transfer most legacy Salix intellectual property to Ireland. Specifically, Salix will license certain intellectual property to VHI, which acts as a principal for the global Valeant group.¹²¹ As compensation for the transfer, VHI "will pay a running royalty to Salix calculated as a percentage of third-party net sales," and it will acquire an option to purchase that intellectual property outright from Salix in the future.¹²² The royalties paid under that license will be "determined on a product-by-product basis based on analysis of the current value and risk profile" of each product.¹²³ Because Salix will become a member of Valeant's U.S. consolidated group, however, Salix's taxable income associated with the intellectual property transfer going forward "will be offset with interest expense and other tax attributes."¹²⁴

As with the Medicis and Bausch & Lomb acquisitions, the practical result of this restructuring is that VHI will contract with related-parties and third-parties to manufacture Salix products and then sell those products as finished goods to a member of Valeant's U.S. group, VPNA. VPNA will earn a return only on its product distribution, sales, and marketing activities. As a result, Valeant will source all income from Salix products to Ireland, except for royalties that VHI pays to its U.S. group for use of Salix intellectual property based on the value at the time of transfer.¹²⁵ As with Medicis's and Bausch & Lomb's intellectual property, if Valeant is successful in its plans to enhance the profitability of Salix intellectual property, the lion's share of those increased or "synergized" profits will flow to VHI and be taxed at the lower Irish rate.

¹²⁰ Valeant Resp. II, 4.

¹²¹ Valeant Resp. II, 3.

¹²² *Id.*

¹²³ *Id.*

¹²⁴ Valeant Resp. II, 4. Valeant notes that, as an alternative to a perpetual license, Valeant may transfer Salix intellectual property to VHI through an outright sale. *Id.*

¹²⁵ Valeant Resp. I, 2-3.

2. Intercompany debt

Valeant structured the Salix acquisition debt in a manner that will significantly reduce Valeant's U.S. tax base. Valeant-Canada raised \$15.2 billion in debt financing from third parties to support the Salix acquisition. Valeant then made an interest-free loan of \$16.5 billion to VFL (Luxembourg). VFL, in turn, made six intercompany loans totaling \$16.5 billion to VPI Delaware at an average interest rate of approximately 6.2%. Valeant projects that, from the first quarter of 2015 through the first quarter of 2017, it will make \$1.67 billion in interest payments on the Salix debt to VFL; those payments are scheduled to continue until the maturity date of each loan (ranging from 2021 to 2025).¹²⁶ To date, Valeant's interest payments on the Salix acquisition debt have been fully deductible in the U.S. and subject to no U.S. federal withholding taxes.¹²⁷ Only a portion of the interest income received by Valeant in Luxembourg is taxable—at single-digit tax rates.

D. Employment Impact of Valeant Acquisitions

As with many mergers and acquisitions, Valeant's purchases of Medicis, Bausch & Lomb, and Salix were followed by significant workforce reductions.

Medicis had approximately 790 full-time employees in the U.S. in the quarter immediately preceding the acquisition.¹²⁸ Valeant reported in public filings that it terminated approximately 750 employees “as a result of the Medicis Acquisition.”¹²⁹ Based on other employment data supplied by Valeant, however, it is clear that all or substantially all of the job cuts were U.S.-based Medicis positions, including approximately 450 employees at the Scottsdale, Arizona headquarters.¹³⁰

Bausch & Lomb had approximately 4,103 full-time employees in the U.S. in the quarter immediately preceding the acquisition.¹³¹ Valeant reported in public filings that it terminated “approximately 3,000” employees of Bausch & Lomb and

¹²⁶ Valeant Resp. I, 20-21; Valeant Resp. II, 11-12.

¹²⁷ Valeant notes that “some deductions were limited pursuant to 163(j),” but as of December 31, 2014, those previously limited deductions have been allowed. Valeant Resp. III, 3.

¹²⁸ Valeant Resp. I, 16.

¹²⁹ Valeant 2013 10-K, at 33, *available at* <http://ir.valeant.com/investor-relations/SEC-Filings/2013/default.aspx>.

¹³⁰ Valeant Resp. I, 16; Valeant Resp. II, 16.

¹³¹ Valeant Resp. I, 16.

of Valeant “as a result of the Bausch & Lomb Acquisition.”¹³² The company reported to the Subcommittee that approximately 1,500 of those terminated positions were in the U.S.—about 1,125 Bausch & Lomb employees, and 375 legacy Valeant employees.

At the time of the acquisition, Salix employed approximately 977 full-time workers in the U.S.¹³³ Workforce reductions at Salix were significantly greater than has been publicly reported. Valeant has eliminated or plans to eliminate approximately 420 Salix jobs—including 261 headquarters jobs in North Carolina and 160 jobs based in other U.S. locations.¹³⁴

In addition to reducing the target company’s workforce, Valeant plans to transfer some contract manufacturing out of the United States in connection with the Medicis and Salix acquisitions. Specifically, Valeant reports that it has transferred or will soon transfer manufacturing work from some contract sites in North Carolina, Texas, Kentucky, and Tennessee to sites in Canada and the UK. Valeant will move contract manufacturing business from one site in Canada to North Carolina. Although job impact figures are not available, the net U.S. contract manufacturing revenue loss is approximately \$16.5 million annually.¹³⁵

Valeant’s total U.S. workforce has grown from 607 U.S.-based full-time employees as of December 2011 to 5,725 U.S.-based full-time employees as of June 2015.¹³⁶ Valeant’s total non-U.S. workforce grew in the same time period from 6,293 full-time employees to 13,644 full-time employees. The vast majority of that headcount increase appears to be attributable to the retained workforce of acquired companies.

II. Burger King Worldwide + Tim Hortons Inc.: Cross-Border Merger of Equals

In addition to foreign acquisitions of U.S. companies, the Subcommittee also examined a merger of equals transaction. In 2014, American fast food giant Burger King Worldwide merged with Tim Hortons, Inc., a Canadian fast food restaurant known for its coffee and donuts. Burger King paid \$11.4 billion to acquire Tim

¹³² Valeant 2014 10-K, *available at* <http://ir.valeant.com/investor-relations/SEC-Filings/2014/default.aspx>.

¹³³ Valeant Resp. I, 18.

¹³⁴ Valeant Resp. III, 2 & Table H-2.

¹³⁵ Valeant Resp. III.9, Table D-1 & E-1.

¹³⁶ Valeant Resp. III, Table A-2.

Hortons, and both brands were placed under the umbrella of a new company called Restaurant Brands International (RBI), headquartered in Ontario, Canada.¹³⁷ As part of the deal, Warren Buffet's Berkshire Hathaway provided \$3 billion in preferred equity funding.¹³⁸ It has been widely reported that the decision to locate RBI in Canada allows Burger King to recognize substantial tax benefits with respect to its international operations.

A brief history of both companies is helpful to understand the decision to merge and the role that tax considerations played. Founded in 1954 in Miami, Florida, Burger King is renowned for its signature burger, the Whopper. Like other prominent fast food chains, Burger King grew quickly and substantially and today has more than 7,000 franchise-owned restaurants in the United States.¹³⁹ By 2013—the last full year before the merger—Burger King had nearly \$1.1 billion in revenues, \$230 million in profits, and an \$11.4 billion market capitalization.¹⁴⁰ The company has been acquired and sold several times during its history. Most recently, in 2010, 3G Capital, a Brazilian investment management firm, purchased Burger King for \$4 billion¹⁴¹ in a take-private deal.¹⁴² After two years of streamlining Burger King's operations, 3G took the company public in 2012.¹⁴³

Tim Hortons was founded in 1964 by Hall of Fame National Hockey League player Tim Horton. It has thousands of franchises across Canada, enjoys a dominant 42% share of the quick service restaurant industry in Canada,¹⁴⁴ and is seeking to add 500 new restaurants its home country by 2018.¹⁴⁵ From 1995

¹³⁷ See Paul Vieira, *Canada Approves Burger King's Deal to Buy Tim Hortons*, WALL ST. J. (Dec. 4, 2014), <http://www.wsj.com/articles/canada-approves-burger-kings-deal-to-buy-tim-hortons-1417728183>.

¹³⁸ William Alden, *In Burger King Deal, Buffett Teams up Again with 3G Capital*, N.Y. TIMES DEALBOOK (Aug. 26, 2014), <http://dealbook.nytimes.com/2014/08/26/in-burger-king-deal-buffett-reunites-with-3g-capital/>.

¹³⁹ Burger King Worldwide, Inc., Annual Report (Form 10-K) (Feb. 21, 2014), *available at* https://www.sec.gov/Archives/edgar/data/1547282/000119312514061827/d648966d10k.htm#tx648966_1 [hereinafter *Burger King 2013 Form 10-K*].

¹⁴⁰ Liz Hoffman & Dana Mattioli, *Burger King in Talks to Buy Tim Hortons in Canada Tax Deal*, WALL ST. J. (Aug. 25, 2014), *available at* <http://www.wsj.com/articles/burger-king-in-talks-to-buy-tim-hortons-1408924294>.

¹⁴¹ *Burger King Holdings*, 3G CAPITAL (Sept. 2, 2010), <http://www.3g-capital.com/bkw.html>.

¹⁴² Anupreeta Das & Mark Peters, *Burger King Goes Public Again*, WALL ST. J. (Apr. 4, 2012, 12:14PM), <http://www.wsj.com/articles/SB10001424052702303816504577322270322801942>.

¹⁴³ *Id.*

¹⁴⁴ TIM HORTONS, WINNING IN THE NEW ERA (n.d.), *available at* http://www.timhortons.com/us/en/pdf/Tim_Hortons_2013_AR_full.pdf.

¹⁴⁵ *Id.*

through 2006, Tim Hortons was owned by U.S. fast food chain Wendy's.¹⁴⁶ But after years of stalled growth, activist investors pressured Wendy's to spin off Tim Hortons into an independent company, which it did in 2006.¹⁴⁷

Prior to the merger, Burger King expected that expansion in overseas markets would be a major driver of its growth.¹⁴⁸ To be sure, Burger King continues to work on growing its U.S. market share, in part through re-modeling.¹⁴⁹ But Burger King's primary growth strategy focuses on expanding its overseas operations. As the company's Chief Financial Officer Joshua Kobza put it—one suspects hyperbolically—Burger King expected “110%” of its growth would come from new restaurants overseas.¹⁵⁰

Like Burger King, Tim Hortons' pre-merger growth plan also called for significant international expansion.¹⁵¹ In a 2013 strategic plan, the company detailed how it would grow outside of Canada. Describing the U.S. market as a “must-win battle,” the company announced its goal of opening 300 restaurants in key U.S. markets by 2018, primarily in the Midwest and Northwest.¹⁵² Tim Hortons also outlined its growth strategy beyond North America, explaining that it would first focus on Persian Gulf states, where it hoped to eventually open 220 restaurants.¹⁵³ Indeed, Tim Hortons projected that, between 2013 and 2018, it

¹⁴⁶ Murad Hemmadi, *Lessons for Burger King from the Tim Hortons-Wendy's Merger*, CANADIAN BUS. (Aug. 25, 2014), <http://www.canadianbusiness.com/companies-and-industries/tim-hortons-wendys-merger-lessons-burger-king/>.

¹⁴⁷ Hoffman & Mattioli, *supra* note 140.

¹⁴⁸ Michael J. De La Merced & Ian Austen, *Global Web of Financial Connections in Burger King's Deal for Tim Hortons*, N.Y. TIMES DEALBOOK, <http://dealbook.nytimes.com/2014/08/26/burger-king-to-buy-tim-hortons-for-11-4-billion/> (last updated Aug. 26, 2014, 9:21PM).

¹⁴⁹ Specifically, Burger King is seeking to cultivate a modern image by remodeling its restaurants to incorporate corrugated metal, brick, wood, and concrete, in a design that “draws inspiration from [its] signature flame-grilled cooking process.” See Burger King 2013 Form 10-K.

¹⁵⁰ Subcommittee Interview with Joshua Kobza, Chief Fin. Officer, Rest. Brands Int'l (June 3, 2015) (noting that “110% of our growth” was expected to be international).

¹⁵¹ Bruce Philip, *Tim Hortons' New CEO Explains How He Plans to Make Canada's Best Brand Better*, Canadian Bus. (May 14, 2014), <http://www.canadianbusiness.com/lists-and-rankings/best-brands/2014-tim-hortons-marc-caira-interview/>.

¹⁵² See TIM HORTONS, WINNING IN THE NEW ERA (n.d.), *available at* http://www.timhortons.com/us/en/pdf/Tim_Hortons_2013_AR_full.pdf (“We expect to open approximately 300 restaurants in the U.S. by the end of 2018.”).

¹⁵³ See *id.* (“We have established a roadmap to 220 restaurants in the GCC within five years based on our current agreements.”).

aimed to grow by 42% overseas, compared to 3% in Canada and 7% in the United States.¹⁵⁴

The Subcommittee reviewed nonpublic deal-related documents to better understand the role that tax considerations played in the merger. It is clear from that record that while non-tax business considerations spurred Burger King's interest in concluding the merger in the first place, tax considerations dominated the decision to place the new headquarters outside of the United States. Before the merger, Tim Hortons and Burger King had similar effective tax rates. In 2013, Burger King had a cash effective tax rate of 29%,¹⁵⁵ while Tim Hortons' paid approximately 26%. Those similar effective tax rates, however, masked an important difference in the two companies' tax profiles: While Tim Hortons was free to repatriate its foreign earnings to Canada without incurring any significant residual tax, Burger King was required to pay residual tax on its foreign earnings. It therefore had significant "locked out" earnings from its restaurants through Europe, Asia, Africa, and the Middle East.¹⁵⁶ Before the acquisition, Burger King had approximately \$700 million in locked-out foreign earnings in 2014, and it expected that its accumulated foreign earnings and profits would "grow significantly" in future years as it opened new restaurants overseas.¹⁵⁷ The company calculated that, if it repatriated those future earnings to invest in the United States, its worldwide effective tax rate would climb up to 40%.¹⁵⁸

Beginning in December 2013, Burger King executives worked with the company's majority shareholder, 3G Capital, to evaluate a potential merger with Tim Hortons.¹⁵⁹ Presentations by Burger King executives to its board of directors indicate that Burger King's initial interest in combining with Tim Hortons was business-driven, not primarily tax-motivated. As reported to the board, company executives saw Tim Hortons as a quick service restaurant business with a "consistent track record of growth, a fully-franchised, healthy, and fragmented [diversified] franchisee base,"¹⁶⁰ and they believed the combination would help

¹⁵⁴ See Burger King Internal Presentation on Project Red, Aug. 25, 2014, App. 21 (BKW-PSI-001437). Burger King's deal documents refer to Burger King as "Blue," Tim Hortons as "Red," the planned merger as "Project Red," and the combined company as "New Red."

¹⁵⁵ Letter from Burger King Worldwide to PSI (July 24, 2015), 10 ("BKW Resp.").

¹⁵⁶ App. 29 (BKW-PSI-001696).

¹⁵⁷ *Id.*

¹⁵⁸ App. 27, 29 (BKW-PSI-001693, 1696); BKW Resp., 10.

¹⁵⁹ Subcommittee Interview with Joshua Kobza, Chief Fin. Officer, Rest. Brands Int'l (July 22, 2015).

¹⁶⁰ App. 8 (BKW-PSI-001369).

diversify Burger King’s current concentration in the United States.¹⁶¹ Burger King executives also saw “meaningful value creation” through spurring Tim Hortons’ “untapped growth opportunities through [restaurant] expansion abroad”¹⁶² and expected to create shareholder value by achieving significant cost savings.¹⁶³ In short, the company appears to have had a clear business rationale for the merger.

But on the issue of *how* to execute the merger and whether to locate the new headquarters in the United States or elsewhere, tax considerations were dispositive. In a March 2014 board presentation, Mr. Kobza and Burger King’s Chief Executive Officer Daniel Schwartz laid out the case for the initial bid for Tim Hortons for \$73(Canadian) per share. The presentation recommends a combination-migration in which the new headquarters would be in the United Kingdom.

Burger King management, in consultation with outside advisors including KPMG and the law firm Paul Weiss, considered a number of potential jurisdictions for headquarters, including the UK, Canada, Belgium, and Ireland—but did not seriously consider the United States.¹⁶⁴ They assessed each potential jurisdiction’s tax rates and corporate governance requirements¹⁶⁵ and initially recommended the UK based primarily on its “low statutory corporate tax rate of 21%” and 0% withholding tax rate on dividends paid to the UK from most jurisdictions.¹⁶⁶ Although Burger King told the Subcommittee that it “did not intend” to place the combined company in the UK,¹⁶⁷ the March 2014 board presentation by Mr. Schwartz and Mr. Kobza clearly states that the creation of a UK parent company was part of a proposed merger plan.¹⁶⁸ Indeed, the financial projections in the presentation assume a combined company with a 23% worldwide effective tax rate—the rate Burger King believed would be achievable through a UK-based corporate group.¹⁶⁹

¹⁶¹ App. 16 (BKW-PSI-001410).

¹⁶² *Id.*

¹⁶³ App. 8, 20 (BKW-PSI-001369, 1427).

¹⁶⁴ App. 32-44 (BKW-PSI001833-45); Subcommittee Interview with Kobza (July 23, 2015).

¹⁶⁵ App. 32-44 (BKW-PSI0001833-45).

¹⁶⁶ App. 45 (BKW-PSI-001897).

¹⁶⁷ BKW Resp., 2.

¹⁶⁸ *See* App. 6 (BKW-PSI-001681) (“The merger would be executed via an inversion into a newly-formed U.K. company.”); *id.* (“We would also subsequently implement a series of tax efficient corporate reorganization steps to move non-U.S. assets out from under both Blue [Burger King] and Red [Tim Hortons] to be directly owned by the new U.K. holding company to facilitate tax-efficient access to future offshore earnings.”).

¹⁶⁹ App. 28 (BKW-PSI-001694).

The United States was not under serious consideration to serve as the headquarters for the combined company because its high statutory rate and tax on repatriated earnings would have “destroyed so much value,” according to Mr. Kobza.¹⁷⁰ Burger King executives wanted a platform that would accelerate, not hinder, the combined company’s international growth. As noted, Burger King expected that its non-U.S. earnings would “grow significantly” in the year ahead,¹⁷¹ and more than 80% of Tim Hortons’ earnings derived from non-U.S. sales.¹⁷² Burger King executives determined that, after the merger, the combined company would need to repatriate its non-U.S. earnings.¹⁷³ But repatriating Burger King’s and Tim Hortons’ income to a corporate headquarters in the United States would have driven the combined company’s tax rate up to 40%.¹⁷⁴ That “11% increase in [effective tax rate] would lead to a 15% decline in Net Income” for Burger King alone, not including the impact on Tim Hortons.¹⁷⁵

Headquartering the combined company in the United States was a nonstarter. Mr. Kobza explained that the “tax dissynergies” from placing the combined company headquarters in the United States would have made the merger infeasible. If placed under a U.S. parent, all of Tim Hortons’ non-U.S. revenues would be pulled into the U.S. tax net. Mr. Kobza indicated that imposing that additional tax burden on Tim Hortons’ Canadian earnings alone would have sunk the deal.¹⁷⁶ In addition, Burger King’s growing foreign earnings would continue to be inaccessible—unless the company paid additional taxes for the privilege of reinvesting those earnings in the U.S. Mr. Kobza explained that Burger King never seriously considered pursuing this “hypothetical” U.S.-headquartered approach.¹⁷⁷ His March 2014 presentation to the Board demonstrates why: When compared to the UK option, locating the headquarters in the U.S. and repatriating its future foreign earnings would have destroyed approximately \$5.5 billion in future value for the new Burger King and Tim Hortons over five years.¹⁷⁸

¹⁷⁰ Subcommittee Interview with Kobza (July 23, 2015). Mr. Kobza noted that placing RBI’s headquarters in the United States “would have destroyed so much value that I don’t know how you would have made the math work.” *Id.*

¹⁷¹ App. 29 (BKW-PSI-001696).

¹⁷² *See* Burger King Internal Presentation on Project Red, Aug. 25, 2014, App. 21 (BKW-PSI-001437).

¹⁷³ Subcommittee Interview with Kobza (July 22, 2015); BKW Resp., 10.

¹⁷⁴ App. 27, 29 (BKW-PSI-001693, 1696); BKW Resp., 10.

¹⁷⁵ App. 31 (BKW-PSI-001825).

¹⁷⁶ Subcommittee Interview with Kobza (July 22, 2015). Mr. Kobza noted that Tim Hortons’ 26% tax rate would have been “grossed up to 40%” in a U.S.-headquartered scenario. *Id.*

¹⁷⁷ Subcommittee Interview with Kobza (July 23, 2015).

¹⁷⁸ App. 25 (BKW-PSI-001672); Subcommittee Interview with Kobza (July 23, 2015).

On March 24, 2014, Burger King submitted a non-binding proposal to Tim Hortons to acquire all outstanding common shares of Tim Hortons for C\$73 per share, payable in cash and stock of the combined company. The proposal would have formed a company that owned both Burger King and Tim Hortons.¹⁷⁹ Tim Hortons rejected the offer on April 25. Two weeks later, on May 12, 2014, Burger King sent Tim Hortons a revised proposal increasing its offer to C\$78 per share. That proposal also did not result in negotiation.

In June 2014, Burger King executives presented a revised merger plan to the Burger King board with two significant changes. The presentation proposed increasing the offer price from C\$78 to C\$85—a 44% premium over Tim Hortons’ average 30-day stock price—and it stated that the “combined company will be domiciled in Canada instead of the UK.”¹⁸⁰ The presentation explained that placing the headquarters in Canada, rather than the UK, “will likely be viewed more favorably by [Tim Hortons]” and other “key stakeholders.”¹⁸¹ Burger King determined that locating the headquarters in Canada would carry “similar tax benefits as the UK,”¹⁸² with a projected GAAP effective tax rate of approximately 22%.¹⁸³ Like the UK-based structure, a Canadian holding company would “allow for tax-efficient access to non-U.S. profits for both [Burger King] and [Tim Hortons].”¹⁸⁴ The presentation explained that, “[s]imilar to the prior [UK-based] structure, we plan to implement a series of tax-efficient reorganization steps to move non-U.S. assets out from under both [Burger King] and [Tim Hortons] to be directly owned by the new Canadian holding company to facilitate tax-efficient access to future [non-U.S.] earnings.”¹⁸⁵ Due to Canada’s territorial system of taxation, these steps would allow the new combined company to bring home its earnings from its restaurants in Europe, Asia and Africa without incurring additional taxes.

Just as placing the combined company in the U.S. would have destroyed shareholder value, Burger King projected that placing the combined company in Canada would create significant value. In its analysis of the merger, Burger King calculated that tax savings would drive fully one-third of the expected “value

¹⁷⁹ BKW Resp., 3.

¹⁸⁰ App. 9 (BKW-PSI-001370).

¹⁸¹ *Id.*

¹⁸² App. 12 (BKW-PSI-001383).

¹⁸³ App. 13 (BKW-PSI-001385). Although the UK statutory rate is lower, Burger King determined it could achieve a lower rate in Canada due to greater opportunity to deduct interest expense associated with the acquisition. Subcommittee Interview with Kobza (July 23, 2015).

¹⁸⁴ App. 8 (BKW-PSI-001369).

¹⁸⁵ App. 11 (BKW-PSI-001375).

creation” for shareholders from the merger.¹⁸⁶ The company projected approximately \$7 per share in incremental value from cost efficiencies and other fundamentals, and another \$4 per share in incremental value from tax savings. Without those tax savings, Burger King could not have hit the value creation target that it uses to evaluate whether a major merger or acquisition is sufficiently profitable to undertake.¹⁸⁷

In its submissions to the Subcommittee, Burger King has emphasized the role of non-tax considerations in its ultimate decision to place the combined company in Canada rather than the UK. The company also notes that it never proposed the UK structure to Tim Hortons. Mr. Kobza explained that, after the initial bid in March, Burger King’s investment bankers reported that the leadership of Tim Hortons strongly preferred to keep their company headquartered in Canada.¹⁸⁸ At the time, Burger King executives reported to the Burger King board that a move to Canada would “likely be viewed more favorably” by Tim Hortons.¹⁸⁹ The presentation also notes that the effective tax rate for the Canada-based structure would be slightly lower than the effective tax rate for the UK-based structure. It further notes that placing the headquarters in Canada would satisfy the “substantial business activities” safe harbor of anti-inversion rules contained in section 7874 of the U.S. tax code. Because neither company has headquarters functions in the UK, the UK structure would not have qualified for that safe harbor and therefore would have had to satisfy other requirements of section 7874.

Burger King has also emphasized the role that the Investment Canada Act (ICA) played in its decision to place the new headquarters in Canada instead of the UK. Because the company redacted a portion of its internal analysis regarding the ICA on privilege grounds, the Majority Staff cannot evaluate the degree to which ICA concerns drove the company’s decision-making. But the board presentations provided by Burger King suggest that the ICA was at most a second-order consideration.¹⁹⁰ In any event, Burger King executives had already ruled out the

¹⁸⁶ App. 10 (BKW-PSI-001371) (“2/3rds of additional value is from fundamentals, leverage, and cost savings, while 1/3rd is from tax savings”).

¹⁸⁷ App. 10 (BKW-PSI-001371); Subcommittee Interview with Kobza (July 23, 2015).

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *See* App. 12 (BKW-PSI-001383) (“The proposed migration to Canada will be viewed more favorably by the [Tim Hortons] Board, [its] shareholders, and [Investment Canada Act] Ministers.”).

U.S. as a potential headquarters due to the additional tax burden before learning about the ICA regulatory risks.¹⁹¹

Management for both companies entered negotiations July 23, 2014.¹⁹² On August 15, 2014, Burger King submitted a revised non-binding proposal to acquire all of the outstanding common shares of Tim Hortons for C\$88.50. As ultimately adopted by the parties, the transaction resulted in Burger King and Tim Hortons becoming indirect subsidiaries of RBI, based in Canada. The agreement provided that each holder of a common share of Tim Hortons would be entitled to receive either C\$65.50 in cash and 0.8025 newly issued shares of RBI in exchange for each common share of Tim Hortons held by the shareholder. Alternatively, Tim Hortons shareholders could elect to receive C\$88.50 per share. The deal closed in December 2014, after approval by Canadian regulators.

III. InBev's Acquisition of Anheuser-Busch

In July 2008, the 150-year-old American brewer Anheuser-Busch accepted a takeover bid from Belgian conglomerate InBev NV. It was an enormous transaction: InBev, the brewer of premium European beers such as Stella Artois, Beck's, Bass, and Hoegaarden, was at the time the second-largest beer company in the world, while Anheuser-Busch was the third. The \$52 billion deal was the second-largest ever in the U.S. consumer goods market, and the third-largest foreign acquisition of a U.S. company.¹⁹³ And as with Burger King and Tim Horton's, the combined entity Anheuser-Busch InBev would be headquartered abroad: not in St. Louis, but in Leuven, Belgium.

By 2008, the beer industry had undergone almost a decade of consolidation. InBev itself was the product of a series of mergers. In 2004 Belgium-based Interbrew—which traced its roots back to Leuven, Belgium in 1366¹⁹⁴—merged with Brazilian brewer AmBev to form InBev. Here in the United States, Anheuser-Busch was the last of the “big three” brewers (Anheuser-Busch, Miller, and Coors) to merge with a foreign brewery. In 2002 South African Breweries (“SAB”) bought Miller Brewing for \$5.6 billion, creating what was then the second largest brewer

¹⁹¹ Subcommittee Interview with Kobza (July 24, 2015).

¹⁹² BKW Resp., 4.

¹⁹³ David Kesmodel & Matthew Karnitschnig, *InBev Uncorks Anheuser Takeover Bid*, Wall St. J., June 12, 2008, at A1, available at <http://www.wsj.com/articles/SB121321760059165613>.

¹⁹⁴ *Our Brand*, STELLA ARTOIS, http://www.stellaartois.com/en_us/our-brand/heritage.html (last visited July 28, 2015).

worldwide.¹⁹⁵ The Adolph Coors Company followed suit, combining with Molson, a Canadian brewer, to form Molson Coors in 2005.¹⁹⁶ Those two combined entities—SABMiller and Molson Coors—merged their U.S. operations in late 2007 into MillerCoors, in order to better compete with Anheuser-Busch. At the time, Anheuser-Busch controlled about 50% of the domestic beer market, followed by SABMiller and Molson Coors at 29%.¹⁹⁷

In 2008 Anheuser-Busch was a \$19-billion-a-year Fortune 500 company. Although Anheuser-Busch was the third largest worldwide brewer by volume, 90% of its sales took place in the U.S.¹⁹⁸ With domestic beer consumption per capita declining and craft breweries on the rise, many analysts believed that Anheuser-Busch was approaching saturation levels domestically and needed to expand abroad. This made Anheuser-Busch attractive for foreign bidders well positioned to expand the company abroad.

On June 11, 2008, InBev announced an unsolicited bid for Anheuser-Busch of \$46.3 billion. At \$65 a share, the bid represented a roughly 30% premium over the company's \$50 share price before talks began. Anheuser-Busch attempted to avoid the takeover by combining with Mexico's Grupo Modelo—a move that would have made the combined firm too expensive for InBev to buy.¹⁹⁹ After a month-long pursuit, however, InBev won over Anheuser-Busch with a bid of about \$52 billion, roughly \$6 billion more than the initial offer.²⁰⁰ The \$70-per-share deal represented a 40% premium over the approximately \$50 pre-negotiation valuation. By increasing its offer by \$5 per share, InBev successfully drew Anheuser-Busch into friendly discussions and thus avoided a protracted hostile takeover. The combination of the two entities officially closed on November 18, 2008.

¹⁹⁵ WILLIAM KNOEDELSEDER, BITTER BREW: THE RISE AND FALL OF ANHEUSER-BUSCH AND AMERICA'S KINGS OF BEER 296 (2012).

¹⁹⁶ Ian Austin, *Molson Moves To Ensure Coors Merger Is Approved*, N.Y. TIMES, Jan. 15, 2015, at C3, available at <http://www.nytimes.com/2015/01/14/business/worldbusiness/molson-moves-to-ensure-coors-merger-is-approved.html>.

¹⁹⁷ Andrew Martin, *Merger for SABMiller and Molson Coors*, N.Y. TIMES, Oct. 10, 2007, at C3, available at http://www.nytimes.com/2007/10/10/business/worldbusiness/10beer.html?_r=0.

¹⁹⁸ KNOEDELSEDER, *supra* note 195, at 296.

¹⁹⁹ David Kesmodel & David Luhnnow, *Anheuser Seeks out a Mexican Ally*, WALL ST. J., June 13, 2008, at B1, available at <http://www.wsj.com/articles/SB121330336018469157>.

²⁰⁰ David Kesmodel, Dennis K. Berman & Dana Cimilucca, *Anheuser, InBev Reach a Deal for \$52 Billion*, WALL ST. J., July 14, 2008, at B1, available at <http://www.wsj.com/articles/SB121598077288249131>.

Today Anheuser-Busch InBev (“AB InBev”) is the largest global beer brewer and a top-five worldwide consumer products company with annual revenues of \$47.1 billion.²⁰¹ AB InBev has operations in 25 countries, sales in over 100 nations, and a global headcount of 155,000.²⁰² North America, including Mexico, and Latin America are the company’s two biggest markets, generating roughly 74.2% of revenue and 70.2% of sales volume in 2014.²⁰³ AB InBev now owns more than 200 brands of beer, 16 of which have estimated retail sales of over \$1 billion.²⁰⁴ The Board of Directors consists of 14 members, four of whom are Brazilian, four Belgian, and one American.²⁰⁵

The Subcommittee reviewed AB InBev’s responses to a limited set of interrogatories focused on the company’s tax profile and employment. The purpose of this inquiry was to assess the role tax considerations played in the acquisition and how the acquisition affected AB InBev’s employment figures in the United States, Belgium, and Brazil.²⁰⁶

Our review of the AB InBev merger reveals that the transaction was driven by non-tax, business considerations. Nevertheless the tax profiles of the two firms differed greatly pre-acquisition. Anheuser-Busch’s worldwide effective tax rate averaged 39.2% from 2005 through 2008, and its foreign earnings were subject to U.S. taxes if repatriated.²⁰⁷ By contrast, InBev’s worldwide effective tax rate before the acquisition averaged 19.7% through the same period.²⁰⁸ (After the merger, AB InBev was able to maintain an average worldwide effective tax rate of 19.3% from 2008 through 2014.²⁰⁹)

²⁰¹ EDWARD NEBB, AB INBEV, ANNUAL REPORT 2014 (Marianne Amssoms ed., Natacha Schepkens & Kathleen Van Boxelaer trans., 2014), *available at* http://www.ab-inbev.com/content/dam/universaltemplate/abinbev/pdf/investors/annual-and-hy-reports/2014/AB_InBev_AR14_EN_full.pdf.

²⁰² *Id.*

²⁰³ *Id.*

²⁰⁴ *Id.*

²⁰⁵ *Id.*

²⁰⁶ At the Subcommittee’s request, AB InBev broke down annual employment figures by location and category. The submission provided by AB InBev does not specify the reason for the reductions or the manners in which they were effected—whether voluntarily or involuntarily.

²⁰⁷ Letter from AB InBev to PSI (July 16, 2015) (“AB InBev Resp. I”).

²⁰⁸ *Id.*

²⁰⁹ AB InBev Resp. I.

In the years following the merger, non-U.S. income attributable to Anheuser-Busch grew significantly.²¹⁰ Had the combined AB InBev adopted the U.S. as its corporate home, it would have faced the following decision: Either repatriate this foreign income into the United States (and pay a significant tax bill) or keep the income abroad, regardless whether that was the most productive use of its capital. Because AB InBev instead had its headquarters in Belgium, it did not face this decision. If the merging parties expected significant non-U.S. growth post-acquisition, easier access to earnings may well have influenced the decision to locate AB InBev outside the U.S. tax net.

It is also clear from the record that a significant number of U.S. jobs were lost following the acquisition. From 2007 to 2015, the number of U.S.-based employees of AB InBev declined by about 30%, while the number of employees based in Leuven, Belgium and in the State of São Paulo, Brazil rose 34%.²¹¹ In particular, the company's U.S. headcount was reduced from 18,345 in 2007 to 12,938 in 2015. That 30% reduction is significantly higher than the 10% to 15% decrease that Anheuser-Busch announced before the merger as part of its restructuring plan.

In fact, due to a spinoff of a side business involving theme parks, the company has actually reduced its U.S.-based workforce by about 42%, going from 22,624 employees in 2007 to 12,938 in 2015. A significant portion of that reduction, however, is attributable to the sale of Busch Entertainment Corporation, which operated Busch Gardens theme parks, to The Blackstone Group in 2009. The Busch Entertainment Group employed roughly 4,500 people in 2008. Excluding the losses associated with the sale of Busch Gardens brings the U.S.-based employment losses to 5,407, which as noted above is a roughly 30% reduction.

Meanwhile, headcount in the state of São Paulo specifically increased roughly 50% from 2007 to 2014, going from 5,910 employees in 2007 to 8,861 in 2015. Between 2008 and 2012, the average yearly increase of State of São Paulo employees was 577. This increase in headcount coincided with an increase in revenue in the North of Latin America. Since 2012, headcount has remained relatively stable (between roughly 8,650 and 8,900 employees), suggesting that staffing levels may have stabilized.

²¹⁰ Letter from AB InBev to PSI (July 28, 2015) ("AB InBev Resp. II). Despite sometimes dramatic yearly fluctuations, non-U.S. income attributable to Anheuser-Busch between 2008 and 2014 greatly exceeded Anheuser-Busch's non-U.S. income from 2003-2008. *See* AB InBev Resp. I. This growth in post-merger income—and fluctuation—is reflective of the company's global growth.

²¹¹ AB InBev Resp. I.

| AB InBev Full-Time Employees in St. Louis, the United States, and Leuven, Belgium and São Paulo, Brazil (combined) | | | |
|--|-----------|-----------------------|-----------------------------|
| | St. Louis | United States | Leuven, Belgium & São Paulo |
| 2007 | 5,078 | 22,624 | 7,762 |
| 2008 | 4,425 | 21,401 | 8,626 |
| 2009 | 3,263 | 14,346 ²¹² | 8,529 |
| 2010 | 2,934 | 12,691 | 9,393 |
| 2011 | 2,540 | 11,989 | 9,698 |
| 2012 | 2,597 | 12,614 | 10,189 |
| 2013 | 2,619 | 12,640 | 10,320 |
| 2014 | 2,629 | 12,862 | 10,171 |
| 2015 | 2,512 | 12,938 | 10,428 |

The single largest category of U.S. job cuts was in the number of corporate workers, which dropped from 2,588 in 2007 to 1,017 in 2015—a roughly 60% reduction. Since 2007, St. Louis itself lost 1,214 employees out of its 2,037-person corporate workforce.²¹³ Compared to 2008 employment figures, the corporate workforce in St. Louis has decreased by approximately 53%.²¹⁴

²¹² As noted above, this decrease of approximately 7,000 employees in 2009 is partly attributable to the sale of Busch Entertainment Corporation, which accounted for the loss of 4,570 employees. Only 63 Busch Entertainment Corporation employees were based in St. Louis.

²¹³ The submission provided by AB InBev does not specify the reason for the reductions or the manners in which they were effected—whether voluntarily or involuntarily.

²¹⁴ It is unclear from AB InBev’s submission whether the 2008 employment figure reflects cuts that took place before or after InBev’s offer was accepted in July 2008.

| AB InBev Corporate Workforce in St. Louis and the United States | | |
|--|-----------|---------------|
| | St. Louis | United States |
| 2007 | 2,037 | 2,588 |
| 2008 | 1,730 | 2,277 |
| 2015 | 823 | 1,017 |

Given the limited nature of the Subcommittee’s review of the AB InBev acquisition, it is not possible to assess definitively whether the job loss experienced at Anheuser-Busch was a result of the acquisition. The facts available to the Majority Staff, however, show the Anheuser-Busch employee headcount fell significantly in the United States in the years following the company’s change of ownership.

CONCLUSION

The lesson policymakers should draw from our findings is straightforward: The high U.S. corporate tax rate and worldwide system of taxation are competitive disadvantages that make it easier for foreign firms to acquire American companies. Those policies also strongly incentivize cross-border merging firms, when choosing where to locate their new headquarters, not to choose the United States. The long term costs of these incentives can be measured in a loss of jobs, corporate headquarters, and revenue to the Treasury.

APPENDIX

Tim Hortons[®]



Lender Presentation

September 15, 2014

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PAGES

BKW-PSI-001324 - BKW-PSI-001358

**REDACTED BY
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INVESTIGATIONS**

Agenda

Ownership and Investment Highlights

Tim Hortons Company Overview

Burger King Company Overview

Strategic Rationale and Key Credit Highlights

Syndication Overview

Appendix

ADDITIONAL PAGES

BKW-PSI-001360 - BKW-PSI-001365

**REDACTED BY
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Project Red

Discussion Materials

June 2014

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PAGE

BKW-PSI-001367

**REDACTED BY
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INVESTIGATIONS**

Key Developments Since Initial Bid in March

We are proposing to increase our offer price to Red shareholders but continue to see similar PF value creation due to better-than-expected financing terms, a later closing date, and a revised tax structure

Price & Value Creation

- Propose increasing offer price – from C\$78 (32% premium to 30-day VWAP) up to C\$85 (44% premium)
- Pro forma value creation (~50% greater than status quo) remains consistent with prior materials due to better-than-expected bank financing terms, a revised tax structure, and a later transaction closing date (deal now expected to close at year-end, leading to higher financing EBITDA)
- The balance of the increase in purchase price will be funded by additional Blue equity issued to Red shareholders while total net leverage will remain consistent with the prior offer. Approximately 2/3rds of the additional purchase price is funded by incremental debt from higher financing EBITDA, with the remaining 1/3rd funded evenly between common equity and incremental preferred equity / cash

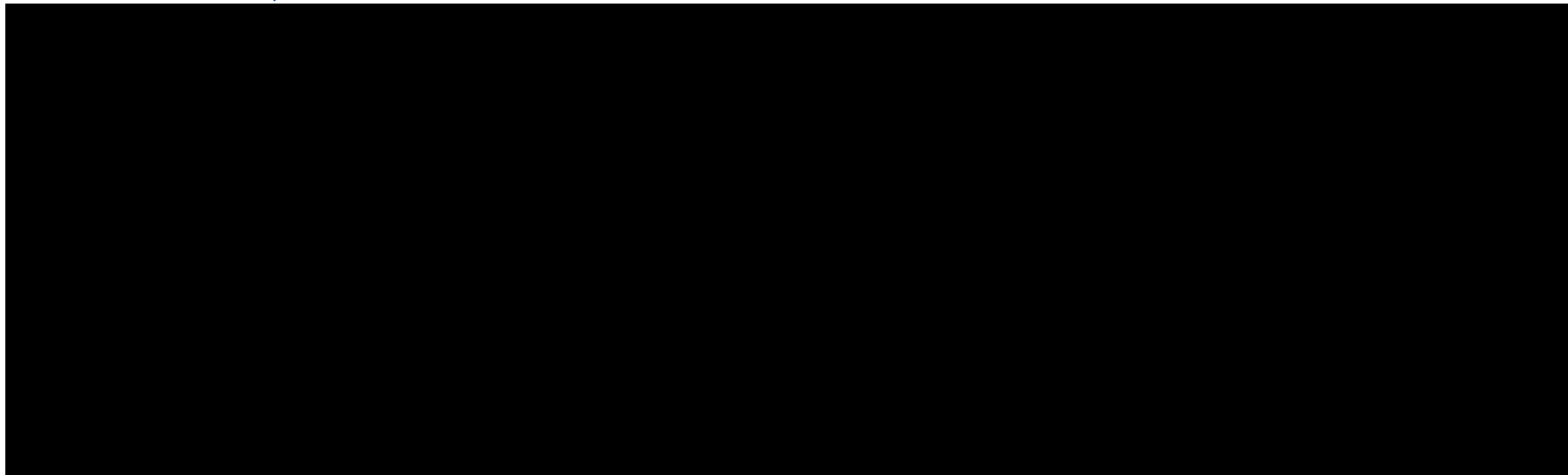
Financing

- Term loan pricing is more favorable than presented in the prior materials (L + 300bps vs. L + 350bps assumed in prior materials)
- Investor remains supportive of the transaction and is committed to providing preferred equity financing on the same terms discussed previously
- Although we would prefer the cash/stock deal outlined above, we are prepared to pursue an all-cash transaction if desired by Red. In this case, we would replace Red's rollover equity with equity from new/existing Blue shareholders, which would be fully-backstopped by bridge financing at signing. We have already secured fully-committed bridge financing on attractive terms from the banks

Investment Overview

We continue to believe that a combination with Red represents a compelling opportunity

1. **Attractive Business:** opportunity to acquire the dominant QSR in Canada with meaningful downside protection: consistent track record of growth, a fully-franchised, healthy, and fragmented franchisee base, and significant real estate control
2. **Attractive Valuation:** business trades at a significant discount to fully-franchised peers and has no significant owners
3. **Meaningful Value Creation:** [REDACTED]
4. **Cost Opportunity:** [REDACTED]
5. **Tax Optimization:** optimizes tax structure by using currently-available tax rules to move Blue offshore, allowing for tax-efficient access to non-U.S. profits for both Blue and Red



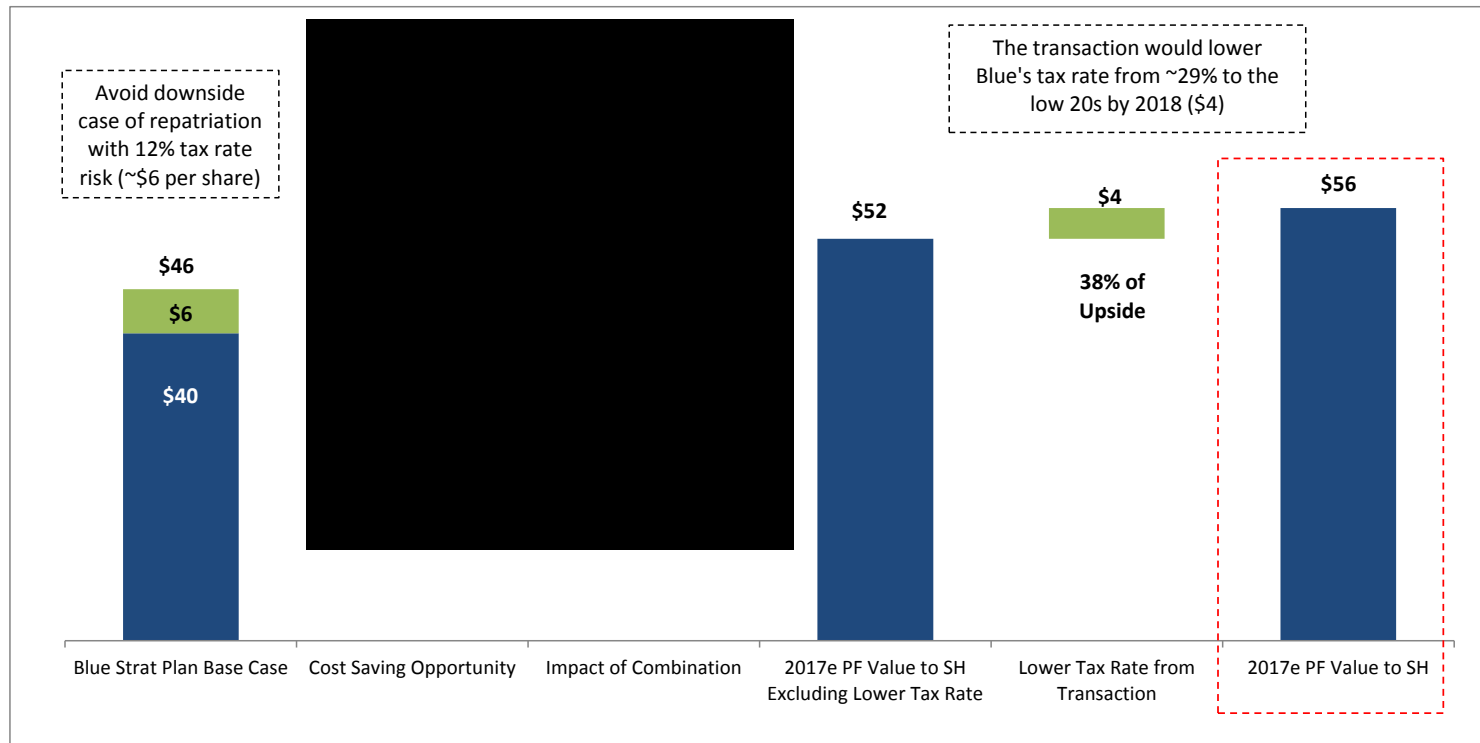
Tax Structure Developments Since Initial Bid in March

The combined company will now be domiciled in Canada instead of the UK, [REDACTED] and will likely be viewed more favorably by Red

- There have been two major changes to the contemplated tax structure:
 1. The combined company will now be domiciled in Canada (instead of the UK), which will likely be viewed more favorably by key stakeholders
 - Under current tax rules, inversions are permitted under one of two cases: (i.) the combined company has substantial business activities in the country of migration (exact definition provided in Appendix) or (ii.) target shareholders own at least 20% of the resulting company (i.e. the “80/20 rule”)
 - Because Red has substantial business activities in Canada, re-domiciling to Canada will successfully satisfy the first requirement
 - Because Red shareholders will continue to own >20% of the combined company, the structure satisfies the second requirement
 2. [REDACTED] we are now relying on an exchangeable share partnership structure to defer shareholder-level gain until shares are actually sold by US shareholders
- [REDACTED]
 - [REDACTED]

We Continue to See ~50% (\$4bn) Incremental Value Creation

2/3rds of additional value is from fundamentals, leverage, and cost savings, while 1/3rd is from tax savings



Note: Assumes forward P/E multiple of 21x earnings.

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5

Transaction Overview

The overall transaction structure has not changed meaningfully from the previous materials

- The acquisition will be funded by bank debt (5x net bank leverage), a preferred investment from Investor (5x-7x net leverage), and rollover equity from Red shareholders
 - **Term Loan**: we have received fully-committed financing packages from the banks on terms more favorable than we presented in March. Net bank leverage remains consistent with prior materials while the quantum of term loan has increased due to an increase in EBITDA based on a 2014 year-end transaction closing date
 - **Preferred Equity**: we have continued our dialogue with Investor and he remains committed to providing the preferred equity. We believe using a preferred instrument allows us to reduce dilution, bring in a strong partner, and increase the likelihood of a deal being approved by Red's Board and the Canadian government
 - **Rollover Equity**: Red shareholders will own ~22% of the combined company versus 21% as contemplated in the prior materials
- The transaction would be executed via a merger into a new-formed Canadian holding company. The transaction would not be taxable to Blue shareholders (to be discussed within)
- Similar to the prior structure, we plan to implement a series of tax-efficient corporate reorganization steps to move non-US assets out from under both Blue and Red to be directly owned by the new Canadian holding company to facilitate tax-efficient access to future offshore earnings

Tax Update – Re-domiciling to Canada

Re-domiciling to Canada provides similar tax benefits as the UK and will likely be viewed more favorably by key stakeholders

- [REDACTED]
- Because the vast majority of Red’s operations are based in Canada, if we were to migrate to Canada, the Substantial Business Activities test (“SBA”) would exempt us from the requirement that Red shareholders must own 20% of the combined company. SBA applies if the combined company has at least 25% of its employees, income, and assets in the destination country. [REDACTED]
 - Note that we will continue to satisfy the 20% PF ownership requirement as well
- Relying on SBA provides a number of benefits: (i) [REDACTED], (ii) the proposed migration to Canada will be viewed more favorably by the Red Board, Red shareholders, and ICA Ministers, and (iii) allows us to offer all-cash consideration to Red shareholders if needed
- The tax rate of a Canada-domiciled HoldCo will be slightly better than a UK-domiciled HoldCo due to differences in debt pushdown and interest income/expense tax rates
- [REDACTED]
- [REDACTED]

Tax Rate Considerations

- The effective tax rate of a Canadian HoldCo will be slightly better than the previously-contemplated UK HoldCo
 - Foreign shareholders will continue to be exempt from capital gains taxes
 - Canadian withholding tax rates for shareholders are more favorable than the US, as low as 15% for countries with treaties. But, they are less favorable than the 0% rate in the UK

| | UK (Prior Structure) | Canada (Current Structure) |
|----------------------------------|-------------------------|---|
| Corp. Income Tax Rate | 20% | 26.5% |
| <u>Dividend Tax Rates</u> | | |
| Local Tax on Dividends | 0% | 0% |
| W/H Tax on Dividends from US | 0% | 5% |
| W/H Tax on Dividends from Canada | 5% | N/M |
| W/H Tax on Dividends Paid to S/H | 0% to all countries | 15% to US 15% to Switzerland 15% to Netherlands 25% if no treaty (e.g. BVI, Brazil) |
| <u>Interest Income Tax Rates</u> | | |
| Local Tax on Interest Income | 5% | 0% |
| W/H Tax on Interest from US | 0% | 0% |
| W/H Tax on Interest from Canada | 10% | 0% |
| Incremental Tax on LAC Royalties | 5% (net of FTCs) | 0% |

ADDITIONAL PAGES

BKW-PSI-001372 - BKW-PSI-001374

BKW-PSI-001376 - BKW-PSI-001382

BKW-PSI-001384

BKW-PSI-001386 - BKW-PSI-001394

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INVESTIGATIONS**

Project Red

Board Update

August 13, 2014

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Investment Rationale

We continue to believe that a combination with Red represents a compelling opportunity

1. **Meaningful Value Creation:** [REDACTED]
[REDACTED]
 - [REDACTED]
 - [REDACTED]
 - Diversifies Blue's current concentration of risk in U.S. and emerging JV markets
 - [REDACTED]
[REDACTED]
2. **Cost Opportunity:** [REDACTED]
[REDACTED]
 - [REDACTED]
[REDACTED]
3. **Tax Optimization:** optimizes tax structure by moving Blue offshore, allowing for tax-efficient access to non-U.S. profits for both Blue and Red
 - Improves Blue's tax rate to low-20's from 40% in fully-distributed standalone scenario
 - Creates a tax-optimized platform for [REDACTED]

PAGES

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BKW-PSI-001438 - BKW-PSI-001475

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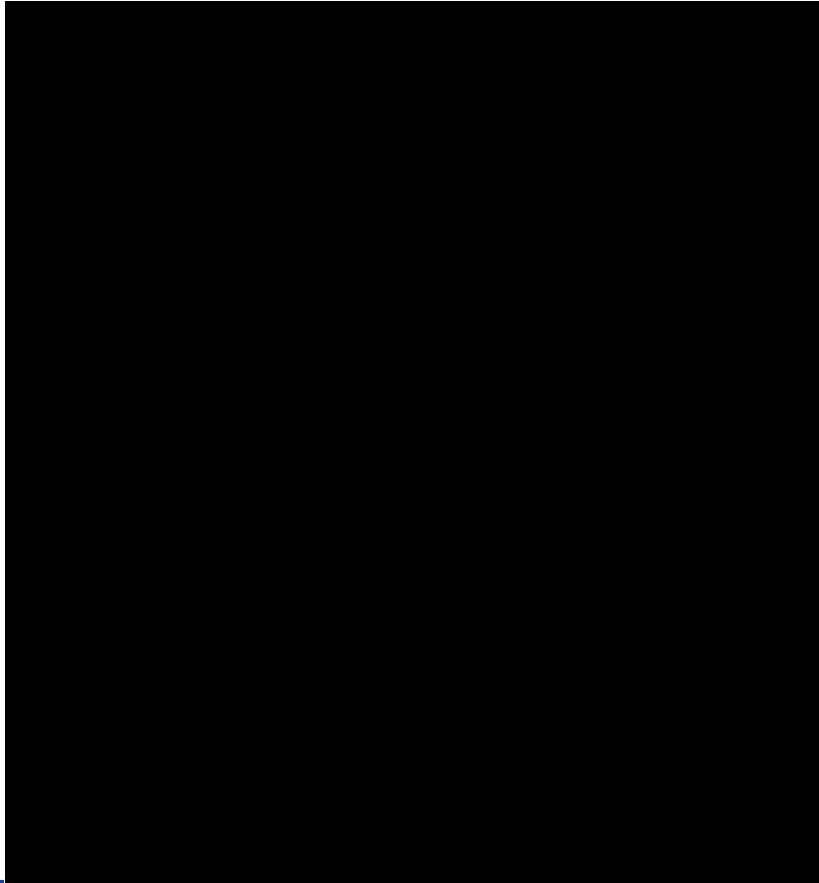
Investment Rationale

The combination with Red will generate substantial value to Blue's shareholders

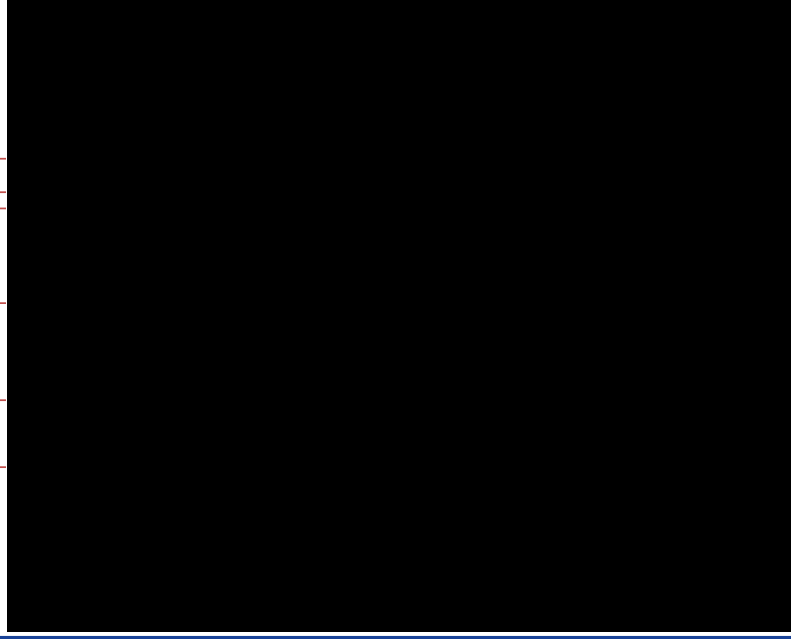
1. **Meaningful Value Creation:** [REDACTED]
[REDACTED]
 - Blue's standalone base case incorporates a 29% tax rate, which assumes that Blue finds a way to tax-efficiently access foreign cash. If this is not possible, Blue's standalone tax rate would increase to 40%, and both accretion and incremental value creation from the transaction are significantly higher
2. **Cost Opportunity:** [REDACTED]
 - [REDACTED]
3. **Tax Optimization:** optimizes tax structure by moving Blue offshore, allowing for tax-efficient access to non-U.S. profits for both Blue and Red
 - Improves Blue's tax rate to low-20's from 29% today and 40% in fully-distributed standalone scenario
 - [REDACTED]

Comparison of Prior Base Case to Red's Strategic Plan Model

- Red Strategic Plan projections are more aggressive than our Base Case as a result of significantly higher SSS growth assumptions of ~4% vs. 2%, offset slightly by higher unit growth in our Base Case of ~5% vs. ~4%



| Red's Strategic Plan (\$USD) | | | | | | | '13A-'18E |
|------------------------------|--------------|---------------|--------------|--------------|--------------|--------------|-------------|
| <u>\$USD</u> | <u>2013A</u> | <u>2014PF</u> | <u>2015E</u> | <u>2016E</u> | <u>2017E</u> | <u>2018E</u> | <u>CAGR</u> |
| Canada Units | 3,588 | 3,716 | 3,844 | 3,960 | 4,053 | 4,130 | 2.9% |
| US Units | 859 | 909 | 958 | 1,018 | 1,092 | 1,182 | 6.6% |
| Intern Units | 38 | 90 | 150 | 178 | 205 | 220 | 42.1% |



PAGES

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Investment Overview (continued)

1. Attractive Business:

[REDACTED]

2. Actionable Today:

[REDACTED]

3. Meaningful Value Creation:

[REDACTED]

4. Cost Opportunity:

[REDACTED]

5. Tax Optimization: value creation through tax at company and shareholder levels

- Utilize currently-available inversion rules to move Blue offshore, reduce Blue's corporate tax rate, and tax-efficiently access non-U.S. cash
- Would reduce current tax rate of 29% to the low to mid 20's in the medium term vs. potential downside of 40% on a standalone basis
- Incremental value creation from tax equates to \$1.4bn vs. status quo and \$5.5bn vs. a scenario where cash is repatriated

Transaction Structure Overview

The transaction can be structured to minimize dilution and not trigger Blue shareholder taxable gain

- | [REDACTED]
- | [REDACTED]
- | [REDACTED]
- | [REDACTED]

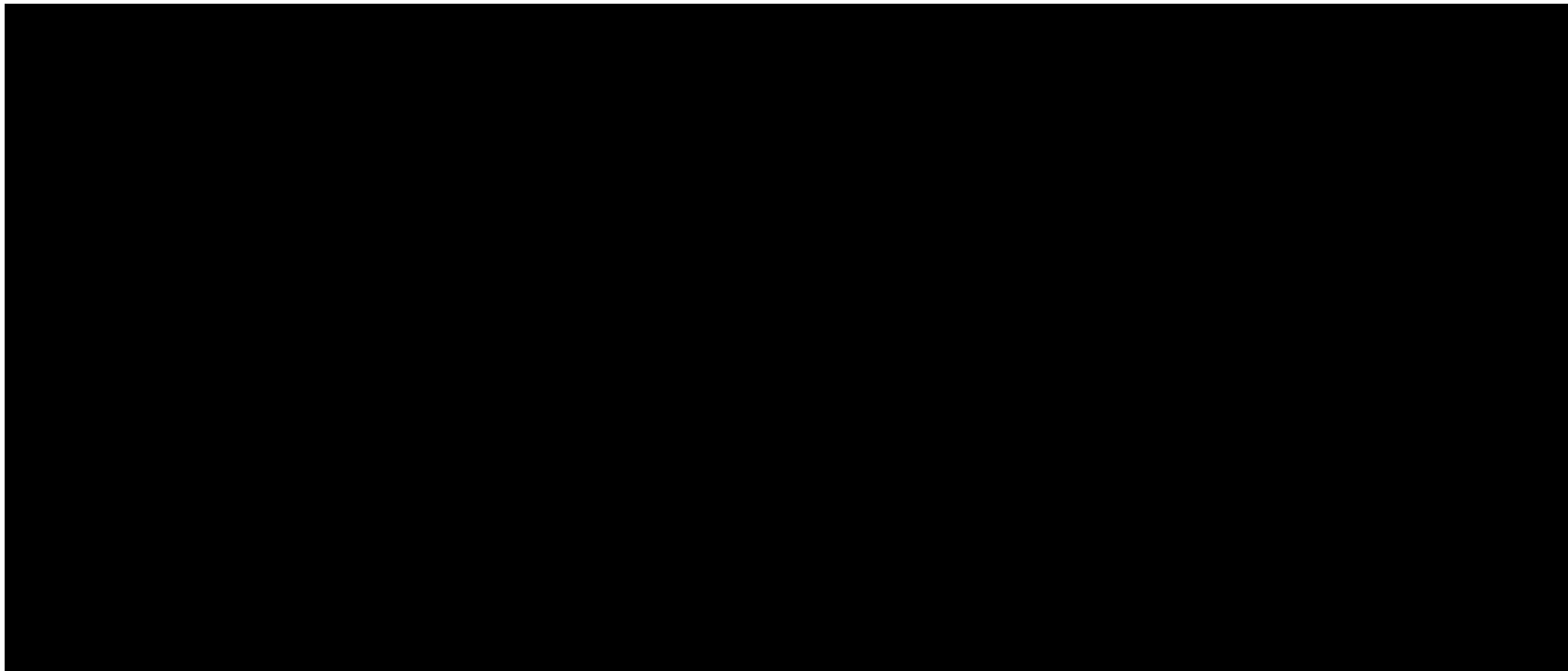
- The merger would be executed via an inversion into a newly-formed U.K. company
- Based on current inversion rules, the transaction would not be taxable to Blue shareholders as long as 20% of the PF shares of the new U.K. company is considered rollover equity from Red or from new investors
- We would also subsequently implement a series of tax efficient corporate reorganization steps to move non-U.S. assets out from under both Blue and Red to be directly owned by the new U.K. holding company to facilitate tax-efficient access to future offshore earnings

Status Quo Blue vs. Incremental Value from Red

From a DCF perspective, an acquisition of Red adds meaningful value relative to the Blue status quo

Assumptions:

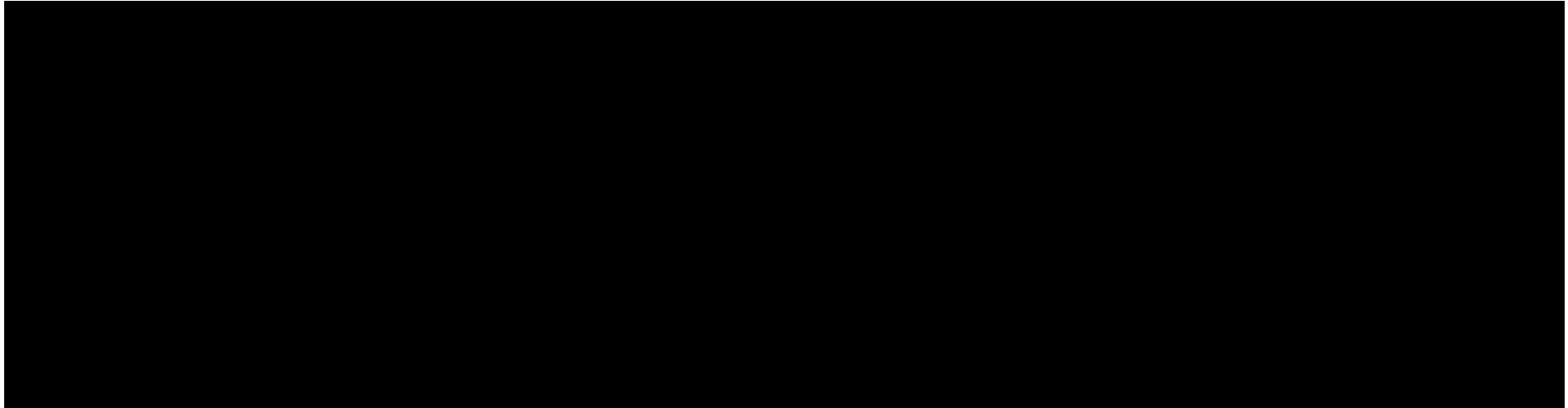
- [REDACTED]
- 40% downside tax rate for Blue standalone



Base Case PF Financial Model



2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024



GAAP Tax Rate % 18.9% 28.3% 27.5% 25.4% 23.3% 23.3% 23.3% 23.1% 22.9% 22.9% 22.9%



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Blue – Status Quo

Blue currently has a book effective tax rate of 28.5%, which is materially lower than the US corporate tax rate of 39.6% due to offshore IP holdings in Switzerland and Singapore. However, offshore earnings cannot be repatriated to the US without incurring material additional tax expense

- Prior owners sold EMEA and APAC IP to BKE and BKAP entities in 2006 via “Project One”
 - At the time, offshore earnings were not as significant as they are today and were largely reinvested to build new company restaurants in the regions
- As we have transitioned to a fully franchised business model with lower capital expenditures and realized significant earnings growth in EMEA and APAC, cash balances have increased to >\$250mm today

█ [REDACTED]

- Blue offshore cash balances are expected to grow significantly in 2014 and subsequent years

- Potential uses for this capital include investments [REDACTED]

- [REDACTED]

- [REDACTED]

Blue – Status Quo Corporate Level ETR

In connection with the 2013 Strategic Plan process, we projected a long term ETR for Blue of 29%. If our position regarding repatriation of foreign earnings were to change, Blue’s ETR would likely increase to >40% (US federal, state, and international withholding taxes).

- An 11% increase in ETR would lead to a 15% decline in Net Income

Burger King Worldwide - Status Quo Tax Rate Forecast

\$ in thousands

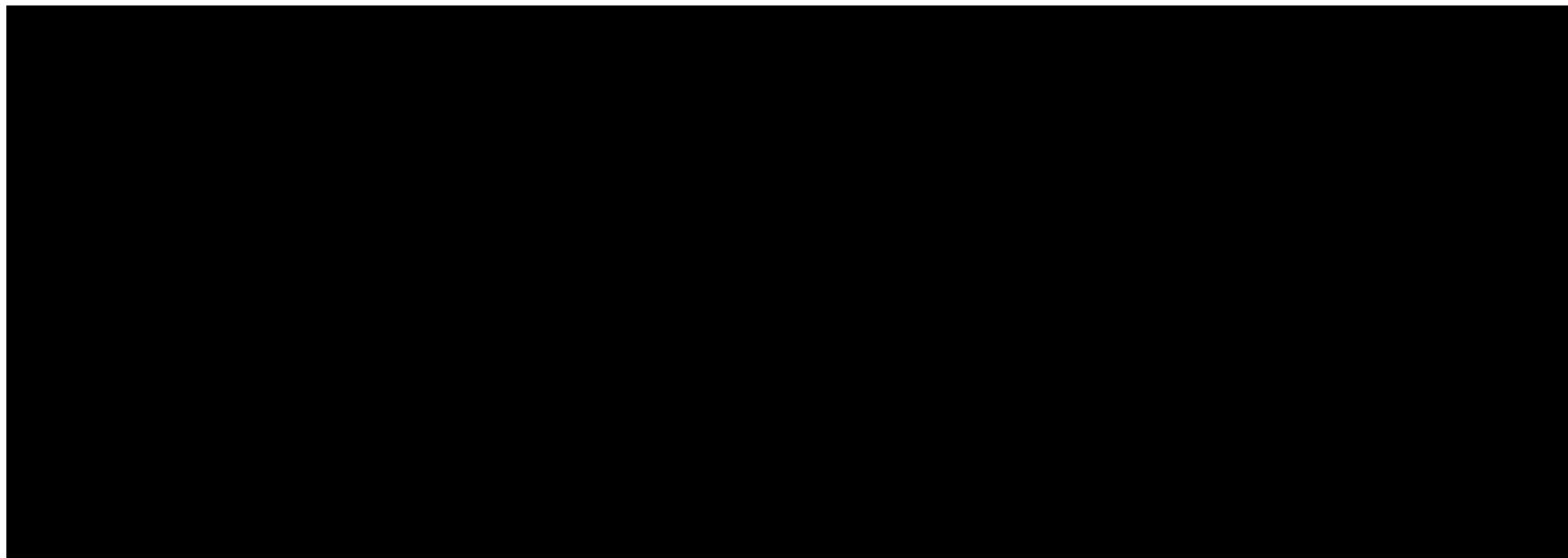
CY 13

CY 14

CY 15

CY 16

CY 17



WW ETR - Current Structure

29%

29%

29%

29%

29%

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HoldCo Jurisdiction

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Governance and Tax Considerations of Different Jurisdictions

SUMMARY TABLE - REQUIREMENTS FOR COMPANIES INCORPORATED IN FOLLOWING JURISDICTIONS

| Requirements | Canada (BCBCA) | Canada (CBCA) | UK | Switzerland | Luxembourg | Belgium | Ireland |
|--------------------------------------|----------------|---------------|----|-------------|------------|---------|---------|
| Head Office | | | | | | | |
| Local Representation on Board | | | | | | | |
| Minimum Board Size | | | | | | | |
| Term Limit | | | | | | | |
| Independent Directors | | | | | | | |
| No. of meetings (minimum) | | | | | | | |
| Location of Meetings | | | | | | | |
| Quorum | | | | | | | |
| Director Liability (indemnification) | | | | | | | |

Governance and Tax Considerations of Different Jurisdictions

| SUMMARY TABLE - SELECTED TAKEOVER RULES IN FOLLOWING JURISDICTIONS | | | | | | | |
|--|----------------|---------------|----|-------------|------------|---------|---------|
| Requirements | Canada (BCBCA) | Canada (CBCA) | UK | Switzerland | Luxembourg | Belgium | Ireland |
| Anti Takeover Allowed | | | | | | | |
| Mandatory Offer | | | | | | | |
| Squeeze Out | | | | | | | |
| Other | | | | | | | |
| Corp. Income tax | | | | | | | |
| Withholding tax on dividends paid | | | | | | | |
| Independent Directors | | | | | | | |
| Local Angle | | | | | | | |

Selected Corporate Governance Considerations

| | CANADA (BCBCA) | CANADA (CBCA) | UK |
|------------------------|----------------|---------------|----|
| HEAD OFFICE | | | |
| LOCAL REPRES. ON BOARD | | | |
| BOARD SIZE | | | |
| TERM LIMIT | | | |
| INDEPENDENCE | | | |
| DIRECTOR MEETINGS | | | |
| QUORUM | | | |
| DIRECTOR LIABILITY | | | |

Selected Corporate Governance Considerations

| | CANADA (BCBCA) | CANADA (CBCA) | UK |
|---------------------------------|----------------|---------------|----|
| OTHER GOVERNANCE CONSIDERATIONS | [REDACTED] | | |

Selected Tax Considerations

| | CANADA | UK |
|-----------------|--|---|
| INCOME TAX | <ul style="list-style-type: none"> Corporate Income Tax Rate: 26.5% | <ul style="list-style-type: none"> Corporate Income Tax Rate: 21% |
| WITHHOLDING TAX | <ul style="list-style-type: none"> 5-15% income tax treaty withholding tax rate on dividends paid to Canada from most jurisdictions | <ul style="list-style-type: none"> 0% income tax treaty withholding tax rate on dividends paid to U.K. from most jurisdictions 0% withholding tax rate on dividends paid to nonresidents (even if a treaty does not apply) Controlled foreign corporate rules may provide additional rate relief, e.g. certain income of CFCs may be taxed only at 5.25% |

Selected Corporate Governance Considerations

| | SWITZERLAND | LUXEMBOURG |
|------------------------|-------------|------------|
| HEAD OFFICE | | |
| LOCAL REPRES. ON BOARD | | |
| BOARD SIZE | | |
| TERM LIMIT | | |
| INDEPENDENCE | | |
| DIRECTOR MEETINGS | | |
| QUORUM | | |
| DIRECTOR LIABILITY | | |

Selected Corporate Governance Considerations

| | SWITZERLAND | LUXEMBOURG |
|---------------------------------|-------------|------------|
| OTHER GOVERNANCE CONSIDERATIONS | [REDACTED] | |

Selected Tax Considerations

| | SWITZERLAND | LUXEMBOURG |
|-----------------|--|--|
| INCOME TAX | <ul style="list-style-type: none"> Corporate Income Tax Rate: 24.43% (Federal and local) | <ul style="list-style-type: none"> Corporate Income Tax Rate: 29.22% |
| WITHHOLDING TAX | <ul style="list-style-type: none"> 0-15% income tax treaty withholding tax rate on dividend paid to Switzerland from most jurisdictions 35% withholding tax rate on dividends paid to nonresidents (unless a treaty applies) | <ul style="list-style-type: none"> 0-15% income tax treaty withholding tax rate on dividends paid to Luxembourg from most jurisdictions 15% withholding tax rate on dividends paid to nonresidents (unless a treaty applies) |

Selected Corporate Governance Considerations

| | BELGIUM | IRELAND |
|------------------------|------------|---------|
| HEAD OFFICE | [REDACTED] | |
| LOCAL REPRES. ON BOARD | | |
| BOARD SIZE | | |
| TERM LIMIT | | |
| INDEPENDENCE | | |
| DIRECTOR MEETINGS | | |
| QUORUM | | |
| DIRECTOR LIABILITY | | |

Selected Corporate Governance Considerations

| | BELGIUM | IRELAND |
|---------------------------------|------------|---------|
| OTHER GOVERNANCE CONSIDERATIONS | [REDACTED] | |

Selected Tax Considerations

| | BELGIUM | IRELAND |
|-----------------|---|---|
| INCOME TAX | <ul style="list-style-type: none"> Corporate Income Tax Rate: 33.99% | <ul style="list-style-type: none"> Corporate Income Tax Rate: 12.5% – 33% (depending on type of income) |
| WITHHOLDING TAX | <ul style="list-style-type: none"> 10-25% withholding rate on dividends paid to nonresidents | <ul style="list-style-type: none"> 5-15% income tax treaty withholding tax rate on dividends paid to Ireland from most jurisdictions 20% withholding tax rate on dividends paid to nonresidents (unless a treaty applies) |

Withholding Tax by Jurisdiction

| DIVIDENDS | | | | | | | | |
|-----------|-------------|-------|---------|--------|---------|------------|-------------|-------|
| | PAYEE | US | BELGIUM | CANADA | IRELAND | LUXEMBOURG | SWITZERLAND | UK |
| PAYOR | US | NA | 0-15% | 5-15% | 5-15% | 5-15% | 0-15% | 0-15% |
| | Belgium | 0-15% | NA | 0-15% | 0-15% | 0-15% | 0-15% | 0-15% |
| | Canada | 5-15% | 0-15% | NA | 5-15% | 5-15% | 0-15% | 5-15% |
| | Ireland | 0% | 0% | 0% | NA | 0% | 0% | 0% |
| | Luxembourg | 0-15% | 0-15% | 0-15% | 0-15% | NA | 0-15% | 0-15% |
| | Switzerland | 5-15% | 0-15% | 0-15% | 0-15% | 0-15% | NA | 0-15% |
| | UK | 0% | 0% | 0% | 0% | 0% | 0% | NA |

| INTEREST | | | | | | | | |
|----------|-------------|-------|---------|--------|---------|------------|-------------|-------|
| | PAYEE | US | BELGIUM | CANADA | IRELAND | LUXEMBOURG | SWITZERLAND | UK |
| PAYOR | US | NA | 0% | 0% | 0% | 0% | 0% | 0% |
| | Belgium | 0-15% | NA | 10% | 0-15% | 0-15% | 0-10% | 0-10% |
| | Canada | 0% | 10% | NA | 10% | 10% | 0-10% | 10% |
| | Ireland | 0% | 0-15% | 0-10% | NA | 0% | 0% | 0% |
| | Luxembourg | 0% | 0% | 0% | 0% | NA | 0% | 0% |
| | Switzerland | 0% | 0% | 0% | 0% | 0% | NA | 0% |
| | UK | 0% | 0-10% | 0-10% | 0-10% | 0% | 0% | NA |

Source: KPMG.

Note: Canadian withholding tax is not imposed on distributions that are reductions of capital. In the transaction as contemplated, all distributions from Red Canada OpCo are expected to be non-taxable reductions of capital in the short to medium term

U.K. Jurisdiction Tax Overview

For the following reasons, the United Kingdom is a desirable jurisdiction for New Red

- Low statutory corporate income tax rate of 21%
- By comparison: Canada (26.5% corporate income tax rate); Ireland (12.5 -33% income tax rate depending on the type of income); Switzerland (24.43% corporate income tax rate); Luxembourg (29.22% corporate income tax rate). [REDACTED]
[REDACTED]
[REDACTED]
- [REDACTED]
[REDACTED]
- Extensive treaty network
- 0% income tax treaty withholding tax rate on qualifying dividends paid to U.K. from most jurisdictions
- [REDACTED]
[REDACTED]
- [REDACTED]
- [REDACTED]
- There have been a number of inversions that have already occurred in the U.K., e.g., Aon Corporation, Rowan Companies

ADDITIONAL PAGES

BKW-PSI-001673 - BKW-PSI-001680

BKW-PSI-001682 - BKW-PSI-001692

BKW-PSI-001695 - BKW-PSI-001695

BKW-PSI-001697 - BKW-PSI-001823

BKW-PSI-001826 - BKW-PSI-001832

BKW-PSI-001846 - BKW-PSI-001896

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Project Merlin

August 31st, 2012



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Project Merlin

August 31st, 2012





Executive summary

- Medicis is a dermatology and Aesthetics company focused on Acne products along with an injection Aesthetics platform
 - Public company founded in 1988, with full sales and marketing capabilities
 - Current Derm force of ~170 sales reps; Aesthetics sales force of ~110 sales reps
 - 2011 net sales of \$721M with gross margin of 90% and EBITDA of \$247M
- Re-reviewing opportunity given recent drop in analyst expectation post Q2 earning call
 - Likely price expectations have dropped as Solodyn future sales expectations have become more clear
 - Have received feedback from Merlin advisors that company is interested in sale and there is general corporate fatigue from continually changing strategies
- Opportunity to build the US Dermatology portfolio and Aesthetics portfolio bolstering presence in acne, and Aesthetic injectable space
 - Oral acne product to compliment topical offerings
 - Restylane and Dysport complement current Sculptra offering
 - Opportunity to leverage current infrastructure to realize corporate synergies
- Preliminary Model at \$44/share (~2.6B)
 - **VPNA Tax Rate (36%)**
 - Base case NPV of 981M with an IRR of 14% and payback of 9.1 years
 - Conservative NPV of 9M with an IRR of 9% and a payback of 10+ years
 - Upside NPV of 2,286M with an IRR of 19% and a payback of 6.1 years
 - **Alternate Tax Rate (20%-TBD)**
 - Base case NPV of 1,721M with an IRR of 17% and payback of 7.2 years
 - Conservative NPV of 476M with an IRR of 12% and a payback of 9.1 years
 - Upside NPV of 3,370M with an IRR₃ of 23% and a payback of 5.0 years



Diligence summary (2/2)

■ HR/Severance

- Reviewed employee contracts and company severance policy
- Based on current synergy estimates we believe calculations are fairly accurate

■ Material Contracts

- S&C reviewed current marketed product contracts
- Finalizing assessment of potential consent requirements needed for in-licensed products and development programs

■ Tax

- Reviewed recent tax returns
- Analysis has shown possible structure for 20% effective tax rate post acquisition

■ Finance

- Reviewed historical financials and most recent forecasts
- No key issues identified



Summary of Valuations (US Tax Rate 36%)

| USD (M) | Base | Conservative | Upside |
|----------------------|-------|--------------|--------|
| NPV (Standalone) | 1,312 | 631 | 2,697 |
| PV of Business | 827 | 526 | 1,519 |
| TV | 485 | 105 | 1,178 |
| Synergy NPV | 2,439 | 2,147 | 2,358 |
| Synergized NPV | 3,613 | 2,640 | 4,913 |
| NPV @ \$44/Share | 981 | 9 | 2,281 |
| IRR | 14% | 9% | 19% |
| Payback undiscounted | 9.1 | 10+ | 6.2 |

Summary of Valuations (Tax Rate 20% - TBD)

| USD (M) | Base | Conservative | Upside |
|-------------------------|--------------|--------------|--------------|
| NPV (Standalone) | 1,403 | 521 | 3,152 |
| PV of Business | 903 | 515 | 1,779 |
| TV | 500 | 7 | 1,373 |
| Synergy NPV | 3,118 | 2,754 | 3,018 |
| Synergized NPV | 4,352 | 3,107 | 5,996 |
| NPV @ \$44/Share | 1,721 | 476 | 3,364 |
| IRR | 17% | 12% | 23% |
| Payback undiscounted | 7.2 | 9.1 | 5.0 |



Tax Benefits

- Large tax on installment sale is offset by:
 - Increased profits attributable to synergies will be taxed at less than 4%
 - Increase interest expense will further erode Merlin's tax base

ADDITIONAL PAGES

VRXPSI-01-0000082 - VRXPSI-01-0000086

VRXPSI-01-0000088 - VRXPSI-01-0000091

VRXPSI-01-0000094 - VRXPSI-01-0000103

VRXPSI-01-0000105 - VRXPSI-01-0000113

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Established global commercial platform in place

MAJOR INVESTMENT

Revenues in
100+ Countries

3,700 Sales
Personnel

Manufacturing in
9 Countries

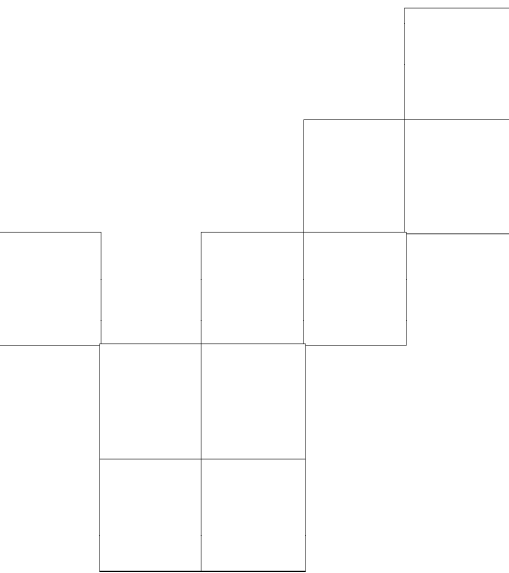
Development
& Research
at 25 Sites

LEVERAGE

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Project Stratos

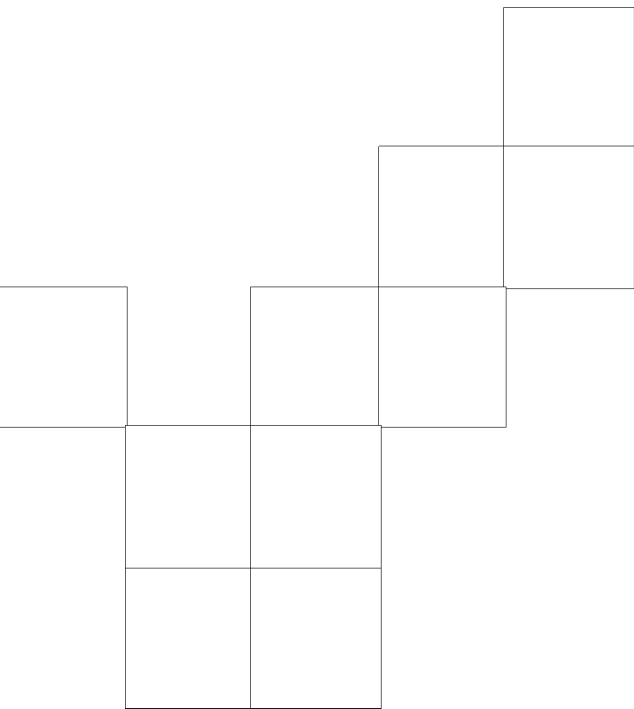
May 19th, 2013

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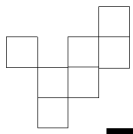
VRXPSI-01-0000612



Project Stratos

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Executive summary

- Opportunity to acquire Bausch & Lomb, leading Ophthalmology focused company from Warburg Pincus
 - Leading Ophthalmology portfolio with leading brands across Rx Pharma, Consumer products, and Surgery
 - Established sales force and commercial operations WW, covering all major markets and geographies
 - WW R&D, supply chain and manufacturing operations, majority of products sold and distributed in house
 - Since privatization, series of management initiatives to cut costs
 - 2012 Expected Sales: ~3B

- Warburg Pincus Acquired B&L in buy-out in 2007
 - ~3.7B buy-out with additional 830M in debt
 - Transaction: ~2B in Cash and 2.5B in Debt

- Opportunity to immediately become leading Ophthalmology company and expand global presence and reach
 - Opportunity for significant further synergies
 - Transaction immediately accretive and reduces debt leverage
 - Opportunity to sell of non-core assets

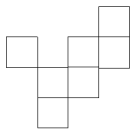
- Preliminary Model (total deal value of ~8.5B, 4.2B in Debt and 4.3B in Equity)
 - 36% Tax: NPV of 3,535M with an IRR of 12% and payback of 9.7 years
 - 20% Tax: NPV of 3,535M with an IRR of 15% and payback of 8.0 years

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Company Comparison

| | Valeant | Stratos |
|---------------------|----------------|----------------|
| Market Cap* | \$24,366 | \$4,300 |
| Enterprise Value* | \$34,481 | \$8,500 |
| Shares | 311.7 | - |
| Sales - 2013E | \$4,790 | \$3,207 |
| EBITA - 2013E | \$2,581 | \$499 |
| Net Income -2013E | \$1,879 | \$186 |
| EPS | \$6.03 | - |
| Net Debt | \$10,115 | \$4,200 |
| Share Price | \$78.17 | - |
| P/EBITA | 9.4 X | 8.6 X |
| P/E 2013 | 13.0 X | 23.1 X |
| Net Debt/Market Cap | 0.4 X | 1.0 X |
| Net Debt/EBITA 2013 | 3.9 X | 8.4 X |
| Tax Rate | 3.00% | 32.00% |

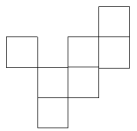
*Market Cap and Enterprise value taken as modeled equity and debt

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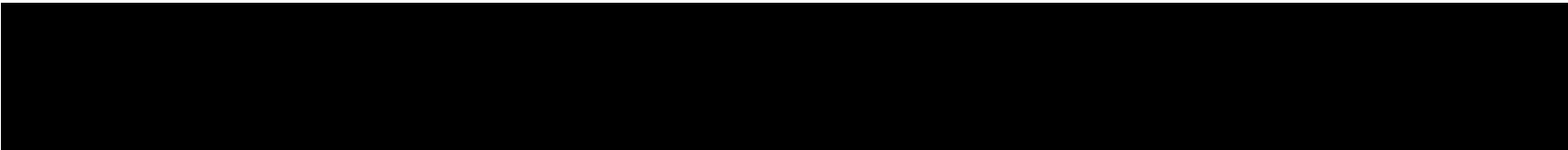
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Key Assumptions

| | Base |
|------------------|---|
| Sales Growth | [REDACTED] |
| COGS | [REDACTED] |
| Distribut. | [REDACTED] |
| Synergy** | [REDACTED] |
| Interest Expense | [REDACTED] |
| Depreciation | [REDACTED] |
| Other | [REDACTED] Tax Rate: 36% VPNA; 20% VPII (Based on sale/license of US and Foreign IP) [REDACTED] |

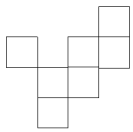


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Summary of Valuations - Base

| USD (M) | US Tax (36%) | VPII (20%) - TBD |
|----------------------|--------------|------------------|
| NPV | \$3,535 | \$3,535 |
| PV of Business | \$2,121 | \$2,121 |
| TV | \$1,413 | \$1,413 |
| Cost Synergy | \$6,736 | \$8,487 |
| Synergized NPV | \$10,110 | \$12,502 |
| NPV @ Price \$8.5B | \$1,610 | \$4,002 |
| IRR | 12% | 15% |
| Payback undiscounted | 9.7 | 8.0 |

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VALEANT
Pharmaceuticals International, Inc.

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Geographic Expansion: Exploiting Three Growth Tracks



2013 – 2014 Financial Assumptions

- **All figures presented on Management Basis (non-GAAP)**
 - excludes results of TPV in the historical periods when it had been spun-out into a joint venture
 - excludes unusual or one-time adjustments consistent with those used in calculating Adjusted EBITDA.
- **Major currency assumptions:**
 - Euro: 1.25
 - Japanese yen: 100
- **Assumed EBIT of \$ [REDACTED] in 2013 and \$ [REDACTED] in 2014**
- **Interest calculations assume June 30 IPO and debt repayment with proceeds and using rates to be effective upon anticipated repricing in May.**
- **Depreciation: \$ [REDACTED] in 2013; \$ [REDACTED] in 2014**
- **Amortization: \$ [REDACTED] in 2013; \$ [REDACTED] in 2014**
- **Non-GAAP effective tax rate of ~32% and does not factor any valuation allowance changes. Additionally, does not include the impact of any potential tax settlements on the effective rate.**
- **Stock compensation expense consistent with historical levels ([REDACTED]). As a public company, this is likely to increase substantially.**

ADDITIONAL PAGES

VRXPSI-01-0000667 - VRXPSI-01-0000692

VRXPSI-01-0000694 - VRXPSI-01-0000698

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INVESTIGATIONS**

Salix Pharmaceuticals Ltd. (SLXP)

Quickly Reducing Inventory; Risks Remain; Reinstating Our Rating at Market Perform

MARKET PERFORM | Price: \$110.11 | Target Price: N/A

MARKET DATA

| | |
|---------------------------|--------------------|
| Price | \$110.11 |
| 52-Week Range: | \$83.26 - \$172.98 |
| Shares Out. (M): | 75.6 |
| Market Cap (\$M): | \$8,324.3 |
| Average Daily Vol. (000): | 865.0 |
| Cash (M): | \$423 |
| Total Debt (M): | \$2,761 |

Source: Thomson Reuters and JMP Securities LLC

INVESTMENT HIGHLIGHTS

Salix Pharmaceuticals provided an updated plan for an expedited inventory work-down, issued 2015-2016 guidance, and announced a three-month Xifaxan IBS PDUFA extension; we are reinstating our rating at Market Perform (our prior rating was Market Outperform). We are pleased that SLXP has chosen to more rapidly draw down its wholesaler inventories by the end of 2015 (vs. end of 2016) to more quickly return to demand-driven results. This move brings 2015 guidance well below consensus and raises 2016 above current consensus. However, in our opinion, the guidance reflects unsustainably low tax rates below SLXP's normalized mid/high-30% rate and if fully taxed, our estimates would be >25% below guidance; thus, we caution against placing a standalone premium multiple on tax-inflated EPS. Investors reacted positively to guidance, the FDA's proactive Xifaxan IBS PDUFA extension, and to SLXP's first-year IBS sales forecast of \$125-\$150M. However, we think the PDUFA delay may suggest increased odds of another Advisory Committee meeting; something we believe the company does not expect, and a potential wildcard, in our view. The IBS sales forecast is difficult to parse from current off-label IBS use, and is not necessarily incremental to current sales. SLXP trades at ~17x fully taxed (37%) 2016 EPS guidance (which does not appear conservative to us). While it is not overly expensive for a growth story, we note that the already taken-out AGN & AUXL are at 20x and 18x consensus, respectively.

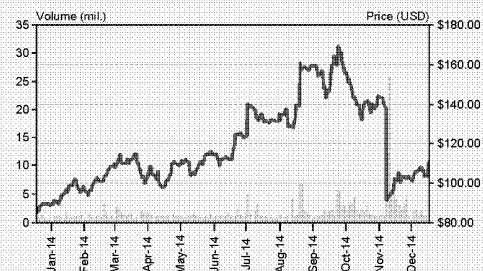
We do not expect an acquisition of SLXP prior to receiving clarity around IBS, resolution on the standing of management and board members, or certainty around regulatory issues or the potential for financial restatement. SLXP provided assurances from E&Y after 3Q that its figures are sound; however, we are not fully comfortable that reported sales/profits that exceed pull-through demand are acceptable, even if 'a sale is a sale'. We question whether the exceptional inventory stocking that appeared to occur over three years across different wholesalers could be perceived as inadvertent. While we like SLXP's underlying assets, we see continued risks to the story and feel that shares are fairly valued currently.

Faster de-stocking, and 2015 and 2016 guidance. Bringing down inventories to three months from nine months on key products by the end of 2015 (vs. the end of 2016) yields lower 2015 net sales guidance (\$1.25B-\$1.35B vs. the Street's \$1.51B), and higher 2016 net sales (\$1.9B-\$2B vs. the Street's \$1.86B). SLXP's product demand projections (Rx growth) are in line with our estimates. EPS guidance for 2015 of \$3.10-\$4.10 (Street \$4.32) reflects an effective 3% tax rate, and 2016 EPS guidance of \$8.50-\$9.50 (Street \$6.12) assumes 14% taxes. We are not yet clear on lower tax rates, but SLXP has historically guided to the mid/high-30% range (thus, its planned "inversion"). Our new estimates fall within guidance ranges, but assuming full/sustainable taxes, our

| FY DEC | | 2013A | 2014E | 2015E |
|---------------|-----------|----------------|------------------|------------------|
| Revenue (\$M) | 1Q | \$202.6 | \$384.4A | -- |
| | 2Q | \$235.4 | \$382.0A | -- |
| | 3Q | \$238.2 | \$354.7A | -- |
| | 4Q | \$257.6 | \$155.1 | -- |
| | FY | \$933.8 | \$1,276.2 | \$1,355.1 |
| EPS | 1Q | \$0.63 | \$1.05A | -- |
| | 2Q | \$0.76 | \$1.59A | -- |
| | 3Q | \$0.90 | \$1.53A | -- |
| | 4Q | \$1.06 | (\$0.55) | -- |
| | FY | \$3.36 | \$3.66 | \$3.91 |
| P/E | 32.8x | 30.1x | 28.2x | |
| Previous FY | NC | \$5.48 | \$5.03 | |

Source: Company reports and JMP Securities LLC

STOCK PRICE PERFORMANCE



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212-906-3566

FOR DISCLOSURE AND FOOTNOTE INFORMATION, REFER TO JMP FACTS AND DISCLOSURES SECTION.

PAGES

VRXPSI-01-0000868 - VRXPSI-01-0000876

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Management Presentation

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Salix Management Projections P&L

Fiscal Year Ended December 31,

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | '15-'19 CAGR | '15-'24 CAGR |
|-----------------------|------------------------|--------------------|---------|---------|---------|---------|---------|---------|---------|---------|-----------------|-----------------|
| Revenue | \$1,433 ⁽¹⁾ | \$2,276 | \$3,108 | \$3,898 | \$5,016 | \$6,377 | \$7,486 | \$8,379 | \$9,143 | \$9,988 | 36.8% | 24.1% |
| % Growth | 23% | 59% ⁽²⁾ | 37% | 25% | 29% | 27% | 17% | 12% | 9% | 9% | | |
| Gross Profit | \$1,142 | \$1,892 | \$2,667 | \$3,372 | \$4,388 | \$5,619 | \$6,613 | \$7,441 | \$8,188 | \$8,979 | 40.0% | 25.8% |
| % Margin | 80% | 83% | 86% | 86% | 87% | 88% | 88% | 89% | 90% | 90% | | |
| SG&A ⁽³⁾ | (556) | (640) | (682) | (856) | (1,101) | (1,400) | (1,643) | (1,839) | (2,007) | (2,192) | | |
| % of Sales | 39% | 28% | 22% | 22% | 22% | 22% | 22% | 22% | 22% | 22% | | |
| R&D ⁽³⁾ | (189) | (223) | (304) | (382) | (491) | (625) | (733) | (821) | (896) | (978) | | |
| % of Sales | 13% | 10% | 10% | 10% | 10% | 10% | 10% | 10% | 10% | 10% | | |
| EBITDA ⁽⁴⁾ | \$469 | \$1,101 | \$1,754 | \$2,210 | \$2,874 | \$3,675 | \$4,318 | \$4,865 | \$5,373 | \$5,897 | 57.4% | 32.5% |
| % Margin | 33% | 48% | 56% | 57% | 57% | 58% | 58% | 58% | 59% | 59% | | |
| Cash Int. Exp. | (116) | (105) | (23) | (18) | (14) | (12) | (6) | (0) | (0) | (0) | | |
| Cash Taxes | (11) | (138) | (658) | (833) | (1,087) | (1,392) | (1,639) | (1,849) | (2,042) | (2,241) | | |
| Cash Tax Rate | 3% | 14% | 38% | 38% | 38% | 38% | 38% | 38% | 38% | 38% | | |
| Adj. Net Income | \$342 | \$859 | \$1,073 | \$1,359 | \$1,773 | \$2,271 | \$2,674 | \$3,016 | \$3,331 | \$3,656 | 50.9% | 30.1% |
| Adjusted EPS | \$4.44 | \$11.15 | \$14.18 | \$17.72 | \$22.82 | \$28.86 | \$33.55 | \$37.38 | \$40.77 | \$44.21 | 50.6% | 29.1% |
| % Growth | 84% | 151% | 27% | 25% | 29% | 26% | 16% | 11% | 9% | 8% | | |
| Memo: DSOs | 77.0 | 77.0 | 75.7 | 76.7 | 77.7 | 78.7 | 79.7 | 80.7 | 81.7 | 82.7 | | |

Source: Financial Projections per Salix management.

Note: Dollars in millions, except per share.

(1) Demand revenue is ~\$395mm above revenue due to channel inventory drawdown in 2015.

(2) 2016 incorporates Oral Relistor launch.

(3) GAAP R&D and SG&A net of milestones and transaction expenses, respectively, as well as amortization expense.

(4) EBITDA adds back depreciation and stock based compensation of \$9mm and \$63mm, respectively, in 2015, growing to \$9mm and \$80mm in 2024.



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PAGES

VRXPSI-01-0000904 - VRXPSI-01-0001046

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Project Sun

February 6, 2015



PAGES

VRXPSI-01-0001072 - VRXPSI-01-0001111

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Base case 1

Description

IRR sensitivity to price and tax rate

| | @1% terminal growth | Purchase price | | | | |
|----------|---------------------|----------------|--------|--------|--------|--------|
| | | \$140 | \$145 | \$150 | \$155 | \$160 |
| Tax rate | 5% | 24.50% | 24.00% | 23.40% | 22.90% | 22.40% |
| | 10% | 23.50% | 23.00% | 22.40% | 21.90% | 21.40% |
| | 36% | 17.50% | 17.00% | 16.50% | 16.10% | 15.60% |

IRR sensitivity to price and terminal growth

| | @36% tax | Purchase price | | | | |
|-----------------|----------|----------------|--------|--------|--------|--------|
| | | \$140 | \$145 | \$150 | \$155 | \$160 |
| Terminal growth | -10% | 10.80% | 10.30% | 9.80% | 9.30% | 8.90% |
| | -5% | 12.90% | 12.40% | 11.90% | 11.50% | 11.00% |
| | 0% | 16.50% | 16.00% | 15.50% | 15.10% | 14.60% |
| | 1% | 17.50% | 17.00% | 16.50% | 16.10% | 15.60% |

Base case 2

Description

IRR sensitivity to price and tax rate

| | @1% terminal growth | Purchase price | | | | |
|----------|---------------------|----------------|--------|--------|--------|--------|
| | | \$140 | \$145 | \$150 | \$155 | \$160 |
| Tax rate | 5% | 17.20% | 16.70% | 16.30% | 15.80% | 15.40% |
| | 10% | 16.40% | 15.90% | 15.40% | 15.00% | 14.50% |
| | 36% | 11.40% | 11.00% | 10.60% | 10.20% | 9.90% |

IRR sensitivity to price and terminal growth

| | @36% tax | Purchase price | | | | |
|-----------------|----------|----------------|--------|--------|--------|-------|
| | | \$140 | \$145 | \$150 | \$155 | \$160 |
| Terminal growth | -10% | 9.90% | 9.40% | 9.00% | 8.60% | 8.30% |
| | -5% | 10.30% | 9.90% | 9.50% | 9.10% | 8.70% |
| | 0% | 11.10% | 10.70% | 10.30% | 10.00% | 9.60% |
| | 1% | 11.40% | 11.00% | 10.60% | 10.20% | 9.90% |

ADDITIONAL PAGES

VRXPSI-01-0001114 - VRXPSI-01-0001120

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Specialty Pharma

CHANGING ESTIMATES

**Medicis Pharmaceutical Corporation**

| | |
|---------------|----------|
| Symbol | MRX |
| Rating | Positive |
| Price | \$33.31 |
| Price target | \$40.00 |
| Downside risk | \$28.00 |

Company market data

| | |
|------------------------------|-----------------|
| 52 week range | \$40.10-\$29.76 |
| Shares out. | 59.493mm |
| Market cap. | 1,982mm |
| Average daily trading volume | 1,084,799 |
| Beta | 0.99 |

Calendar year December

| | 2011e | | 2012e | | 2013e | |
|-----------|-------|---------|-------|---------|-------|---------|
| | Prior | Current | Prior | Current | Prior | Current |
| EPS | | | | | | |
| Q1 | 0.55A | 0.60A | - | - | - | - |
| Q2 | 0.68A | 0.45 | 0.52A | - | - | - |
| Q3 | 0.61A | 0.81 | 0.53 | - | - | - |
| Q4 | 0.56A | 0.92 | 0.80 | - | - | - |
| CY EPS | 2.40 | 2.78 | 2.45 | 3.20 | 3.00 | - |
| Revs | 721 | 849 | 810 | 953 | 920 | - |
| Consensus | 2.54 | 2.70 | - | - | - | - |

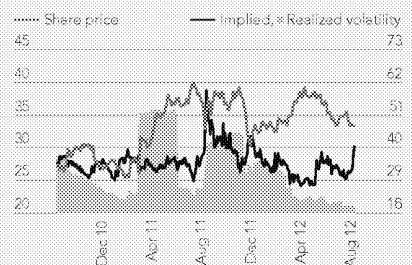
EPS: EPS beginning 2011 are cash EPS excluding amortization

Credit

| | |
|------------------------------|---------|
| Gross leverage | 11.60% |
| Net debt/EBITDA (12m fwd) | (1.8)x |
| Free cash flow (12m fwd) | \$174mm |
| Free cash flow yld (12m fwd) | 8.90% |
| 5-yr US treasury yield | 0.73% |

Derivatives

| | |
|------------------------|-------|
| Volume (contracts) | 1,335 |
| Skew rank (2yr %-tile) | 37.37 |



Medicis Pharmaceutical Corporation: Strong 2Q, but Destocking Drives Lower Guidance

Call to action

There were some positive data points coming out of 2Q, including higher ASPs for key products, strong facial sales and lower costs. Unfortunately, MRX took down its 2H guidance with a delayed recovery for Solodyn and Ziana resulting in destocking shifting more to 3Q, which could take the stock a little lower. Importantly though, we think this dynamic is more ST, and we see the LT outlook remaining solid. At current levels, the stock still seems compelling to us and we maintain our Positive rating.

HIGHLIGHTS

Yesterday, MRX reported a high quality 2Q. Revenue of \$197 mln exceeded our forecast and consensus of \$191 mln, as well as the guidance range of \$185-\$195 mln. Cash EPS of \$0.52 beat our forecast of \$0.45 and the consensus \$0.46, as well as guidance of \$0.37-\$0.47. The key drivers of the upside were higher ASPs for key products (Solodyn, Ziana and Zyclara), strong facial sales (Dysport and Restylane/Perlane), and lower than expected SG&A. Despite the strong quarter, much of the investor focus will be on the lowered guidance, which we thought management did explain well as it relates to the timing of the rebound for Solodyn and Ziana and wholesaler stocking of the product that it had not forecast appropriately (demand curve happening later than MRX thought as a result of the AF program). The good news is AF is working with an increase in the number of profitable Rx's and higher ASPs for Solodyn and Ziana. However, greater uncertainty on the overall numbers could cause investors to take pause with the stock in the near term. We remain confident with the longer term outlook though. We're anticipating an inflection in Solodyn and Ziana Rx's at some point in the next few months, we look forward to the launch of Zyclara 2.5% in 3Q to help accelerate that franchise, and we like the cost-cutting efforts that management is implementing that should continue into next year. It was also good to hear that MRX is filing an NDA in 1Q13 for a therapeutic derm product, since it typically doesn't get credit for its pipeline.

Continued on the next page

Catalysts

Potential inflection in Rx's for Solodyn and Ziana, Zyclara trends with 2.5% formulation launch in 3Q, additional data on pipeline, and/or further M&A.

Downside risk/upside price target

We see \$28 as downside if Solodyn generics/pricing have a much greater impact than we expect and both Dysport and the pipeline disappoint. Lowering 2015 sales by ~\$150 mln

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IMPORTANT DISCLOSURES AND CERTIFICATIONS.

Susquehanna International Group, LLP (SIG) is comprised of affiliated entities, including Susquehanna Financial Group, L.L.P. (SFG). SFG is a provider of research and execution services. SFG is a member of FINRA. SFG does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Please see important disclosures on pages 8-9.

PAGES

VRXPSI-02-0000084 - VRXPSI-02-0000085

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Figure 2: Medicis Income Statement (2007-2015E)

| (\$ Millions Except EPS) Calendar YE Dec 31 | (f) 2007 | (e-h, f) 2008 | 2009 | 2010 | 1Q | 2Q | 3Q | 4Q | 2011 | 1QA | 2QA | 3QE | 4QE | 2012E | 2013E | 2014E | 2015E | 5-Yr CAGR | |
|--|---------------|------------------|---------------|---------------|---------------|---------------|---------------|---------------|----------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|----------------|--------------|-----|
| Revenue | | | | | | | | | | | | | | | | | | | |
| Acne | 243.4 | 325.0 | 398.9 | 482.4 | 103.5 | 123.1 | 119.1 | 101.9 | 447.6 | 108.5 | 93.1 | 88.9 | 106.0 | 396.5 | 443.2 | 463.0 | 482.9 | | |
| Non-Acne | 172.9 | 148.0 | 133.6 | 175.0 | 52.2 | 57.7 | 55.7 | 64.0 | 229.6 | 74.0 | 81.1 | 81.3 | 88.4 | 324.8 | 377.6 | 420.7 | 457.2 | | |
| Non-Derm | 41.1 | 44.7 | 39.5 | 42.6 | 9.2 | 10.0 | 9.9 | 14.8 | 43.9 | 19.2 | 22.4 | 22.8 | 24.3 | 88.7 | 79.2 | 65.9 | 67.7 | | |
| New Products | - | - | - | - | - | - | - | - | - | - | - | - | - | - | 20.0 | 50.0 | 80.0 | | |
| Total Revenue | 457.4 | 517.7 | 572.0 | 700.0 | 164.9 | 190.8 | 184.7 | 180.7 | 721.126 | 201.7 | 196.6 | 193.0 | 218.7 | 810.0 | 920.0 | 999.7 | 1,087.8 | 9% | |
| Cost of Goods Sold | 56.1 | 38.7 | 56.8 | 70.0 | 14.3 | 18.2 | 17.2 | 17.2 | 66.9 | 20.9 | 21.8 | 21.1 | 22.8 | 86.6 | 92.5 | 103.4 | 115.9 | | |
| Gross Profit | 401.3 | 479.0 | 515.2 | 630.0 | 150.6 | 172.6 | 167.5 | 163.6 | 654.2 | 180.8 | 174.8 | 171.9 | 195.9 | 723.3 | 827.5 | 896.3 | 971.9 | | |
| MRX standalone | | | | | | | | | | | | | | | | | | | |
| Graceyway | | | | | | | | | | 90.7 | 91.8 | 90.0 | 87.7 | 363.6 | 285.8 | 400.0 | 410.0 | | |
| SG&A | 243.1 | 275.0 | 283.0 | 322.2 | 82.7 | 85.9 | 90.7 | 87.0 | 346.4 | 99.7 | 102.6 | 97.0 | 92.7 | 392.0 | 410.0 | 420.0 | 430.0 | | |
| MRX standalone | | | | | | | | | | 11.0 | 11.0 | 10.0 | 9.0 | 41.0 | 54.0 | 62.0 | 70.0 | | |
| Graceyway | | | | | | | | | | 4.0 | 4.0 | 4.0 | 4.0 | 16.0 | 18.0 | 18.0 | 20.0 | | |
| R&D | 31.4 | 34.9 | 39.0 | 39.4 | 7.1 | 7.7 | 7.7 | 10.4 | 32.9 | 12.5 | 15.4 | 14.0 | 13.0 | 57.0 | 72.0 | 81.0 | 90.0 | | |
| D&A | 24.5 | 27.7 | 29.0 | 29.3 | 4.0 | 3.8 | 4.0 | 2.0 | 13.8 | 2.3 | 2.3 | 2.3 | 2.3 | 9.4 | 9.4 | 9.4 | 9.4 | | |
| Operating Income | 102.3 | 141.5 | 164.2 | 239.1 | 56.7 | 75.2 | 65.1 | 64.1 | 261.1 | 66.2 | 54.4 | 58.5 | 87.9 | 265.0 | 336.2 | 385.9 | 442.5 | 13% | |
| EBITDA | 126.8 | 169.2 | 193.2 | 268.4 | 60.8 | 79.0 | 69.0 | 66.2 | 274.9 | 68.6 | 56.8 | 60.9 | 90.2 | 274.3 | 345.5 | 395.3 | 451.9 | 11% | |
| Non-Op | | | | | | | | | | | | | | | | | | | |
| Interest Income | 38.8 | 27.8 | 7.6 | 4.2 | 1.3 | 1.2 | 1.3 | 0.9 | 4.7 | 0.7 | 0.9 | 1.1 | 1.3 | 4.0 | 8.0 | 12.0 | 16.0 | | |
| Interest Expense | (10.4) | (10.4) | (4.2) | (4.4) | (1.1) | (1.1) | (1.3) | (1.4) | (4.9) | (1.1) | (2.3) | (2.3) | (2.3) | (8.1) | (9.3) | (9.3) | (9.3) | | |
| Other Non-Op | - | (6.4) | 1.5 | (0.3) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | |
| Total Non-Op | 28.4 | 11.0 | 4.9 | (0.4) | 0.2 | 0.1 | 0.0 | (0.5) | (0.2) | (0.4) | (1.4) | (1.2) | (1.0) | (4.1) | (1.3) | 2.7 | 6.7 | | |
| Pre-tax Income | 130.6 | 152.5 | 169.1 | 238.7 | 56.9 | 75.3 | 65.1 | 63.6 | 260.9 | 65.8 | 53.0 | 57.3 | 86.8 | 260.9 | 334.9 | 388.7 | 449.3 | | |
| Tax Rate | 36.6% | 37.7% | 37.0% | 37.4% | 36.5% | 38.0% | 35.3% | 41.3% | 37.8% | 40.9% | 36.5% | 39.5% | 39.5% | 39.6% | 39.5% | 39.5% | 39.5% | | |
| Taxes | 47.9 | 57.4 | 62.5 | 89.2 | 20.6 | 28.6 | 23.0 | 26.3 | 98.6 | 26.9 | 19.3 | 22.6 | 34.3 | 103.2 | 132.3 | 153.5 | 177.5 | | |
| Net Income | 82.8 | 95.0 | 106.5 | 149.5 | 36.2 | 46.7 | 42.1 | 37.3 | 162.3 | 38.9 | 33.7 | 34.7 | 52.5 | 157.7 | 202.6 | 235.1 | 271.8 | | |
| After-tax Addback | 6.4 | 3.5 | (1.0) | (2.0) | (0.3) | (0.7) | (0.5) | (0.4) | (2.0) | (0.6) | (0.4) | (0.5) | (0.5) | (2.0) | (2.0) | (2.0) | (2.0) | | |
| Adjusted Net Income | 89.1 | 98.6 | 105.5 | 147.5 | 35.8 | 46.0 | 41.6 | 36.9 | 160.4 | 38.3 | 33.3 | 34.2 | 52.0 | 155.7 | 200.7 | 233.2 | 269.9 | | |
| Average Diluted Shares | 71.2 | 66.3 | 61.8 | 64.6 | 65.4 | 67.1 | 67.9 | 66.4 | 66.7 | 63.6 | 64.0 | 64.5 | 65.0 | 64.3 | 67.0 | 69.0 | 71.0 | | |
| Operating EPS | \$1.25 | \$1.49 | \$1.66 | \$2.28 | \$0.55 | \$0.68 | \$0.61 | \$0.56 | \$2.40 | \$0.60 | \$0.52 | \$0.53 | \$0.80 | \$2.45 | \$3.00 | \$3.38 | \$3.80 | | |
| Adjusted for FAS 123 (a) | \$1.25 | \$1.49 | \$1.66 | \$2.28 | \$0.55 | \$0.68 | \$0.61 | \$0.56 | \$2.40 | \$0.60 | \$0.52 | \$0.53 | \$0.80 | \$2.45 | \$3.00 | \$3.38 | \$3.80 | | |
| | | | | | | | | | | | | | | | | | | 4-Yr CAGR | |
| | | | | | | | | | | | | | | | | | | | 12% |

| % Change | 2007/ 2006/ | 2008/ 2007/ | 2009/ 2008/ | 2010/ 2009/ | 1Q | 2Q | 3Q | 4Q | 2011/ 2010/ | 1QA | 2QA | 3QE | 4QE | 2012E/ 2011/ | 2013E/ 2012E/ | 2014E/ 2013E/ | 2015E/ 2014E/ |
|----------------------------|----------------|----------------|----------------|----------------|-------------|------------|-------------|-------------|----------------|------------|--------------|--------------|------------|-----------------|------------------|------------------|------------------|
| Revenue | | | | | | | | | | | | | | | | | |
| Acne | 54% | 34% | 23% | 21% | (14%) | (1%) | 1% | (14%) | (7%) | 5% | (24%) | (25%) | 4% | (11%) | 12% | 4% | 4% |
| Non-Acne | 9% | (14%) | (10%) | 31% | 52% | 41% | 12% | 27% | 31% | 42% | 41% | 46% | 38% | 41% | 16% | 11% | 9% |
| Non-Derm | 24% | 9% | (12%) | 8% | (23%) | 22% | 6% | 14% | 3% | 109% | 123% | 131% | 64% | 102% | (11%) | (17%) | 3% |
| New Products | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM |
| Total Revenue | 31% | 13% | 10% | 22% | (1%) | 10% | 4% | (1%) | 3% | 22% | 3% | 5% | 21% | 12% | 14% | 9% | 9% |
| Cost of Goods Sold | 34% | (31%) | 47% | 23% | (9%) | 10% | (5%) | (13%) | (4%) | 46% | 19% | 23% | 33% | 30% | 7% | 12% | 12% |
| Gross Profit | 30% | 19% | 8% | 22% | (0%) | 10% | 5% | 1% | 4% | 20% | 1% | 3% | 20% | 11% | 14% | 8% | 8% |
| SG&A | 31% | 13% | 3% | 14% | 9% | 6% | 10% | 5% | 8% | 21% | 19% | 7% | 6% | 13% | 5% | 2% | 2% |
| R&D | (11%) | 11% | 12% | 1% | (30%) | (27%) | 4% | (8%) | (16%) | 76% | 100% | 81% | 25% | 73% | 26% | 13% | 11% |
| D&A | 7% | 13% | 5% | 1% | (43%) | (47%) | (45%) | (74%) | (53%) | (42%) | (39%) | (41%) | 15% | (32%) | - | - | - |
| Operating Income | 59% | 38% | 16% | 46% | (1%) | 28% | 5% | 6% | 9% | 17% | (28%) | (10%) | 37% | 1% | 27% | 15% | 15% |
| EBITDA | 45% | 33% | 14% | 39% | (6%) | 19% | (1%) | (3%) | 2% | 13% | (28%) | (12%) | 36% | (0%) | 26% | 14% | 14% |
| Non-Op | | | | | | | | | | | | | | | | | |
| Interest Income | 27% | (28%) | (73%) | (44%) | 12% | 54% | 18% | (25%) | 11% | (46%) | (25%) | (15%) | 44% | (15%) | 100% | 50% | 33% |
| Interest Expense | (0%) | - | (59%) | 3% | 2% | 4% | 17% | 26% | 13% | 6% | 110% | 81% | 61% | 65% | 14% | - | - |
| Other Non-Op | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM |
| Total Non-Op | 41% | (61%) | (55%) | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | 1825% | (69%) | (314%) | 147% |
| Pre-tax Income | 55% | 17% | 11% | 41% | (1%) | 28% | 5% | 5% | 9% | 16% | (30%) | (12%) | 37% | (0%) | 28% | 16% | 16% |
| Tax Rate | 13% | 3% | (2%) | 1% | (5%) | 1% | (9%) | 18% | 1% | 12% | (4%) | 12% | (4%) | 5% | (0%) | - | - |
| Taxes | 76% | 20% | 9% | 43% | (6%) | 29% | (4%) | 25% | 10% | 29% | (32%) | (1%) | 31% | 5% | 28% | 16% | 16% |
| Net Income | 45% | 15% | 12% | 40% | 2% | 28% | 10% | (5%) | 9% | 7% | (28%) | (18%) | 41% | (3%) | 28% | 16% | 16% |
| After-tax Addback | (3%) | (45%) | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM | NM |
| Adjusted Net Income | 40% | 11% | 7% | 40% | 3% | 28% | 10% | (5%) | 9% | 7% | (28%) | (18%) | 41% | (3%) | 29% | 16% | 16% |
| Average Diluted Shares | 1% | (7%) | (7%) | 5% | 2% | 4% | 5% | 2% | 3% | (3%) | (5%) | (5%) | (2%) | (4%) | 4% | 3% | 3% |
| Operating EPS | 38% | 19% | 12% | 37% | 1% | 23% | 5% | (7%) | 5% | 10% | (24%) | (14%) | 44% | 2% | 22% | 13% | 12% |

Footnotes

See Margin Analysis for footnotes.

(a) We include FAS123 stock option expense beginning 3Q06

E = SFG Research Estimates NM = Not Meaningful A = Actual

Source: Company Data, SFG Research Estimates

ADDITIONAL PAGES

VRXPSI-02-0000087 - VRXPSI-02-0000091

**REDACTED BY
THE PERMANENT SUBCOMMITTEE ON
INVESTIGATIONS**