

Campus Crest Communities, Inc.
Form DEFA14A
October 19, 2015

United States

Securities And Exchange Commission

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the

Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): October 16, 2015

CAMPUS CREST COMMUNITIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Maryland	001-34872	27-2481988
(State or other jurisdiction	(Commission File Number)	(IRS Employer
of incorporation or organization)		Identification No.)

2100 Rexford Road, Suite 414
Charlotte, North Carolina 28211
(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: (704) 496-2500

Not Applicable

(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 1.01. Entry into a Material Definitive Agreement.

On October 16, 2015, Campus Crest Communities, Inc., a Maryland corporation (the “Company”), entered into an Agreement and Plan of Merger (the “Merger Agreement”) with HSRE Quad Merger Parent, LLC, a Delaware limited liability company (“Parent”), HSRE Quad Merger Sub, LLC, a Maryland limited liability company and a wholly owned Subsidiary of Parent (“Merger Sub”) and CCGSR, Inc., a Delaware corporation (the “Stockholders’ Representative”). Pursuant to the terms of the Merger Agreement, the Company will be merged with and into Merger Sub (the “Merger”), with Merger Sub surviving the Merger as a wholly owned subsidiary of Parent (the “Surviving Entity”). Parent is an affiliate of Harrison Street Real Estate Capital, LLC (“HSRE”).

The Merger Agreement was unanimously approved by the Company’s Board of Directors (the “Board”), based on the recommendation of an independent Transaction Committee of the Board formed to, among other things, review, evaluate and negotiate any potential transaction with any potentially interested party.

As contemplated by the Merger Agreement, the Company also entered into an agreement (the “Montreal Sale Agreement”) to sell its interests in its evo Montreal joint venture (the “Montreal JV”) to its joint venture partner, with a closing currently expected to occur by October 30, 2015. Assuming the sale of the Montreal JV occurs upon the terms and conditions set forth in the Montreal Sale Agreement, at the time that the Merger becomes effective (the “Effective Time”) each issued and outstanding share of common stock of the Company, par value \$0.01 per share (the “Common Stock”), other than certain excluded shares owned, directly or indirectly, by Parent, Merger Sub or the Company, will be converted automatically into the right to receive (i) a cash amount currently estimated to be \$6.90 (the “Cash Consideration”), plus (ii) a pro-rata portion of the net proceeds from the sale of the Montreal JV interests (the “Contingent Consideration”, and together with the Cash Consideration, the “Merger Consideration”). If the sale of the Montreal JV interests closes on the terms contemplated by the Montreal Sale Agreement, the Contingent Consideration is currently estimated to be \$0.13 per share, and the total Merger Consideration payable to the Company’s stockholders at the Effective Time would be an estimated \$7.03 per share. The Cash Consideration and the Contingent Consideration are subject to change if the Company is unable to sell its Montreal JV interests prior to the Effective Time, or if it sells the interests on terms other than those currently provided in the Montreal Sale Agreement, as follows:

- If the Company sells its Montreal JV interests prior to the Effective Time but for a lower or higher price than is currently provided for in the Montreal Sale Agreement, then the amount of the Contingent Consideration would be based on the actual net proceeds, after repaying debt on the Montreal properties and certain operating expenses, taxes and transaction costs, which could be lower or higher than the currently estimated \$0.13 per share. If the sale price of the Montreal JV interests is insufficient to fully satisfy the outstanding debt on the Montreal properties owned by the Montreal JV, then the Company would be obligated to contribute to the repayment of the deficiency in accordance with its outstanding guaranty of such indebtedness (the “Montreal Guaranty”). In such event, the Cash Consideration per share would be reduced by a pro-rata portion of the amount paid by the Company to discharge its obligations

under the Montreal Guaranty. Based on the current balance of the indebtedness, the Company's obligation under the Montreal Guaranty today is approximately CAD\$56.0 million, which equates to approximately \$0.67 per share of Common Stock (based upon current exchange rates).

If the Company is unable to sell its Montreal JV interests prior to the Effective Time then, subject to the terms of the Merger Agreement, Parent would be obligated to deposit an amount (the “Montreal Guaranty Amount”) sufficient to fully satisfy the Montreal Guaranty into an escrow account, and that amount (converted to US Dollars at the then-current exchange rate) would be deducted from the Cash Consideration payable to stockholders at the Effective Time. In such event, the Cash Consideration would be reduced to approximately \$6.23 (based on current exchange rates). The Company would deposit its Montreal JV interests into the escrow account, and the Stockholders’ Representative would have responsibility for seeking to sell the Montreal JV interests. In such event, the entire Contingent Consideration per share payable to stockholders would be represented by a non-transferable contingent value right (“CVR”), with each CVR entitled to a pro-rata share of the net proceeds of any sale of the Montreal JV interests after the Effective Time (after taking into account certain operating expenses, taxes and transaction costs), plus a pro-rata portion of the Montreal Guaranty Amount, if any, that is not required to satisfy the Montreal Guaranty.

The Merger Agreement provides that, immediately prior to the Effective Time, any outstanding Company restricted stock will become fully vested and free of restrictions, and will be automatically converted into the right to receive the Merger Consideration.

The Merger Agreement further provides that, at the Effective Time, each share of the Company’s 8.00% Series A Cumulative Redeemable Preferred Stock, \$0.01 par value per share (the “Series A Preferred Stock”), will be redeemed by the Company in accordance with the terms of the Series A Preferred Stock, or, in the alternative, the Company will set aside sufficient funds for the redemption of each share of Series A Preferred Stock in trust for the benefit of the holders of the Series A Preferred Stock in accordance with the terms the Series A Preferred Stock.

Following the Merger, the Surviving Entity will enter into a merger agreement with Campus Crest Communities Operating Partnership, LP (the “Company Operating Partnership”) and a wholly owned subsidiary of the Surviving Entity (the “OP Merger Agreement”), pursuant to which (i) such wholly owned subsidiary of the Surviving Entity and the Company Operating Partnership will merge (the “OP Merger”). Upon the consummation of the OP Merger in accordance with the OP Merger Agreement, each limited partner of the Company Operating Partnership will be entitled to receive for each limited partnership unit in the Company Operating Partnership an amount equal to the Merger Consideration.

Stockholders of the Company will be asked to vote on the adoption of the Merger Agreement and the approval of the Merger at a special stockholders’ meeting (the “Stockholders’ Meeting”) that will be held on a date to be determined and announced in accordance with the terms of the Merger Agreement. Completion of the Merger is subject to various closing conditions, including, among others, (a) the affirmative vote of at least a majority of the outstanding shares of Common Stock entitled to vote at the Stockholders’ Meeting in favor of adopting the Merger Agreement and approving the Merger (the “Stockholder Approval”), (b) the absence of any law, injunction, judgment, order, decree or ruling restraining or prohibiting consummation of the Merger, (c) the parties shall have received consents from third parties relating to certain indebtedness of the Company and its subsidiaries that will be assumed by the Surviving Entity relating to at least eighty five percent (85%) of the outstanding principal balance of such assumed indebtedness,

(d) the transactions contemplated by the Purchase, Sale and Redemption Agreement dated as of October 16, 2015, by and among Harrison Street Real Estate, LLC and the other parties signatory thereto have been closed, conditioned only upon the occurrence of the closing of the Merger, and (e) in the event that the Company's Form 10-K for the fiscal year ended December 31, 2015 (the "2015 10-K") shall have become due under the Securities Exchange Act of 1934, as amended (the "Exchange Act") (without giving effect to any extensions permitted thereunder), the Company will have filed the 2015 10-K with the SEC. Each party's obligation to consummate the Merger is also subject to certain additional conditions, which include the accuracy of the other party's representations and warranties and the other party's compliance with its covenants and obligations in all material respects (in each case, as contained and more fully described in the Merger Agreement). The Merger Agreement does not contain a financing condition.

The Merger Agreement contains customary representations and warranties by each of the Company, Parent and Merger Sub, and also contains customary covenants and agreements, including, among others, agreements by the Company to (i) carry on its business in the ordinary course consistent with past practice and (ii) refrain from undertaking a number of actions without the prior written consent of Parent (not to be unreasonably withheld), including, but not limited to, incurring indebtedness, settling claims or actions, certain matters related to capital expenditures, the declaration of dividends, the issuance or sale of equity interests, and amending material contracts (in each case, during the period from the date of the Merger Agreement to the Effective Time). In addition, Parent has agreed to maintain in effect the Company's current directors' and officers' liability insurance for a period of six years following the Effective Time. The Merger Agreement provides that each of the parties shall use its respective reasonable best efforts to take all actions necessary to cause the conditions to the closing of the Merger and the other transactions contemplated by the Merger Agreement to be satisfied as promptly as practicable and to obtain all required regulatory approvals and consents.

The Company is subject to customary non-solicitation restrictions on its ability to solicit, initiate, or knowingly encourage or take any actions to facilitate or encourage alternative acquisition proposals. However, subject to certain limitations set forth in the Merger Agreement, the Company may furnish non-public information to and negotiate with third parties who submit unsolicited alternative acquisition proposals at any time prior to receipt of the Stockholder Approval if the Board determines in good faith after consultation with the Company's legal counsel and financial advisor, that the alternative proposal constitutes or would reasonably be expected to result in a Superior Proposal (as defined in the Merger Agreement). Additionally, subject to certain limitations set forth in the Merger Agreement, at any time prior to receipt of the Stockholder Approval, the Board may make a Company Adverse Recommendation Change (as defined in the Merger Agreement) if the Board determines in good faith after consultation with the Company's legal advisors and financial advisor, that (i) failure to take such action would be reasonably likely to violate the directors' fiduciary duties under applicable law, and (ii) such proposal constitutes a Superior Proposal.

Upon a termination of the Merger Agreement under specified circumstances set forth therein, the Company will be required to pay Parent a termination fee equal to \$5,000,000. The Merger Agreement also provides that upon a termination of the Merger Agreement under certain circumstances set forth in the Merger Agreement, Parent will be required to pay the Company a reverse termination fee equal to \$10,000,000. In the event that the Stockholder Approval is not received, the Company will also be required to reimburse Parent's expenses in an amount up to \$1,000,000, which reimbursement would reduce any termination fee subsequently payable by the Company on a dollar-for-dollar basis. Subject to certain limitations set forth in the Merger Agreement, either party may terminate the Merger Agreement if the Merger is not consummated by March 31, 2016.

The foregoing description of the Merger Agreement and the transactions contemplated thereby does not purport to be complete and is subject to, and qualified in its entirety by, the full text of the Merger Agreement, attached as Exhibit 2.1 to this Current Report on Form 8-K, which is incorporated herein by this reference.

The Merger Agreement has been included as an exhibit to this filing to provide investors with information regarding its terms. It is not intended to provide any other factual information about the Company. In particular, the representations and warranties contained in the Merger Agreement were made only for the purposes of the Merger Agreement as of the specific dates therein, and were solely for the benefit of the parties to the Merger Agreement. The representations and warranties contained in the Merger Agreement may be subject to limitations agreed upon by the parties to the Merger Agreement and have been qualified by confidential disclosures made to Parent and Merger Sub in connection with the Merger Agreement. These confidential disclosures contain information that modifies, qualifies and creates exceptions to the representations and warranties set forth in the Merger Agreement. Moreover, certain representations and warranties in the Merger Agreement may be subject to a standard of materiality provided for in the Merger Agreement and have been used for the purpose of allocating risk among the parties, rather than establishing matters of fact. Investors should not rely on the representations, warranties and covenants or any descriptions thereof as characterizations of the actual state of facts or condition of the Company or any of its subsidiaries or affiliates. Moreover, information concerning the subject matter of the representations and warranties may change after the date of the Merger Agreement, which subsequent information may or may not be fully reflected in the Company's public disclosures.

Item 8.01 Other Events.

On October 16, 2015, the Company and HSRE issued a joint press release announcing, among other things, the Company's entry into the Merger Agreement. A copy of that press release is attached hereto as Exhibit 99.1 and incorporated herein by reference.

The information in Exhibit 99.1 attached hereto shall not be deemed filed for purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in filings under the Securities Act of 1933, as amended, or the Exchange Act, regardless of any general incorporation language in such filing.

Additional Information and Where to Find It

This filing may be deemed solicitation material in respect of the proposed acquisition of the Company by Parent. A full description of the terms of the Merger and the Merger Agreement will be provided in the proxy statement that the Company intends to file with the Securities and Exchange Commission ("SEC") to be used at its special meeting of stockholders in lieu of an annual meeting to approve the proposed transaction with HSRE. STOCKHOLDERS ARE ADVISED TO READ, WHEN AVAILABLE, THE COMPANY'S PRELIMINARY PROXY STATEMENT AND DEFINITIVE PROXY STATEMENT IN CONNECTION WITH THE SOLICITATION OF PROXIES FOR THE SPECIAL MEETING BECAUSE THESE STATEMENTS WILL CONTAIN IMPORTANT INFORMATION. The definitive proxy statement will be mailed to stockholders as of a record date to be established for voting on the proposed merger. Stockholders will also be able to obtain a copy of the proxy statement, without charge, by directing a request to: Campus Crest, 2100 Rexford Road, Suite 400, Charlotte, NC 28211, Attention: Investor Relations, or at its website, www.campuscrest.com. The preliminary proxy statement and definitive proxy statement, once available, can also be obtained, without charge, at the SEC's internet site (<http://www.sec.gov>)

Participants in Solicitation

The directors, executive officers and certain other members of management and employees of the Company may be deemed "participants" in the solicitation of proxies from stockholders of the Company in favor of the proposed Merger. Information regarding the persons who may, under the rules of the SEC, be considered participants in the solicitation of the stockholders of the Company in connection with the proposed Merger will be set forth in the proxy statement and the other relevant documents to be filed with the SEC. You can find information about the Company's executive officers and directors in its Annual Report on Form 10-K for the fiscal year ended December 31, 2014 (the "Form 10-K") as filed with the SEC on April 1, 2015 and Amendment No. 1 to the Form 10-K as filed with the SEC on

August 25, 2015.

Forward-Looking Statements

This communication contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. The forward-looking statements, which include statements regarding the proposed Merger between the Company and Parent, may be identified by the inclusion of words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “seeks,” “estimates,” “goal” and variations of such words and other similar expressions, and are based on current expectations, estimates, assumptions and projections that are subject to change, and actual results may differ materially from the forward-looking statements. These statements, as they relate to the Company or the Parent, the management of either such company or the proposed Merger, involve risks and uncertainties that may cause results to differ materially from those set forth in the statements. The Company intends that such forward-looking statements be subject to the safe-harbor provided by the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the Company’s actual results, performance or achievements or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Many factors, including the following, could cause actual results to differ materially from the forward-looking statements: the occurrence of any event, change or other circumstances that could give rise to the termination of the Merger Agreement or the purchase agreement for the Montreal Sale; the outcome of any legal proceedings that may be instituted against the Company and others following announcement of the Merger Agreement; the inability to complete the proposed Merger due to the failure to satisfy the conditions to the Merger, including obtaining the approval of the Company’s stockholders, lender consents and other closing conditions more fully described in the Merger Agreement; risks that the proposed Merger disrupts current plans and operations of the Company; potential difficulties in employee retention as a result of the proposed Merger; the value of any CVRs which may be issued in connection with the Merger; legislative, regulatory and economic developments; risks related to disruption of management’s attention from the Company’s ongoing business operations due to the proposed Merger; the effect of the announcement of the proposed Merger on the Company’s relationships with colleges and universities, relationships with tenants, operating results and business generally, and other risks and uncertainties described under “Item 1A. Risk Factors” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014 and in the Company’s Quarterly Reports on Form 10-Q for the fiscal quarters ended March 31, 2015 and June 30, 2015 and in other documents filed with the SEC by the Company. Given these uncertainties, current and prospective investors should be cautioned in their reliance on such forward-looking statements. Except as required by law, the Company disclaims any obligation to update any such factors or to publicly announce the results of any revision to any of the forward-looking statements contained herein to reflect future events or developments. A more comprehensive discussion of risks, uncertainties, financial reporting restatements, and forward-looking statements may be seen in the Company’s Annual Report on Form 10-K and other periodic filings with the SEC.

Item 9.01 Financial Statements and Exhibits.

(d) Exhibits.

Exhibit No.	Exhibit Description
2.1	Agreement and Plan of Merger, dated October 16, 2015, by and among HSRE Quad Merger Parent, LLC, HSRE Quad Merger Sub, LLC, CCGSR, Inc. and Campus Crest Communities, Inc.
99.1	Joint Press Release issued by Campus Crest Communities, Inc. and HSRE on October 16, 2015

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

**CAMPUS CREST
COMMUNITIES, INC.**

By: /s/ Scott R. Rochon
Scott R. Rochon
Chief Accounting Officer

Dated: October 16, 2015

Exhibit Index

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Diluted Earnings per Share (in U.S. dollars)

- Bearer shares

26.05

17.55

48.4

%

- Registered shares

10.42

7.02

48.4

%

- American depositary shares

0.65

0.44

48.4

%

Basic earnings per share are calculated in accordance with IAS 33 (Earnings per Share) by dividing the net income of the group, US\$404.5 million (2003 US\$278.4 million), by an appropriate number of shares. This is 11,059,040 bearer shares (2003 11,429,052) and 11,013,040 registered shares (2003 11,013,040). The total weighted average equivalent number of bearer shares is 15,464,256 (2003 15,834,268) for the nine months ended September 30, 2004. As each American depositary share represents ownership interest in one fortieth of a bearer share, basic and diluted earnings per American depositary share is calculated as one fortieth of the earnings per bearer share.

For diluted earnings per share, the total number of bearer shares is adjusted to assume conversion of all in the money share options granted to employees and directors as well as the impact of the convertible bond, which is also dilutive. The number of bearer shares used to calculate diluted earnings per share is 11,509,808 (2003 11,450,658).

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Consolidated Balance Sheets

As of	September 30, 2004 *	December 31, 2003
	US\$'000	US\$'000
Assets		
Current Assets		
Cash and cash equivalents	444,415	1,003,972
Short-term financial assets	760,816	434,810
Trade accounts receivable	374,685	318,388
Inventories	289,471	319,820
Prepaid expenses and other current assets	250,074	220,334
Total Current Assets	2,119,461	2,297,324
Non-Current Assets		
Property, plant and equipment	705,250	701,453
Long-term financial assets	1,048,057	1,104,333
Intangible assets	286,401	259,626
Deferred tax assets	172,235	169,693
Other long-term assets	79,525	39,174
Total Non-Current Assets	2,291,468	2,274,279
Total Assets	4,410,929	4,571,603
Liabilities		
Current Liabilities		
Trade and other payables	331,011	338,862
Short-term financial debts	56,445	51,224
Income taxes	157,416	146,086
Deferred income - current	46,687	47,200
Other current liabilities	227,442	170,019
Total Current Liabilities	819,001	753,391
Non-Current Liabilities		
Long-term financial debts	556,543	532,022
Deferred tax liabilities	13,507	15,919
Deferred income - non current	154,045	174,911
Provisions and other long-term liabilities	225,605	213,556
Total Non-Current Liabilities	949,700	936,408
Total Liabilities	1,768,701	1,689,799
Minority Interests	1,422	1,614
Shareholders' Equity		
Share capital	254,417	253,895
Share premium	1,022,742	1,002,991
Treasury shares	(695,357)	(157,642)
Retained earnings	1,974,801	1,669,700
Fair value and other reserves	14,867	22,711
Cumulative foreign currency translation adjustments	69,336	88,535

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Total Shareholders' Equity	2,640,806	2,880,190
Total Liabilities, Minority Interests and Shareholders' Equity	4,410,929	4,571,603

* Unaudited

-more-

Consolidated Statements of Equity

	Share capital US\$'000	Share premium US\$'000	Treasury shares US\$'000	Retained earnings US\$'000	Fair value and other reserves US\$'000	Cumulative foreign currency translation adjustments US\$'000	Total US\$'000
Balance as of January 1, 2003	253,416	989,141	(126,460)	1,364,626	(44,807)	25,282	2,461,198
Issue of share capital to employees	466	13,611	10,844				24,921
Purchase of treasury shares			(24,637)				(24,637)
Written calls				723			723
Net income for 2003				278,350			278,350
Dividend for 2002 - bearer shares				(61,849)			(61,849)
Dividend for 2002 - registered shares				(23,860)			(23,860)
Revaluation adjustments					18,614		18,614
Foreign currency translation adjustments						47,162	47,162
Balance as of September 30, 2003 *	253,882	1,002,752	(140,253)	1,557,990	(26,193)	72,444	2,720,622
Balance as of January 1, 2004	253,895	1,002,991	(157,642)	1,669,700	22,711	88,535	2,880,190
Issue of share capital to employees	522	19,751	3,301				23,574
Net income for 2004				404,455			404,455
Purchase of treasury shares			(541,016)				(541,016)
Dividend for 2003 - bearer shares				(71,096)			(71,096)
Dividend for 2003 - registered shares				(28,258)			(28,258)
Revaluation adjustments					313		313
Cash flow hedge reserve					(8,157)		(8,157)
Foreign currency translation adjustments						(19,199)	(19,199)
Balance as of September 30, 2004 *	254,417	1,022,742	(695,357)	1,974,801	14,867	69,336	2,640,806

* Unaudited

Consolidated Statements of Cash Flows

Nine months ended September 30	2004 * US\$'000	2003 * US\$'000
Cash Flows From Operating Activities		
Income before taxes and minority interests	481,279	327,747
Depreciation and amortization	108,603	100,849
Financial income	(51,304)	(37,077)
Financial expense	17,704	13,720
Other non-cash items	5,458	23,503
Cash Flows From Operating Activities Before Working Capital Changes	561,740	428,742
Working Capital Changes		
Trade accounts payable, other current liabilities and deferred income	55,933	72,346
Trade accounts receivable and other receivables	(102,815)	(45,036)
Inventories	(570)	(48,785)
Prepaid expenses and other current assets	(22,301)	12,596
Taxes paid	(67,914)	(67,697)
Net Cash Flows From Operating Activities	424,073	352,166
Cash Flows From Investing Activities		
Purchase of property, plant and equipment	(130,774)	(125,323)
Purchase of intangible and other long-term assets	(21,773)	(6,842)
Purchase of financial assets	(838,059)	(505,423)
Proceeds from sale of financial assets	536,611	296,980
Proceeds from sale of property, plant and equipment	3,867	8,804
Interest received	75,095	53,988
Net Cash Flows From Investing Activities	(375,033)	(277,816)
Cash Flows From Financing Activities		
Proceeds from issuance of share capital	10,333	13,105
Proceeds from exercises of stock options	2,095	7,651
Premiums received on written calls	--	1,249
Issuance of long-term financial debt	24,488	44,208
Purchase of treasury shares	(541,016)	(24,637)
Repayment of bank advances	--	(30,812)
Receipt of bank advances	11,704	--
Repayment of long-term debt	(5,504)	(13,965)
Other non-current liabilities	(7,013)	(10,204)
Interest paid	(3,249)	(3,361)
Dividends paid	(99,354)	(85,709)
Net Cash Flows From Financing Activities	(607,516)	(102,475)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	(1,081)	4,022
Net Decrease in Cash and Cash Equivalents	(559,557)	(24,103)
Cash and Cash Equivalents		

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- Beginning of period	1,003,972	686,033
- End of period	444,415	661,930

* Unaudited

Selected explanatory notes to the interim consolidated financial statements (unaudited)**1. Accounting principles**

The accompanying condensed unaudited interim consolidated financial statements have been prepared in accordance with IAS 34 (Interim Financial Reporting). The accounting policies used in the preparation of the interim consolidated financial statements are consistent with those used by Serono in its annual consolidated financial statements for the year ended December 31, 2003. These interim consolidated financial statements should be read in conjunction with the 2003 annual consolidated financial statements. These consolidated financial statements were approved for issuance on October 25th, 2004 by Serono S.A.'s board of directors.

2. Adoption of International Accounting Standards

There were no new standards adopted in the first 9 months of the year.

3. Segment information - geographic segment

	Europe	North America	Latin America	Other	Group
Nine months ended September 30, 2004	US\$000	US\$000	US\$000	US\$000	US\$000
Product sales	647,425	605,191	80,500	240,366	1,573,482
Royalty and license income	128,004	626	-	76,212	204,842
Total revenues	775,429	605,817	80,500	316,578	1,778,324
Allocable operating income	373,652	295,411	38,427	85,717	793,207
Corporate R&D expenses					(284,951)
Unallocated expenses					(68,948)
Operating income					439,308
Nine months ended September 30, 2003	US\$000	US\$000	US\$000	US\$000	US\$000
Product sales	567,755	501,564	69,444	199,970	1,338,733
Royalty and license income	62,276	740	-	51,804	114,820
Total revenues	630,031	502,304	69,444	251,774	1,453,553
Allocable operating income	319,738	263,241	28,662	59,773	671,414
Corporate R&D expenses					(280,261)
Unallocated expenses					(88,651)
Operating income					302,502

Unallocated expenses represent corporate expenses. Product sales are based on the country in which the customer is located, while royalty and license income is based on the country that receives the royalty. There are no sales or other transactions between the business segments.

4. Taxes

The effective tax rate for the nine months ended September 30, 2004 amounts to 16.0% (2003: 15.0%).

Selected explanatory notes - continued

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5. Earnings per share

Basic earnings per share is calculated in accordance with IAS 33 (Earnings per Share) by dividing the net income of the company by the weighted average number of shares outstanding during the period presented.

	2004	2003
Nine months ended September 30 (unaudited)	US\$000	US\$000
Net income attributable to bearer shareholders	289,439	200,911
Net income attributable to registered shareholders	115,016	77,439
Total net income	404,455	278,350
Weighted average number of bearer shares in issue	11,059,040	11,429,052
Weighted average number of registered shares in issue	11,013,040	11,013,040
	US\$	US\$
Basic earnings per bearer share	26.15	17.58
Basic earnings per registered share	10.46	7.03
Basic earnings per American depositary share	0.65	0.44

Each American depositary share represents an ownership interest that is equivalent to one-fortieth of a bearer share, and therefore, earnings per American depositary share is calculated as one-fortieth of earnings per bearer share.

For diluted earnings per share, the weighted average number of bearer shares is adjusted to assume conversion of all potential dilutive shares arising from outstanding stock options and the convertible bond. For stock options a calculation is done to determine the number of shares that could have been acquired at fair value with proceeds from the exercise of stock options and compared with the number of shares that would have been issued assuming the exercise of the stock options. The difference is added to the denominator as additional shares issued for no consideration. There is no adjustment made to the numerator.

During the first nine months ended September 30, 2004, share equivalents of 26,772 bearer shares arising from stock options granted to employees and directors were included in calculating diluted earnings per share (2003: 21,606). For the convertible bond, the weighted average number of bearer shares is increased by 423,996 bearer shares, which is the number of bearer shares that will be issued upon conversion of the bond. Net income attributable to bearer and registered shares holders is increased by the amount of interest expense, net of tax, that would not be incurred if the convertible bond was converted. The impact of the convertible bond was anti-dilutive in 2003.

	2004	2003
Nine months ended September 30 (unaudited)	US\$000	US\$000
Net income attributable to bearer shareholders	299,846	201,016
Net income attributable to registered shareholders	114,762	77,334
Total net income	414,608	278,350
Weighted average number of bearer shares in issue	11,509,808	11,450,658
Weighted average number of registered shares in issue	11,013,040	11,013,040
	US\$	US\$
Diluted earnings per bearer share	26.05	17.55
Diluted earnings per registered share	10.42	7.02

Diluted earnings per American depositary share	0.65	0.44
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Selected explanatory notes - continued

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Class of shares	Share capital			
	Number of shares	Nominal value	CHF000	US\$000
As of September 30, 2004				
Issued and fully paid share capital				
Registered	11,013,040	CHF10	110,130	68,785
Bearer	11,738,050	CHF25	293,452	185,632
Total			403,582	254,417
Authorized share capital - bearer	1,400,000	CHF25	35,000	27,991
Conditional share capital - bearer for option and/or convertible debt	1,452,000	CHF25	36,300	29,031
Conditional share capital - bearer for stock options	726,776	CHF25	18,169	14,531
As of December 31, 2003				
Issued and fully paid share capital				
Registered	11,013,040	CHF10	110,130	68,785
Bearer	11,711,826	CHF25	292,796	185,110
Total			402,926	253,895
Authorized share capital - bearer	1,400,000	CHF25	35,000	28,377
Conditional share capital - bearer for option and/or convertible debt	152,000	CHF25	3,800	3,081
Conditional share capital - bearer for stock options	352,996	CHF25	8,825	7,155

During the Annual General Meeting held on May 25th, 2004, shareholders approved increasing the conditional capital to CHF 36,300,000 (1,452,000 bearer shares of a par value of CHF 25) for options and/or convertible loans and to CHF 18,825,000 (753,000 bearer shares of a par value of CHF 25) for stock options. In addition, shareholders have approved the authorization to increase capital by CHF 35,000,000 (1,400,000 bearer shares of a par value of CHF 25) for a period of two years.

7. Treasury shares

There were 304,939 treasury shares held by a group company as of January 1, 2004. During the first five months ended May 31, 2004, 351,209 bearer shares were purchased for a total consideration of CHF280.9 million or \$221.8 million, which resulted in the complete utilization of the CHF500 million share buy back plan that was initiated in July 2002. During the first nine months of the year, 7,149 treasury shares were distributed to employees mostly as part of an Employee Share Purchase Plan whereby shares purchased under the plan that are held for one year after the purchase date entitle each participant to receive, on a one-time basis, one matching share for every three shares purchased and held.

In June 2004, a second share buy back plan was initiated that was authorized to acquire CHF750 million worth of bearer shares; however, the shares acquired under this second plan will be cancelled and thus will not be available for re-issue. The total cost of the shares acquired under the second share buy back plan as of September 30, 2004, was CHF405.0 million or \$319.2 million. The total number of treasury shares held as of September 30, 2004 is 1,165,984 of which 516,985 will eventually be cancelled.

8.

Distribution of earnings

At the Annual Shareholders Meeting on May 25, 2004, a proposed gross dividend in respect of 2003 of CHF3.20 (2002: CHF2.80) per registered share and CHF8.00 (2002: CHF7.00) per bearer share, amounting to a total of CHF123.9 million (2002: CHF110.8 million), was ratified. This dividend, equivalent to \$99.4 million, was subsequently paid in May 2004 and has been accounted for in shareholders equity as an appropriation of retained earnings in the nine months ended September 30, 2004.

9. Stock option plans

Stock options are granted to senior management members of Serono S.A. and its affiliates. Each stock option gives the holder the right to purchase one bearer share or one American depositary share of Serono S.A. stock. Stock options are granted every plan year and vest as follows: 25% one year after date of grant, 50% after two years, 75% after three years and 100% after four years. Options expire six years after the fourth and final vesting date such that each option has a 10-year duration. The exercise price is determined as the closing share price of the share (bearer share and American depositary share) on the date of grant. Movements in the number of stock options outstanding, for both bearer shares and American depositary shares, are as follows:

	Bearer Options		American depositary share Options	
	Options outstanding	Weighted average exercise price CHF	Options outstanding	Weighted average exercise price US\$
As of January 1, 2003	220,300	1,272	-	-
Granted	97,830	652	20,000	16.51
Cancelled	(22,087)	1,301	-	-
Exercised	(2,741)	546	-	-
As of December 31, 2003	293,302	1,070	20,000	16.51
Granted	100,160	788	1,092,000	15.52
Cancelled	(22,556)	1,091	(55,200)	15.55
Exercised	(4,405)	598	-	-
As of September 30, 2004	367,101	CHF 961	1,056,800	\$ 15.54

10. Share purchase plans**Employee Share Purchase Plan**

The group has an Employee Share Purchase Plan ("the ESPP") covering substantially all of its employees. The plan is designed to allow employees to purchase bearer shares or American depositary shares at 85% of the lower of the fair market value at either the date of the beginning of the plan period or the purchase date. Purchases under the plan are subject to certain restrictions and may not exceed 15% of the employee's annual salary. In January 2004, 20,301 bearer shares (2003: 23,229 bearer shares) were issued to employees at a price of CHF654 per share (2003: CHF654 per share). As of September 30, 2004, a total of \$8.2 million (2003: \$7.4 million) in contributions was held by the company and will be used to purchase bearer and American depositary shares on behalf of its employees in January 2005. The accrued compensation cost from the discount to be offered to employees based on the contributions held as at September 30, 2004 is \$1.4 million (2003: \$3.8 million).

Shares purchased under the plan that are held for one year after the purchase date entitle each participant to receive, on a one-time basis, one matching share for every three shares purchased and held. In January 2004, 6,648 bearer shares (2003: 4,208) were distributed to employees. The accrued compensation cost for the nine months ended September 30, 2004, related to the matching shares that will be distributed in January 2005, is \$2.8 million (2003: \$3.5 million) and is calculated based on the estimated number of matching shares that will be issued multiplied by the current month-end share price.

Director Share Purchase Plan

During 2003, the group initiated a Share Purchase Plan reserved for its Board of Directors (the DSPP). The DSPP allows board members to purchase Serono S.A. bearer shares through allocation of 50% or 100% of their gross yearly fees. Each cycle commences on the first business day following the company s Annual General Meeting (the AGM) and concludes on the day of the next AGM. The purchase price per share is eighty-five percent of the fair market value of the share on the fifth business day following the AGM. In June, 1,518 bearer shares were issued to Directors that participated in the plan.

11. Principal shareholder

At September 30, 2004, Bertarelli & Cie, a partnership limited by shares with its principal offices at Chésereux (Vaud), Switzerland, held 55.43% of the capital and 64.01% of the voting rights in Serono S.A. Ernesto Bertarelli controls Bertarelli & Cie. On the same date, Maria-Iris Bertarelli, Ernesto Bertarelli and Donata Bertarelli Späth owned in the aggregate 7.55% of the capital and 10.31% of the voting rights of Serono S.A.

12. Events after the balance sheet date

On September 7th, 2004, the company entered into a binding contractual agreement with ZymoGenetics, Inc to research, develop and commercialize novel protein and antibody therapeutics based on discoveries made by ZymoGenetics. The actual payment commitments to ZymoGenetics as of September 30, 2004 include \$31.25 million in exchange for the rights to license proteins over the next five years and the purchase of \$50.0 million of ZymoGenetics common stock.

As disclosed in the press release issued on September 8th, 2004, the terms of this agreement were subject to review by the United States Federal Trade Commission and Department of Justice, under the provisions of Section 7A of the Clayton Act, 15 U.S.C. § 18a, as added by the Hart-Scott-Rodino Antitrust Improvements Act of 1976. As U.S. regulatory approval was not received until October 5th, 2004, the \$31.25 million liability and corresponding research and development expense have not been reflected in the balance sheet as of September 30, 2004 or the statement of income for the three and nine months ended September 30, 2004, following strict interpretation of International Financial Reporting Standards. Had U.S. regulatory approval been received prior to September 30, 2004, research and development expense for the three and nine months ended would have increased by \$31.25 million; tax expense and taxes payable would have decreased by \$5.0 million; and net income for the three and nine months ended would have decreased by \$26.3 million, compared to actual reported results.

On October 12th, 2004, the company purchased 3,176,620 common shares of ZymoGenetics, Inc. at price of \$15.74 per share. The closing price of ZymoGenetics shares on October 6, the date at which the price to be paid was finalized as per the terms of the agreement, was \$18.45 per share, resulting in financial income of \$8.6 million. Reported net income for the three and nine months ended September 30, 2004, included an unrealized gain of \$5.4 million as the commitment to acquire \$50.0 million of ZymoGenetics common shares at a fixed price of \$15.74 qualified as a forward contract for which changes in fair value are reflected in the statement of income in accordance with IAS 39 Financial Instruments.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SERONO S.A.
a Swiss corporation
(Registrant)

October 26, 2004

By:	/s/ François Naef
Name:	François Naef
Title:	Secretary

