

TAYLOR DEVICES INC
Form 8-A12G
October 03, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 8-A

FOR REGISTRATION OF CERTAIN CLASSES OF SECURITIES
PURSUANT TO SECTION 12(b) OR (g) OF THE
SECURITIES EXCHANGE ACT OF 1934

TAYLOR DEVICES, INC.

(Exact name of registrant as specified in its charter)

New York

(State of incorporation or organization)

16-0797789

(I.R.S. Employer Identification No.)

90 Taylor Drive, PO Box 748 North Tonawanda, NY 14120-0748

(Address of principal executive offices) (Zip Code)

Securities to be registered pursuant to Section 12(b) of the Act:

Title of each class to be so registered	Name of each exchange on which each class is to be registered
Preferred Stock Purchase Rights	NASDAQ

If this form relates to the registration of a class of securities pursuant to Section 12(b) of the Exchange Act and is effective pursuant to General Instruction A.(c), check the following box. []

If this form relates to the registration of a class of securities pursuant to Section 12(g) of the Exchange Act and is effective pursuant to General Instruction A.(d), check the following box. [X]

Securities Act registration statement file number to which this form relates: _____ (if applicable)

Securities to be registered pursuant to Section 12(g) of the Act:

None
(Title of class)

Item 1. Description of Registrant's Securities to be Registered.

As of September 15, 2008, the Board of Directors of TAYLOR DEVICES, INC. (the "Company") declared a dividend of one Right for each outstanding share of the Company's Common Stock, par value \$.025 per share (the "Common Stock"), to shareholders of record at the close of business on October 3, 2008 (the "Record Date"). Each Right entitles the registered holder to purchase from the Company a unit consisting of one two-thousandths (1/2000) of a share of Series 2008 Junior Participating Preferred Stock, par value \$.05 per share (the "Series 2008 Preferred Stock"), at a Purchase Price of \$5.00 per unit of one two-thousandths of a share, subject to adjustment. The description and terms of the Rights are set forth in a Rights Agreement (the "Rights Agreement") between the Company and Regan & Associates, Inc., as Rights Agent. Registrar and Transfer Company, with offices located at 10 Commerce Drive, Cranford, NJ 07016-3572, currently serves as the

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Company's transfer agent (the "Transfer Agent").

Initially, the Rights will be attached to all Common Stock certificates representing shares then outstanding, and no separate Rights Certificates will be distributed. A Distribution Date will occur and the Rights will separate from the Common Stock upon the earliest of (i) 10 days following a public announcement that a person or group of affiliated or associated persons (an "Acquiring Person") has acquired, or obtained the right to acquire, beneficial ownership of 15% or more of the shares of Common Stock then outstanding (the "Stock Acquisition Date"), (ii) 10 business days following the commencement of a tender offer or exchange offer that would result in a person or group beneficially owning 10% or more of such outstanding shares of Common Stock (unless such tender offer or exchange offer is an offer for all outstanding shares of Common Stock which a majority of the unaffiliated Directors who are not officers of the Company determine to be fair to and otherwise in the best interests of the Company and its shareholders) and (iii) the date the Board of Directors declares a person to be an "Adverse Person", upon a determination by the Board that such Person, together with his affiliates or associates, is or has become the beneficial owner of 10% or more of the shares of Common Stock outstanding, and upon a determination by at least a majority of the Continuing Directors (as defined below) who are not officers of the Company, after reasonable inquiry and investigation, that (a) such beneficial ownership by such person is intended to cause the Company to repurchase the Common Stock beneficially owned by such person or to cause pressure on the Company to take action or enter into a transaction or series of transactions intended to provide such person with short-term financial gain under circumstances where such Continuing Directors determine that the best long-term interests of the Company and its shareholders would not be served by taking such action or entering into such transactions or series of transactions at that time, or (b) such beneficial ownership is causing or reasonably likely to cause a material adverse impact (including, but not limited to, impairment of relationships with customers, impairment of the Company's ability to maintain its competitive position or impairment of the Company's business reputation or ability to deal with governmental agencies) on the business or prospects of the Company.

Under the Rights Agreement, for purposes of calculating percentages of Common Stock outstanding, shares of Common Stock outstanding shall include all shares of Common Stock deemed to be beneficially owned by a Person and its affiliates and associates, even if not actually then outstanding.

Until the Distribution Date, (i) the Rights will be evidenced by the Common Stock certificates and will be transferred with and only with such Common Stock certificates, (ii) new Common Stock certificates issued after October 5, 2008 will contain a notation incorporating the Rights Agreement by reference, and (iii) the surrender for transfer of any certificates for Common Stock outstanding will also constitute the transfer of the Rights associated with the Common Stock represented by such certificate. The Rights are exercisable commencing immediately upon the close of business on October 5, 2008 (the expiration of the Company's preceding rights plan) and will expire at the close of business on October 5, 2018, unless earlier redeemed by the Company as described below.

As soon as practicable after the Distribution Date, Rights Certificates will be mailed to holders of record of the Common Stock as of the close of business on the Distribution Date and, thereafter, the separate Rights Certificates alone will represent the Rights. Except (i) with respect to certain shares of Common Stock issued or sold pursuant to the exercise of stock options or under any employee plan or arrangement, or upon the exercise, conversion or exchange of certain securities of the Company, or (ii) as otherwise determined by the Board of Directors, only shares of Common Stock issued prior to the Distribution Date will be issued with Rights.

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In the event that (i) a person becomes the beneficial owner of 15% or more of the then outstanding shares of Common Stock (except pursuant to an offer for all outstanding shares of Common Stock which a majority of the Directors who are not officers of the Company and who are not affiliates or associates of such person determine to be fair to and otherwise in the best interests of the Company and its shareholders) or (ii) the Board of Directors declares that a person is an Adverse Person (each such event, a "Flip-in Event"), each holder of a Right will thereafter have the right to receive, upon payment of the Purchase Price, Common Stock (or, in certain circumstances, cash, property or other securities of the Company) having a value (based on a formula set forth in the Rights Agreement) equal to two times the Purchase Price of the Right. Notwithstanding any of the foregoing, following the occurrence of the Flip-in Event, all Rights that are, or (under certain circumstances specified in the Rights Agreement) were, beneficially owned by an Acquiring Person or an Adverse Person (or by certain related parties) will be null and void. However, Rights are not exercisable following the occurrence of the Flip-in Event until such time as the Rights are no longer redeemable by the Company as set forth below.

For example, at a Purchase Price of \$5.00 per Right, each Right not owned by an Acquiring Person or an Adverse Person (or by certain related parties) following a Flip-in Event would entitle its holder to purchase \$10.00 worth of Common Stock (or other consideration, as noted above) determined pursuant to a formula set forth in the Rights Agreement, for \$5.00. Assuming that the Common Stock had a per share value of \$5.00 at such time (as determined pursuant to such formula), the holder of each valid Right would be entitled to purchase two shares of Common Stock for \$5.00.

In the event that, at any time following the Stock Acquisition Date, (i) the Company is acquired in a merger or other business combination transaction in which the Company is not the surviving corporation or in which it is the surviving corporation but its Common Stock is changed or exchanged (other than a merger meeting certain conditions which follows an offer for all outstanding shares of Common Stock

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which a majority of the unaffiliated Directors who are not officers of the Company determine to be fair to and otherwise in the best interests of the Company and its shareholders), or (ii) 50% or more of the Company's assets, earning power or cash flow is sold or transferred ("Flip-over Event"), each holder of a Right (except Rights which previously have been voided as set forth above) shall thereafter have the right to receive, upon payment of the Purchase Price, common stock of the acquiring company having a value equal to two times the exercise price of the Right. The Flip-over Events set forth in this paragraph and the Flip-in Event described in the second preceding paragraph are referred to as the "Triggering Events."

The Purchase Price payable, and the number of units of one two-thousandths of a share of Series 2008 Preferred Stock or other securities or property issuable, upon exercise of the Rights are subject to adjustment from time to time to prevent dilution (i) in the event of a stock dividend on, or a subdivision, combination or reclassification of, the Preferred Stock, (ii) if holders of the Series 2008 Preferred Stock are granted certain rights or warrants to subscribe for Series 2008 Preferred Stock or convertible securities at less than the current market price of the Series 2008 Preferred Stock, or (iii) upon the distribution to holders of the Series 2008 Preferred Stock of evidences of indebtedness or assets (excluding regular quarterly cash dividends) or of subscription rights or warrants (other than those referred to above).

With certain exceptions, no adjustment in the Purchase Price will be required until cumulative adjustments amount to at least 1% of the Purchase Price. No fractional shares of Series 2008 Preferred Stock (other than fractions of one two-thousandths of a share, or integral multiples thereof) will be issued and, in lieu thereof, an adjustment in cash will be made based on the market price of the Series 2008 Preferred Stock on the last trading date prior to the date of exercise.

The term "Continuing Director" means any member of the Board of Directors of the Company who was a member of the Board prior to the date of the Rights Agreement, and any person who is subsequently elected to the Board if such person is recommended or approved by a majority of the Continuing Directors, but shall not include an Acquiring Person, an Adverse Person or an affiliate or associate of any such person, or any representative of any of the foregoing.

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At any time until 10 days following the Stock Acquisition Date, the Company may redeem the Rights in whole, but not in part, at a price of \$0.01 per Right (payable in cash, Common Stock or other consideration deemed appropriate by the Board of Directors). Under certain circumstances set forth in the Rights Agreement, the decision to redeem shall require the concurrence of a majority of the Continuing Directors who are not officers of the Company. Immediately upon the action of the Board of Directors ordering redemption of the Rights, with, where required, the concurrence of such Continuing Directors, the Rights will terminate and the only right of the holders of Rights will be to receive the \$0.01 redemption price.

Until a Right is exercised, the holder thereof, as such, will have no rights as a shareholder of the Company, including, without limitation, the right to vote or to receive dividends. While the distribution of the Rights will not be taxable to shareholders or to the Company, shareholders may, depending upon the circumstances, recognize taxable income in the event that the Rights become exercisable for Common Stock (or other consideration) of the Company or for common stock of the acquiring company as set forth above, or are redeemed as provided in the preceding paragraph.

Other than certain provisions relating to the principal economic terms of the Rights, any of the provisions of the Rights Agreement may be amended by the Board of Directors of the Company prior to the Distribution Date. After the Distribution Date, the provisions of the Rights Agreement may be amended by the Board (in certain circumstances, with the concurrence of the Continuing Directors) in order to cure any ambiguity, to make changes which do not adversely affect the interests of holders of Rights (other than an Acquiring Person, an Adverse Person or an affiliate or associate thereof), or to shorten or lengthen any time period under the Rights Agreement; provided, however, that no amendment to adjust the time period governing redemption shall be made at such time as the Rights are not redeemable.

The Rights have certain anti-takeover effects. Exercise of the Rights will cause substantial dilution to a person or group that attempts to acquire the Company on terms not approved by the Company's Board of Directors. The existence of Rights, however, should not affect an offer at a fair price and otherwise in the best interests of the Company and its shareholders as determined by the Board of Directors. The Rights should not interfere with any merger or other business combination approved by the Board of Directors since the Board of Directors may, at its option, at any time until 10 days following the Stock Acquisition Date redeem all but not less than all of the then outstanding Rights at the \$0.01 redemption price.

The Rights Agreement between the Company and the Rights Agent specifying the terms of the Rights, which includes as Exhibit B the Form of Rights Certificate, the press release announcing the declaration of the Rights and a letter to the holders of the Company's Common Stock (together with a summary of the Rights attached thereto) are attached hereto as exhibits and are incorporated herein by reference. The foregoing description of the Rights does not purport to be complete and is qualified in its entirety by reference to such exhibits.

Item 2. EXHIBITS

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4 Rights Agreement, dated as of October 5, 2008, between Taylor Devices, Inc. and Regan & Associates, Inc., as Rights Agent, and accompanying Exhibits:

- A. Certificate of Amendment, incorporated by reference to Exhibit (3)(i) of Report on Form 8-K, dated September 18, 2008
- B. Form of Rights Certificate
- C. Form of Election to Purchase; and
- D. Summary of Rights to Purchase Series 2008 Preferred Stock

20 Letter to the holders of Taylor Devices, Inc. Common Stock, dated October 6, 2008 (including Summary of Rights)

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SIGNATURE

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereto duly authorized.

Date: October 6, 2008

TAYLOR DEVICES, INC.
By: /s/ Douglas P. Taylor
Name: Douglas P. Taylor
Title: President

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EXHIBIT 4

TAYLOR DEVICES, INC. AND REGAN & ASSOCIATES, INC. RIGHTS AGENT RIGHTS AGREEMENT
DATED AS OF OCTOBER 5, 2008

RIGHTS AGREEMENT

RIGHTS AGREEMENT, dated as of October 5, 2008 (the "Agreement"), between TAYLOR DEVICES, INC., a New York corporation (the "Company"), and REGAN & ASSOCIATES, INC., a Delaware corporation (the "Rights Agent").

WITNESSETH

WHEREAS, as of September 15, 2008 (the "Rights Dividend Declaration Date"), the Board of Directors of the Company authorized and declared a dividend distribution of one Right for each share of common stock, par value \$0.025 per share, of the Company (the "Common Stock") outstanding at the close of business on October 3, 2008 (the "Record Date"), and has authorized the issuance of one Right (as such number may hereinafter be adjusted pursuant to the provisions of Section 11(k) hereof) for each share of Common Stock of the Company issued between the Record Date (whether originally issued or delivered from the Company's treasury) and the earlier of the Distribution Date or the Expiration Date, each whole Right initially representing the right to purchase one two thousandths (1/2000) of a share of Series 2008 Junior Participating Preferred Stock of the Company having the rights, powers and preferences set forth in the form of Certificate of Designation, Preferences and Rights of the Company attached hereto as Exhibit A, upon the terms and subject to the conditions hereinafter set forth (the "Rights").

TERMS OF AGREEMENT

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NOW, THEREFORE, in consideration of the premises and the mutual agreements herein set forth, the parties hereby agree as follows:

Section 1. CERTAIN DEFINITIONS.

For purposes of this Agreement, the following terms have the meanings indicated:

(a) "Acquiring Person" shall mean any Person who or which, together with all Affiliates and Associates of such Person, shall be the Beneficial Owner of 15% or more of the shares of Common Stock then outstanding, but shall not include (i) the Company, (ii) any Subsidiary of the Company, (iii) any employee benefit plan of the Company or of any Subsidiary of the Company, or any Person or entity organized, appointed or established by the Company for or pursuant to the terms of any such plan, or (iv) any Person who becomes an Acquiring Person solely as a result of a reduction in the number of shares of Common Stock outstanding due to the repurchase of shares of Common Stock by the Company, unless and until such Person shall purchase or otherwise become (as a result of actions taken by such Person or its Affiliates or Associates) the Beneficial Owner of additional shares of Common Stock. Notwithstanding the foregoing, if the Board of Directors of the Company determines in good faith that a Person who would otherwise be an Acquiring Person, as defined pursuant to the foregoing provisions of this paragraph, has become such inadvertently (including, without limitation, because (i) such Person was unaware that it beneficially owned a percentage of Common Stock that would otherwise cause such Person to be an Acquiring Person, or (ii) such Person was aware of the extent of its Beneficial Ownership of Common Stock but had no actual knowledge of the consequences of such Beneficial Ownership under this Agreement) and without any intention of changing or influencing control of the Company, and such Person divests as promptly as practicable a sufficient number of shares of Common Stock so that such Person would no longer be an Acquiring Person as defined pursuant to the foregoing provisions of this paragraph, then such Person shall not be deemed to be or to have become an Acquiring Person for any purposes of this Agreement.

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For purposes of the foregoing and all other provisions of this Agreement, in computing the percentage of the shares of Common Stock outstanding at any time which are beneficially owned by a Person and its Affiliates and Associates, the shares of Common Stock then outstanding shall be deemed to include all shares of Common Stock beneficially owned by such Person and its Affiliates and Associates but not actually then outstanding, including the shares of Common Stock, if any, then issuable to such Person and its Affiliates and Associates upon the exercise of conversion rights, exchange rights, rights, warrants or options.

(b) "Adverse Person" shall mean any Person declared to be an Adverse Person by the Board of Directors of the Company, upon a determination by the Continuing Directors who are not officers of the Company that the criteria set forth in Section 11(a)(ii)(B) apply to such Person.

(c) "Affiliate" and "Associate" shall have the respective meanings ascribed to such terms in Rule 12b-2 of the General Rules and Regulations under the Securities Exchange Act of 1934 (the "Exchange Act").

(d) A Person shall be deemed the "Beneficial Owner" of, and shall be deemed to "beneficially own," any securities:

(i) which such Person or any of such Person's Affiliates or Associates, directly or indirectly, has the right to acquire (whether such right is exercisable immediately or only after the passage of time) pursuant to any agreement, arrangement or understanding (whether or not in writing) or upon the exercise of conversion rights, exchange rights, rights, warrants or options, or otherwise; provided, however, that a Person shall not be deemed the "Beneficial Owner" of, or to "beneficially own," (A) securities tendered pursuant to a tender or exchange offer made by such Person or any of such Person's Affiliates or Associates until such tendered securities are accepted for purchase or exchange, or (B) securities issuable upon exercise of Rights at any time prior to the occurrence of a Triggering Event, or (C) securities issuable upon exercise of Rights from and after the occurrence of a Triggering Event which Rights were acquired by such Person or any of such Person's Affiliates or Associates prior to the Distribution Date or pursuant to Section 3(a) or Section 22 hereof (the "Original Rights") or pursuant to Section 11(e) hereof in connection with an adjustment made with respect to any Original Rights;

(ii) which such Person or any of such Person's Affiliates or Associates, directly or indirectly, has the right to vote or dispose of or has "Beneficial Ownership" of (as determined pursuant to Rule 13d-3 of the General Rules and Regulations under the Exchange Act), including pursuant to any agreement, arrangement or understanding, whether or not in writing; provided, however, that a Person shall not be deemed the "Beneficial Owner" of, or to "beneficially own," any security under this subparagraph (ii) as a result of an agreement, arrangement or understanding to vote such security if such agreement, arrangement or understanding: (A) arises solely from a revocable proxy given in response to a public proxy or consent solicitation made pursuant to, and in accordance with, the applicable provisions of the General Rules and Regulations under the Exchange Act, and (B) is not also then reportable by such Person on Schedule 13D or Schedule 13G under the Exchange Act (or any comparable or successor reports); or

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(iii) which are beneficially owned, directly or indirectly, by any other Person (or any Affiliate or Associate thereof) with which such Person (or any of such Person's Affiliates or Associates) has any agreement, arrangement or understanding (whether or not in writing), for the purpose of acquiring, holding, voting (except pursuant to a revocable proxy as described in the proviso to subparagraph (ii) of this paragraph (d)) or disposing of any voting securities of the Company; provided, however, that nothing in this paragraph (d) shall cause a Person engaged in business as an underwriter of securities to be the "Beneficial Owner" of, or to "beneficially own," any securities acquired through such Person's participation in good faith in a firm commitment underwriting until the expiration of forty days after the date of such acquisition.

(e) "Business Day" shall mean any day other than a Saturday, Sunday or a day on which banking institutions in the State of New York are authorized or obligated by law or executive order to close.

(f) "Close of business" on any given date shall mean 5:00 P.M., New York City time, on such date; provided, however, that if such date is not a Business Day it shall mean 5:00 p.m., New York City time, on the next succeeding Business Day.

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(g) "Common Stock" shall mean the common stock, par value \$0.025 per share, of the Company, except that "Common Stock" when used with reference to any Person other than the Company shall mean the capital stock of such Person with the greatest voting power, or the equity securities or other equity interest having power to control or direct the management, of such Person.

(h) "Continuing Director" shall mean (i) any member of the Board of Directors of the Company, while such individual is a member of such Board, who is not an Acquiring Person or Adverse Person, or an Affiliate or Associate of an Acquiring Person or Adverse Person, or a representative of an Acquiring Person, Adverse Person or any such Affiliate or Associate, and was a member of such Board prior to the date of this Agreement, or (ii) any individual who subsequently becomes a member of the Board of Directors of the Company, while such individual is a member of such Board, who is not an Acquiring Person or an Adverse Person, or an Affiliate or Associate of an Acquiring Person or Adverse Person, or a representative of an Acquiring Person or Adverse Person or any such Affiliate or Associate, if such individual's nomination for election or election to such Board is recommended or approved by a majority of the Continuing Directors.

(i) "Person" shall mean any individual, firm, corporation, partnership, trust, limited partnership, limited liability corporation, or other entity.

(j) "Preferred Stock" shall mean shares of Series 2008 Junior Participating Preferred Stock, par value \$.05 per share, of the Company.

(k) "Section 11(a)(ii) Event" shall mean any event described in Section 11(a)(ii)(A) or (B) hereof.

(l) "Section 13 Event" shall mean any event described in clauses (x), (y) or (z) of Section 13(a) hereof.

(m) "Stock Acquisition Date" shall mean the first date of public announcement (which, for purposes of this definition, shall include, without limitation, a report filed pursuant to Section 13(d) or Section 13(g) under the Exchange Act) by the Company or an Acquiring Person that an Acquiring Person has become such.

(n) "Subsidiary" shall mean, with reference to any Person, any corporation of which an amount of voting securities sufficient to elect at least a majority of the directors of such corporation is beneficially owned, directly or indirectly, by such Person, or otherwise controlled by such Person.

(o) "Transfer Agent" shall mean the Registrar and Transfer Company in its capacity as transfer agent, or any successor transfer agent registered in accordance with Section 17A(c)(2) of the Exchange Act.

(p) "Triggering Event" shall mean any Section 11(a)(ii) Event or any Section 13 Event.

Section 2. APPOINTMENT OF RIGHTS AGENT OR SUCCESSOR TRANSFER AGENT.

The Company hereby appoints the Rights Agent to act as agent for the Company in accordance with the terms and conditions hereof, and the Rights Agent hereby accepts such appointment. The Company may from time to time appoint such Co-Rights Agents as it may deem necessary or desirable. The Rights Agent is not authorized to and shall not perform duties required of the Transfer Agent, including, but not limited to, countersigning securities upon issuance, monitoring issuance of securities with a view to preventing unauthorized issuance, registering the transfer of securities, exchanging or converting securities, or transferring record ownership of securities by bookkeeping entry

without physical issuance of securities certificates. In all instances, whether or not expressly stated in this Agreement, such duties shall be performed by the Transfer Agent.

Section 3. ISSUANCE OF RIGHTS CERTIFICATES.

(a) Until the earliest of (i) the close of business on the 10th day after the Stock Acquisition Date (or, if the 10th day after the Stock Acquisition Date occurs before the Record Date, the close of business on the Record Date), (ii) the close of business on the 10th Business Day (or such later date as the Board of Directors of the Company shall determine) after the date that a tender or exchange offer by any Person (other than the Company, any Subsidiary of the Company, any employee benefit plan of the Company or of any Subsidiary of the Company, or any Person or entity organized, appointed or established by the Company for or pursuant to the terms of any such plan) is first published or sent or given within the meaning of Rule 14d-2(a) of the General Rules and Regulations under the Exchange Act, if upon consummation thereof, such Person would be the Beneficial Owner of 10% or more of the shares of Common Stock then outstanding and (iii) the close of business on the day that the Board of Directors of the Company determines, upon determination of the Continuing Directors, pursuant to the criteria set forth in Section 11(a)(ii)(B) hereof that a Person is an Adverse Person (the earliest of (i), (ii) and (iii) being herein referred to as the "Distribution Date"), (x) the Rights will be evidenced (subject to the provisions of paragraph (b) of this Section 3) by the certificates for the Common Stock registered in the names of the holders of the Common Stock (which certificates shall be deemed also to be certificates for Rights) and not by separate certificates, and (y) the Rights will be transferable only in connection with the transfer of the underlying shares of Common Stock (including a transfer to, or redemption by, the Company). As soon as practicable after the Distribution Date, the Rights Agent will send by first-class, postage prepaid mail, to each record holder of the Common Stock as of the close of business on the Distribution Date, at the address of such holder shown on the records of the Company, one or more right certificates, in substantially the form of Exhibit B hereto (the "Rights Certificates"), evidencing one Right for each share of Common Stock so held, subject to adjustment as provided herein. In the event that an adjustment in the number of Rights per share of Common Stock has been made pursuant to Section 11(k) hereof, at the time of distribution of the Right Certificates, the Company shall make the necessary and appropriate rounding adjustments (in accordance with Section 14(a) hereof) so that Rights Certificates representing only whole numbers of Rights are distributed and cash is paid in lieu of any fractional Rights. As of and after the Distribution Date, the Rights will be evidenced solely by such Rights Certificates.

(b) As promptly as practicable following the Record Date, the Company will send a copy of a Summary of Rights, in substantially the form attached hereto as Exhibit C (the "Summary of Rights") to each record holder of the Common Stock as of the close of business on the Record Date, at the address of such holder shown on the records of the Company. With respect to certificates for the Common Stock outstanding as of the Record Date, until the Distribution Date, the Rights will be evidenced by such certificates and the registered holders of the Common Stock shall also be the registered holders of the associated Rights. Until the earlier of the Distribution Date or the Expiration Date (as such term is defined in Section 7 hereof), the transfer of any certificates representing shares of Common Stock in respect of which Rights have been issued shall also constitute the transfer of the Rights associated with such shares of Common Stock.

(c) Unless otherwise specifically decided by a majority of the Company's Board of Directors, Rights shall be issued in respect of all shares of Common Stock which are issued (whether originally issued or from the Company's treasury) after the Record Date but prior to the earlier of the Distribution Date or the Expiration Date. Certificates representing such shares of Common Stock shall also be deemed to be certificates for Rights, and shall bear the following legend:

"This certificate also evidences and entitles the holder hereof to certain Rights as set forth in the Rights Agreement between Taylor Devices, Inc. (the "Company") and Regan & Associates, Inc., dated as of October 5, 2008 (the "Rights Agreement"), the terms of which are hereby incorporated herein by reference and a copy of which is on file at the principal offices of the Company. Under certain circumstances, as set forth in the Rights Agreement, such Rights will be evidenced by separate certificates and will no longer be evidenced by this certificate. The Company will mail to the holder of this certificate a copy of the Rights Agreement, as in effect on the date of mailing, without charge promptly after receipt of a written request therefor. Under certain circumstances set forth in the Rights Agreement, Rights issued to, or held by, any Person who is, was or becomes an Acquiring Person, an Adverse Person or any Affiliate or Associate thereof (as such terms are defined in the Rights Agreement), whether currently held by or on behalf of such Person or by any subsequent holder, may become null and void."

With respect to such certificates containing the foregoing legend, and with respect to certificates for shares of Common Stock which were issued and outstanding on the Record Date, until the earlier of (i) the Distribution Date or (ii) the Expiration Date or redemption date, the Rights associated with the Common Stock represented by such certificates shall be evidenced by such certificates alone and registered holders of Common Stock shall also be the registered holders of the associated Rights, and the transfer of any of such certificates shall also constitute the transfer of the Rights associated with the Common Stock represented by such certificates.

Section 4. FORM OF RIGHTS CERTIFICATES.

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(a) The Rights Certificates (and the forms of election to purchase and of assignment to be printed on the reverse thereof) shall each be substantially in the form set forth in Exhibit B hereto and may have such marks of identification or designation and such legends, summaries or endorsements printed thereon as the Company may deem appropriate and as are not inconsistent with the provisions of this Agreement, or as may be required to comply with any applicable law or with any rule or regulation made pursuant thereto or with any rule or regulation of any stock exchange on which the Rights may from time to time be listed, or to conform to usage. Subject to the provisions of Section 11 and Section 22 hereof, the Rights Certificates, whenever distributed, shall be dated as of the Record Date and on their face shall entitle the holders thereof to purchase such number of one two-thousandths of a share of Preferred Stock as shall be set forth therein at the price set forth therein (such exercise price per one two-thousandths of a share is referred to as the "Purchase Price"), but the amount and type of securities purchasable upon the exercise of each Right and the Purchase Price thereof shall be subject to adjustment as provided herein.

(b) Any Rights Certificate issued pursuant to Section 3(a) or Section 22 hereof that represents Rights beneficially owned by: (i) an Acquiring Person, an Adverse Person or any Associate or Affiliate of an Acquiring Person or Adverse Person, (ii) a transferee of an Acquiring Person or an Adverse Person (or of any such Associate or Affiliate) who becomes a transferee after the Acquiring Person or Adverse Person becomes such, or (iii) a transferee of an Acquiring Person or an Adverse Person (or of any such Associate or Affiliate) who becomes a transferee prior to or concurrently with the Acquiring Person or Adverse Person becoming such and receives such Rights pursuant to either (A) a transfer (whether or not for consideration) from the Acquiring Person or Adverse Person to holders of equity interests in such Acquiring Person or Adverse Person or to any Person with whom such Acquiring Person or Adverse Person has any continuing agreement, arrangement or understanding regarding the transferred Rights or (B) a transfer which the Continuing Directors of the Company have determined is part of a plan, arrangement or understanding which has as a primary purpose or effect avoidance of Section 7(e) hereof, and any Rights Certificate issued pursuant to Section 6, Section 11 or Section 22 hereof upon transfer, exchange, replacement or adjustment of any other Rights Certificate referred to in this sentence, shall contain (to the extent feasible) the following legend:

"The Rights represented by this Rights Certificate are or were beneficially owned by a Person who was or became an [Acquiring Person][Adverse Person] or an Affiliate or Associate of an [Acquiring Person][Adverse Person] (as such terms are defined in the Rights Agreement). Accordingly, this Rights Certificate and the Rights represented hereby may become null and void in the circumstances specified in Section 7(e) of such Agreement."

Section 5. COUNTERSIGNATURE AND REGISTRATION.

(a) The Rights Certificates shall be executed on behalf of the Company by its President or any Vice President, either manually or by facsimile signature, and shall have affixed thereto the Company's seal or a facsimile thereof which shall be attested by the Secretary or an Assistant Secretary of the Company, either manually or by facsimile signature. The Rights Certificates shall be manually countersigned by the Transfer Agent and shall not be valid for any purpose unless so countersigned. In case any officer of the Company who shall have signed any of the Rights Certificates shall cease to be such officer of the Company before countersignature by the Transfer Agent and issuance and delivery by the Company, such Rights Certificates, nevertheless, may be countersigned by the Transfer Agent and issued and delivered by the Company with the same force and effect as though the Person who signed such Rights Certificates had not ceased to be such officer of the Company; and any Rights Certificates may be signed on behalf of the Company by any Person who, at the actual date of the execution of such Rights Certificate, shall be a proper officer of the Company to sign such Rights Certificate, although at the date of the execution of this Rights Agreement any such Person was not such an officer.

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(b) Following the Distribution Date, the Transfer Agent will keep or cause to be kept, at its principal office or offices designated as the appropriate place for surrender of Rights Certificates upon exercise or transfer, books for registration and transfer of the Rights Certificates issued hereunder. Such books shall show the names and addresses of the respective holders of the Rights Certificates, the number of Rights evidenced on its face by each of the Rights Certificates and the date of each of the Rights Certificates.

Section 6. TRANSFER, SPLIT UP, COMBINATION AND EXCHANGE OF RIGHTS CERTIFICATES; MUTILATED, DESTROYED, LOST OR STOLEN RIGHTS CERTIFICATES.

(a) Subject to the provisions of Section 4(b), Section 7(e) and Section 14 hereof, at any time after the close of business on the Distribution Date, and at or prior to the close of business on the Expiration Date, any Rights Certificate or Certificates may be transferred, split up, combined or exchanged for another Rights Certificate or Certificates, entitling the registered holder to purchase a like number of one two-thousandths of a share of Preferred Stock (or, following a Triggering Event, Common Stock, other securities, cash or other assets, as the case may be) as the Rights Certificate or Certificates surrendered then entitled such holder (or former holder in the case of a transfer) to purchase. Any registered holder desiring to transfer, split up, combine or exchange any Rights Certificate or Certificates shall make such request in writing delivered to the Transfer Agent, or Rights Agent, and shall surrender the Rights Certificate or Certificates to be transferred, split up, combined or exchanged at the principal office or offices of the Transfer Agent designated for such purpose. Neither the Transfer Agent nor the Company shall be obligated to take any action whatsoever with respect to the transfer of any such surrendered Rights Certificate until the registered holder shall have completed and signed the certificate contained in the form of assignment on the reverse side of

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such Rights Certificate and shall have provided such additional evidence of the identity of the Beneficial Owner (or former Beneficial Owner) or Affiliates or Associates thereof as the Company shall reasonably request. Thereupon the Transfer Agent shall, subject to Section 4(b), Section 7(e) and Section 14 hereof, countersign and deliver to the Person entitled thereto a Rights Certificate or Rights Certificates, as the case may be, as so requested. The Company may require payment of a sum sufficient to cover any tax or governmental charge that may be imposed in connection with any transfer, split up, combination or exchange of Rights Certificates.

(b) Upon receipt by the Company and the Transfer Agent of evidence reasonably satisfactory to them of the loss, theft, destruction or mutilation of a Rights Certificate, and, in case of loss, theft or destruction, of indemnity or security reasonably satisfactory to them, and reimbursement to the Company and the Transfer Agent of all reasonable expenses incidental thereto, and upon surrender to the Transfer Agent and cancellation of the Rights Certificate if mutilated, the Company will execute and deliver a new Rights Certificate of like tenor to the Transfer Agent for countersignature and delivery to the registered owner in lieu of the Rights Certificate so lost, stolen, destroyed or mutilated.

Section 7. EXERCISE OF RIGHTS; PURCHASE PRICE; EXPIRATION DATE OF RIGHTS.

(a) Subject to Section 7(e) hereof, the registered holder of any Rights Certificate may exercise the Rights evidenced thereby [except as otherwise provided herein including, without limitation, the restrictions on exercisability set forth in Section 9(c), Section 11(a)(iii) and Section 23(a) hereof] in whole or in part at any time after the Distribution Date upon surrender of the Rights Certificate, with the form of election to purchase and the certificate on the reverse side thereof duly executed, to the Transfer Agent at the principal office or offices of the Transfer Agent designated for such purpose, together with payment of the aggregate Purchase Price with respect to the total number of one two-thousandths of a share of Preferred Stock (or other securities, cash or other assets, as the case may be) as to which such surrendered Rights are then exercisable, and an amount equal to any applicable transfer tax, at or prior to the earlier of (i) the close of business on October 5, 2018 (the "Final Expiration Date"), or (ii) the time at which the Rights are redeemed as provided in Section 23 hereof (the earlier of (i) and (ii) being herein referred to as the "Expiration Date").

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(b) The Purchase Price for each one two-thousandths of a share of Preferred Stock pursuant to the exercise of a Right shall initially be \$5.00, and shall be subject to adjustment from time to time as provided in Sections 11 and 13(a) hereof and shall be payable in accordance with paragraph (c) below.

(c) Upon receipt of a Rights Certificate representing exercisable Rights, with the form of election to purchase and the certificate duly executed, accompanied by payment, with respect to each Right so exercised, of the Purchase Price per one two-thousandths of a share of Preferred Stock (or other shares, securities, cash or other assets, as the case may be) to be purchased as set forth below and an amount equal to any applicable transfer tax, the Transfer Agent shall, subject to Section 20(k) hereof, thereupon promptly (i) (A) requisition from any transfer agent of the shares of Preferred Stock (or make available, if the Transfer Agent is the transfer agent for such shares) certificates for the total number of one two-thousandths of a share of Preferred Stock to be purchased and the Company hereby irrevocably authorizes its transfer agent to comply with all such requests, or (B) if the Company shall have elected to deposit the total number of shares of Preferred Stock issuable upon exercise of the Rights hereunder with a depository agent, requisition from the depository agent depository receipts representing such number of one two-thousandths of a share of Preferred Stock as are to be purchased (in which case certificates for the shares of Preferred Stock represented by such receipts shall be deposited by the transfer agent with the depository agent) and the Company will direct the depository agent to comply with such request, (ii) requisition from the Company the amount of cash, if any, to be paid in lieu of fractional shares in accordance with Section 14 hereof, (iii) after receipt of such certificates or depository receipts, cause the same to be delivered to or upon the order of the registered holder of such Rights Certificate, registered in such name or names as may be designated by such holder, and (iv) after receipt thereof, deliver such cash, if any, to or upon the order of the registered holder of such Rights Certificate. The payment of the Purchase Price (as such amount may be reduced pursuant to Section 11(a)(iii) hereof) shall be made in cash, or by certified check or official bank check payable to the order of the Company. In the event that the Company is obligated to issue other securities (including Common Stock) of the Company, pay cash or distribute other property pursuant to Section 11(a) hereof, the Company will make all arrangements necessary so that such other securities, cash and other property is available for distribution by the Transfer Agent, if and when appropriate. The Company reserves the right to require prior to the occurrence of a Triggering Event that, upon any exercise of Rights, a number of Rights be exercised so that only whole shares of Preferred Stock would be issued.

(d) In case the registered holder of any Rights Certificate shall exercise less than all the Rights evidenced thereby, a new Rights Certificate evidencing Rights equivalent to the Rights remaining unexercised shall be issued by the Transfer Agent and delivered to, or upon the order of, the registered holder of such Rights Certificate, registered in such name or names as may be designated by such holder, subject to the provisions of Section 14 hereof.

(e) Notwithstanding anything in this Agreement to the contrary, from and after the first occurrence of a Section 11(a)(ii) Event, any Rights beneficially owned by (i) an Acquiring Person or an Adverse Person or an Associate or Affiliate of an Acquiring Person or an Adverse Person, (ii) a transferee of an Acquiring Person or an Adverse Person (or of any such Associate or Affiliate) who becomes

a transferee after the Acquiring Person or an Adverse Person becomes such, or (iii) a transferee of an Acquiring Person or an Adverse Person (or of any such Associate or Affiliate) who becomes a transferee prior to or concurrently with the Acquiring Person or an Adverse Person becoming such and receives such Rights pursuant to either (A) a transfer (whether or not for consideration) from the Acquiring Person or an Adverse Person to holders of equity interests in such Acquiring Person or an Adverse Person or to any Person with whom the Acquiring Person or an Adverse Person has any continuing agreement, arrangement or understanding regarding the transferred Rights or (B) a transfer which the Continuing Directors of the Company have determined is part of a plan, arrangement or understanding which has as a primary purpose or effect the avoidance of this Section 7(e), shall become null and void without any further action and no holder of such Rights shall have any rights whatsoever with respect to such Rights, whether under any provision of this Agreement or otherwise. The Company shall use all reasonable efforts to insure that the provisions of this Section 7(e) and Section 4(b) hereof are complied with, but shall have no liability to any holder of Rights Certificates or other Person as a result of its failure to make any determinations with respect to an Acquiring Person or an Adverse Person or any of its Affiliates, Associates or transferees hereunder.

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(f) Notwithstanding anything in this Agreement to the contrary, not any of the Rights Agent, the Transfer Agent or the Company shall be obligated to undertake any action with respect to a registered holder upon the occurrence of any purported exercise as set forth in this Section 7 unless such registered holder shall have (i) completed and signed the certificate contained in the form of election to purchase set forth on the reverse side of the Rights Certificate surrendered for such exercise, and (ii) provided such additional evidence of the identity of the Beneficial Owner (or former Beneficial Owner) or Affiliates or Associates thereof as the Company shall reasonably request.

Section 8. CANCELLATION AND DESTRUCTION OF RIGHTS CERTIFICATES.

All Rights Certificates surrendered for the purpose of exercise, transfer, split up, combination or exchange shall, if surrendered to the Company or any of its agents, be delivered to the Transfer Agent for cancellation or in cancelled form, or, if surrendered to the Transfer Agent, shall be cancelled by it, and no Rights Certificates shall be issued in lieu thereof except as expressly permitted by any of the provisions of this Agreement. The Company shall deliver to the Transfer Agent for cancellation and retirement, and the Transfer Agent shall so cancel and retire, any other Rights Certificate purchased or acquired by the Company otherwise than upon the exercise thereof. The Transfer Agent shall deliver all cancelled Rights Certificates to the Company, or shall, at the written request of the Company, destroy such cancelled Rights Certificates, and in such case shall deliver a certificate of destruction thereof to the Company.

Section 9. RESERVATION AND AVAILABILITY OF CAPITAL STOCK.

(a) The Company covenants and agrees that it will cause to be reserved and kept available out of its authorized and unissued shares of Preferred Stock (and, following the occurrence of a Triggering Event, out of its authorized and unissued shares of Common Stock and other securities or out of its authorized and issued shares held in its treasury), the number of shares of Preferred Stock (and, following the occurrence of a Triggering Event, Common Stock and other securities) that, as provided in this Agreement including Section 11(a)(iii) hereof, will be sufficient to permit the exercise in full of all outstanding Rights.

(b) If and so long as the shares of Preferred Stock (and, following the occurrence of a Triggering Event, Common Stock and/or other securities) issuable and deliverable upon the exercise of the Rights may be listed on any national securities exchange, the Company shall use its best efforts to cause, from and after such time as the Rights become exercisable, all shares reserved for such issuance to be listed on such exchange upon official notice of issuance upon such exercise.

(c) The Company shall use its best efforts to (i) file, as soon as practicable following the earliest date after the first occurrence of a Section 11(a)(ii) Event on which the consideration to be delivered by the Company upon exercise of the Rights has been determined in accordance with Section 11(a)(iii) hereof, a registration statement under the Securities Act of 1933 (the "Act"), with respect to the securities purchasable upon exercise of the Rights on an appropriate form, (ii) cause such registration statement to become effective as soon as practicable after such filing, and (iii) cause such registration statement to remain effective (with a prospectus at all times meeting the requirements of the Act) until the earlier of (A) the date as of which the Rights are no longer exercisable for such securities, and (B) the date of the expiration of the Rights. The Company will also take such action as may be appropriate under, or to ensure compliance with, the securities or "blue sky" laws of the various states in connection with the exercisability of the Rights. The Company may temporarily suspend, for a period of time not to exceed ninety (90) days after the date set forth in clause (i) of the first sentence of this Section 9(c), the exercisability of the Rights in order to prepare and file such registration statement and permit it to become effective. Upon any such suspension, the Company shall issue a public announcement stating that the exercisability of the Rights has been temporarily suspended, as well as a public announcement at such time as the suspension is no longer in effect. In addition, if the Company shall determine that a registration statement is required following the Distribution Date, the Company may temporarily suspend the exercisability of the Rights until such time as a registration statement has been declared effective. Notwithstanding any provision of this Agreement to the contrary, the Rights shall not be exercisable in any jurisdiction if the requisite qualification in such jurisdiction shall not have been obtained, the exercise thereof shall not be permitted under applicable law or a registration statement shall not have been declared effective.

(d) The Company will take all such action as may be necessary to ensure that all one two-thousandths of a share of Preferred Stock (and, following the occurrence of a Triggering Event, Common Stock and other securities) delivered upon exercise of Rights shall, at the time of delivery of the certificates for such shares (subject to payment of the Purchase Price), be duly and validly authorized and issued and fully paid and nonassessable.

(e) The Company will pay when due and payable any and all federal and state transfer taxes and charges which may be payable in respect of the issuance or delivery of the Rights Certificates and of any certificates for a number of one two-thousandths of a share of Preferred Stock (or Common Stock and other securities, as the case may be) upon the exercise of Rights. The Company shall not, however, be required to pay any transfer tax which may be payable in respect of any transfer or delivery of Rights Certificates to a Person other than, or the issuance or delivery of a number of one two-thousandths of a share of Preferred Stock (or Common Stock and other securities, as the case may be) in respect of a name other than that of, the registered holder of the Rights Certificates evidencing Rights surrendered for exercise or to issue or deliver any certificates for a number of one two-thousandths of a share of Preferred Stock (or Common Stock and other securities, as the case may be) in a name other than that of the registered holder upon the exercise of any Rights until such tax shall have been paid (any such tax being payable by the holder of such Rights Certificate at the time of surrender) or until it has been established to the Company's satisfaction that no such tax is due.

Section 10. PREFERRED STOCK RECORD DATE.

Each Person in whose name any certificate for a number of one two-thousandths of a share of Preferred Stock (or Common Stock and other securities, as the case may be) is issued upon the exercise of Rights shall for all purposes be deemed to have become the holder of record of such fractional shares of Preferred Stock (or Common Stock and other securities, as the case may be) represented thereby on, and such certificate shall be dated, the date upon which the Rights Certificate evidencing such Rights was duly surrendered and payment of the Purchase Price (and all applicable transfer taxes) was made; provided, however, that if the date of such surrender and payment is a date upon which the Preferred Stock (or Common Stock and other securities, as the case may be) transfer books of the Company are closed, such Person shall be deemed to have become the record holder of such shares (fractional or otherwise) on, and such certificate shall be dated, the next succeeding Business Day on which the Preferred Stock (or Common Stock and other securities, as the case may be) transfer books of the Company are open. Prior to the exercise of the Rights evidenced thereby, the holder of a Rights Certificate shall not be entitled to any rights of a shareholder of the Company with respect to shares for which the Rights shall be exercisable, including, without limitation, the right to vote, to receive dividends or other distributions or to exercise any preemptive rights, and shall not be entitled to receive any notice of any proceedings of the Company, except as provided herein.

Section 11. ADJUSTMENT OF PURCHASE PRICE, NUMBER AND KIND OF SHARES OR NUMBER OF RIGHTS.

The Purchase Price, the number and kind of shares covered by each Right and the number of Rights outstanding are subject to adjustment from time to time as provided in this Section 11.

(a) (i) In the event the Company shall at any time after the date of this Agreement (A) declare a dividend on the Preferred Stock payable in shares of Preferred Stock, (B) subdivide the outstanding Preferred Stock, (C) combine the outstanding Preferred Stock into a smaller number of shares, or (D) issue any shares of its capital stock in a reclassification of the Preferred Stock (including any such reclassification in connection with a consolidation or merger in which the Company is the continuing or surviving corporation), except as otherwise provided in this Section 11(a) and Section 7(e) hereof, the Purchase Price in effect at the time of the record date for such dividend or of the effective date of such subdivision, combination or reclassification, and the number and kind of shares of Preferred Stock or capital stock, as the case may be, issuable on such date, shall be proportionately adjusted so that the holder of any Right exercised after such time shall be entitled to receive, upon payment of the Purchase Price then in effect, the aggregate number and kind of shares of Preferred Stock or capital stock, as the case may be, which, if such Right had been exercised immediately prior to such date and at a time when the Preferred Stock transfer books of the Company were open, that holder would have owned upon such exercise and been entitled to receive by virtue of such dividend, subdivision, combination or reclassification. If an event occurs which would require an adjustment under both this Section 11(a)(i) and Section 11(a)(ii) hereof, the adjustment provided for in this Section 11(a)(i) shall be in addition to, and shall be made prior to, any adjustment required pursuant to Section 11(a)(ii) hereof.

(ii) In the event:

(A) any Person (other than the Company, any Subsidiary of the Company, any employee benefit plan of the Company or of any Subsidiary of the Company, or any Person or entity organized, appointed or established by the Company for or pursuant to the terms of any such plan [but only to the extent of their Beneficial Ownership of any shares of Common Stock which were issued and outstanding on the Record Date]), alone or together with its Affiliates and Associates, shall, at any time after the Rights Dividend Declaration Date, become the Beneficial Owner of

15% or more of the shares of Common Stock then outstanding, unless the event causing the 15% threshold to be crossed is a transaction set forth in Section 13(a) hereof, or is an acquisition of shares of Common Stock pursuant to a tender offer or an exchange offer for all outstanding shares of Common Stock at a price and on terms determined by at least a majority of the Continuing Directors of the Company and who are not representatives, nominees, Affiliates or Associates of the Person making such tender or exchange offer, to be (a) at a price which is fair to shareholders (taking into account all factors which Continuing Directors of the Company deem relevant including, without limitation, prices which could reasonably be achieved if the Company or its assets were sold on an orderly basis designed to realize maximum value) and (b) otherwise in the best interests of the Company and its shareholders, or

(B) the Board of Directors of the Company shall declare any Person to be an Adverse Person, upon a determination that such Person, alone or together with its Affiliates and Associates, had, at any time after this Agreement has been filed with the Securities and Exchange Commission as an exhibit to a filing under the Exchange Act, become the Beneficial Owner of at least 10% of the shares of Common Stock then outstanding, and a determination by at least a majority of the Continuing Directors who are not officers of the Company, after reasonable inquiry and investigation, including consultation with such Persons as such Continuing Directors shall deem appropriate, that (a) such Beneficial Ownership by such Person is intended to cause the Company to repurchase the Common Stock beneficially owned by such Person or to cause pressure on the Company to take action or enter into a transaction or series of transactions intended to provide such Person with short-term financial gain under circumstances where such Continuing Directors determine that the best long-term interests of the Company and its shareholders would not be served by taking such action or entering into such transactions or series of transactions at that time or (b) such Beneficial Ownership is causing or reasonably likely to cause a material adverse impact on the business or prospects of the Company (including, but not limited to, impairment of relationships with customers, impairment of the Company's ability to maintain its competitive position or impairment of the Company's business reputation or ability to deal with governmental agencies) to the detriment of the Company's shareholders, then, promptly following the occurrence of any such event described in Section 11(a)(ii)(A) or (B) hereof, proper provision shall be made so that each holder of a Right (except as provided below and in Section 7(e) hereof) shall thereafter have the right to receive, upon exercise thereof at the then current Purchase Price in accordance with the terms of this Agreement, in lieu of a number of one two-thousandths of a share of Preferred Stock, such number of shares of Common Stock of the Company as shall equal the result obtained by (x) multiplying the then current Purchase Price by the then number of one two-thousandths of a share of Preferred Stock for which a Right was exercisable immediately prior to the first occurrence of a Section 11(a)(ii) Event, and (y) dividing that product (which, following such first occurrence, shall thereafter be referred to as the "Purchase Price" for each Right and for all purposes of this Agreement) by 50% of the Current Market Price (determined pursuant to Section 11(d) hereof) per share of Common Stock on the date of such first occurrence (such number of shares, the "Adjustment Shares").

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(iii) In the event that the number of shares of Common Stock which are authorized by the Company's certificate of incorporation but not outstanding or reserved for issuance for purposes other than upon exercise of the Rights is not sufficient to permit the exercise in full of the Rights in accordance with the foregoing subparagraph (ii) of this Section 11(a), the Company shall (A) determine the value of the Adjustment Shares issuable upon the exercise of a Right (the "Current Value"), and (B) with respect to each Right (subject to Section 7(e) hereof), make adequate provision to substitute for the Adjustment Shares, upon the exercise of a Right and payment of the applicable Purchase Price, (1) cash, (2) a reduction in the Purchase Price, (3) Common Stock or other equity securities of the Company (including, without limitation, shares, or units of shares, of preferred stock, such as the Preferred Stock, which the Board of Directors of the Company has deemed to have essentially the same value or economic rights as shares of Common Stock [such shares of preferred stock being referred to as "Common Stock Equivalents"]), (4) debt securities of the Company, (5) other assets, or (6) any combination of the foregoing, having an aggregate value equal to the Current Value (less the amount of any reduction in the Purchase Price); *provided, however*, that if the Company shall not have made adequate provision to deliver value pursuant to clause (B) above within thirty (30) days following the later of (x) the first occurrence of a Section 11(a)(ii) Event and (y) the date on which the Company's right of redemption pursuant to Section 23(a) expires (the later of (x) and (y) being referred to herein as the "Section 11(a)(ii) Trigger Date"), then the Company shall be obligated to deliver, upon the surrender for exercise of a Right and without requiring payment of the Purchase Price, shares of Common Stock (to the extent available) and then, if necessary, cash, which shares and/or cash have an aggregate value equal to the Spread. For purposes of the preceding sentence, the term "Spread" shall mean the excess of (i) the Current Value over (ii) the Purchase Price. If the Board of Directors of the Company determines in good faith that it is likely that sufficient additional shares of Common Stock could be authorized for issuance upon exercise in full of the Rights, the thirty (30) day period set forth above may be extended to the extent necessary, but not more than ninety (90) days after the Section 11(a)(ii) Trigger Date, in order that the Company may seek shareholder approval for the authorization of such additional shares (such period, as extended, is herein called the "Substitution Period"). To the extent that action is to be taken pursuant to the first and/or third sentences of this Section 11(a)(iii), the Company (1) shall provide, subject to Section 7(e) hereof, that such action shall apply uniformly to all outstanding Rights, and (2) may suspend the exercisability of the Rights until the expiration of the Substitution Period in order to seek such shareholder approval for such authorization of additional shares and/or to decide the appropriate form of distribution to be made pursuant to such first sentence and to determine the value thereof. In the event of any such suspension, the Company shall issue a public announcement stating that the exercisability of the Rights has been temporarily suspended, as well as a public announcement at such time as the suspension is no longer in effect. For purposes of this Section 11(a)(iii), the value of each Adjustment Share shall be the Current Market Price per share of the Common Stock on the Section 11(a)(ii) Trigger Date and the per share or per unit value of any Common Stock Equivalent shall be deemed to equal the Current Market Price per share of the Common Stock on such date.

(b) (i) For the purpose of any computation hereunder, other than computations made pursuant to Section 11(a)(iii) hereof, the "Current Market Price" per share of Common Stock on any date shall be deemed to be the average of the daily closing prices per share of such Common Stock for the thirty (30) consecutive Business Days immediately prior to such date, and for purposes of computations made pursuant to Section 11(a)(iii) hereof, the "Current Market Price" per share of Common Stock on any date shall be deemed to be the average of the daily closing prices per share of such Common Stock for the ten (10) consecutive Business Days immediately following such date; *provided, however*, that in the event that the Current Market Price per share of the Common Stock is determined during a period following the announcement by the issuer of such Common Stock of (A) a dividend or distribution on such Common Stock payable in shares of such Common Stock or securities convertible into shares of such Common Stock (other than the Rights), or (B) any subdivision, combination or reclassification of such Common Stock, and the ex-dividend date for such dividend or distribution, or the record date for such subdivision, combination or reclassification shall not have occurred prior to the commencement of the requisite thirty (30) Business Day or ten (10) Business Day period, as set forth above, then, and in each such case, the Current Market Price shall be properly adjusted to take into account ex-dividend trading. The closing price for each day shall be the last quoted price or, if not so quoted, the average of the high bid and low asked prices in the over-the-counter market, as reported by the National Association of Securities Dealers, Inc. Automated Quotation System ("NASDAQ") or such other system then in use, or, if on any such date the shares of Common Stock are not quoted by any such organization, the average of the closing bid and asked prices as furnished by a professional market maker making a market in the Common Stock selected by the Board of Directors of the Company. If on any such date no market maker is making a market in the Common Stock, the fair value of such shares on such date as determined in good faith by the Board of Directors of the Company shall be used. If the Common Stock is not publicly held or not so listed or traded, Current Market Price per share shall mean the fair value per share as determined in good faith by the Board of Directors of the Company, whose determination shall be described in a statement filed with the Rights Agent and the Transfer Agent and shall be conclusive for all purposes.

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(ii) For the purpose of any computation hereunder, the "Current Market Price" per share of Preferred Stock shall be determined in the same manner as set forth above for the Common Stock in clause (i) of this Section 11(b) (other than the last sentence thereof). If the Current Market Price per share of Preferred Stock cannot be determined in the manner provided above or if the Preferred Stock is not publicly held or listed or traded in a manner described in clause (i) of this Section 11(b), the Current Market Price per share of Preferred Stock shall be conclusively deemed to be an amount equal to 2,000 (as such number may be appropriately adjusted for such events as stock splits, stock dividends and recapitalizations with respect to the Common Stock occurring after the date of this Agreement) multiplied by the Current Market Price per share of the Common Stock. If neither the Common Stock nor the Preferred Stock is publicly held or so listed or traded, Current Market Price per share of the Preferred Stock shall mean the fair value per share as determined in good faith by the Board of Directors of the Company, whose determination shall be described in a statement filed with the Rights Agent and the Transfer Agent, and shall be conclusive for all purposes.

(c) Anything herein to the contrary notwithstanding, no adjustment in the Purchase Price shall be required unless such adjustment would require an increase or decrease of at least one percent (1%) in the Purchase Price; *provided, however*, that any adjustments which by reason of this Section 11(c) are not required to be made shall be carried forward and taken into account in any subsequent adjustment. All calculations under this Section 11 shall be made to the nearest cent or to the nearest ten-thousandth of a share of Common Stock or other share or one-millionth of a share of Preferred Stock, as the case may be. Notwithstanding the first sentence of this Section 11(c), any adjustment required by this Section 11 shall be made no later than the earlier of (i) three (3) years from the date of the transaction which mandates such adjustment, or (ii) the Expiration Date.

(d) All Rights originally issued by the Company subsequent to any adjustment made to the Purchase Price hereunder shall evidence the right to purchase, at the adjusted Purchase Price, the number of one two-thousandths of a share of Preferred Stock purchasable from time to time hereunder upon exercise of the Rights, all subject to further adjustment as provided herein.

(e) The Company may elect on or after the date of any adjustment of the Purchase Price to adjust the number of Rights, in lieu of any adjustment in the number of one two-thousandths of a share of Preferred Stock purchasable upon the exercise of a Right. Each of the Rights outstanding after the adjustment in the number of Rights shall be exercisable for the number of one two-thousandths of a share of Preferred Stock for which a Right was exercisable immediately prior to such adjustment. Each Right held of record prior to such adjustment of the number of Rights shall become that number of Rights (calculated to the nearest one-ten-thousandths) obtained by dividing the Purchase Price in effect immediately prior to adjustment of the Purchase Price by the Purchase Price in effect immediately after adjustment of the Purchase Price. The Company shall make a public announcement of its election to adjust the number of Rights, indicating the record date for the adjustment, and, if known at the time, the amount of the adjustment to be made. This record date may be the date on which the Purchase Price is adjusted or any day thereafter, but, if the Rights Certificates have been issued, shall be at least 10 calendar days later than the date of the public announcement. If Rights Certificates have been issued, upon each adjustment of the number of Rights pursuant to this Section 11(e), the Company shall, as promptly as practicable, cause to be distributed to holders of record of Rights Certificates on such record date Rights Certificates evidencing, subject to Section 14 hereof, the additional Rights to which such holders shall be entitled as a result of such adjustment, or, at the option of the Company, shall cause to be distributed to such holders of record in substitution and replacement for the Rights Certificates held by such holders prior to the date of adjustment, and upon surrender thereof, if required by the Company, new Rights Certificates evidencing all the Rights to which such holders shall be entitled after such adjustment. Rights Certificates so to be distributed shall

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be issued, executed and countersigned in the manner provided for herein (and may bear, at the option of the Company, the adjusted Purchase Price) and shall be registered in the names of the holders of record of Rights Certificates on the record date specified in the public announcement.

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(f) Irrespective of any adjustment or change in the Purchase Price or the number of one two-thousandths of a share of Preferred Stock issuable upon the exercise of the Rights, the Rights Certificates theretofore and thereafter issued may continue to express the Purchase Price per one two-thousandths of a share and the number of one two-thousandths of a share which were expressed in the initial Rights Certificates issued hereunder.

(g) Before taking any action that would cause an adjustment reducing the Purchase Price below the then stated value, if any, of the number of one two-thousandths of a share of Preferred Stock issuable upon exercise of the Rights, the Company shall take any corporate action which may, in the opinion of its counsel, be necessary in order that the Company may validly and legally issue fully paid and nonassessable such number of one two-thousandths of a share of Preferred Stock at such adjusted Purchase Price.

(h) In any case in which this Section 11 shall require that an adjustment in the Purchase Price be made effective as of a record date for a specified event, the Company may elect to defer until the occurrence of such event the issuance to the holder of any Right exercised after such record date the number of one two-thousandths of a share of Preferred Stock and other capital stock or securities of the Company, if any, issuable upon such exercise over and above the number of one two-thousandths of a share of Preferred Stock and other capital stock or securities of the Company, if any, issuable upon such exercise on the basis of the Purchase Price in effect prior to such adjustment; *provided, however*, that the Company shall deliver to such holder a due bill or other appropriate instrument evidencing such holder's right to receive such additional shares (fractional or otherwise) or securities upon the occurrence of the event requiring such adjustment.

(i) The Company will not, at any time after the Distribution Date, (i) consolidate with any other Person (other than a Subsidiary of the Company in a transaction which complies with Section 11(j) hereof), (ii) merge with or into any other Person [other than a Subsidiary of the Company in a transaction which complies with Section 11(i) hereof], or (iii) sell or transfer (or permit any Subsidiary to sell or transfer), in one transaction, or a series of related transactions, assets, cash flow or earning power aggregating more than 50% of the assets, cash flow or earning power of the Company and its Subsidiaries (taken as a whole) to any other Person or Persons [other than the Company and/or any of its Subsidiaries in one or more transactions each of which complies with Section 11(j) hereof], if (x) at the time of or immediately after such consolidation, merger or sale there are any rights, warrants or other instruments or securities outstanding or agreements in effect which would substantially diminish or otherwise eliminate the benefits intended to be afforded by the Rights or (y) prior to, simultaneously with or immediately after such consolidation, merger or sale, the shareholders of the Person who constitutes, or would constitute, the "Principal Party" for purposes of Section 13(a) hereof shall have received a distribution of Rights previously owned by such Person or any of its Affiliates and Associates.

(j) After the Distribution Date, the Company will not, except as permitted by Section 23 or Section 26 hereof, take (or permit any Subsidiary to take) any action if at the time such action is taken it is reasonably foreseeable that such action will diminish substantially or otherwise eliminate the benefits intended to be afforded by the Rights.

(k) Anything in this Agreement to the contrary notwithstanding, in the event that the Company shall at any time after the Rights Dividend Declaration Date and prior to the Distribution Date (i) declare a dividend on the outstanding shares of Common Stock payable in shares of Common Stock, (ii) subdivide the outstanding shares of Common Stock, or (iii) combine the outstanding shares of Common Stock into a smaller number of shares, the number of Rights then outstanding, or issued or delivered thereafter but prior to the Distribution Date, shall be proportionately adjusted so that the number of Rights outstanding following any such event shall equal the result obtained by multiplying the number of Rights outstanding immediately prior to such event by a fraction the denominator of which shall be the total number of shares of Common Stock outstanding immediately prior to the occurrence of the event and the numerator of which shall be the total number of shares of Common Stock outstanding immediately following the occurrence of such event.

(l) The failure by the Board of Directors of the Company to declare a Person to be an Adverse Person following such Person becoming the Beneficial Owner of 10% or more of the outstanding Common Stock shall not imply that such Person is not an Adverse Person or limit the right at any time in the future of the Board of Directors of the Company to declare such Person to be an Adverse Person.

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Whenever an adjustment is made as provided in Section 11 and Section 13 hereof, the Company shall (a) promptly prepare a certificate setting forth such adjustment and a brief statement of the facts accounting for such adjustment, (b) promptly file with the Transfer Agent, a copy of such certificate, and (c) mail a brief summary thereof to each holder of a Rights Certificate (or, if prior to the Distribution Date, to each holder of a certificate representing shares of Common Stock) in accordance with Section 25 hereof. The Transfer Agent shall be fully protected in relying on any such certificate and on any adjustment therein contained.

Section 13. CONSOLIDATION, MERGER OR SALE OR TRANSFER OF ASSETS, CASH FLOW OR EARNING POWER.

(a) In the event that, following the Stock Acquisition Date, directly or indirectly, (x) the Company shall consolidate with, or merge with and into, any other Person [other than a Subsidiary of the Company in a transaction which complies with Section 11(j) hereof], and the Company shall not be the continuing or surviving corporation of such consolidation or merger, (y) any Person [other than a Subsidiary of the Company in a transaction which complies with Section 11(j) hereof] shall consolidate with, or merge with or into, the Company, and the Company shall be the continuing or surviving corporation of such consolidation or merger and, in connection with such consolidation or merger, all or part of the outstanding shares of Common Stock shall be changed into or exchanged for stock or other securities of any other Person or cash or any other property, or (z) the Company shall sell or otherwise transfer (or one or more of its Subsidiaries shall sell or otherwise transfer), in one transaction or a series of related transactions, assets, cash flow or earning power aggregating more than 50% of the assets or earning power of the Company and its Subsidiaries (taken as a whole) to any Person or Persons [other than the Company or any Subsidiary of the Company in one or more transactions each of which complies with Section 11(j) hereof], then, and in each such case [except as may be contemplated by Section 13(d) hereof], proper provision shall be made so that: (i) each holder of a Right, except as provided in Section 7(e) hereof, shall thereafter have the right to receive, upon the exercise thereof at the then current Purchase Price in accordance with the terms of this Agreement, such number of validly authorized and issued, fully paid, non-assessable and freely tradeable shares of Common Stock of the Principal Party (as such term is hereinafter defined), not subject to any liens, encumbrances, rights of first refusal or other adverse claims, as shall be equal to the result obtained by dividing the then current Purchase Price by 50% of the Current Market Price [determined pursuant to Section 11(b) hereof] per share of the Common Stock of such Principal Party on the date of consummation of such Section 13 Event; (ii) such Principal Party shall thereafter be liable for, and shall assume, by virtue of such Section 13 Event, all the obligations and duties of the Company pursuant to this Agreement; (iii) the term "Company" shall thereafter be deemed to refer to such Principal Party, it being specifically intended that the provisions of Section 11 hereof shall apply only to such Principal Party following the first occurrence of a Section 13 Event; and (iv) such Principal Party shall take such steps (including, but not limited to, the reservation of a sufficient number of shares of its Common Stock) in connection with the consummation of any such transaction as may be necessary to assure that the provisions hereof shall thereafter be applicable, as nearly as reasonably may be, in relation to its shares of Common Stock thereafter deliverable upon the exercise of the Right.

(b) "Principal Party" shall mean

(i) in the case of any transaction described in clause (x) or (y) of the first sentence of Section 13(a), the Person that is the issuer of any securities into which shares of Common Stock of the Company are converted in such merger or consolidation, and if no securities are so issued, the Person that is the other party to such merger or consolidation; and

(ii) in the case of any transaction described in clause (z) of the first sentence of Section 13(a), the Person that is the party receiving the greatest portion of the assets, cash flow or earning power transferred pursuant to such transaction or transactions; provided, however, that in any such case, (1) if the Common Stock of such Person is not at such time and has not been continuously over the preceding twelve (12) month period registered under Section 12 of the Exchange Act, and such Person is a direct or indirect Subsidiary of another Person the Common Stock of which is and has been so registered, "Principal Party" shall refer to such other Person; and (2) in case such Person is a Subsidiary, directly or indirectly, of more than one Person, the Common Stocks of two or more of which are and have been so registered, "Principal Party" shall refer to whichever of such Persons is the issuer of the Common Stock having the greatest aggregate market value.

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(c) The Company shall not consummate any such consolidation, merger, sale or transfer unless the Principal Party shall have a sufficient number of authorized shares of its Common Stock which have not been issued or reserved for issuance to permit the exercise in full of the Rights in accordance with this Section 13 and unless prior thereto the Company and such Principal Party shall have executed and delivered to the Rights Agent a supplemental agreement providing for the terms set forth in paragraphs (a) and (b) of this Section 13 and further providing that, as soon as practicable after the date of any consolidation, merger or sale of assets, cash flow or earnings power mentioned in paragraph (a) of this Section 13, the Principal Party will:

(i) prepare and file a registration statement under the Act, with respect to the Rights and the securities purchasable upon exercise of the Rights on an appropriate form, and will use its best efforts to cause such registration statement to (A) become effective as soon as practicable after such filing and (B) remain effective (with a prospectus at all times meeting the requirements of the Act) until the Expiration Date; and

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(ii) deliver to holders of the Rights historical financial statements for the Principal Party and each of its Affiliates which comply in all respects with the requirements for registration on Form 10 under the Exchange Act.

The provisions of this Section 13 shall similarly apply to successive mergers or consolidations or sales or other transfers. In the event that a Section 13 Event shall occur at any time after the occurrence of a Section 11(a)(ii) Event, the Rights which have not theretofore been exercised shall thereafter become exercisable in the manner described in Section 13(a).

(d) Notwithstanding anything in this Agreement to the contrary, Section 13 shall not be applicable to a transaction described in subparagraphs (x) and (y) of Section 13(a) if (i) such transaction is consummated with a Person or Persons who acquired shares of Common Stock pursuant to a tender offer or exchange offer for all outstanding shares of Common Stock which complies with the provisions of Section 11(a)(ii) hereof (or a wholly owned subsidiary of any such Person or Persons), (ii) the price per share of Common Stock offered in such transaction is not less than the price per share of Common Stock paid to all holders of shares of Common Stock whose shares were purchased pursuant to such tender offer or exchange offer and (iii) the form of consideration being offered to the remaining holders of shares of Common Stock pursuant to such transaction is the same as the form of consideration paid pursuant to such tender offer or exchange offer. Upon consummation of any such transaction contemplated by this Section 13(d), all Rights hereunder shall expire.

Section 14. FRACTIONAL RIGHTS AND FRACTIONAL SHARES.

(a) The Company shall not be required to issue fractions of Rights, except prior to the Distribution Date as provided in Section 11(k) hereof, or to distribute Rights Certificates which evidence fractional Rights. In lieu of such fractional Rights, there shall be paid to the registered holders of the Rights Certificates with regard to which such fractional Rights would otherwise be issuable, an amount in cash equal to the same fraction of the current market value of a whole Right. For purposes of this Section 14(a), the current market value of a whole Right shall be the closing price of the Rights for the Trading Day immediately prior to the date on which such fractional Rights would have been otherwise issuable. The closing price of the Rights for any day shall be the last sale price, regular way, or, in case no such sale takes place on such day, the average of the closing bid and asked prices, regular way, in either case as reported in the principal consolidated transaction reporting system with respect to securities listed or admitted to trading on NASDAQ or, if the Rights are not listed or admitted to trading on NASDAQ, as reported in the principal consolidated transaction reporting system with respect to securities listed on the principal national securities exchange on which the Rights are listed or admitted to trading, or if the Rights are not listed or admitted to trading on any national securities exchange, the last quoted price or, if not so quoted, the average of the high bid and low asked prices in the over-the-counter market, as reported by NASDAQ or such other system then in use or, if on any such date the Rights are not quoted by any such organization, the average of the closing bid and asked prices as furnished by a professional market maker making a market in the Rights selected by the Board of Directors of the Company. If on any such date no such market maker is making a market in the Rights the fair value of the Rights on such date as determined in good faith by the Board of Directors of the Company shall be used.

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(b) The Company shall not be required to issue fractions of shares of Preferred Stock (other than fractions which are integral multiples of one two-thousandths of a share of Preferred Stock) upon exercise of the Rights or to distribute certificates which evidence fractional shares of Preferred Stock (other than fractions which are integral multiples of one two-thousandths of a share of Preferred Stock). In lieu of fractional shares of Preferred Stock that are not integral multiples of one two-thousandths of a share of Preferred Stock, the Company may pay to the registered holders of Rights Certificates at the time such Rights are exercised as herein provided an amount in cash equal to the same fraction of the current market value of one two-thousandths of a share of Preferred Stock. For purposes of this Section 14(b), the current market value of one two-thousandths of a share of Preferred Stock shall be one two-thousandths of the closing price of a share of Preferred Stock (as determined pursuant to Section 11(b)(ii) hereof) for the Business Day immediately prior to the date of such exercise.

(c) Following the occurrence of a Triggering Event, the Company shall not be required to issue fractions of shares of Common Stock upon exercise of the Rights or to distribute certificates which evidence fractional shares of Common Stock. In lieu of fractional shares of Common Stock, the Company may pay to the registered holders of Rights Certificates at the time such Rights are exercised as herein provided an amount in cash equal to the same fraction of the current market value of one (1) share of Common Stock. For purposes of this Section 14(c), the current market value of one share of Common Stock shall be the closing price of one share of Common Stock (as determined pursuant to Section 11(d)(i) hereof) for the Trading Day immediately prior to the date of such exercise.

(d) The holder of a Right by the acceptance of the Rights expressly waives his right to receive any fractional Rights or any fractional shares upon exercise of a Right, except as permitted by this Section 14.

Section 15. RIGHTS OF ACTION.

All rights of action in respect of this Agreement are vested in the respective registered holders of the Rights Certificates (and, prior to the Distribution Date, the registered holders of the Common Stock); and any registered holder of any Rights Certificate (or, prior to the Distribution Date, of the Common Stock), without the consent of the Rights Agent and the Transfer Agent or of the holder of any other Rights

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Certificate (or, prior to the Distribution Date, of the Common Stock), may, in his own behalf and for his own benefit, enforce, and may institute and maintain any suit, action or proceeding against the Company to enforce, or otherwise act in respect of, his right to exercise the Rights evidenced by such Rights Certificate in the manner provided in such Rights Certificate and in this Agreement. Without limiting the foregoing or any remedies available to the holders of Rights, it is specifically acknowledged that the holders of Rights would not have an adequate remedy at law for any breach of this Agreement and shall be entitled to specific performance of the obligations hereunder and injunctive relief against actual or threatened violations of the obligations hereunder of any Person subject to this Agreement.

Section 16. AGREEMENT OF RIGHTS HOLDERS.

Every holder of a Right by accepting the same consents and agrees with the Company, the Rights Agent and the Transfer Agent, and with every other holder of a Right that:

(a) prior to the Distribution Date, the Rights will be transferable only in connection with the transfer of Common Stock;

(b) after the Distribution Date, the Rights Certificates are transferable only on the registry books of the Transfer Agent if surrendered at the principal office or offices of the Rights Agent or the Transfer Agent designated for such purposes, duly endorsed or accompanied by a proper instrument of transfer and with the appropriate forms and certificates fully executed;

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(c) subject to Section 6(a) and Section 7(f) hereof, the Company and the Transfer Agent may deem and treat the Person in whose name a Rights Certificate (or, prior to the Distribution Date, the associated Common Stock certificate) is registered as the absolute owner thereof and of the Rights evidenced thereby (notwithstanding any notations of ownership or writing on the Rights Certificates or the associated Common Stock certificate made by anyone other than the Company or the Transfer Agent) for all purposes whatsoever, and neither the Company nor the Transfer Agent, subject to the last sentence of Section 7(e) hereof, shall be required to be affected by any notice to the contrary; and

(d) notwithstanding anything in this Agreement to the contrary, not any of the Company, or the Rights Agent, or the Transfer Agent shall have any liability to any holder of a Right or other Person as a result of its inability to perform any of its obligations under this Agreement by reason of any preliminary or permanent injunction or other order, decree or ruling issued by a court of competent jurisdiction or by a governmental, regulatory or administrative agency or commission, or any statute, rule, regulation or executive order promulgated or enacted by any governmental authority, prohibiting or otherwise restraining performance of such obligation; provided, however, the Company must use its best efforts to have any such order, decree or ruling lifted or otherwise overturned as soon as possible.

Section 17. RIGHTS CERTIFICATE HOLDER NOT DEEMED A SHAREHOLDER.

No holder, as such, of any Rights Certificate shall be entitled to vote, receive dividends or be deemed for any purpose the holder of the number of one two-thousandths of a share of Preferred Stock or any other securities of the Company which may at any time be issuable on the exercise of the Rights represented thereby, nor shall anything contained herein or in any Rights Certificate be construed to confer upon the holder of any Rights Certificate, as such, any of the rights of a shareholder of the Company or any right to vote for the election of directors or upon any matter submitted to shareholders at any meeting thereof, or to give or withhold consent to any corporate action, or to receive notice of meetings or other actions affecting shareholders (except as provided in Section 24 hereof), or to receive dividends or subscription rights, or otherwise, until the Right or Rights evidenced by such Rights Certificate shall have been exercised in accordance with the provisions hereof.

Section 18. CONCERNING THE RIGHTS AGENT AND TRANSFER AGENT.

(a) The Company agrees to pay to the Rights Agent (and Transfer Agent, if other than the Company) reasonable compensation for all services rendered by it hereunder and, from time to time, on demand of the Rights Agent, or the Transfer Agent, its reasonable expenses and counsel fees and disbursements and other disbursements incurred in the administration and execution of this Agreement and the exercise and performance of its duties hereunder. The Company also agrees to indemnify the Rights Agent (or the Transfer Agent, if other than the Company) for, and to hold it harmless against, any loss, liability, or expense, incurred without negligence, bad faith or willful misconduct on the part of the Rights Agent or the Transfer Agent, for anything done or omitted by the Rights Agent or the Transfer Agent in connection with the acceptance and administration of this Agreement, including the costs and expenses of defending against any claim of liability in the premises.

(b) The Rights Agent (and Transfer Agent, if other than the Company) shall be protected and shall incur no liability for or in respect of any action taken, suffered or omitted by it in connection with its administration of this Agreement in reliance upon any Rights Certificate or certificate for Common Stock or for other securities of the Company, instrument of assignment or transfer, power of attorney,

endorsement, affidavit, letter, notice, direction, consent, certificate, statement, or other paper or document believed by it to be genuine and to be signed, executed and, where necessary, verified or acknowledged, by the proper Person or Persons.

Section 19. MERGER OR CONSOLIDATION OR CHANGE OF NAME OF RIGHTS AGENT OR SUBSTITUTION OF TRANSFER AGENT.

(a) Any corporation into which the Rights Agent or any successor Rights Agent may be merged or with which it may be consolidated, or any corporation resulting from any merger or consolidation to which the Rights Agent or any successor Rights Agent shall be a party, such entity shall be the successor to the Rights Agent under this Agreement without the execution or filing of any paper or any further act on the part of any of the parties hereto. In the event that the Company designates another entity to serve as Transfer Agent, such corporation shall be eligible for appointment as a successor Transfer Agent under the provisions of Section 21 hereof. In case at the time such successor Transfer Agent shall succeed to the agency created by this Agreement, any of the Rights Certificates shall have been countersigned but not delivered, any such successor Transfer Agent may adopt the countersignature of a predecessor Transfer Agent and deliver such Rights Certificates so countersigned; and in case at that time any of the Rights Certificates shall not have been countersigned, any successor Transfer Agent may countersign such Rights Certificates either in the name of the predecessor or in the name of the successor Transfer Agent; and in all such cases such Rights Certificates shall have the full force provided in the Rights Certificates and in this Agreement.

(b) In case at any time the name of the Transfer Agent shall be changed and at such time any of the Rights Certificates shall have been countersigned but not delivered, the Transfer Agent may adopt the countersignature under its prior name and deliver Rights Certificates so countersigned; and in case at that time any of the Rights Certificates shall not have been countersigned, the Transfer Agent may countersign such Rights Certificates either in its prior name or in its changed name; and in all such cases such Rights Certificates shall have the full force provided in the Rights Certificates and in this Agreement.

Section 20. DUTIES OF RIGHTS AGENT AND TRANSFER AGENT.

The Rights Agent and Transfer Agent undertake the duties and obligations imposed by this Agreement upon the following terms and conditions, by all of which the Company and the holders of Rights Certificates, by their acceptance thereof, shall be bound:

(a) The Rights Agent and the Transfer Agent may consult with legal counsel (who may be legal counsel for the Company), and the opinion of such counsel shall be full and complete authorization and protection to the Rights Agent and Transfer Agent as to any action taken or omitted by it in good faith and in accordance with such opinion.

(b) Whenever in the performance of its duties under this Agreement either or both of the Rights Agent or Transfer Agent shall deem it necessary or desirable that any fact or matter (including, without limitation, the identity of any Acquiring Person and the determination of "current market price") be proved or established by the Company prior to taking or suffering any action hereunder, such fact or matter (unless other evidence in respect thereof be herein specifically prescribed) may be deemed to be conclusively proved and established by a certificate signed by the President, any Vice President, the Treasurer, any Assistant Treasurer, the Secretary or any Assistant Secretary of the Company and delivered to the Rights Agent and the Transfer Agent; and such certificate shall be full authorization to the Rights Agent or Transfer Agent for any action taken or suffered in good faith by it under the provisions of this Agreement in reliance upon such certificate.

(c) The Rights Agent and Transfer Agent each shall be liable hereunder only for its own negligence, bad faith or willful misconduct.

(d) Neither the Rights Agent nor the Transfer Agent shall be liable for or by reason of any of the statements of fact or recitals contained in this Agreement or in the Rights Certificates or be required to verify the same (except as to its countersignature on such Rights Certificates), but all such statements and recitals are and shall be deemed to have been made by the Company only.

(e) The Rights Agent or Transfer Agent shall not be under any responsibility in respect of the validity of this Agreement or the execution and delivery hereof (except the due execution hereof by the Rights Agent) or in respect of the validity or execution of any Rights Certificate (except countersignature thereof by the Transfer Agent); nor shall they be responsible for any breach by the Company of any covenant or condition contained in this Agreement or in any Rights Certificate; nor shall they be responsible for any adjustment required under the provisions of Section 11 or Section 13 hereof or responsible for the manner, method or amount of any such adjustment or the ascertaining of the existence of facts that would require any such adjustment (except with respect to the exercise of Rights evidenced by Rights Certificates after actual notice of any such adjustment); nor shall they by any act hereunder be deemed to make any representation or warranty as to the authorization or reservation of any shares of Common Stock or Preferred Stock to be issued pursuant to this Agreement or any Rights Certificate or as to whether any shares of Common Stock or Preferred Stock will, when so issued, be validly authorized and issued, fully paid

and nonassessable.

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(f) The Company agrees that it will perform, execute, acknowledge and deliver or cause to be performed, executed, acknowledged and delivered all such further and other acts, instruments and assurances as may reasonably be required by the Rights Agent or the Transfer Agent for the carrying out or performing by the Rights Agent or Transfer Agent of the provisions of this Agreement.

(g) The Rights Agent and Transfer Agent are each hereby authorized and directed to accept instructions with respect to the performance of its duties hereunder from the President, any Vice President, the Secretary, any Assistant Secretary, the Treasurer or any Assistant Treasurer of the Company, and to apply to such officers for advice or instructions in connection with its duties, and it shall not be liable for any action taken or suffered to be taken by it in good faith in accordance with instructions of any such officer.

(h) The Rights Agent, or Transfer Agent, and any shareholder, director, officer or employee of the Rights Agent, or such Transfer Agent may buy, sell or deal in any of the Rights or other securities of the Company or become pecuniarily interested in any transaction in which the Company may be interested, or contract with or lend money to the Company or otherwise act as fully and freely as though it were not Rights Agent or Transfer Agent under this Agreement. Nothing herein shall preclude the Rights Agent or Transfer Agent from acting in any other capacity for the Company or for any other legal entity.

(i) The Rights Agent and Transfer Agent each may execute and exercise any of the rights or powers hereby vested in it or perform any duty hereunder either itself or by or through its attorneys or agents, and the Rights Agent and the Transfer Agent each shall not be answerable or accountable for any act, default, neglect or misconduct of any such attorneys or agents or for any loss to the Company resulting from any such act, default, neglect or misconduct; *provided, however*, reasonable care was exercised in the selection and continued employment thereof.

(j) No provision of this Agreement shall require the Rights Agent or Transfer Agent to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties hereunder or in the exercise of its rights if there shall be reasonable grounds for believing that repayment of such funds or adequate indemnification against such risk or liability is not reasonably assured to it.

(k) If, with respect to any Right Certificate surrendered to the Transfer Agent for exercise or transfer, the certificate attached to the form of assignment or form of election to purchase, as the case may be, has either not been completed or indicates an affirmative response to clause 1 and/or 2 thereof, the Transfer Agent shall not take any further action with respect to such requested exercise of transfer without first consulting with the Company.

Section 21. CHANGE OF RIGHTS AGENT OR TRANSFER AGENT.

The Rights Agent, or any successor Rights Agent, or any successor Transfer Agent may resign and be discharged from its duties under this Agreement upon 30 days' notice in writing mailed to the Company, and to each transfer agent of the Common Stock and Preferred Stock, by registered or certified mail, and to the holders of the Rights Certificates by first-class mail. The Company may remove the Rights Agent or any successor Rights Agent, or any successor Transfer Agent, upon 30 days' notice in writing, mailed to the Rights Agent, or successor Rights Agent, or successor Transfer Agent, as the case may be, and to each transfer agent of the Common Stock and Preferred Stock, by registered or certified mail, and to the holders of the Rights Certificates by first-class mail. If the Rights Agent or the Transfer Agent shall resign or be removed or shall otherwise become incapable of acting, the Company shall appoint a successor to the Rights Agent or Transfer Agent. If the Company shall fail to make such appointment within a period of 30 days after giving notice of such removal or after it has been notified in writing of such resignation or incapacity by the resigning or incapacitated Rights Agent or Transfer Agent or by the holder of a Rights Certificate (who shall, with such notice, submit his Rights Certificate for inspection by the Company), then any registered holder of any Rights Certificate may apply to any court of competent jurisdiction for the appointment of a new Rights Agent or Transfer Agent. In the case of the Transfer Agent, any successor, whether appointed by the Company or by such a court, shall be a corporation organized and doing business under the laws of the United States or of the State of New York or of any other state of the United States, in good standing, which is authorized under such laws to exercise corporate trust powers and is subject to supervision or examination by federal or state authority. After appointment, the successor Transfer Agent shall be vested with the same powers, rights, duties and responsibilities as if it had been originally named as Transfer Agent without further act or deed; but the predecessor Transfer Agent shall deliver and transfer to the successor Transfer Agent any property at the time held by it hereunder, and execute and deliver any further assurance, conveyance, act or deed necessary for the purpose. Not later than the effective date of any such appointment, the Company shall file notice thereof in writing with the predecessor Transfer Agent and each transfer agent of the Common Stock and the Preferred Stock and mail a notice thereof in writing to the registered holders of the Rights Certificates. Failure to give any notice provided for in this Section 21, however, or any defect therein, shall not affect the legality or validity of the resignation or removal of the Transfer Agent or the appointment of the successor Transfer Agent, as the case may be.

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Section 22. ISSUANCE OF NEW RIGHTS CERTIFICATES.

Notwithstanding any of the provisions of this Agreement or of the Rights to the contrary, the Company may, at its option, issue new Rights Certificates evidencing Rights in such form as may be approved by the Board of Directors of the Company to reflect any adjustment or change in the Purchase Price and the number or kind or class of shares or other securities or property purchasable under the Rights Certificates made in accordance with the provisions of this Agreement. In addition, in connection with the issuance or sale of shares of Common Stock following the Distribution Date and prior to the redemption or expiration of the Rights, the Company (a) shall, with respect to shares of Common Stock so issued or sold pursuant to the exercise of stock options or under any employee plan or arrangement, granted or awarded as of the Distribution Date, or upon the exercise, conversion or exchange of securities issued by the Company prior to the Distribution Date, and (b) may, in any other case, if deemed necessary or appropriate by the Board of Directors of the Company, issue Rights Certificates representing the appropriate number of Rights in connection with such issuance or sale; *provided, however*, that (i) no such Rights Certificate shall be issued if, and to the extent that, the Company shall be advised by counsel that such issuance would create a significant risk of material adverse tax consequences to the Company or the Person to whom such Rights Certificate would be issued, and (ii) to the extent that any adjustments in the Company's securities have been made as a result of the issuance of Rights Certificates (including, without limitation, adjustments to conversion ratios or other adjustments resulting from the operation of anti-dilution provisions in convertible securities, stock options or similar securities), the number of Rights, or fractions thereof, issuable shall equal, and not exceed, the number necessary to enable the holder to receive, upon such conversion, exchange or exercise of such security and after exercise of such Rights, the number of shares of Common Stock such holder would have received if it had converted, exchanged or exercised such security immediately prior to the Distribution Date and had subsequently exercised the Rights issuable in respect of such shares.

Section 23. REDEMPTION AND TERMINATION.

(a) The Board of Directors of the Company may, at its option, at any time prior to the earlier of (i) the close of business on the 10th day following the Stock Acquisition Date (or, if the Stock Acquisition Date shall have occurred prior to the Record Date, the close of business on the tenth day following the Record Date), or (ii) the Final Expiration Date, redeem all but not less than all the then outstanding Rights at a redemption price of \$0.01 per Right, as such amount may be appropriately adjusted to reflect any stock split, stock dividend or similar transaction occurring after the date hereof (such redemption price being hereinafter referred to as the "Redemption Price"); *provided, however*, if the Board of Directors of the Company authorizes redemption of the Rights in either of the circumstances set forth in clauses (x) and (y) below, then there must be Continuing Directors then in office and such authorization shall require the concurrence of a majority of such Continuing Directors: (x) such authorization occurs on or after the time a Person becomes an Acquiring Person, or (y) such authorization occurs on or after the date of a change (resulting from a proxy or consent solicitation) in a majority of the directors in office at the commencement of such solicitation if any Person who is a participant in such solicitation has stated (or, if upon the commencement of such solicitation, a majority of the Board of Directors of the Company has determined in good faith) that such Person (or any of its Affiliates or Associates) intends to take, or may consider taking, any action which would result in such Person becoming an Acquiring Person or which would cause the occurrence of a Triggering Event unless, concurrent with such solicitation, such Person (or one or more of its Affiliates or Associates) is making a cash tender offer pursuant to a Schedule 14D-1 (or any successor form) filed with the Securities and Exchange Commission for all outstanding shares of Common Stock not beneficially owned by such Person (or by its Affiliates or Associates). Notwithstanding the foregoing, the Board of Directors of the Company may not redeem any Rights following a determination made pursuant to section 11(a)(ii)(B) that any person is an Adverse Person. Notwithstanding anything contained in this Agreement to the contrary, the Rights shall not be exercisable after the first occurrence of a Section 11(a)(ii) Event until such time as the Company's right of redemption hereunder has expired. The Company may, at its option, pay the Redemption Price in cash, shares of Common Stock [based on the "current market price", as defined in Section 11(b)(i) hereof, of the Common Stock at the time of redemption] or any other form of consideration deemed appropriate by the Board of Directors of the Company.

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(b) Immediately upon the action of the Board of Directors of the Company ordering the redemption of the Rights, evidence of which shall have been filed with the Rights Agent and the Transfer Agent and without any further action and without any notice, the right to exercise the Rights will terminate and the only right thereafter of the holders of Rights shall be to receive the Redemption Price for each Right so held. Promptly after the action of the Board of Directors of the Company ordering the redemption of the Rights, the Company shall give notice of such redemption to the Rights Agent and the Transfer Agent and the holders of the then outstanding Rights by mailing such notice to all such holders at each holder's last address as it appears upon the registry books of the Transfer Agent or, prior to the Distribution Date, on the registry books of the Transfer Agent for the Common Stock. Any notice which is mailed in the manner herein provided shall be deemed given, whether or not the holder receives the notice. Each such notice of redemption will state the method by which the payment of the Redemption Price will be made.

Section 24. NOTICE OF CERTAIN EVENTS.

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(a) In case the Company shall propose, at any time after the Distribution Date, (i) to pay any dividend payable in stock of any class to the holders of Preferred Stock or to make any other distribution to the holders of Preferred Stock (other than a regular quarterly cash dividend out of earnings or retained earnings of the Company), or (ii) to offer to the holders of Preferred Stock rights or warrants to subscribe for or to purchase any additional shares of Preferred Stock or shares of stock of any class or any other securities, rights or options, or (iii) to effect any reclassification of its Preferred Stock (other than a reclassification involving only the subdivision of outstanding shares of Preferred Stock), or (iv) to effect any consolidation or merger into or with any other Person [other than a Subsidiary of the Company in a transaction which complies with Section 11(j) hereof], or to effect any sale or other transfer (or to permit one or more of its Subsidiaries to effect any sale or other transfer), in one transaction or a series of related transactions, of more than 50% of the assets, cash flow or earning power of the Company and its Subsidiaries (taken as a whole) to any other Person or Persons [other than the Company or any of its Subsidiaries in one or more transactions each of which complies with Section 11(j) hereof], or (v) to effect the liquidation, dissolution or winding up of the Company, then, in each such case, the Company shall give to each holder of a Rights Certificate, to the extent feasible and in accordance with Section 25 hereof, a notice of such proposed action, which shall specify the record date for the purposes of such stock dividend, distribution of rights or warrants, or the date on which such reclassification, consolidation, merger, sale, transfer, liquidation, dissolution, or winding up is to take place and the date of participation therein by the holders of the shares of Preferred Stock, if any such date is to be fixed, and such notice shall be so given in the case of any action covered by clause (i) or (ii) above at least 20 days prior to the record date for determining holders of the shares of Preferred Stock for purposes of such action, and in the case of any such other action, at least 20 days prior to the date of the taking of such proposed action or the date of participation therein by the holders of the shares of Preferred Stock whichever shall be the earlier.

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(b) In case any event set forth in Section 11(a)(ii) hereof shall occur, then, in such case, (i) the Company shall as soon as practicable thereafter give to each holder of a Rights Certificate, to the extent feasible and in accordance with Section 25 hereof, a notice of the occurrence of such event, which shall specify the event and the consequences of the event to holders of Rights under Section 11(a)(ii) hereof, and (ii) all references in the preceding paragraph to Preferred Stock shall be deemed thereafter to refer to Common Stock and, if appropriate, other securities.

Section 25. NOTICES.

Notices or demands authorized by this Agreement to be given or made by the Rights Agent, the Transfer Agent, or by the holder of any Rights Certificate to or on the Company shall be sufficiently given or made if sent by first-class mail, postage prepaid, addressed (until another address is filed in writing with the Rights Agent or the Transfer Agent) as follows:

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The Company: Taylor Devices, Inc.
90 Taylor Drive
North Tonawanda, New York 14120
Attention: President

Subject to the provisions of Section 21, any notice or demand authorized by this Agreement to be given or made by the Company or by the holder of any Rights Certificate to or on the Rights Agent or the Transfer Agent shall be sufficiently given or made if sent by first-class mail, postage prepaid, addressed (until another address is filed in writing with the Company) as follows:

The Rights Agent: Regan & Associates, Inc.
505 Eighth Avenue - Suite 800
New York, New York 10018

The Transfer Agent: Registrar and Transfer Company
10 Commerce Drive
Cranford, New Jersey 07016-3572
Attention: Investor Relations Department

Notices or demands authorized by this Agreement to be given or made by the Company or the Rights Agent, or the Transfer Agent to the holder of any Rights Certificate (or, if prior to the Distribution Date, to the holder of certificates representing shares of Common Stock) shall be sufficiently given or made if sent by first-class mail, postage prepaid, addressed to such holder at the address of such holder as shown on the registry books of the Company.

Section 26. SUPPLEMENTS AND AMENDMENTS.

Prior to the Distribution Date and subject to the penultimate sentence of this Section 26, the Company and the Rights Agent shall, if the Company so directs, supplement or amend any term, definition or other provision of this Agreement without the approval of any holders of certificates representing shares of Common Stock; *provided, however*, that no such supplement or amendment shall diminish any rights granted to holders of Common Stock in the Company's Certificate of Incorporation; and provided, further that any supplement or amendment of this Agreement after the Stock Acquisition Date must be approved by a majority of the Continuing Directors. From and after the Distribution Date and subject to the penultimate sentence of this Section 26, the Company and the Transfer Agent or Rights Agent, as appropriate, shall, if the Company so directs, supplement or amend this Agreement without the approval of any holders of Rights Certificates in order (i) to cure any ambiguity, (ii) to correct or supplement any provision contained herein which may be defective or inconsistent with any other provisions herein, (iii) to shorten or lengthen any time period hereunder, or (iv) to change or supplement the provisions hereunder in any manner which the Company may deem necessary or desirable and which shall not adversely affect the interests of the holders of Rights Certificates (other than an Acquiring Person or an Adverse Person or an Affiliate or Associate of such Acquiring Person or Adverse Person); provided, this Agreement may not be supplemented or amended to lengthen, pursuant to clause (iii) of this sentence, (A) a time period relating to when the Rights may be redeemed at such time as the Rights are not then redeemable, or (B) any other time period unless such lengthening is for the purpose of protecting, enhancing or clarifying the rights of, and/or the benefits to, the holders of Rights. Upon the delivery of a certificate from an appropriate officer of the Company which states that the proposed supplement or amendment is in compliance with the terms of this Section 26, the Rights Agent or Transfer Agent shall execute such supplement or amendment. Notwithstanding anything contained in this Agreement to the contrary, no supplement or amendment shall be made which changes the Redemption Price, the Final Expiration Date, the Purchase Price or the number of one two-thousandths of a share of Preferred Stock for which a Right is exercisable; provided, however, that any time prior to (i) the existence of an Acquiring Person or (ii) the date that a tender or exchange offer by any person (other than the Company, any Subsidiary of the Company, any employee benefit plan of the Company or any Subsidiary of the Company, or any Person or entity organized, appointed or established by the Company for or pursuant to the terms of any such plan) is first published or sent or given within the meaning of Rule 14d-2(a) of the General Rules and Regulations under the Exchange Act, if upon consummation thereof, such Person would be the Beneficial Owner of 10% or more of the shares of Common Stock then outstanding, the Board may amend this Agreement to increase the Purchase Price or extend the Final Expiration Date. Prior to the Distribution Date, the interests of the holders of Rights shall be deemed coincident with the interests of the holders of Common Stock.

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Section 27. SUCCESSORS.

All the covenants and provisions of this Agreement by or for the benefit of the Company or the Rights Agent or the Transfer Agent shall bind and inure to the benefit of their respective successors and assigns hereunder.

Section 28. DETERMINATIONS AND ACTIONS BY THE BOARD OF DIRECTORS, ETC.

For all purposes of this Agreement, any calculation of the number of shares of Common Stock outstanding at any particular time, including for purposes of determining the particular percentage of such outstanding shares of Common Stock of which any Person is the Beneficial Owner, shall be made in accordance with the last sentence of Rule 13d-3(d)(1)(i) of the General Rules and Regulations under the Exchange Act. The Board of Directors of the Company (with, where specifically provided for herein, the concurrence of the Continuing Directors) shall have the exclusive power and authority to administer this Agreement and to exercise all rights and powers specifically granted to such Board (with, where specifically provided for herein, the concurrence of the Continuing Directors) or to the Company, or as may be necessary or advisable in the administration of this Agreement, including, without limitation, the right and power to (i) interpret the provisions of this Agreement, and (ii) make all determinations deemed necessary or advisable for the administration of this Agreement (including a determination to redeem or not redeem the Rights or to amend the Agreement). All such actions, calculations, interpretations and determinations [including, for purposes of clause (y) below, all omissions with respect to the foregoing] which are done or made by the Board of Directors of the Company (with, where specifically provided for herein, the concurrence of the Continuing Directors) in good faith, shall (x) be final, conclusive and binding on the Company, the Rights Agent, the Transfer Agent, the holders of the Rights and all other parties, and (y) not subject the Board of Directors of the Company or the Continuing Directors to any liability to the holders of the Rights.

Section 29. BENEFITS OF THIS AGREEMENT.

Nothing in this Agreement shall be construed to give to any Person other than the Company, the Rights Agent, the Transfer Agent, and the registered holders of the Rights Certificates (and, prior to the Distribution Date, registered holders of the Common Stock) any legal or equitable right, remedy or claim under this Agreement; but this Agreement shall be for the sole and exclusive benefit of the Company, the Rights Agent, the Transfer Agent, and the registered holders of the Rights Certificates (and, prior to the Distribution Date, registered holders of the Common Stock).

Section 30. SEVERABILITY.

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If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction or other authority to be invalid, void or unenforceable, the remainder of the terms, provisions, covenants and restrictions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated; *provided, however*, that notwithstanding anything in this Agreement to the contrary, if any such term, provision, covenant or restriction is held by such court or authority to be invalid, void or unenforceable and the Board of Directors of the Company determines in its good faith judgment that severing the invalid language from this Agreement would adversely affect the purpose or effect of this Agreement, the right of redemption set forth in Section 23 hereof shall be reinstated and shall not expire until the close of business on the tenth day following the date of such determination by the Board of Directors of the Company.

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Section 31. GOVERNING LAW.

This Agreement, each Right and each Rights Certificate issued hereunder shall be deemed to be a contract made under the laws of the State of New York and for all purposes shall be governed by and construed in accordance with the laws of such State applicable to contracts made and to be performed entirely within such State.

Section 32. COUNTERPARTS.

This Agreement may be executed in any number of counterparts. It is not necessary that all parties sign all or any one of the counterparts, but each party must sign at least one counterpart for this agreement to be effective.

Section 33. DESCRIPTIVE HEADINGS.

Descriptive headings of the several Sections of this Agreement are inserted for convenience only and shall not control or affect the meaning or construction of any of the provisions hereof.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed and their respective corporate seals to be hereunto affixed and attested, all as of the day and year first above written.

Attest: TAYLOR DEVICES, INC.

By: /s/Richard G. Hill
Name: Richard G. Hill
Title: Vice President

By: /s/ Douglas P. Taylor
Douglas P. Taylor
President and Chief
Executive Officer

Attest: REGAN & ASSOCIATES, INC.

By: /s/Audrey Quinn
Name: Audrey Quinn
Title: Senior Vice President

By: /s/Artie Regan
Artie Regan
President

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Exhibit A

**CERTIFICATE OF AMENDMENT
OF
CERTIFICATE OF INCORPORATION
OF
TAYLOR DEVICES, INC.**

under Section 805 of the Business Corporation Law

Exhibit B

[FORM OF RIGHTS CERTIFICATE]

Certificate No. R-

RIGHTS

NOT EXERCISABLE AFTER OCTOBER 5, 2018 OR EARLIER IF REDEEMED BY THE COMPANY. THE RIGHTS ARE SUBJECT TO REDEMPTION, AT THE OPTION OF THE COMPANY, AT \$.01 PER RIGHT ON THE TERMS SET FORTH IN THE RIGHTS AGREEMENT. UNDER CERTAIN CIRCUMSTANCES, RIGHTS BENEFICIALLY OWNED BY AN ACQUIRING OR AN ADVERSE PERSON OR AN AFFILIATE OR ASSOCIATE THEREOF (AS SUCH TERMS ARE DEFINED IN THE RIGHTS AGREEMENT) AND ANY SUBSEQUENT HOLDER OF SUCH RIGHTS MAY BECOME NULL AND VOID. [THE RIGHTS REPRESENTED BY THIS RIGHTS CERTIFICATE ARE OR WERE BENEFICIALLY OWNED BY A PERSON WHO WAS OR BECAME AN ACQUIRING OR AN ADVERSE PERSON OR AN AFFILIATE OR ASSOCIATE OF SUCH PERSON (AS SUCH TERMS ARE DEFINED IN THE RIGHTS AGREEMENT). ACCORDINGLY, THIS RIGHTS CERTIFICATE AND THE RIGHTS REPRESENTED HEREBY MAY BECOME NULL AND VOID IN THE CIRCUMSTANCES SPECIFIED IN SECTION 7(e) OF SUCH AGREEMENT].¹

RIGHTS CERTIFICATE

TAYLOR DEVICES, INC.

This certifies that _____, or registered assigns, is the registered owner of the number of Rights set forth above, each of which entitles the owner thereof, subject to the terms, provisions and conditions of the Rights Agreement, dated as of October 5, 2008 (the "Rights Agreement"), between Taylor Devices, Inc., a New York corporation (the "Company"), and Regan & Associates, Inc. (the "Rights Agent"), to purchase from the Company at any time prior to 5:00 p.m. (New York City time) on October 5, 2018 at the office or offices of the Company, as Transfer Agent, or other transfer agent designated for such purpose, one two-thousandths (1/2000) of a fully paid, non-assessable share of Series 2008 Junior Participating Preferred Stock (the "Series 2008 Preferred Stock") of the Company, at a purchase price (the "Purchase Price") of \$5.00 per unit of one two-thousandths of a share, upon presentation and surrender of this Rights Certificate with the Form of Election to Purchase and related Certificate duly executed. The number of Rights evidenced by this Rights Certificate (and the number of shares of Preferred Stock which may be purchased upon exercise thereof) set forth above, and the Purchase Price per share set forth above, are the number and Purchase Price as of October 3, 2008, based on the Preferred Stock as constituted at such date. The Company reserves the right to require prior to the occurrence of a Triggering Event (as such term is defined in the Rights Agreement) that a number of Rights be exercised so that only whole shares of Series 2008 Preferred Stock will be issued.

Upon the occurrence of a Section 11(a)(ii) Event (as such term is defined in the Rights Agreement), if the Rights evidenced by this Rights Certificate are beneficially owned by (i) an Acquiring Person, an Adverse Person or an Affiliate or Associate of any such Person (as such terms are defined in the Rights Agreement), (ii) a transferee of any such Acquiring Person, Adverse Person, Associate or Affiliate, or (iii) under certain circumstances specified in the Rights Agreement, a transferee of a Person who, after such transfer, became an Acquiring Person, an Adverse Person or an Affiliate or Associate of any such Person, such Rights shall become null and void and no holder hereof shall have any right with respect to such Rights from and after the occurrence of such Section 11(a)(ii) Event.

As provided in the Rights Agreement, the Purchase Price and the number and kind of shares of Series 2008 Preferred Stock or other securities which may be purchased upon the exercise of the Rights evidenced by this Rights Certificate are subject to modification and adjustment upon the happening of certain events, including Triggering Events.

¹ The portion of the legend in brackets shall be inserted only if applicable and shall replace the preceding sentence.

This Rights Certificate is subject to all of the terms, provisions and conditions of the Rights Agreement, which terms, provisions and conditions are hereby incorporated herein by reference and made a part hereof and to which Rights Agreement reference is hereby made for a full description of the rights, limitations of rights, obligations, duties and immunities hereunder of the Rights Agent, the Company and the holders of the Rights Certificates, which limitations of rights include the temporary suspension of the exercisability of such Rights under the specific circumstances set forth in the Rights Agreement. Copies of the Rights Agreement are on file at the office of the Company and are also

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available upon written request to the Company.

This Rights Certificate, with or without other Rights Certificates, upon surrender at the shareholder services office or offices of the Rights Agent designated for such purpose, may be exchanged for another Rights Certificate or Rights Certificates of like tenor and date evidencing rights entitling the holder to purchase a like aggregate number of one two-thousandths of a share of Series 2008 Preferred Stock as the Rights evidenced by the Rights Certificate or Rights Certificates surrendered shall have entitled such holder to purchase. If this Rights Certificate shall be exercised in part, the holder shall be entitled to receive upon surrender hereof another Rights Certificate or Rights Certificates for the number of whole Rights not exercised.

Subject to the provisions of the Rights Agreement, the Rights evidenced by this Certificate may be redeemed by the Company at its option at a redemption price of \$.01 per Right at any time prior to the earlier of the close of business on (a) the 10th day following the Stock Acquisition Date (as such time period may be extended pursuant to the Rights Agreement), and (b) the Final Expiration Date. Under certain circumstances set forth in the Rights Agreement, the decision to redeem shall require the concurrence of a majority of the Continuing Directors (as such term is defined in the Rights Agreement).

No fractional shares of Series 2008 Preferred Stock will be issued upon the exercise of any right or rights evidenced hereby (other than fractions which are integral multiples of one two-thousandths of a share of Series 2008 Preferred Stock, which may, at the election of the Company, be evidenced by depositary receipts), but in lieu thereof a cash payment will be made, as provided in the Rights Agreement.

No holder of this Rights Certificate shall be entitled to vote or receive dividends or be deemed for any purpose the holder of shares of Series 2008 Preferred Stock or of any other securities of the Company which may at any time be issuable on the exercise hereof, nor shall anything contained in the Rights Agreement or herein be construed to confer upon the holder hereof, as such, any of the rights of a shareholder of the Company or any right to vote for the election of directors or upon any matter submitted to shareholders at any meeting thereof, or to give or withhold consent to any corporate action, or to receive notice of meetings or other actions affecting shareholders (except as provided in the Rights Agreement), or to receive dividends or subscription rights, or otherwise, until the Right or Rights evidenced by this Rights Certificate shall have been exercised as provided in the Rights Agreement.

This Rights Certificate shall not be valid or obligatory for any purpose until it shall have been countersigned by the Transfer Agent.

WITNESS the facsimile signature of the proper officers of the Company and its corporate seal.

Dated as of _____, _____

ATTEST:

TAYLOR DEVICES, INC.

By: _____

By: _____

Secretary

Title: President

Countersigned:

By: _____

Authorized Signature

[FORM OF REVERSE SIDE OF RIGHTS CERTIFICATE]

FORM OF ASSIGNMENT

(To be executed by the registered holder if such holder desires to transfer the Rights Certificate.)

FOR VALUE RECEIVED

hereby sells, assigns and transfers unto

(Please print name and address of transferee)

this Rights Certificate, together with all right, title and interest therein, and does hereby irrevocably constitute and appoint _____ Attorney, to transfer the within Rights Certificate on the books of the within-named Company, with full power of substitution.

Dated: _____, _____

Signature

Signature Guaranteed:

CERTIFICATE

The undersigned hereby certifies by checking the appropriate boxes that:

(1) this Rights Certificate [] is [] is not being sold, assigned and transferred by or on behalf of a Person who is or was an Acquiring Person or Adverse Person or an Affiliate or Associate of any such Person (as such terms are defined pursuant to the Rights Agreement);

(2) after due inquiry and to the best knowledge of the undersigned, it [] did [] did not acquire the Rights evidenced by this Rights Certificate from any Person who is, was or subsequently became an Acquiring Person, an Adverse Person or an Affiliate or Associate of such Person.

Dated: _____, _____

Signature

Signature Guaranteed:

NOTICE

The signature to the foregoing Assignment and Certificate must correspond to the name as written upon the face of this Rights Certificate in every particular, without alteration or enlargement or any change whatsoever.

Exhibit C

[FORM OF ELECTION TO PURCHASE]

(To be executed if holder desires to exercise Rights represented by the Rights Certificate.)

To: TAYLOR DEVICES, INC.

The undersigned hereby irrevocably elects to exercise _____ Rights represented by this Rights Certificate to purchase the shares of Series 2008 Preferred Stock issuable upon the exercise of the Rights (or such other securities of the Company or of any other Person which may be issuable upon the exercise of the Rights) and requests that certificates for such shares be issued in the name of and delivered to: Please insert social security or other identifying number

(Please print name and address)

If such number of Rights shall not be all the Rights evidenced by this Rights Certificate, a new Rights Certificate for the balance of such Rights shall be registered in the name of and delivered to: Please insert social security or other identifying number

(Please print name and address)

Dated: _____, _____

Signature

Signature Guaranteed:

CERTIFICATE

The undersigned hereby certifies by checking the appropriate boxes that:

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(1) the Rights evidenced by this Rights Certificate [] are [] are not being exercised by or on behalf of a Person who is or was an Acquiring Person, an Adverse Person or an Affiliate or Associate of any such Person (as such terms are defined pursuant to the Rights Agreement);

(2) after due inquiry and to the best knowledge of the undersigned, it [] did [] did not acquire the Rights evidenced by this Rights Certificate from any Person who is, was or became an Acquiring Person, an Adverse Person or an Affiliate or Associate of such Person.

Dated: _____, _____

Signature

Signature Guaranteed:

NOTICE

The signature to the foregoing Election to Purchase and Certificate must correspond to the name as written upon the face of this Rights Certificate in every particular, without alteration or enlargement or any change whatsoever.

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Exhibit D

SUMMARY OF RIGHTS TO PURCHASE
SERIES 2008 PREFERRED STOCK

As of September 15, 2008, the Board of Directors of Taylor Devices, Inc. (the "Company") declared (i) a dividend of one Right for each outstanding share of the Company's Common Stock, par value \$.025 per share (the "Common Stock"), to shareholders of record at the close of business on October 3, 2008 (the "Record Date"). Each Right entitles the registered holder to purchase from the Company a unit consisting of one two-thousandths (1/2000) of a share of Series 2008 Junior Participating Preferred Stock, par value \$.05 per share (the "Series 2008 Preferred Stock"), at a Purchase Price of \$5.00 per unit of one two-thousandths of a share, subject to adjustment. The description and terms of the Rights are set forth in a Rights Agreement (the "Rights Agreement") between the Company and Regan & Associates, Inc., as Rights Agent. Registrar and Transfer Company, with offices located at 10 Commerce Drive, Cranford, NJ 07016-3572, serves as the Company's transfer agent (the "Transfer Agent").

Initially, the Rights will be attached to all Common Stock certificates representing shares then outstanding, and no separate Rights Certificates will be distributed. A Distribution Date will occur and the Rights will separate from the Common Stock upon the earliest of (i) 10 days following a public announcement that a Person or group of affiliated or associated Persons (an "Acquiring Person") has acquired, or obtained the right to acquire, beneficial ownership of 15% or more of the shares of Common Stock then outstanding¹ (the "Stock Acquisition Date"), (ii) 10 business days following the commencement of a tender offer or exchange offer that would result in a Person or group beneficially owning 10% or more of such outstanding shares of Common Stock (unless such tender offer or exchange offer is an offer for all outstanding shares of Common Stock which a majority of the unaffiliated Directors who are not officers of the Company determine to be fair to and otherwise in the best interests of the Company and its shareholders) or (iii) the date the Board of Directors declares a person to be an "Adverse Person", upon a determination by the Board that such Person, together with his affiliates or associates, is or has become the beneficial owner of 10% or more of the shares of Common Stock outstanding, and upon a determination by at least a majority of the Continuing Directors (as defined below) who are not officers of the Company, after reasonable inquiry and investigation, including consultation with such persons as such Directors shall deem appropriate, that (a) such beneficial ownership by such person is intended to cause the Company to repurchase the Common Stock beneficially owned by such person or to cause pressure on the Company to take action or enter into a transaction or series of transactions intended to provide such person with short-term financial gain under circumstances where such Continuing Directors determine that the best long-term interests of the Company and its shareholders would not be served by taking such action or entering into such transactions or series of transactions at that time, or (b) such beneficial ownership is causing or reasonably likely to cause a material adverse impact (including, but not limited to, impairment of relationships with customers, impairment of the Company's ability to maintain its competitive position or impairment of the Company's business reputation or ability to deal with governmental agencies) on the business or prospects of the Company.

Until the Distribution Date, (i) the Rights will be evidenced by the Common Stock certificates and will be transferred with and only with such Common Stock certificates, (ii) new Common Stock certificates issued after October 5, 2008 will contain a notation incorporating the Rights Agreement by reference, and (iii) the surrender for transfer of any certificates for Common Stock outstanding will also constitute the transfer of the Rights associated with the Common Stock represented by such certificate.

The Rights are exercisable commencing immediately upon the close of business on October 5, 2008 (the expiration of the Company's preceding rights plan) and will expire at the close of business on October 5, 2018, unless earlier redeemed by the Company as described below.

As soon as practicable after the Distribution Date, Rights Certificates will be mailed to holders of record of the Common Stock as of the close of business on the Distribution Date and, thereafter, the separate Rights Certificates alone will represent the Rights. Except (i) with respect to certain shares of Common Stock issued or sold pursuant to the exercise of stock options or under any employee plan or arrangement, or upon the exercise, conversion or exchange of certain securities of the Company, or (ii) as otherwise determined by the Board of Directors, only shares of Common Stock issued prior to the Distribution Date will be issued with Rights.

¹ Under the Rights Agreement, for purposes of calculating percentages of Common Stock outstanding, shares of Common Stock outstanding shall include all shares of Common Stock deemed to be beneficially owned by a person and its affiliates and associates, even if not actually then outstanding.

In the event that (i) a Person becomes the beneficial owner of 15% or more of the then outstanding shares of Common Stock (except pursuant to an offer for all outstanding shares of Common Stock which a majority of the Directors who are not officers of the Company and who are not affiliates or associates of such Person determine to be fair to and otherwise in the best interests of the Company and its shareholders), or (ii) the Board of Directors declares, upon the determination by at least a majority of the Continuing Directors who are not officers of the Company, that a person is an Adverse Person (each such event, a "Flip-in Event"), each holder of a Right will thereafter have the right to receive, upon payment of the Purchase Price, Common Stock (or, in certain circumstances, cash, property or other securities of the Company) having a value (based on a formula set forth in the Rights Agreement) equal to two times the Purchase Price of the Right. Notwithstanding any of the foregoing, following the occurrence of the Flip-in Event, all Rights that are, or (under certain circumstances specified in the Rights Agreement) were, beneficially owned by an Acquiring Person or an Adverse Person (or by certain related parties) will be null and void. However, Rights are not exercisable following the occurrence of the Flip-in Event until such time as the Rights are no longer redeemable by the Company as set forth below.

For example, at a Purchase Price of \$5.00 per Right, each Right not owned by an Acquiring or an Adverse Person (or by certain related parties) following a Flip-in Event would entitle its holder to purchase \$10.00 worth of Common Stock (or other consideration, as noted above) determined pursuant to a formula set forth in the Rights Agreement, for \$5.00. Assuming that the Common Stock had a per share value of \$5.00 at such time (as determined pursuant to such formula), the holder of each valid Right would be entitled to purchase two (2) shares of Common Stock for \$5.00.

In the event that, at any time following the Stock Acquisition Date or the date on which a Person is determined to be an Adverse Person, (i) the Company is acquired in a merger or other business combination transaction in which the Company is not the surviving corporation or in which it is the surviving corporation but its Common Stock is changed or exchanged (other than a merger meeting certain conditions which follows an offer for all outstanding shares of Common Stock which a majority of the unaffiliated Directors who are not officers of the Company determine to be fair to and otherwise in the best interests of the Company and its shareholders), or (ii) 50% or more of the Company's assets, earning power or cash flow is sold or transferred ("Flip-over Event"), each holder of a Right (except Rights which previously have been voided as set forth above) shall thereafter have the right to receive, upon payment of the Purchase Price, common stock of the acquiring company having a value equal to two times the exercise price of the Right. The Flip-over Events set forth in this paragraph and the Flip-in Events described in the second preceding paragraph are referred to as the "Triggering Events."

The Purchase Price payable, and the number of units of one two-thousandths of a share of Series 2008 Preferred Stock or other securities or property issuable, upon exercise of the Rights are subject to adjustment from time to time to prevent dilution (i) in the event of a stock dividend on, or a subdivision, combination or reclassification of, the Series 2008 Preferred Stock, (ii) if holders of the Preferred Stock are granted certain rights or warrants to subscribe for Series 2008 Preferred Stock or convertible securities at less than the current market price of the Series 2008 Preferred Stock, or (iii) upon the distribution to holders of the Series 2008 Preferred Stock of evidences of indebtedness or assets (excluding regular quarterly cash dividends) or of subscription rights or warrants (other than those referred to above).

With certain exceptions, no adjustment in the Purchase Price will be required until cumulative adjustments amount to at least 1% of the Purchase Price. No fractional shares of Series 2008 Preferred Stock (other than fractions of one two-thousandth of a share, or integral multiples thereof) will be issued and, in lieu thereof, an adjustment in cash will be made based on the market price of the Series 2008 Preferred Stock on the last trading date prior to the date of exercise.

At any time until 10 days following the Stock Acquisition Date, the Company may redeem the Rights in whole, but not in part, at a price of \$0.01 per Right (payable in cash, Common Stock or other consideration deemed appropriate by the Board of Directors). Under certain circumstances set forth in the Rights Agreement, the decision to redeem shall require the concurrence of a majority of the Continuing Directors who are not officers of the Company. The Company may not redeem the Rights if the Board of Directors has previously declared a Person to be an Adverse Person. Immediately upon the action of the Board of Directors ordering redemption of the Rights, with, where required, the concurrence of such Continuing Directors, the Rights will terminate and the only right of the holders of Rights will be to receive the \$0.01 redemption price.

The term "Continuing Director" means any member of the Board of Directors of the Company who was a member of the Board prior to the date of the Rights Agreement, and any Person who is subsequently elected to the Board if such Person is recommended or approved by a majority of the Continuing Directors, but shall not include an Acquiring Person, an Adverse Person or an affiliate or associate of any such Person, or any representative of any of the foregoing.

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Until a Right is exercised, the holder thereof, as such, will have no rights as a shareholder of the Company, including, without limitation, the right to vote or to receive dividends. While the distribution of the Rights will not be taxable to shareholders or to the Company, shareholders may, depending upon the circumstances, recognize taxable income in the event that the Rights become exercisable for Common Stock (or other consideration) of the Company or for common stock of the acquiring company as set forth above, or are redeemed as provided in the second preceding paragraph.

Other than certain provisions relating to the principal economic terms of the Rights, any of the provisions of the Rights Agreement may be amended by the Board of Directors of the Company prior to the Distribution Date. After the Distribution Date, the provisions of the Rights Agreement may be amended by the Board (in certain circumstances, with the concurrence of the Continuing Directors) in order to cure any ambiguity, to make changes which do not adversely affect the interests of holders of Rights (other than an Acquiring Person, an Adverse Person or an affiliate or associate thereof), or to shorten or lengthen any time period under the Rights Agreement; provided, however, that no amendment to adjust the time period governing redemption shall be made at such time as the Rights are not redeemable.

The Rights have certain anti-takeover effects. Exercise of the Rights will cause substantial dilution to a Person or group that attempts to acquire the Company on terms not approved by the Company's Board of Directors. The existence of Rights, however, should not affect an offer at a fair price and otherwise in the best interests of the Company and its shareholders as determined by the Board of Directors. The Rights should not interfere with any merger or other business combination approved by the Board of Directors since the Board of Directors may, at its option, at any time until 10 days following the Stock Acquisition Date or until a Person has been determined to be an Adverse Person redeem all but not less than all of the then outstanding Rights at the \$0.01 redemption price.

A copy of the Rights Agreement has been filed with the Securities and Exchange Commission as an Exhibit to a Registration Statement on Form 8-A. A copy of the Rights Agreement is available free of charge from the Company. This summary description of the Rights does not purport to be complete and is qualified in its entirety by reference to the Rights Agreement, which is incorporated herein by reference.

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EXHIBIT 20

LETTER TO HOLDERS OF COMMON STOCK

Dear Shareholder:

The Directors of Taylor Devices, Inc. have adopted a Shareholder Rights Plan that protects your interests in the event that the Company is confronted with coercive or unfair takeover tactics. The plan provides for a dividend of Rights to purchase shares of a new series of Series 2008 Preferred Stock (or, in certain circumstances, Common Stock or other consideration), that are exercisable upon the occurrence of certain events.

This Plan contains provisions to protect you in the event of an unsolicited offer to acquire the Company. The Plan provides protection from offers that do not treat all shareholders equally, acquisitions in the open market of shares constituting control without offering fair value to all shareholders, and other coercive or unfair takeover tactics that could impair the Directors' ability to represent your interests fully.

The Plan will not affect an offer at a fair price and otherwise in the best interests of the Company and its shareholders as determined by its Board of Directors. The Plan will not interfere with a merger or other business combination that the Board approves as fair and as constituting a recognition of full value to the shareholders.

The Rights become exercisable to purchase shares of Preferred Stock (or, in certain circumstances, Common Stock) only if (i) a person acquired 15% or more of the Company's Common Stock, or (ii) a person commenced a tender or exchange offer for 10% or more of the Company's Common Stock, or (iii) the Board of Directors determined that the beneficial owner of at least 10% of the Company's Common Stock intended to cause the Company to take certain actions adverse to it and its shareholders or that such ownership would have a material adverse effect on the Company. In circumstances described in clauses (i) and (iii) above, holders of Rights would be entitled to purchase, in lieu of Preferred Stock, Common Stock of the Company at a 50% discount from market value. Moreover, in the event that the Company were to enter into certain merger or asset sale transactions, after the occurrence of circumstances described in clauses (i) or (iii), holders would be entitled to exercise the Rights for common stock of the acquiring entity. The acquiring or adverse persons described in clauses (i) and (iii) would not be entitled to exercise Rights.

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The Rights attach to and trade with your shares. No separate Rights Certificates will be mailed to you unless an event triggering the Rights occurs. The issuance of Rights does not in any way weaken the financial strength of the Company or interfere with its business plans, and will not change the way in which you can currently trade shares of the Company's Common Stock.

A summary of the Plan is enclosed. The Plan is complex, and we urge you to read this summary carefully. Its premise, however, is straightforward: to serve and protect the interests of the Company's shareholders.

Sincerely,

/s/ Douglas P. Taylor
Chairman, President and CEO

October 6, 2008

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4,087

Deferred income tax provision (benefit)

(395

)

11,672

Changes in operating assets and liabilities:

Accounts receivable

(7,776

)

	(9,630)
)	
Inventories	
	(4,376)
)	
	178
Prepaid expenses and other current assets	
	(8,060)
)	
	(1,791)
)	
Other non-current assets	
	(342)
)	
Accounts payable	
	(3,838)
)	
	50
Accrued sales deductions	

	1,701
	5,678
Accrued expenses	
	2,964
	(1,283
)	
Income taxes payable	
	(15,938
)	
	1,601
Deferred licensing revenue	
	(130
)	
Other non-current liabilities	
	1,873
	477
	33

Net cash provided by operating activities

33,689

39,300

Cash flows from investing activities

Purchases of marketable securities

(491,655

)

(48,468

)

Sales and maturities of marketable securities

19,466

12,419

Purchases of property, plant and equipment

(557

)

(852

)

Deferred legal fees

(401

)

(9,224

)

Net cash used in investing activities

(473,147

)

(46,125

)

Cash flows from financing activities

Proceeds from issuance of convertible notes

402,500

Convertible notes issuance financing costs

(10,435

)

Proceeds from issuance of warrants

65,688

Purchases of convertible note hedges

(92,897

)

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Proceeds from issuance of common stock

9,503

2,164

Net cash provided by financing activities

374,359

2,164

Net change in cash and cash equivalents

(65,099

)

(4,661

)

Cash and cash equivalents at beginning of year

100,304

66,398

Cash and cash equivalents at end of period

\$

35,205

\$

61,737

Supplemental cash flow information:

Cash paid for interest

\$

\$

Income taxes paid

\$

29,279

\$

1,710

Non-cash financial activity:

Conversion of convertible notes and interest make-whole

\$

\$

2,984

Deferred legal fees included in accounts payable and accrued expenses

\$

480

\$

1,884

See accompanying notes.

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Supernus Pharmaceuticals, Inc.

Notes to Consolidated Financial Statements

For the Six Months ended June 30, 2018 and 2017

(unaudited)

1. Organization and Business

Supernus Pharmaceuticals, Inc. (the Company) was incorporated in Delaware and commenced operations in 2005. The Company is a specialty pharmaceutical company focused on developing and commercializing products for the treatment of central nervous system (CNS) diseases. The Company markets two products, Oxtellar XR for the treatment of epilepsy and Trokendi XR for the prophylaxis of migraine headache and treatment of epilepsy. The Company has several proprietary product candidates in clinical development that address the psychiatry market.

The Company launched Oxtellar XR and Trokendi XR in 2013 for the treatment of epilepsy and launched Trokendi XR for the prophylaxis of migraine headache in adolescents and adults in April 2017.

2. Summary of Significant Accounting Policies

Basis of Presentation

The Company's consolidated financial statements include the accounts of Supernus Pharmaceuticals, Inc. and Supernus Europe Ltd., collectively referred to herein as Supernus or the Company. All significant intercompany transactions and balances have been eliminated in consolidation. The Company's unaudited consolidated financial statements have been prepared in accordance with the requirements of the U.S. Securities and Exchange Commission (SEC) for interim financial information.

As permitted under Generally Accepted Accounting Principles in the United States (U.S. GAAP), certain notes and other information have been omitted from the interim unaudited consolidated financial statements presented in this Quarterly Report on Form 10-Q. Therefore, these financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC.

In the opinion of management, the consolidated financial statements reflect all adjustments necessary to fairly present the Company's financial position, results of earnings, and cash flows for the periods presented. These adjustments are of a normal recurring nature. The Company, which is primarily located in the United States (U.S.), operates in one operating segment.

The results of operations for the three and six months ended June 30, 2018 are not necessarily indicative of the Company's future financial results.

Use of Estimates

The preparation of the Company's consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, as well as related disclosure of contingent assets and liabilities. Actual results could differ materially from the Company's estimates. To the extent that there are material differences between these estimates and actual results, the Company's financial condition or operating results will be affected. The Company bases its estimates on historical experience or on various forecasts, including information received from its service providers and other assumptions that the Company believes are reasonable under the circumstances. The Company evaluates the methodology employed in its estimates on an ongoing basis.

Cash and Cash Equivalents

The Company considers all investments in highly liquid financial instruments with an original maturity of three months or less to be cash equivalents.

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Marketable Securities

Marketable securities consist of investments in U.S. Treasury bills and notes, certificates of deposit, various U.S. governmental agency debt securities, corporate and municipal bonds and other fixed income securities. The Company places all investments with government, industrial or financial institutions whose debt is rated as investment grade. The Company classifies all available-for-sale marketable securities with maturities greater than one year from the balance sheet date as non-current assets.

The Company's investments are classified as available-for-sale and are carried at estimated fair value. Except for changes in fair value of equity securities which are recognized through net income, any unrealized holding gains or losses are reported, net of any reported tax effects, as accumulated other comprehensive earnings (loss), which is a separate component of stockholders' equity.

Realized gains and losses, and declines in value judged to be other-than-temporary, if any, are included in consolidated results of operations. A decline in the market value of any available-for-sale security below cost that is deemed to be other-than-temporary results in a reduction in fair value, with that reduction charged to earnings in that period. A new cost basis for the security is then established. Dividend and interest income is recognized when earned. The cost of securities sold is calculated using the specific identification method.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash, cash equivalents, accounts receivable and marketable securities. The counterparties are various corporations and financial institutions of high credit standing, as described above.

Substantially all of the Company's cash and cash equivalents are maintained in U.S. government agency debt and debt of well-known, investment grade, corporations. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and, therefore, management believes they bear minimal default risk.

The majority of our product sales are to wholesalers and distributors who, in turn sell the products to pharmacies, hospitals, and other customers. Three wholesale pharmaceutical distributors collectively accounted for more than 90% of our total revenue for the six months ended June 30, 2018.

Inventories

Inventories, which are recorded at the lower of cost or market, include materials, labor, and other direct and indirect costs and are valued using the first-in, first-out method. The Company capitalizes inventories produced in preparation for commercial launches when it becomes probable

that the related product candidates will receive regulatory approval and that the related costs will be recoverable through the commercial sale of the product.

Intangible Assets

Intangible assets consist of patent defense costs, which are deferred legal fees that have been incurred in connection with legal proceedings related to the defense of patents for Oxtellar XR and Trokendi XR. Patent defense costs will be charged to expense in the event of an unsuccessful outcome of the ongoing litigation. Patents are carried at cost less accumulated amortization, which is calculated on a straight line basis over the estimated useful lives of the patents. Amortization commences in the quarter after the costs are incurred. The amortization period is based initially upon the remaining patent life and is adjusted, if necessary, for any subsequent settlements or other changes to the expected useful life of the patent. The carrying value of the patents is assessed for impairment annually during the fourth quarter of each year, or more frequently if impairment indicators exist.

Impairment of Long-Lived Assets

Long-lived assets consist primarily of property and equipment and patent defense costs. The Company assesses the recoverability of its long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If indications of impairment exist, projected future undiscounted cash flows associated with the asset are compared to the carrying value to determine whether the asset's value is recoverable. Evaluating for impairment requires judgment, including the estimation of future cash flows, future growth rates and profitability, and the expected life over which cash flows will occur. Changes in the Company's business strategy or adverse changes in market conditions could impact impairment analyses and require the recognition of an impairment charge equal to the excess of the carrying value of the long-lived asset over its estimated fair value.

Table of Contents**Deferred Financing Costs**

Deferred financing costs consist of costs incurred by the Company in connection with the closing of the Company's sale of \$402.5 million of 0.625% Convertible Senior Notes due 2023 (the 2023 Notes) (see Note 8). The Company amortizes deferred financing costs over the term of the related debt using the effective interest method. When extinguishing debt, the related deferred financing costs are written off.

Preclinical Study and Clinical Trial Accruals

The Company estimates preclinical study and clinical trial expenses based on the services performed pursuant to contracts with research institutions, clinical investigators, clinical research organizations (CROs) and other service providers that conduct activities on its behalf. In recording service fees, the Company estimates the time period over which the related services will be performed and compares the level of effort expended through the end of each period to the cumulative expenses recorded and payments made for such services. As appropriate, the Company accrues additional service fees or defers any non-refundable advance payments until the related services are performed. If the actual timing of the performance of services or the level of effort varies from the estimate, the Company will adjust its accrued expenses or deferred advance payments accordingly. If the Company later determines that it no longer expects the services associated with a nonrefundable advance payment to be rendered, the remaining portion of that advance payment will be charged to expense in the period in which such determination is made.

Revenue Recognition

In May 2014, the Financial Accounting Standards Board (FASB) issued a comprehensive new standard, Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers* and its related amendments, which amended revenue recognition principles. The Company adopted the new standard on January 1, 2018. While results for reporting periods beginning after January 1, 2018 are presented under the new guidance, prior period amounts are not adjusted and continue to be reported under the accounting standards in effect for the prior period. The accounting policy for revenue recognition for periods prior to January 1, 2018 is described in Note 2 of the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

	Three Months ended June 30,	
	2018	2017
	(unaudited)	(unaudited)
Net Product Sales:		
Trokendi XR	\$ 76,474	\$ 55,989
Oxtellar XR	20,556	17,339
Total Net Product Sales	97,030	73,328
Royalty Revenues	1,758	1,179
Licensing Revenue	750	1,322
Total Revenues	\$ 99,538	\$ 75,829

	Six Months ended June 30,	
	2018	2017
	(unaudited)	(unaudited)

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Net Product Sales:			
Trokendi XR	\$	147,029	\$ 97,998
Oxtellar XR		39,121	31,699
Total Net Product Sales		186,150	129,697
Royalty Revenues		3,067	2,328
Licensing Revenue		750	1,380
Total Revenues	\$	189,967	\$ 133,405

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Revenue from Product Sales

Revenue from product sales is recognized when control of the Company's products is transferred to the customer, which consists of wholesalers and pharmaceutical distributors. Product sales are recorded net of various forms of variable consideration, including estimated rebates paid to managed care plans, chargebacks, allowances, discounts, patient co-pay assistance and other deductions as well as estimated product returns (collectively, sales deductions). Variability in the transaction price for its products pursuant to its contracts with customers primarily arises from these amounts. Significant judgment is required in estimating sales deductions, considering historical experience, current contract prices under applicable programs, unbilled claims, processing time lags and inventory levels in the distribution channel. If actual results in the future vary from its estimates, the Company adjusts these estimates, which would affect net product sales and earnings in the period such variances become known.

The Company's products are distributed through wholesalers and pharmaceutical distributors. Each of these wholesalers and distributors takes control of the product, including title and ownership to the product, upon physical receipt of the product and then distributes the Company's products to pharmacies.

Sales Deductions

Allowances for estimated sales deductions are provided for the following:

- **Rebates:** Rebates include mandated discounts under the Medicaid Drug Rebate Program, the Medicare coverage gap program, as well as negotiated discounts with commercial healthcare providers. Rebates are amounts owed after the final dispensing of product to a benefit plan participant has occurred and are based upon contractual agreements or legal requirements with the public sector (e.g., Medicaid) and with private sector benefit providers (e.g., commercial managed care providers). The allowance for rebates is based on statutory and contractual discount rates and expected claimed rebates based on a plan provider's utilization.

Rebates are generally invoiced and paid quarterly in arrears so that the accrual balance consists of an estimate of the amount expected to be incurred for the current quarter's activity, plus an accrual balance for known or estimated prior quarters' unpaid rebates. If actual rebates vary from estimates, the Company may need to adjust the balances of such rebates to reflect its actual expenditures with respect to these programs, which would affect net product sales and earnings in the period of adjustment. Allowances for estimated rebates are recorded as current liabilities in *Accrued Sales Deductions*.

- **Co-pay assistance:** Patients who pay in cash or have commercial healthcare insurance and meet certain eligibility requirements may receive co-pay assistance from the Company. The intent of this program is to reduce the patient's out of pocket costs when filling a prescription. Liabilities for co-pay assistance are based on actual program participation as well as estimates of program activity using data provided by third-party administrators. Allowances for estimated co-pay are recorded as current liabilities in *Accrued Sales Deductions*.

- Distributor/wholesaler deductions and discounts: U.S. specialty distributors and wholesalers are offered various forms of consideration including allowances, service fees and prompt payment discounts as consideration for distributing our products. Distributor allowances and service fees arise from contractual agreements with distributors and are generally a percentage of the price at which the Company sells product to distributors and wholesalers. Wholesale customers are offered a prompt pay discount for payment within a specified period. Allowances for estimated discounts are recorded as a deduction in *Accounts Receivable, net*, which is recorded under current assets.
- Returns: Sales of the Company's products are not subject to a general right of return; however, the Company will accept the return of product that is damaged or defective when shipped directly from our warehouse. The Company will also accept expired product six months prior to and up to 12 months subsequent to its expiry date. Product that has been used to fill patient prescriptions is no longer subject to any right of return. Returned product (i.e., damaged, defective or expired) cannot be re-sold, therefore a right of return asset is not recorded. Allowances for estimated returns are recorded as current liabilities in *Accrued Sales Deductions*.
- Chargebacks: Chargebacks are discounts that occur when contracted customers purchase directly from an intermediary distributor or wholesaler. Contracted customers, which currently consist primarily of Public Health Service institutions and federal government entities purchasing via the Federal Supply Schedule, generally purchase the Company's products at a discounted price. The distributor or wholesaler, in turn, charges back the difference between the price initially paid by the distributor or wholesaler and the discounted price paid to the distributor or wholesaler by the customer. The allowance for distributor/wholesaler chargebacks is based on sales to contracted customers. Allowances for estimated chargebacks are recorded as current liabilities in *Accrued Sales Deductions*.

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Customer orders are generally fulfilled within a few days of receipt, resulting in minimal order backlog. Open purchase orders for products from customers are expected to be fulfilled within the next twelve months. There are no minimum product purchase requirements.

Incremental costs of obtaining a contract include only those costs that the Company would not have incurred if the contract had not been obtained, for example sales commissions. Costs of obtaining a contract that are incremental and recoverable are capitalized and amortized on a straight-line basis over the expected customer relationship period. As a practical expedient, the Company expenses costs to obtain a contract as incurred if the expected amortization period of the asset would have been a year or less or if the amount is immaterial. These costs are recorded in selling, general and administrative expenses in the consolidated statement of earnings. Costs to fulfill a contract are expensed as incurred and recorded in cost of product sales in the consolidated statement of earnings.

As of June 30, 2018, the Company had not capitalized any costs of obtaining any of its contracts and had not incurred any costs to fulfill any contracts.

License Revenue

License and Collaboration Agreements

The Company has entered into collaboration agreements to commercialize both Oxtellar XR and Trokendi XR outside of the United States which involve the right to use the Company's intellectual property as a functional license. These agreements generally include an up-front license fee and ongoing milestone payments upon the achievement of specific events. These agreements may also require minimum royalty payments based on sales of products developed from the applicable intellectual property.

Up-front license fees are recognized once the license has been delivered to the customer.

Milestones are a form of variable consideration that are recognized when either the underlying events have been achieved (event-based milestone) or the sales-based targets have been met by the collaborative partner (sales-based milestone). Both types of milestone payments are non-refundable. The Company evaluates whether achieving the milestones is considered probable and estimates the amount to be included in the transaction price using the most likely amount method. This can involve management's judgment that includes assessing factors that are outside of the Company's influence, such as: likelihood of regulatory success; availability of third party information; and expected duration of time until achievement of event. These factors will be evaluated based on the specific facts and circumstances. If it is probable that a significant revenue reversal would not occur, the value of the associated milestone is included in the transaction price.

Event-based milestones are recognized in the period that the related event, such as regulatory approval, occurs. Sales-based milestones are recognized as revenue when the sales target is achieved. Milestone payments that are not within the control of the Company, such as approval from regulatory authorities or where attainment of the specified event is dependent on the development activities of a third-party, are not considered probable of being achieved until the specified event occurs. Revenue is recognized from the satisfaction of performance obligations in the amount billable to the customer.

The Company recorded \$750,000 of milestone revenue for both the three and six months ended June 30, 2018 and \$1.3 million of milestone revenue for both the three and six months ended June 30, 2017, respectively. Revenue associated with future milestones will be recognized when the related event occurs or sales-based target is achieved. There are no guaranteed minimum amounts owed to the Company related to license and collaboration agreements.

Royalty Revenue

The Company recognizes non-cash royalty revenue for royalty amounts earned pursuant to a royalty agreement with United Therapeutics that involves the right to use the Company's intellectual property as a functional license. In 2014, the Company sold certain of these royalty rights to Healthcare Royalty Partners III, L.P. (HC Royalty) (see Note 14). Accordingly, the Company records non-cash royalty revenue based on estimated sales by United Therapeutics that result in payments made from United Therapeutics to HC Royalty in connection with these agreements.

Royalty revenue also includes royalty amounts received from collaboration partners, including from Shire Plc (Shire) based on net product sales of Shire's product, Mydayis. Royalty revenue is only recognized when the underlying sale occurs. The Shire arrangement also involves the right to use the Company's intellectual property as a functional license and royalty revenue is recognized based on estimated net product sales by Shire in the current period.

There are no guaranteed minimum amounts owed to the Company related to royalty revenue agreements.

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For the three and six months ended June 30, 2018, revenue recognized from performance obligations related to prior periods (for example, due to changes in transaction price) was not material in the aggregate for Net Product Sales, License Revenue and Royalty Revenue.

Accounts Receivable, net

Accounts receivable are reported on the consolidated balance sheets at outstanding amounts due from customers, less an allowance for doubtful accounts and discounts. The Company extends credit without requiring collateral. The Company writes off uncollectible receivables when the likelihood of collection is remote. The Company evaluates the collectability of accounts receivable on a regular basis. An allowance, when needed, is based upon various factors including the financial condition and payment history of customers, an overall review of collections experience on other accounts, and economic factors or events expected to affect future collections experience. All arrangements are payable no later than one year after the transfer of the product. The Company does not assess whether a contract has a significant financing component if the expectation at contract inception is such that the period between the transfer of the promised good to the customer and receipt of payment will be one year or less. There are no significant financing components.

The Company recorded no allowance for bad debt as of June 30, 2018 and December 31, 2017. There were no impairment losses on accounts receivable for the three and six months ended June 30, 2018 and June 30, 2017.

The Company recorded an allowance of approximately \$9.3 million and \$8.9 million for expected sales discounts, related to prompt pay discounts and contractual fee for service arrangements, to wholesalers and distributors as of June 30, 2018 and December 31, 2017, respectively.

There were no contract assets or liabilities recorded as of January 1, 2018 or June 30, 2018.

Cost of Product Sales

The cost of product sales consists primarily of materials, third-party manufacturing costs, freight and distribution costs, allocation of labor, quality control and assurance, and other manufacturing overhead costs.

Research and Development Costs

Research and development costs are expensed as incurred. Research and development costs consist primarily of: employee-related expenses, including salaries and benefits; share-based compensation expense; expenses incurred under agreements with CROs; fees paid to clinical investigators who are participating in our clinical trials; fees paid to consultants and other vendors that conduct the Company's clinical trials; the cost of acquiring and manufacturing clinical trial materials; the cost of manufacturing materials used in process validation, but only to the extent that those materials are manufactured prior to receiving regulatory approval and are not expected to be sold commercially; facilities costs that do

not have an alternative future use; related depreciation and other allocated expenses; license fees for, and milestone payments related to in-licensed products and technologies; and costs associated with animal testing activities and regulatory approvals.

Advertising Expense

Advertising expense includes costs of promotional materials and activities, such as marketing materials, marketing programs and speaker programs. The costs of the Company's advertising efforts are expensed as incurred. The Company incurred approximately \$11.1 million and \$19.0 million in advertising costs for the three and six months ended June 30, 2018 and approximately \$9.8 million and \$16.5 million in advertising costs for the three and six months ended June 30, 2017, respectively. These expenses are recorded in the selling, general and administrative expense line item.

Share-Based Compensation

Employee share-based compensation is measured based on the estimated fair value as of the grant date. The grant date fair value is calculated using the Black-Scholes option-pricing model, which requires the use of subjective assumptions, including stock volatility, expected term, risk-free rate, and the fair value of the underlying common stock. The Company recognizes expense using the straight-line method.

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The Company records the expense for stock option grants to non-employees based on the estimated fair value of the stock option using the Black-Scholes option pricing model. The fair value of awards to non-employees is re-measured at each reporting period. As a result, stock compensation expense for non-employee awards with vesting is affected by subsequent changes in the fair value of the Company's common stock, with those changes recorded in the relevant period.

Income Taxes

The Company utilizes the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax reporting bases of assets and liabilities and are measured using enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. When appropriate, valuation allowances are established to reduce deferred tax assets to the amounts expected to be realized.

The Company accounts for uncertain tax positions in its consolidated financial statements when it is more-likely-than-not that the position will be sustained upon examination by the tax authorities. Such tax positions must initially and subsequently be measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the tax authority, assuming full knowledge of the position and relevant facts. The Company's policy is to recognize any interest and penalties related to income taxes as income tax expense in the relevant period.

Recently Issued Accounting Pronouncements

Accounting Pronouncements Adopted in 2018

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*, and has subsequently issued a number of amendments to ASU 2014-09, which provides a comprehensive model to be used in the accounting for revenue arising from contracts with customers and supersedes current revenue recognition guidance, including industry-specific guidance.

On January 1, 2018, the Company adopted ASC 606, *Revenue from Contracts with Customers* and all the related amendments (the New Revenue Standard) using the modified retrospective method applied to those contracts which had not been completed as of January 1, 2018. The Company recognized the cumulative effect of initially applying the New Revenue Standard as an adjustment to the opening balance of retained earnings.

The Company recorded a decrease of \$2.3 million to the accumulated deficit of January 1, 2018 due to the cumulative impact of adopting the New Revenue Standard. The decrease resulted from the acceleration of both up-front licensing fees from license and collaboration agreements and the acceleration of royalties from sales of licensed product. Under the New Revenue Standard, up-front licensing fees will be recognized when the license is delivered to the customer and royalties from the sale of licensed product will be recognized as the underlying sales of product occur by the licensee. There were no changes in the timing of revenue recognition related to net product sales.

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The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods, in thousands of dollars:

	December 31, 2017		Adjustments		January 1, 2018
	As Reported		(unaudited)		(unaudited)
Accounts receivable, net	\$ 65,586	\$	1,620	\$	\$ 67,206
Deferred licensing revenue	287		(287)		
Deferred licensing revenue, net of current portion	1,149		(1,149)		
Deferred income taxes (asset)	20,843		(734)		20,109
Accumulated deficit	26,823		(2,322)		24,501

Adoption of the New Revenue Standard had no material impact on the Company's consolidated balance sheets or statements of earnings and had no impact on cash from or used in total operating, investing or financing activities on the Company's consolidated statements of cash flows.

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In May 2017, the FASB issued ASU 2017-09, *Compensation Stock Compensation (Topic 718): Scope of Modification Accounting*, which clarifies when to account for a change to the terms or conditions of a share-based payment award as a modification. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. ASU 2017-09 is effective for all annual periods, and interim periods within those annual periods, beginning after December 15, 2017, with early adoption permitted. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, *Classification of Certain Cash Receipts and Cash Payments*. The standard eliminates diversity in the practice of how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, *Statement of Cash Flows*, and other Topics. ASU 2016-15 is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2017. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

New Accounting Pronouncements Not Yet Adopted

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The standard requires a lessee to recognize a right-of-use asset and a lease liability on the balance sheet for leases with lease terms greater than 12 months. ASU 2016-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018, and early adoption is permitted. The Company is evaluating the impact that adopting this new standard will have on its consolidated financial statements. The Company expects the ASU to have a material impact on its consolidated balance sheet due to the recognition of assets and liabilities, principally for certain leases currently accounted for as operating leases. The Company does not expect the ASU to have a material impact on its cash flows or results of operations.

In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. ASU 2017-12 provides new guidance about income statement classification and eliminates the requirement to separately measure and report hedge ineffectiveness. The entire change in fair value for qualifying hedge instruments included in the effectiveness measurement will be recorded in other comprehensive income (OCI) and amounts deferred in OCI will be reclassified to earnings in the same income statement line item in which the earnings effect of the hedged item is reported. This standard will be effective for the first annual period beginning after December 15, 2018, including interim periods within those periods. Early adoption is permitted. The Company is currently assessing the impact that this standard will have on its consolidated financial statements, but does not expect it to have a material impact.

The Company has evaluated all other ASUs issued through the date the consolidated financial statements were issued in this Quarterly Report on Form 10-Q and believes that no other ASUs will have a material impact on the Company's consolidated financial statements.

3. Fair Value of Financial Instruments

The fair value of an asset or liability represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Such transactions to sell an asset or transfer a liability are assumed to occur in the principal or most advantageous market for the asset or liability. Accordingly, fair value is determined based on a hypothetical transaction at the measurement date, considered from the perspective of a market participant rather than from a reporting entity's perspective.

The Company reports assets and liabilities that are measured at fair value using a three level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy maximizes the use of observable inputs and minimizes the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1 Inputs are unadjusted quoted prices in active markets for identical assets that the Company has the ability to access at the measurement date.
- Level 2 Inputs are quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (interest rates, yield curves, etc.) and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).
- Level 3 Unobservable inputs that reflect the Company's own assumptions, based on the best information available, including the Company's own data.

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In accordance with the fair value hierarchy described above, the following tables show the fair value of the Company's financial assets and liabilities that are required to be measured at fair value, in thousands of dollars:

	Fair Value Measurements at June 30, 2018 (unaudited)			
	Total Carrying Value at June 30, 2018	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents	\$ 35,205	\$ 35,205	\$	\$
Marketable securities	139,208	1,376	137,832	
Long term marketable securities:				
Corporate debt securities	500,173	689	499,484	
Government debt securities	3,139		3,139	
Other non-current assets:				
Marketable securities - restricted (SERP)	356	1	355	
Total assets at fair value	\$ 678,081	\$ 37,271	\$ 640,810	\$

	Fair Value Measurements at December 31, 2017			
	Total Carrying Value at December 31, 2017	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents	\$ 100,304	\$ 100,304	\$	\$
Marketable securities	39,736	2,118	37,618	
Long term marketable securities:				
Corporate debt securities	132,477	448	132,029	
Government debt securities	1,161		1,161	
Other non-current assets:				
Marketable securities - restricted (SERP)	335		335	
Total assets at fair value	\$ 274,013	\$ 102,870	\$ 171,143	\$

The fair value of the restricted marketable securities is included within other non-current assets in the consolidated balance sheets.

The Company's Level 1 assets include cash held with banks, certificates of deposit, and money market funds.

Level 2 assets include the SERP (Supplemental Executive Retirement Plan) assets, commercial paper and investment grade corporate and government debt securities and other fixed income securities. Level 2 securities are valued using third-party pricing sources that apply applicable inputs and other relevant data in their models to estimate fair value.

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The carrying value, face value and estimated fair value of the 2023 Notes were approximately \$321.9 million, \$402.5 million and \$491.0 million, respectively, as of June 30, 2018. The fair value was estimated based on actual trade information as well as quoted prices provided by bond traders, which would be characterized within Level 2 of the fair value hierarchy.

The carrying amounts of other financial instruments, including accounts receivable, accounts payable and accrued expenses approximate fair value due to their short-term maturities.

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Unrestricted marketable securities held by the Company were as follows, in thousands of dollars:

At June 30, 2018 (unaudited):

Available for Sale	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate and government debt securities	\$ 647,253	12	(4,745)	\$ 642,520

At December 31, 2017:

Available for Sale	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate and government debt securities	\$ 174,235	48	(909)	\$ 173,374

The contractual maturities of the unrestricted available for sale marketable securities held by the Company were as follows, in thousands of dollars:

	June 30, 2018 (unaudited)
Less Than 1 Year	\$ 139,208
1 year to 2 years	165,451
2 year to 3 years	169,167
3 years to 4 years	168,694
Greater Than 4 Years	
Total	\$ 642,520

The Company has not experienced any other-than-temporary losses on its marketable securities and restricted marketable securities. The cost of securities sold is calculated using the specific identification method.

4. Inventories

Inventories consist of the following, in thousands of dollars:

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	June 30, 2018 (unaudited)		December 31, 2017
Raw materials	\$ 2,914	\$	2,995
Work in process	6,142		8,873
Finished goods	11,624		4,436
	\$ 20,680	\$	16,304

Table of Contents**5. Property and Equipment**

Property and equipment consist of the following, in thousands of dollars:

	June 30, 2018	December 31, 2017
	(unaudited)	
Lab equipment and furniture	\$ 8,804	\$ 8,331
Leasehold improvements	2,848	2,731
Software	2,122	2,004
Computer equipment	1,230	1,226
Construction in progress	140	178
	15,144	14,470
Less accumulated depreciation and amortization	(10,247)	(9,346)
	\$ 4,897	\$ 5,124

Depreciation and amortization expense on property and equipment was approximately \$500,000 and \$900,000 for the three and six months ended June 30, 2018, and approximately \$300,000 and \$600,000 for the three and six months ended June 30, 2017, respectively.

There were no indicators of impairment identified.

6. Intangible Assets

Intangible assets consist of patent defense costs, which are legal fees incurred in conjunction with defending patents for Oxtellar XR and Trokendi XR.

The following sets forth the gross carrying amount and related accumulated amortization of the intangible assets, in thousands of dollars:

	Weighted- Average Life	June 30, 2018	December 31, 2017
		(unaudited)	
Capitalized patent defense costs	4.5 -8.75 years	\$ 44,546	\$ 44,185
Less accumulated amortization		(10,752)	(8,166)
		\$ 33,794	\$ 36,019

In March 2017, the Company entered into two settlements with various companies related to Trokendi XR patent litigation. The remaining unamortized aggregate capitalized patent defense costs for Trokendi XR have subsequently been amortized over the remaining useful life of the

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patents at issue, or January 1, 2023, which is the date the Company is obligated under the settlements to grant a non-exclusive license to the patents at issue.

Amortization expense on intangible assets was approximately \$1.3 million and \$2.6 million for the three and six months ended June 30, 2018, and approximately \$1.0 million and \$1.4 million for the three and six months ended June 30, 2017, respectively.

There were no indicators of impairment identified.

Table of Contents**7. Accrued Expenses**

Accrued expenses are comprised of the following, in thousands of dollars:

	June 30, 2018 (unaudited)	December 31, 2017
Accrued clinical trial and clinical supply costs	\$ 11,810	\$ 6,996
Accrued compensation	10,302	10,279
Accrued product costs	1,217	726
Accrued professional fees	1,912	2,890
Accrued interest expense	734	
Other accrued expenses	3,313	6,414
	\$ 29,288	\$ 27,305

8. Convertible Senior Notes

On March 14, 2018, the Company entered into a Purchase Agreement (the Purchase Agreement) with Jefferies LLC, J.P. Morgan Securities LLC and Cowen and Company, LLC, as the initial purchasers (collectively, the Initial Purchasers), in connection with the offering and sale of \$350 million aggregate principal amount of 2023 Notes. The Company also granted the Initial Purchasers an over-allotment option to purchase, within a 30-day period, up to an additional \$52.5 million principal amount of additional 2023 Notes on the same terms and conditions, which the Initial Purchasers exercised in full on March 15, 2018.

On March 19, 2018, the sale of the 2023 Notes was settled and the 2023 Notes were issued pursuant to an Indenture, dated as of March 19, 2018 (the Indenture), between the Company and Wilmington Trust, National Association, as trustee. The Indenture includes customary terms and covenants, including certain events of default upon which the 2023 Notes may be due and payable immediately. The Indenture governing the 2023 Notes does not contain any financial or operating covenants or any restrictions on the payment of dividends, the issuance of other indebtedness or the issuance or repurchase of securities by the Company.

The Company will pay interest on the 2023 Notes at an annual rate of 0.625%, payable semi-annually in arrears on April 1 and October 1 of each year, beginning on October 1, 2018. The 2023 Notes will mature on April 1, 2023, unless earlier converted or repurchased by the Company.

Noteholders may convert their 2023 Notes at their option only in the following circumstances: (1) during any calendar quarter commencing after the calendar quarter ending on June 30, 2018, if the last reported sale price per share of the Company's common stock for each of at least 20 trading days (whether or not consecutive) during the 30 consecutive trading days ending on, and including the last trading day of the immediately preceding calendar quarter exceeds 130% of the conversion price, or a price of approximately \$77.13 per share, on such trading day; (2) during the five consecutive business days immediately after any 10 consecutive trading day period (such 10 consecutive trading day period, the measurement period) in which the trading price per \$1,000 principal amount of notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price per share of the Company's common stock on such trading day and the conversion rate on such trading day; (3) upon the occurrence of certain corporate events or distributions on the Company's common stock, as specified in the

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Indenture; and (4) at any time from, and including, October 1, 2022 until the close of business on the second scheduled trading day immediately before the maturity date. The Company will settle conversions by paying or delivering, as applicable, cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock, at its election, based on the applicable conversion rate. The initial conversion rate is 16.8545 shares per \$1,000 principal amount of the 2023 Notes, which represents an initial conversion price of approximately \$59.33 per share, and is subject to adjustment as specified in the Indenture.

If a make-whole fundamental change (as defined in the Indenture) occurs, then the Company will in certain circumstances increase the conversion rate for a specified period of time. If a fundamental change (as defined in the Indenture) occurs, then noteholders may require the Company to repurchase their 2023 Notes at a cash repurchase price equal to the principal amount of the 2023 Notes to be repurchased, plus accrued and unpaid interest, if any.

The Company may not redeem the 2023 Notes at its option before maturity.

In the event of conversion, holders would forgo all future interest payments, any unpaid accrued interest and the possibility of further stock price appreciation. Upon the receipt of conversion requests, the settlement of the 2023 Notes will be paid pursuant to the

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terms of the Indenture. In the event that all of the 2023 Notes are converted, the Company would be required to repay the \$402.5 million in principal value and any conversion premium in cash, shares or any combination of cash and shares of its common stock (at the Company's option).

The 2023 Notes are the Company's senior, unsecured obligations and will be equal in right of payment with the Company's future senior, unsecured indebtedness, senior in right of payment to the Company's future indebtedness that is expressly subordinated to the 2023 Notes and effectively subordinated to the Company's future secured indebtedness, to the extent of the value of the collateral securing that indebtedness. The 2023 Notes will be structurally subordinated to all future indebtedness and other liabilities, including trade payables.

Convertible Notes Hedge and Warrant Transactions

In connection with the pricing of the 2023 Notes on March 14, 2018, and in connection with the exercise of the over-allotment option by the Initial Purchasers on March 15, 2018, the Company entered into separate privately negotiated convertible note hedge transactions (collectively, the Convertible Note Hedge Transactions) with each of the call spread counterparties. The Convertible Note Hedge Transactions cover, subject to customary anti-dilution adjustments substantially similar to those applicable to the 2023 Notes, the number of shares of the Company's common stock underlying the 2023 Notes, as described above. The Company issued 402,500 convertible note hedge options, including options purchased on the exercise of the over-allotment option. In the event that shares or cash are deliverable to holders of the 2023 Notes upon conversion at limits defined in the Indenture, counterparties to the convertible note hedges will be required to deliver up to approximately 6.8 million shares of the Company's common stock or pay cash to the Company in a similar amount as the value that the Company delivers to the holders of the 2023 Notes based on a conversion price of \$59.33 per share. The total cost of the convertible note hedge transactions was \$92.9 million.

Concurrently with entering into the Convertible Note Hedge Transactions on each such date, the Company also entered into separate privately negotiated warrant transactions (collectively, the Warrant Transactions) with each of the call spread counterparties whereby the Company sold to the call spread counterparties warrants to purchase, subject to customary anti-dilution adjustments, up to the same number of shares of the Company's common stock.

The Convertible Note Hedge Transactions and the Warrant Transactions are separate contracts entered into by the Company with the Call Spread Counterparties, are not part of the terms of the 2023 Notes and will not affect the noteholders' rights under the 2023 Notes. Holders of the 2023 Notes will not have any rights with respect to the Convertible Note Hedge Transactions or the Warrant Transactions. The Company issued a total of 6,783,939 warrants. The warrants entitle the holder to one share per warrant at the strike price through 2023. The strike price of the Warrant Transactions will initially be \$80.9063 per share of the Company's common stock (subject to adjustment). The Company received proceeds of approximately \$65.7 million from the sale of these warrants.

The Convertible Note Hedge Transactions are expected to reduce generally the potential dilution with respect to the Company's common stock upon conversion of the 2023 Notes and/or offset any potential cash payments the Company is required to make in excess of the principal amount of converted 2023 Notes, as the case may be, upon any conversion of the 2023 Notes. The Warrant Transactions are intended to partially offset the cost to the Company of the purchased Convertible Note Hedge Transactions; however, the Warrant Transactions could have a dilutive effect with respect to the Company's common stock to the extent that the market price per share of the Company's common stock, as measured under the terms of the Warrant Transactions, exceeds the strike price of the warrants. As these transactions meet certain accounting criteria under ASC 815-40-25, the convertible note hedges and warrants are recorded in stockholders' equity and are not accounted for as derivatives. The net cost incurred in connection with the convertible note hedges and warrant transactions was recorded as a reduction to additional paid-in capital in the

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consolidated balance sheet as of June 30, 2018.

In accordance with accounting guidance on embedded conversion features, the Company valued and bifurcated the conversion option associated with the 2023 Notes from the respective host debt instrument, which is referred to as debt discount, and initially recorded the conversion option of \$76.4 million in additional paid-in capital on the consolidated balance sheet. The resulting debt discount on the 2023 Notes is being amortized to interest expense at an effective interest rate of 5.41% over the contractual term of the 2023 Notes.

The Company incurred approximately \$10.4 million of debt financing costs. Approximately \$2.0 million of this amount is allocated to the additional paid-in capital and the remaining \$8.4 million is recorded as deferred costs and is being amortized to interest expense over the contractual term of the 2023 Notes.

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The liability component of the 2023 Notes consisted of the following, in thousands of dollars, unaudited:

	June 30, 2018
Principal amount of the 2023 Notes	\$ 402,500
Debt discount	(76,434)
Deferred financing costs	(8,453)
Accretion of debt discount and deferred financing costs	4,307
June 30, 2018 carrying value	\$ 321,920

No 2023 Notes were converted in the six months ended June 30, 2018.

9. Summary Stockholders Equity

The following summary table provides details related to the activity in certain captions within Stockholders Equity for the six month period ended June 30, 2018, in thousands of dollars:

	Common Stock	Additional Paid-in Capital (unaudited)	Retained Earnings (Accumulated Deficit)
Balance, December 31, 2017	\$ 51	\$ 294,999	\$ (26,823)
Cumulative-effect of adoption of ASC 606			2,322
Balance, January 1, 2018	51	294,999	(24,501)
Share-based compensation		5,703	
Issuance of ESPP shares		1,184	
Exercise of stock options	1	8,319	
Equity component of convertible notes issuance, net of tax		56,215	
Purchases of convertible note hedges, net of tax		(70,137)	
Issuance of warrants		65,688	
Net income			57,089
Balance, June 30, 2018	\$ 52	\$ 361,971	\$ 32,588

10. Share-Based Payments*Stock Option Plans*

The Company has adopted the Supernus Pharmaceuticals, Inc. 2012 Equity Incentive Plan, as amended (the 2012 Plan), which is stockholder approved, and provides for the grant of stock options and certain other awards, including stock appreciation rights (SAR), restricted and

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unrestricted stock, stock units, performance awards, cash awards and other awards that are convertible into or otherwise based on the Company's common stock, to the Company's key employees, directors, consultants and advisors. The 2012 Plan is administered by the Company's Board of Directors and the Company's Compensation Committee and provides for the issuance of up to 8,000,000 shares of the Company's common stock. Option awards are granted with an exercise price equal to the estimated fair value of the Company's common stock at the grant date. Option awards granted to employees, consultants and advisors generally vest in four equivalent annual installments, starting on the first anniversary of the date of the grant and have ten-year contractual terms. Option awards granted to the directors generally vest over a one year term and have ten year contractual terms.

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Share-based compensation recognized related to the grant of employee and non-employee stock options, SAR, Employee Stock Purchase Plan (ESPP) awards and non-vested stock was as follows, in thousands of dollars:

	Three Months ended June 30,		Six Months ended June 30,	
	2018	2017	2018	2017
	(unaudited)		(unaudited)	
Research and development	\$ 534	\$ 398	\$ 952	\$ 715
Selling, general and administrative	2,534	1,862	4,751	3,372
Total	\$ 3,068	\$ 2,260	\$ 5,703	\$ 4,087

The following table summarizes stock option and SAR activity:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)
Outstanding, December 31, 2017	4,280,670	\$ 14.50	7.37
Granted (unaudited)	734,465	\$ 39.84	
Exercised (unaudited)	(829,518)	\$ 10.03	
Forfeited (unaudited)	(168,816)	\$ 24.26	
Outstanding, June 30, 2018 (unaudited)	4,016,801	\$ 19.65	7.52
As of December 31, 2017:			
Vested and expected to vest	4,280,670	\$ 14.50	7.37
Exercisable	1,952,769	\$ 9.35	6.16
As of June 30, 2018:			
Vested and expected to vest (unaudited)	4,016,801	\$ 19.65	7.52
Exercisable (unaudited)	1,947,495	\$ 12.07	6.35

11. Earnings per Share

Basic earnings per common share is determined by dividing earnings attributable to common stockholders by the weighted-average number of common shares outstanding during the period, without consideration of common stock equivalents. Diluted earnings per share is computed by dividing the earnings attributable to common stockholders by the weighted-average number of common share equivalents outstanding for the period. The treasury stock method is used to determine the dilutive effect of the Company's stock option grants, SAR, warrants, ESPP awards, and the 2023 Notes.

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The following common stock equivalents were excluded in the calculation of diluted earnings per share because their inclusion would be anti-dilutive as applied to the earnings from continuing operations applicable to common stockholders for the three and six months ended June 30, 2018 and 2017:

	Three Months ended June 30,		Six Months ended June 30,	
	2018	2017	2018	2017
	(unaudited)		(unaudited)	
Warrants to purchase common stock	4,362,485		2,816,135	
Convertible notes	66,961		61,104	
Convertible notes hedges	67		61	
Stock options, stock appreciation rights, and ESPP awards	137,565	122,666	184,760	206,448

The following table sets forth the computation of basic and diluted net earnings per share for the three and six months ended June 30, 2018 and 2017, in thousands of dollars, except share and per share amounts:

	Three Months ended June 30,		Six Months ended June 30,	
	2018	2017	2018	2017
	(unaudited)		(unaudited)	
Numerator, in thousands:				
Net earnings used for calculation of basic EPS	\$ 30,737	\$ 17,368	\$ 57,089	\$ 27,665
Interest expense on convertible debt		58		147
Changes in fair value of derivative liabilities		(23)		(76)
Loss on extinguishment of debt		103		204
Loss on extinguishment of outstanding debt, as if converted		(258)		(321)
Total adjustments		(120)		(46)
Net earnings used for calculation of diluted EPS	\$ 30,737	\$ 17,248	\$ 57,089	\$ 27,619
Denominator:				
Weighted average shares outstanding, basic	51,919,894	50,530,968	51,729,243	50,345,830
Effect of dilutive potential common shares:				
Shares underlying Convertible Senior Notes		421,708		551,235
Shares issuable to settle interest make-whole derivatives		4,631		7,013
Stock options and stock appreciation rights	2,283,414	2,266,407	2,292,698	2,122,245
Total dilutive potential common shares	2,283,414	2,692,746	2,292,698	2,680,493
Weighted average shares outstanding, diluted	54,203,308	53,223,714	54,021,941	53,026,323
Net earnings per share, basic	\$ 0.59	\$ 0.34	\$ 1.10	\$ 0.55
Net earnings per share, diluted	\$ 0.57	\$ 0.32	\$ 1.06	\$ 0.52

12. Income Taxes

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The following table provides a comparative summary of the Company's income tax expense and effective tax rate for the three and six months ended June 30, 2018 and 2017, in thousands of dollars:

	Three Months ended June 30, 2018		2017		Six Months ended June 30, 2018		2017	
	(unaudited)				(unaudited)			
Income tax expense	\$	3,119	\$	9,057	\$	7,949	\$	14,983
Effective tax rate		9.2%		34.3%		12.2%		35.1%

The income tax expense for the three and six months ended June 30, 2018, is attributable to U.S. federal and state income taxes. The decrease in the income tax expense and the effective tax rate for the three and six months ended June 30, 2018 as compared to the same periods in the prior year is primarily attributable to the reduction of the U.S. corporate income tax rate, from 35% to 21%, as a result of the Tax Cuts and Jobs Act passed on December 22, 2017.

In addition, for the three and six months ended June 30, 2018, the Company recorded income tax benefits of approximately \$4.4 million and \$6.4 million, respectively, as a result of the Company recognizing excess tax benefits related to the employee exercise of stock options. These tax benefits caused the effective tax rate to be significantly less than the Company's statutory annual effective tax rate for the three and six months ended June 30, 2018.

Table of Contents**13. Commitments and Contingencies**

The Company has concurrent leases for its current headquarters office and lab space that extend through April 2020. The Company may elect to extend the term of the leases for an additional five-year term. The leases provide for a tenant improvement allowance of approximately \$2.1 million in aggregate. During the three and six months ended June 30, 2018, none of the allowance was utilized. During the three and six months ended June 30, 2017, approximately \$49,000 and \$79,000 of the allowance, respectively, was utilized. These amounts were included in fixed assets and deferred rent. As of June 30, 2018, approximately \$400,000 is available for tenant improvements.

The Company has entered into a new lease agreement, effective February 27, 2018, with Rockside-700 LLC, for its new headquarters. The term of the new lease commences upon the Company's substantial completion of the initial buildout of the premises, but in no event later than July 10, 2019, and shall continue until April 30, 2033, unless earlier terminated in accordance with the terms of the new lease (the Lease Term). Under the new lease, the Company has the option to extend the Lease Term for two additional five-year periods. The new lease provides for a tenant improvement allowance of approximately \$8.9 million in aggregate. The Company has the right to terminate the lease if, by September 30, 2018, the landlord fails to obtain certain site approval pre-requisites per the lease agreement. As of June 30, 2018, none of the tenant improvement allowance has been received and the full amount of the allowance is available for tenant improvements.

Rent expense for the leased facilities and leased vehicles was approximately \$898,000 and \$1.8 million for the three and six months ended June 30, 2018 and approximately \$500,000 and \$1.2 million for the three and six months ended June 30, 2017, respectively.

Future minimum lease payments under non-cancelable operating leases as of June 30, 2018 are as follows, in thousands of dollars, unaudited:

Year ending December 31:		
2018 (remaining)	\$	1,715
2019		3,393
2020		2,482
Thereafter		1,014
	\$	8,604

The Company has obtained exclusive licenses from third parties for proprietary rights to support the product candidates in the Company's psychiatry portfolio. Under license agreements with Afecta Pharmaceuticals, Inc. (Afecta), the Company has exclusive worldwide rights to selected product candidates, including an exclusive license to SPN-810. The Company may pay up to \$300,000 upon the achievement of certain milestones, none of which was owed as of June 30, 2018. The Company is obligated to pay royalties to Afecta as a low single digit percentage of worldwide net product sales.

The Company has also entered into a purchase and sale agreement with Rune HealthCare Limited (Rune), where the Company obtained the exclusive worldwide rights to a product concept from Rune. There are no future milestone payments due to Rune under this agreement. If the Company receives approval to market and sell any products based on the Rune product concept for SPN-809, the Company is obligated to pay royalties to Rune as a low single digit percentage of worldwide net product sales.

14. Collaboration Agreements

In the third quarter of 2014, the Company received a \$30.0 million payment pursuant to a Royalty Interest Acquisition Agreement related to the purchase by HC Royalty of certain of the Company's rights under the agreement with United Therapeutics Corporation related to the commercialization of Orenitram (treprostinil) Extended-Release Tablets. The Company will retain full ownership of the royalty rights if and when a certain cumulative payment threshold is reached per the terms of the agreement. The Company has recorded a non-recourse liability related to this transaction and has begun to amortize this amount to recognize non-cash royalty revenue. Revenue recognition is based on estimated net product sales by United Therapeutics that result in payments made from United Therapeutics to HC Royalty in connection with these agreements. The Company also recognized non-cash interest expense related to this liability that accrues at an effective interest rate. That rate is determined based on projections of HC Royalty's rate of return.

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The Company recognized non-cash royalty revenue of \$1.5 million and \$2.8 million for the three and six months ended June 30, 2018 and \$1.2 million and \$2.3 million for the three and six months ended June 30, 2017, respectively. The Company recognized non-cash interest expense of \$1.2 million and \$1.9 million for the three and six months ended June 30, 2018 and \$0.2 million and \$1.1 million for the three and six months ended June 30, 2017.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to help the reader understand the results of operations and the financial condition of Supernus Pharmaceuticals, Inc. (the Company, we, us, or our). The interim financial statements included in this report and this Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our audited consolidated financial statements and notes thereto for the year ended December 31, 2017 and the related Management's Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 1, 2018.

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which are intended to be covered by the safe harbors created thereby. These forward-looking statements may include declarations regarding the Company's belief or current expectations of management, such as statements including the words budgeted, anticipate, project, estimate, expect, may, believe, potential, and similar expressions, which are intended to be among the statements that are forward-looking statements, as such statements reflect the reality of risk and uncertainty that is inherent in our business. Actual results may differ materially from those expressed or implied by such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which are made as of the date this report was filed with the Securities and Exchange Commission. Our actual results and the timing of events could differ materially from those discussed in our forward-looking statements as a result of many factors, including those set forth under the Risk Factors section of our Annual Report on Form 10-K and elsewhere in this report as well as in other reports and documents we file with the Securities and Exchange Commission from time to time. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances occurring after the date of this Quarterly Report on Form 10-Q.

Solely for convenience, in this Quarterly Report on Form 10-Q, the trade names are referred to without the TM symbols and the trademark registrations are referred to without the circled R, but such references should not be construed as any indicator that the Company will not assert, to the fullest extent under applicable law, our rights thereto.

Overview

We are a specialty pharmaceutical company focused on developing and commercializing products for the treatment of central nervous system (CNS) diseases.

Oxtellar XR and Trokendi XR are the first once-daily extended release oxcarbazepine and topiramate products, launched in 2013 for the treatment of epilepsy in the U.S. market. During 2017, we launched Trokendi XR for the additional indication of prophylaxis of migraine headache in adults and adolescents. These products differ from immediate release products by offering once-daily dosing and unique pharmacokinetic profiles which we believe can have positive clinical effects for many patients. We believe a once-daily dosing regimen

improves adherence, making it more probable that patients maintain sufficient levels of medication in their bloodstream to protect against seizures and migraines. In addition, we believe that the unique smooth and steady pharmacokinetic profiles of our once-daily formulations reduce the peak to trough blood level fluctuations that are typically associated with immediate release products and which may result in increased adverse events (AEs), more side effects and decreased efficacy.

In addition, we are developing multiple product candidates in psychiatry to address significant unmet medical needs and market opportunities. We are developing SPN-810 (molindone hydrochloride) initially to treat impulsive aggression (IA) in children and adolescents who have attention deficit hyperactivity disorder (ADHD). We plan to subsequently develop SPN-810 for the treatment of IA in other CNS diseases, such as autism, post traumatic stress disorder (PTSD), bipolar disorder, and some forms of dementia. There are currently no approved products in the U.S. indicated for the treatment of IA. We are developing SPN-812 (viloxazine hydrochloride) as a novel, non-stimulant candidate to treat patients who have ADHD.

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The table below summarizes our current portfolio of novel products and product candidates.

Product	Indication	Status
Oxtellar XR	Epilepsy	In the market
Trokendi XR	Epilepsy	In the market
	Migraine*	In the market
SPN-810	IA**	Phase III
SPN-812	ADHD	Phase III
SPN-809	Depression	Phase II ready

* Prophylaxis of migraine headache in adults and adolescents.

** Initial program is for IA in patients with ADHD, with plans to add other indications, such as IA in patients with autism, PTSD, bipolar disorder, and some forms of dementia.

We are continuing to expand our intellectual property portfolio to provide additional protection for our technologies, products, and product candidates. We currently have eight U.S. patents issued covering Oxtellar XR and nine U.S. patents issued covering Trokendi XR, with the patents expiring no earlier than 2027 for each product.

*Commercial Products**Trokendi XR*

Trokendi XR, the first once-daily extended release topiramate product indicated for patients with epilepsy in the U.S. market, is designed to improve patient adherence over the current immediate release products, which must be taken multiple times per day. In 2017, we launched Trokendi XR for prophylaxis of migraine headache in adults and adolescents.

Oxtellar XR

Oxtellar XR is the only once-daily extended release oxcarbazepine product indicated for the treatment of patients with epilepsy in the U.S. as adjunctive therapy. In April 2018, the U.S. Food and Drug Administration (FDA) accepted for review our efficacy supplement requesting expansion of the current indication for Oxtellar XR to include monotherapy treatment of partial seizures of epilepsy for adults and for children 6 to 17 years of age. We expect a decision by the FDA on this supplement by year-end 2018.

Product Prescriptions

We expect the number of prescriptions filled for Oxtellar XR and Trokendi XR to continue to increase through 2018 and in subsequent years. Data from IQVIA (formerly Intercontinental Marketing Services (IMS)) shows that 415,719 total prescriptions were filled for both of these drugs during the six months ended June 30, 2018, which is 42% higher than the 293,201 prescriptions reported for the same prior year period.

Total prescriptions for Trokendi XR increased by 52,963 or 43% in the second quarter of 2018 over the second quarter of 2017. Total prescriptions for Oxtellar XR increased by 3,321 or 10% in the second quarter of 2018 over the second quarter of 2017.

Patents

We are in litigation against TWi Pharmaceuticals, Inc. alleging infringement of some of our Orange Book listed Oxtellar XR patents. In August 2017, we prevailed against TWi in the U.S. District Court for the District of New Jersey. TWi has appealed the decision to the U.S. Court of Appeals for the Federal Circuit. (See Part II, Item 1 Legal Proceedings for additional information.)

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Product Candidates

SPN-810

We are developing SPN-810 as a novel treatment for IA in children and adolescents who have ADHD. SPN-810 has been granted fast-track designation by the FDA. One of our Phase III clinical trials (P301) is being conducted under a Special Protocol Assessment (SPA) with the FDA, using a novel measurement scale developed by us. We initiated two Phase III clinical trials in 2015 (P301 and P302) in children, using the same trial design and the same novel measurement scale except that under the SPA, an interim analysis was conducted in the first trial when one-half of the patients (146 patients) reached randomization. The purpose of the interim analysis was to assess the efficacy of the doses being tested and to allow for optimization of the trial design of both trials.

The interim analysis was completed and both trials will continue through completion. The results of the interim analysis led to our discontinuing the 18 mg dose arm. Moving forward, all patients in each of the two trials are randomized to either the 36 mg dose arm or placebo until the predetermined total number of patients are enrolled in each of the two trials. We expect patient enrollment to continue through 2018. The Company anticipates data from the P301 trial will be available by the first quarter of 2019 and data from the P302 trial will be available in mid-2019. Patients completing the Phase III trials can continue treatment under our open label extension trial.

Patient screening has been initiated in a Phase III trial for SPN-810 treating IA in adolescents who have ADHD.

SPN-812

SPN-812 is being developed as a novel non-stimulant treatment for ADHD. During 2016, we completed a Phase IIb dose ranging trial and announced positive topline results. We initiated four Phase III clinical trials for SPN-812 in September of 2017. The program consists of four three-arm, placebo-controlled trials: P301 and P302 trials in patients 6-11 years old, and P303 and P304 trials in adolescent patients. Patient enrollment is complete in the P301 trial. Data from this trial is expected to be available in the fourth quarter of 2018. Additionally, we expect data from the remaining three trials to be available by the first quarter of 2019. Patients completing the Phase III trials can continue treatment under our open label extension trial.

We expect to incur significant research and development expenses related to the continued development of each of our product candidates from 2018 through FDA approval or until the program terminates.

Critical Accounting Policies and the Use of Estimates

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The significant accounting policies and bases of presentation for our consolidated financial statements are described in Note 2 Summary of Significant Accounting Policies. The preparation of our consolidated financial statements in accordance with U.S. generally accepted accounting principles (GAAP) requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses and to disclose contingent assets and liabilities. Actual results could differ from those estimates.

We believe the following accounting policies and estimates to be critical:

Revenue Recognition

Revenue from product sales is recognized when control of our products is transferred to our customers, who are wholesalers and pharmaceutical distributors. Product sales are recorded net of various forms of variable consideration, including estimated rebates, chargebacks, allowances, discounts, patient co-pay assistance and other deductions as well as estimated product returns (collectively, sales deductions)

We derive our estimated sales deductions from an analysis of historical levels of deductions specific to each product, as well as contractual terms with our customers, managed care providers and governmental entities. In addition, we also consider the impact of actual or anticipated changes in product price, sales trends and changes in managed care coverage and co-pay assistance programs. We adjust our estimates at the earlier of when the most likely amount of consideration we expect to receive changes or when the consideration becomes fixed. For a complete description of Trokendi XR and Oxtellar XR gross revenues and gross to net adjustments, see Part I, Item 1, Financial Statements, Note 2, Revenue from Product Sales.

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Research and Development Expenses and Related Accrued Clinical Expenses

Research and development expenditures are expensed as incurred. Research and development costs primarily consist of employee-related expenses, including salaries and benefits; share-based compensation expense; expenses incurred under agreements with clinical research organizations (CROs), fees paid to investigators who are participating in our clinical trials, consultants and other vendors that conduct the Company's clinical trials; the cost of acquiring and manufacturing clinical trial materials; the cost of manufacturing materials used in process validation, to the extent that those materials are manufactured prior to receiving regulatory approval for those products and are not expected to be sold commercially; facilities costs that do not have an alternative future use; related depreciation and other allocated expenses; license fees for and milestone payments related to in-licensed products and technologies; and costs associated with animal testing activities and regulatory approvals.

Clinical trials are inherently complex and often involve multiple service providers. Because billing for services often lags by a substantial period of time, we often are required to estimate and accrue a significant portion of our clinical expenses. This process involves reviewing open contracts and communicating with our subject matter expert personnel and the appropriate service provider personnel to identify services that have been performed on our behalf but for which no invoice has been received. We accrue for the estimated but unbilled services performed and the associated cost incurred.

Payments to service providers can either be based on hourly rates for service or based on performance driven milestones. When accruing clinical expenses, we estimate the time period over which services will be performed during the life of the entire clinical program, the total cost of the program, and the level of effort to be expended in each intervening period. To the maximum extent possible, we work with each service provider to obtain an estimate for incurred but unbilled services as of the end of the calendar quarter, including estimates for payments to site investigators.

We work diligently to minimize, if not eliminate, estimates based solely on company generated calculations. If the service provider underestimates or overestimates the cost associated with a trial or service at any given point in time, adjustments to research and development expenses may be necessary in future periods. Historically, our estimated accrued clinical expenses have closely approximated actual expense incurred.

Table of Contents**Results of Operations***Comparison of the three months ended June 30, 2018 and June 30, 2017*

	Three Months ended June 30, 2018		2017 (unaudited, in thousands)		Increase/ (decrease)
Revenue					
Net product sales	\$	97,030	\$	73,328	23,702
Royalty revenue		1,758		1,179	579
Licensing revenue		750		1,322	(572)
Total revenue		99,538		75,829	
Costs and expenses					
Cost of product sales		3,683		3,861	(178)
Research and development		20,038		10,823	9,215
Selling, general and administrative		40,097		35,078	5,019
Total costs and expenses		63,818		49,762	
Operating earnings		35,720		26,067	
Other income (expense)					
Interest income		3,664		656	3,008
Interest expense		(4,324)		(58)	4,266
Interest expense-nonrecourse liability related to sale of future royalties		(1,204)		(160)	1,044
Changes in fair value of derivative liabilities				23	(23)
Loss on extinguishment of debt				(103)	(103)
Total other expenses		(1,864)		358	
Earnings before income taxes		33,856		26,425	
Income tax expense		3,119		9,057	(5,938)
Net earnings	\$	30,737	\$	17,368	

Net Product Sales. The increase in net product sales from 2017 to 2018 is primarily driven by increased prescription volume generated by the launch of the migraine indication for Trokendi XR in April 2017. Price increases in 2017 and 2018 also contributed to the increase in net product sales. Net product sales are based on gross revenue from shipments to wholesalers and distributors, less estimates for discounts, rebates, allowances, returns and other sales deductions.

The table below lists our net product sales by product, in thousands.

	Net Product Sales Three Months ended June 30, 2018		2017 (unaudited)		Change in Net Product Sales (%)
Trokendi XR	\$	76,474	\$	55,989	36.6%

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Oxtellar XR	20,556	17,339	18.6%
Total	\$ 97,030	\$ 73,328	32.3%

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Royalty Revenue. Royalty revenue includes royalty from net product sales of Shire Plc's (Shire) product, Mydayis, and non-cash royalty revenue from the Healthcare Royalty Partners III, L.P. (HC Royalty) agreement. Non-cash royalty revenue for the three months ended June 30, 2018 and 2017 was \$1.5 million and \$1.2 million, respectively. The increase is primarily due to increased non-cash royalty revenue as a result of increased sales of Orenitram.

Licensing Revenue. There was \$750,000 in milestone revenue earned during the three months ended June 30, 2018. Total licensing revenue for the three months ended June 30, 2017 was \$1.3 million. The decrease from prior year is primarily due to the adoption of the new revenue recognition standard, Accounting Standards Codification (ASC) 606, which resulted in accelerated amortization of previously deferred up-front license revenue. The impact of the adoption was recorded as an adjustment to the opening balance of retained earnings in 2018.

Cost of Product Sales. Cost of product sales during the three months ended June 30, 2018 was \$3.7 million, a decrease of approximately \$200,000 as compared to \$3.9 million for the three months ended June 30, 2017. The quarter over quarter decrease is attributable primarily to manufacturing efficiencies, partially offset by higher unit volume.

Research and Development Expense. Research and development (R&D) expenses during the three months ended June 30, 2018 were \$20.0 million as compared to \$10.8 million for the three months ended June 30, 2017, an increase of \$9.2 million. This increase is primarily due to the initiation of the four Phase III clinical trials for SPN-812, ongoing patient recruitment for the Phase III trials for SPN-810, and their related open label extension trials.

The table below shows the comparison of selling and marketing and general and administrative expenses for the three months ended June 30, 2018 and 2017:

	Selling, General and Administrative Expense			Change (%)
	Three Months ended June 30,			
	2018	2017		
	(unaudited, in thousands)			
Selling and Marketing	\$ 31,421	\$ 27,766		13.2%
General and Administrative	8,676	7,312		18.7%
Total	\$ 40,097	\$ 35,078		14.3%

Selling and Marketing. Selling and marketing expenses increased by approximately \$3.7 million for the three months ended June 30, 2018 as compared to 2017. Approximately \$1.4 million of the total increase is due to increased compensation, benefits and other employee-related expenses associated with increased headcount in our field salesforce and headcount related expenses. In addition, approximately \$2.0 million of the total increase is due to increased expenses for promotional and marketing programs, speaker programs, and consulting services to support our

commercial products, particularly the migraine indication for Trokendi XR.

General and Administrative. General and administrative expenses (G&A) increased by \$1.4 million for the three months ended June 30, 2018, as compared to 2017. Of this total, approximately \$1.0 million is due to increased compensation, benefits and other employee-related expenses associated with increased administrative headcount, and approximately \$300,000 is due to an increase in patent amortization expense.

Interest Income. For the three months ended June 30, 2018 and 2017, we recognized \$3.7 million and approximately \$700,000, respectively, of interest income earned on our cash, cash equivalents and marketable securities. The increase is primarily attributable to an increase in cash, cash equivalents and marketable securities holdings year over year and the net proceeds from the issuance of \$402.5 million of 0.625% Convertible Senior Notes due 2023 (2023 Notes).

Interest Expense. Interest expense was \$4.3 million for the three months ended June 30, 2018 as compared to approximately \$58,000 for the three months ended June 30, 2017. The increase of \$4.3 million was primarily due to the interest on the 2023 Notes, which were issued in 2018. Of the increase, non-cash interest expense from the amortization of deferred financing costs on the 2023 Notes was \$3.7 million for the three months ended June 30, 2018.

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Interest Expense Non-recourse Liability Related to Sale of Future Royalties. Non-cash interest expense related to our non-recourse royalty liability was \$1.2 million for the three months ended June 30, 2018 as compared to \$200,000 for the three months ended June 30, 2017. The increase of \$1.0 million for this non-cash expense was primarily due to changes in the projection of future royalties on Orenitram and the liability amortization term as a result of a favorable settlement of patent litigation for United Therapeutics.

Changes in Fair Value of Derivative Liability. The make-whole fundamental change provision in the Indenture governing the 7.5% Convertible Senior Secured Notes due 2019 (2019 Notes) expired in May 2017. For the three months ended June 30, 2017, we recognized a non-cash gain of approximately \$23,000 related to a change in the estimated fair value of the interest make-whole derivative liability of the 2019 Notes.

Loss on Extinguishment of Debt. There were no 2023 Notes converted in the three months ended June 30, 2018. For the three months ended June 30, 2017, we recognized a non-cash loss on extinguishment of debt of approximately \$100,000 related to the conversion of \$2.0 million aggregate principal amount of the 2019 Notes.

Income Tax. For the three months ended June 30, 2018, we recorded \$3.1 million of income tax expense, a decrease of \$5.9 million as compared to the three months ended June 30, 2017 is primarily due to the reduction of the U.S. corporate income tax rate from, 35% to 21%, as a result of the Tax Cuts and Jobs Act passed on December 22, 2017 and the \$4.4 million tax benefit from the exercise of employee stock options.

Net Earnings. Net earnings for the three months ended June 30, 2018 were \$30.7 million, compared to net earnings of \$17.4 million during the three months ended June 30, 2017, an increase of \$13.3 million. This increase was primarily due to the revenue generated from our two commercial products, Trokendi XR and Oxtellar XR, and lower income tax expense, partially offset by an increase in R&D and SG&A spending.

Comparison of the six months ended June 30, 2018 and June 30, 2017

	Six Months ended June 30,		Increase/ (decrease)
	2018	2017	
	(unaudited, in thousands)		
Revenues:			
Net product sales	\$ 186,150	\$ 129,697	56,453
Royalty revenue	3,067	2,328	739
Licensing revenue	750	1,380	(630)
Total revenues	189,967	133,405	
Costs and expenses			
Cost of product sales	6,961	6,809	152

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Research and development	38,946	20,425	18,521
Selling, general and administrative	76,946	63,316	13,630
Total costs and expenses	122,853	90,550	
Operating income	67,114	42,855	
Other income (expense)			
Interest income	4,870	1,187	3,683
Interest expense	(5,041)	(147)	4,894
Interest expense-nonrecourse liability related to sale of future royalties	(1,905)	(1,119)	786
Changes in fair value of derivative liabilities		76	(76)
Loss on extinguishment of debt		(204)	(204)
Total other expenses	(2,076)	(207)	
Earnings before income taxes	65,038	42,648	
Income tax expense	7,949	14,983	(7,034)
Net earnings	\$ 57,089	\$ 27,665	

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Net Product Sales. The increase in net product sales from 2017 to 2018 is primarily driven by increased prescription volume generated by the migraine indication for Trokendi XR. Price increases in 2017 and 2018 also contributed to the increase in net product sales. Net product sales are based on gross revenue from shipments to wholesalers and distributors, less estimates for discounts, rebates, allowances, returns and other sales deductions.

The table below lists our net product sales by product, in thousands.

	Net Product Sales Six Months ended June 30, 2018		2017		Change in Net Product Sales (%)
	(unaudited)				
Trokendi XR	\$	147,029	\$	97,998	50.0%
Oxtellar XR		39,121		31,699	23.4%
Total	\$	186,150	\$	129,697	43.5%

Royalty Revenue. Royalty revenue includes royalty from net product sales of Shire's product, Mydayis, and non-cash royalty from the HC Royalty agreement. Non-cash royalty revenue for the six months ended June 30, 2018 and 2017 was \$2.8 million and \$2.3 million, respectively. The increase is primarily due to increased non-cash royalty revenue as a result of increased sales of Orenitram.

Licensing Revenue. There was \$750,000 in milestone revenue earned during the six months ended June 30, 2018. Total licensing revenue for the six months ended June 30, 2017 was \$1.4 million. The decrease from prior year is primarily due to the adoption of ASC 606, which resulted in accelerated amortization of previously deferred up-front license revenue. The impact of the adoption was recorded as an adjustment to the opening balance of retained earnings in 2018.

Cost of Product Sales. Cost of product sales during the six months ended June 30, 2018 was \$7.0 million, an increase of approximately \$200,000 as compared to \$6.8 million for the six months ended June 30, 2017. The period over period increase is attributable primarily to increased product unit volume, partially offset by manufacturing efficiencies.

Research and Development Expense. R&D expenses during the six months ended June 30, 2018 were \$38.9 million as compared to \$20.4 million for the six months ended June 30, 2017, an increase of \$18.5 million. This increase is primarily due to the initiation of the four Phase III clinical trials for SPN-812, ongoing patient recruitment for the Phase III trials for SPN-810, and their related open label extension trials.

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The table below shows the comparison of selling and marketing and general and administrative expenses for the six months ended June 30, 2018 and 2017:

Selling, General and Administrative Expense					
Six Months ended June 30,					
		2018		2017	Change (%)
(unaudited, in thousands)					
Selling and Marketing	\$	59,015	\$	49,676	18.8%
General and Administrative		17,931		13,640	31.5%
Total	\$	76,946	\$	63,316	21.5%

Selling and Marketing. Selling and marketing expenses increased by approximately \$9.3 million for the six months ended June 30, 2018 as compared to 2017. Approximately \$4.7 million of the total increase is due to increased compensation, benefits and other employee-related expenses associated with increased headcount in our field salesforce and headcount related expenses. In addition, approximately \$4.1 million of the total increase is due to increased expenses for promotional and marketing programs, speaker programs, and consulting services to support our commercial products, particularly the migraine indication for Trokendi XR.

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General and Administrative. G&A expenses increased by \$4.3 million for the six months ended June 30, 2018, as compared to 2017. Of this total, approximately \$2.4 million is due to increased compensation, benefits and other employee-related expenses associated with increased administrative headcount, approximately \$1.1 million is due to an increase in patent amortization expense, and approximately \$900,000 is due to increased professional and consulting services.

Interest Income. For the six months ended June 30, 2018 and 2017, we recognized \$4.9 million and \$1.2 million, respectively, of interest income earned on our cash, cash equivalents and marketable securities. The increase is primarily attributable to an increase in cash, cash equivalents and marketable securities holdings period over period as a result of the net proceeds from the issuance of the 2023 Notes.

Interest Expense. Interest expense was \$5.0 million for the six months ended June 30, 2018 as compared to approximately \$150,000 for the six months ended June 30, 2017. The increase of \$4.9 million was primarily due to the interest on the 2023 Notes entered into in March 2018. Of the increase, non-cash interest expense related to the amortization of deferred financing costs on the 2023 Notes was \$4.3 million for the six months ended June 30, 2018.

Interest Expense Non-recourse Liability Related to Sale of Future Royalties. Non-cash interest expense related to our non-recourse royalty liability was \$1.9 million for the six months ended June 30, 2018 as compared to \$1.1 million for the six months ended June 30, 2017. The increase of approximately \$800,000 for this non-cash expense was primarily due to changes in the projected sales of Orenitram and the liability amortization term as a result of favorable settlement of patent litigation for United Therapeutics.

Changes in Fair Value of Derivative Liability. The make-whole fundamental change provision in the Indenture governing the 2019 Notes expired in May 2017. For the six months ended June 30, 2017, we recognized a non-cash gain of approximately \$76,000 related to a change in the estimated fair value of the interest make-whole derivative liability of the 2019 Notes.

Loss on Extinguishment of Debt. There were no 2023 Notes converted in the six months ended June 30, 2018. For the six months ended June 30, 2017, we recognized a non-cash loss on extinguishment of debt of approximately \$200,000 related to the conversion of \$2.0 million aggregate principal amount of the 2019 Notes.

Income Tax. For the six months ended June 30, 2018, we recorded \$7.9 million of income tax expense. As compared to 2017, this decrease of \$7.0 million is primarily due to the reduction of the U.S. corporate income tax rate from, 35% to 21%, as a result of the Tax Cuts and Jobs Act passed on December 22, 2017 and the \$6.4 million tax benefit from the exercise of employee stock options.

Net Earnings. Net earnings for the six months ended June 30, 2018 were \$57.1 million, compared to net earnings of \$27.7 million during the six months ended June 30, 2017, an increase of \$29.4 million. This increase was primarily due to the revenue generated from our two commercial products, Trokendi XR and Oxtellar XR, and lower income tax expense, partially offset by an increase in R&D and SG&A spending.

Liquidity and Capital Resources

We believe our increasing levels of net product sales will be sufficient to finance our operations in 2018 and subsequent years, including the increased R&D expenses for our clinical trials, increased expenses to support our commercial products, and the increased expenses in anticipation of launching our product candidates. We expect to incur R&D expenses for the remainder of 2018 at levels similar to that incurred in the first six months to support the development of SPN-810 and SPN-812, including their respective Phase III trials. We expect our selling, general and administrative expenses to continue to increase for the foreseeable future, as we continue to invest in the commercialization of Trokendi XR and Oxtellar XR, and in areas such as compliance, finance, management of our intellectual property portfolio, information technology systems, and personnel, in each case, commensurate with the growth of our business.

Our working capital at June 30, 2018 was \$180.6 million, an increase of \$75.1 million compared to our working capital of \$105.5 million at December 31, 2017. In addition, our long term marketable securities at June 30, 2018 were \$503.3 million, an increase of \$369.7 million, as compared to \$133.6 million at December 31, 2017. This increase is primarily attributable to the net proceeds generated by the issuance of the 2023 Notes.

Our stockholders' equity increased by \$123.0 million during the six-month period ended June 30, 2018, primarily as a result of net earnings, option exercises, share-based compensation and the issuance of the 2023 Notes and warrants, partially offset by the purchase of convertible note hedges.

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On March 14, 2018, we issued \$402.5 million in aggregate principal amount of 2023 Notes pursuant to an indenture, dated as of March 19, 2018 (the Indenture) between us and Wilmington Trust, National Association, as trustee. The Indenture includes customary terms and covenants, including certain events of default after which the 2023 Notes may be due and payable immediately. Interest on the 2023 Notes, at an annual rate of 0.625%, is payable semi-annually in arrears on April 1 and October 1 of each year. As of June 30, 2018, the outstanding aggregate principal amount of 2023 Notes was \$402.5 million. We will settle conversions of the 2023 Notes by paying or delivering, as applicable, cash, shares of our common stock or a combination of cash and shares of our common stock, at our election, based on the applicable conversion rate. The initial conversion rate is 16.8545 shares per \$1,000 principal amount of the 2023 Notes, which represents an initial conversion price of approximately \$59.33 per share, and is subject to adjustments specified in the Indenture. We may not redeem the 2023 Notes at our option before maturity.

We also entered into separately negotiated convertible note hedge transactions (collectively, the Convertible Note Hedge Transactions). The Convertible Note Hedge Transactions cover, subject to customary anti-dilution adjustments substantially similar to those applicable to the 2023 Notes, the number of shares of our common stock underlying the 2023 Notes. Concurrently with entering into the Convertible Note Hedge Transactions on each such date, we also entered into separate privately negotiated warrant transactions (collectively, the Warrant Transactions) whereby we sold warrants to purchase, subject to customary anti-dilution adjustments, up to the same number of shares of our common stock. The Convertible Note Hedge Transactions and the Warrant Transactions are separate contracts entered into by the Company. The Convertible Note Hedge Transactions are expected to reduce generally the potential dilution with respect to the Company's common stock upon conversion of the 2023 Notes and/or offset any potential cash payments we are required to make in excess of the principal amount of converted Notes, as the case may be, upon any conversion of the 2023 Notes. The Warrant Transactions are intended to partially offset the cost to the purchased Convertible Note Hedge Transactions; however, the Warrant Transactions could have a dilutive effect with respect to our common stock to the extent that the market price per share of our common stock, as measured under the terms of the Warrant Transactions, exceeds the strike price of the warrants, or \$80.9063 per share of Company's common stock.

We achieved positive cash flow and profitability from operations in the six months ended June 30, 2018 and 2017. While we expect continued profitability in 2018 as we continue to increase sales, we anticipate there may be significant variability from quarter to quarter in our level of profitability due to increasing spending to advance our clinical product candidates.

Cash Flows

The following table sets forth the major sources and uses of cash for the periods set forth below (summarized, in thousands):

	Six Months ended June 30,		
	2018	2017	Change
	(unaudited)		
Net cash provided by (used in):			
Operating activities	\$ 33,689	\$ 39,300	\$ (5,611)
Investing activities	(473,147)	(46,125)	(427,022)
Financing activities	374,359	2,164	372,195
Net decrease in cash and cash equivalents	\$ (65,099)	\$ (4,661)	\$ (60,438)

Table of Contents**Operating Activities**

Net cash provided by operating activities is comprised of two components: cash provided by operating earnings and cash provided by changes in working capital.

Results for the six months ended June 30, 2018 and June 30, 2017 are summarized below, in thousands:

	Six Months ended June 30,		
	2018	2017	Change
	(unaudited)		
Cash provided by operating earnings	\$ 67,481	\$ 44,150	\$ 23,331
Cash used in working capital	(33,792)	(4,850)	(28,942)
Net cash provided by operating activities	\$ 33,689	\$ 39,300	\$ (5,611)

The decrease in net cash provided by operating activities is primarily driven by an increase in cash used in working capital due to payments of income taxes.

The changes in certain operating assets and liabilities are, in thousands:

	Six Months ended June 30,		
	2018	2017	Explanation of Change
	(unaudited)		
Increase in accounts receivable	\$ (7,776)	\$ (9,630)	Increased product sales offset by timing of cash collections.
Increase (decrease) in inventory	(4,376)	178	Increased inventory volume production resulting from increased product demand following launch of the migraine indication of Trokendi XR.
Decrease in prepaid expenses, other current assets, and other non-current assets	(8,402)	(1,791)	Progress of clinical trials and timing differences primarily related to prepayment of drug regulatory fees in fourth quarter of 2017 and income tax payments in 2018.
Increase in accounts payable, accrued sales deductions and accrued expenses	827	4,445	Timing of vendor payments and increased accrued sales deductions due to increased product sales.
Increase (decrease) in income taxes payable	(15,938)	1,601	Timing of income tax payments.
Other	1,873	347	
	\$ (33,792)	\$ (4,850)	

Investing Activities

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We invest excess cash in marketable securities in accordance with our investment policy. Marketable securities consist of investments which mature in four years or less, including U.S. Treasury and various government agency debt securities, as well as investment grade securities in industrial and financial institutions. Fluctuations in investing activities between periods relate exclusively to the timing of marketable security purchases and the related maturities of these securities.

Net cash used in investing activities for the six months ended June 30, 2018 of \$473.1 million primarily relates to net purchases of marketable securities of \$472.2 million. Net cash used in investing activities for the six months ended June 30, 2017 of \$46.1 million related to net purchase of marketable securities of \$36.0 million, patent defense costs of \$9.2 million, and property and equipment purchases of approximately \$900,000.

Table of Contents**Financing Activities**

Net cash provided by financing activities of \$374.4 million for the six months ended June 30, 2018 is from proceeds from the issuance of the 2023 Notes, the Warrant Transactions, and the issuance of common stock due to stock option exercises, partially offset by payments made for the Convertible Note Hedge Transactions and financing costs.

Net cash provided by financing activities of \$2.2 million for the six months ended June 30, 2017 is from proceeds from the issuance of common stock due to stock option exercises.

Contractual Obligations and Commitments

The following table summarizes our contractual obligations and commitments as of June 30, 2018 (except as noted below), in thousands, unaudited:

Contractual Obligations	Less than 1 Year	1 - 3 Years	3 - 5 Years	Greater than 5 Years	Total
Convertible Senior Notes (1)	\$	\$	\$ 402,500	\$	\$ 402,500
Interest on Convertible Notes (1)	2,516	5,031	4,402		11,949
Operating Leases (2)	3,420	7,582	4,238	26,109	41,349
Purchase Obligations (3)	151,171	2,236	39		153,446
Total (4)	\$ 157,107	\$ 14,849	\$ 411,179	\$ 26,109	\$ 609,244

(1) Relates to the 2023 Notes (see Note 8 in the Notes to the Consolidated Financial Statements in Part I.)

(2) Our commitments for operating leases relate to our lease of office equipment, fleet vehicles and lease of current and new headquarters office and laboratory space as of June 30, 2018. We have the right to terminate the new headquarters lease if, by September 30, 2018, the landlord fails to obtain certain site approval pre-requisites per the lease agreement.

(3) Relates primarily to agreements and purchase orders with contractors and vendors.

(4) This table does not include (a) any milestone payments which may become payable to third parties under license agreements or contractual agreements regarding our clinical trials, as the timing and likelihood of such payments are not known, (b) any royalty payments to third parties as the amounts, timing and likelihood of such payments are not known and (c) contracts that are entered into in the ordinary course of business which are not material in the aggregate in any period presented above.

(5) As of June 30, 2018, we had liabilities related to uncertain tax positions. Due to uncertainties in the timing of potential tax audits, the timing of the resolution of these positions is uncertain and we are unable to make a reasonably reliable estimate of the timing of payments in individual years beyond 12 months. As a result, liabilities related to uncertain tax positions are not included in the above table.

In addition to the above table, we are contractually obligated to pay to HC Royalty all royalty payments earned under a licensing agreement with United Therapeutics. Although we have recorded a liability of \$25.5 million at June 30, 2018 related to this obligation, it is a non-recourse liability for which we have no obligation to make any cash payments to HC Royalty. Accordingly, this obligation will have no impact on our liquidity at any time. Therefore, the non-recourse liability has not been included in the table above.

We have obtained exclusive licenses from third parties for proprietary rights to support the product candidates in our psychiatry portfolio. We have two license agreements with Afecta Pharmaceuticals, Inc. (Afecta) pursuant to which we obtained exclusive worldwide rights to selected product candidates, including an exclusive license to SPN-810. We may pay up to \$300,000 upon the achievement of certain milestones. If a product candidate is successfully developed and commercialized, we will be obligated to pay royalties to Afecta at a low single digit percentage of worldwide net product sales.

We have also entered into a purchase and sale agreement with Rune HealthCare Limited (Rune), where we obtained the exclusive worldwide rights to a product concept from Rune. There are no future milestone payments owing to Rune under this

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agreement. If we receive approval to market and sell any products based on the Rune product concept for SPN-809, we will be obligated to pay royalties at a low single digit percentage of worldwide net sales.

Off-Balance Sheet Arrangements

We do not currently have, nor have we ever had, any relationships with unconsolidated entities or financial partnerships, such entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or for other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts.

Recently Issued Accounting Pronouncements

For a discussion of new accounting pronouncements, see Note 2 in the Notes to the Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The primary objective of our investment activities is to preserve our capital to fund operations and to facilitate business development activities. We also seek to maximize income from our investments without assuming significant interest rate or liquidity risk. Our exposure to market risk is confined to our cash, cash equivalents, marketable securities and long term marketable securities. As of June 30, 2018, we had unrestricted cash, cash equivalents, marketable securities and long term marketable securities of \$677.7 million. We do not engage in any hedging activities against changes in interest rates. Because of the short-term maturities of our cash, cash equivalents, marketable securities and long term marketable securities and because we generally hold these securities to maturity, we do not believe that an increase in market rates would have any significant impact on the realizable value of our investments. We do not have any currency or other derivative financial instruments other than the outstanding warrants to purchase common stock and the convertible note hedges.

We may contract with CROs and investigational sites globally. Currently, we do not have ongoing trials outside the United States. We do not hedge our foreign currency exchange rate risk. Transactions denominated in currencies other than the U.S. dollar are recorded based on exchange rates at the time such transaction arises. As of December 31, 2017, substantially all of our total liabilities were denominated in the U.S. dollar. Inflation generally affects us by increasing our cost of labor and clinical trial costs. We do not believe that inflation and changing prices over the six months ended June 30, 2018 and 2017 had a significant impact on our consolidated results of operations.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Our disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed by us in the reports we file or submit under the Exchange Act has been appropriately recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, to allow timely decisions regarding required disclosure.

We conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2018, the end of the period covered by this report. Based on that evaluation, under the supervision and with the participation of our management, including our CEO and CFO, we concluded that our disclosure controls and procedures were effective as of June 30, 2018.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

From time to time and in the ordinary course of business, we are subject to various claims, charges and litigation. We may be required to file infringement claims against third parties for the infringement of our patents. We have filed such claims for infringement of the Orange Book patents listed for our product Oxtellar XR.

Supernus Pharmaceuticals, Inc. v. TWi Pharmaceuticals, Inc., et al., C.A. No. 15-369 (RMB)(JS) (D.N.J.)

Supernus Pharmaceuticals, Inc. v. TWi Pharmaceuticals, Inc., et al., Appeal No. 2017-2513 (Fed. Cir.)

We received a Paragraph IV Notice Letter against United States Patent Nos. 7,722,898, 7,910,131, 8,617,600, and 8,821,930 from generic drug maker TWi Pharmaceuticals, Inc. on December 9, 2014. On January 16, 2015, we filed a lawsuit against TWi Pharmaceuticals, Inc. and TWi International LLC (d/b/a TWi Pharmaceuticals USA) (collectively TWi) alleging infringement of United States Patent Nos. 7,722,898, 7,910,131, 8,617,600, and 8,821,930. The Complaint filed in the U.S. District Court for the District of New Jersey alleged, inter alia, that TWi infringed our Oxtellar XR patents by submitting to the FDA an ANDA seeking to market a generic version of Oxtellar XR prior to the expiration of our patents. On February 13, 2015, TWi answered the Complaint and denied the substantive allegations of the Complaint. TWi also asserted Counterclaims seeking declaratory judgments of non-infringement and invalidity of United States Patent Nos. 7,722,898 and 7,910,131. On March 20, 2015, we filed our Reply, denying the substantive allegations of those Counterclaims. A four-day bench trial was held between April 3 and April 6, 2017. On August 15, 2017, the Court issued an opinion and order finding that: (i) TWi's ANDA products infringe United States Patent Nos. 7,722,898, 7,910,131, and 8,821,930; and (ii) United States Patent Nos. 7,722,898, 7,910,131, and 8,821,930 are not invalid. The Court entered a final judgment on August 28, 2017: (i) enjoining the FDA from approving TWi's ANDA before the expiration date of United States Patent Nos. 7,722,898, 7,910,131, and 8,821,930; and (ii) enjoining TWi from commercially manufacturing, using, offering to sell, or selling within the United States, or importing into the United States, TWi's ANDA products until the expiration of United States Patent Nos. 7,722,898, 7,910,131, and 8,821,930. On August 31, 2017, TWi filed a Notice of Appeal to the United States Court of Appeals for the Federal Circuit. The appeal was briefed and oral arguments were heard by the U.S. Court of Appeals for the Federal Circuit on August 6, 2018.

Supernus Pharmaceuticals, Inc. v. TWi Pharmaceuticals, Inc., et al., C.A. No. 17-2164 (RMB)(JS) (D.N.J.)

We received a second Paragraph IV Notice Letter against United States Patent Nos. 7,722,898, 7,910,131, 8,617,600, 8,821,930, 9,119,791, 9,351,975, and 9,370,525 from generic drug maker TWi Pharmaceuticals, Inc. on February 16, 2017. On March 31, 2017, we filed a lawsuit against TWi Pharmaceuticals, Inc. and TWi International LLC alleging infringement of United States Patent Nos. 7,722,898, 7,910,131, 8,617,600, 8,821,930, 9,119,791, 9,351,975, and 9,370,525. TWi filed a motion to dismiss Supernus's March 31, 2017 Complaint on May 10, 2017. On May 19, 2017, the Court administratively terminate[d] this matter pending this Court's decision in the First TWi Action [concerning United States Patent Nos. 7,722,898, 7,910,131, 8,617,600, and 8,821,930]. As of the date of this filing, Civil Action No. 17-2164 (RMB)(JS) (D.N.J.) remains administratively terminated.

Item 1A. Risk Factors

Any investment in our business involves a high degree of risk. Before making an investment decision, you should carefully consider the information we include in this Quarterly Report on Form 10-Q, including our consolidated financial statements and related notes, and the additional information in the other reports we file with the Securities and Exchange Commission along with the risks described in our Annual Report on Form 10-K for the year ended December 31, 2017 and Quarterly Report on Form 10-Q for the quarter ended March 31, 2018. These risks may result in material harm to our business and our financial condition and results of operations. In such an eventuality, the market price of our common stock may decline and you could lose part or all of your investment.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Sales of Unregistered Securities.

During the three months ended June 30, 2018, the Company granted options to employees to purchase an aggregate of 35,013 shares of common stock at a weighted-average exercise price of \$48.59 per share. Once vested, the options are exercisable for a period of ten years from the grant date. These issuances were exempt from registration in reliance on Section 4(a)(2) of the Securities Act as transactions not involving any public offering.

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Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

None

Item 5. Other Information

None

Item 6. Exhibits

The following exhibits are filed or furnished as part of this Quarterly Report on Form 10-Q:

- | | |
|---------|--|
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a). |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a). |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document. |
| 101.SCH | XBRL Taxonomy Extension Schema Document. |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document. |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document. |
| 101.LAB | XBRL Taxonomy Extension Label/Linkbase Document. |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document. |

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EXHIBIT INDEX

Number	Description
31.1	<u>Certification of Chief Executive Officer pursuant to Rule 13a-14(a).</u>
31.2	<u>Certification of Chief Financial Officer pursuant to Rule 13a-14(a).</u>
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101.INS	XBRL Instance Document.
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101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label/Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

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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.

SUPERNUS PHARMACEUTICALS, INC.

DATED: August 9, 2018

By: */s/ Jack A. Khattar*
Jack A. Khattar
President, Secretary and Chief Executive Officer

DATED: August 9, 2018

By: */s/ Gregory S. Patrick*
Gregory S. Patrick
Vice President and Chief Financial Officer