Q2 2014 US health services deals insights

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A publication from the PwC's Deals practice

pwc

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The heart of the matter

Q2 2014 US health services deals insights

With the first half of 2014 behind us, we see a steady pace in the volume of deals for the health services sectors from the first to second quarters with 143 and 138 announced deals (281 total deals), respectively. This volume is also consistent on a year to date basis with 2013 and its 289 announced deals. However, we also note that on a quarterly basis, the second quarter of 2014's deal volume (138 deals) has declined almost 13% from the same period in 2013 (158 deals).

In contrast to the overall health services deal volume, the disclosed value of the period's deals has risen 43% from $17.2 billion in the first half of 2013 to $24.6 billion in the first half of 2014. However, we qualify this increase with the disclaimer that deal value is heavily dependent on public disclosure of deal value and deal volume may be the better indicator of deal appetite.

For the majority of the sectors and consistent with the overall trend, we see reduced sector deal volumes from the first half of 2013 to the first half of 2014. The most notable decreases are seen in hospitals (-50%), behavioral health (-50%), and home health (-25%). With only a 7% decrease in deal volume, the physician practice sector may consider itself unscathed compared to these other sectors. Most notable is the acquisition of Sheridan Healthcare by AmSurg Corp.

Sectors experiencing volume upticks in the first half of 2014 compared to the first half of 2014 include managed care (160%) and long term care (20%). In the managed care sector, strategic buyers continue to seek membership volume and infrastructure related opportunities related opportunities through acquisitions to offset potentially lower margins under the ACA and to better manage the shift toward population health strategies. In long term care, the period's activity was primarily marked by Ventas's acquisition of American Realty Capital—accounting for over half of the sector's deal value for the second quarter.

For private equity, fortune seems to be favoring the sellers as higher multiples and an influx of strategic buyers attract divestitures. Conversely, many private equity buyers are shying away from competitive auction processes with the risk of overpricing.

Finally, as our Spotlight Article this quarter, we provide insight into the role that mergers and acquisitions have played in facilitating innovation and introducing new entrants to the healthcare economy.

An in-depth discussion

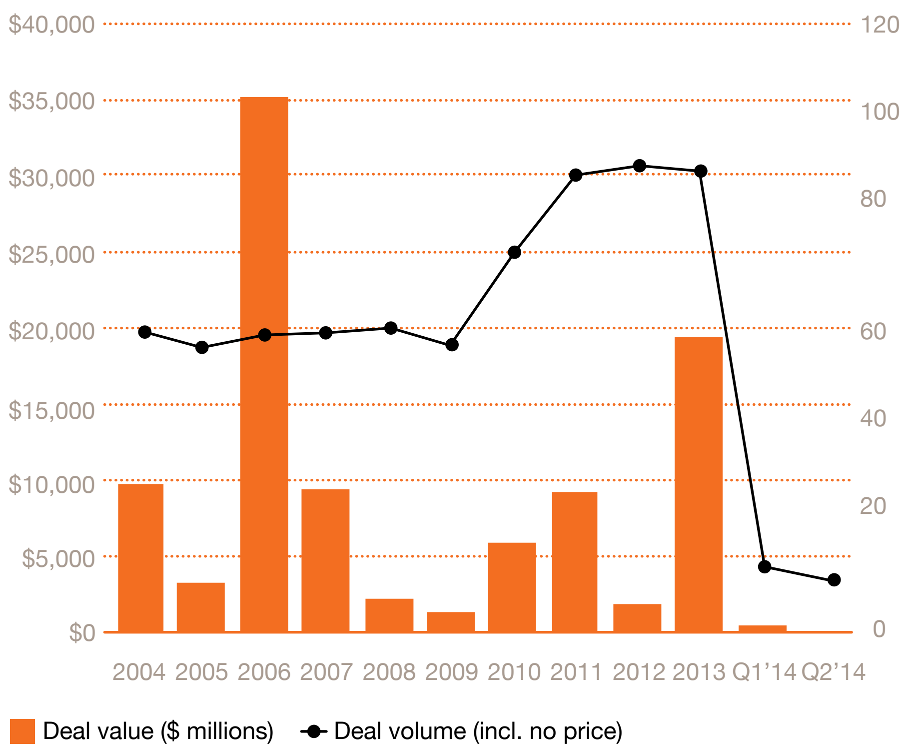
Deal activity in Q2 2014

Sector synopses: Hospitals

During Q2 2014, deal volume experienced a decrease when compared to Q2 2013. The total volume of hospital transactions was down from 22 in Q2 2013 to 7 in Q2 2014, a decrease of approximately 68%. Q2 2014 volume also fell short of Q1 2014 volume by about 42% (down from 12 transactions in Q1 2014). Q2 2014 hospital sector deals did not have a disclosed value, as a majority of the transactions involved not for profit entities in some capacity.

Although the deal volume indicators for reported and closed hospital transactions decreased between 2014 and 2013, there are many active discussions across the US regarding consolidations/mergers among hospitals and health systems, which are not reflected in the figures based on the stage of the potential deal. Activity in this sector will continue for the foreseeable future as consolidation continues in all aspects of the hospital space regardless of the for profit or not-for profit status of a facility or system.

Figure 1: Hospitals



Source: *The Health Care M&A Information Source*, www.healthcareMandA.com

Q2 2014 selected deals

Table A

Announcement date	Target	Acquiror	Deal value $ (million)
1-Apr-14	Fairmont General Hospital	Alecto Healthcare Services, LLC	ND
10-Apr-14	Community Memorial Healthcenter	VCU Health System	ND
15-May-14	Cadence Health	Northwestern Memorial Healthcare	ND
3-Jun-14	Texas Regional Medical Center at Sunnyvale	Tenet Healthcare Corporation	ND
3-Jun-14	Rutherford Regional Health System	Duke LifePoint Healthcare	ND
23-Jun-14	Botsford Health Care and Oakwood Healthcare	Beaumont Health System	ND

ND = not disclosed

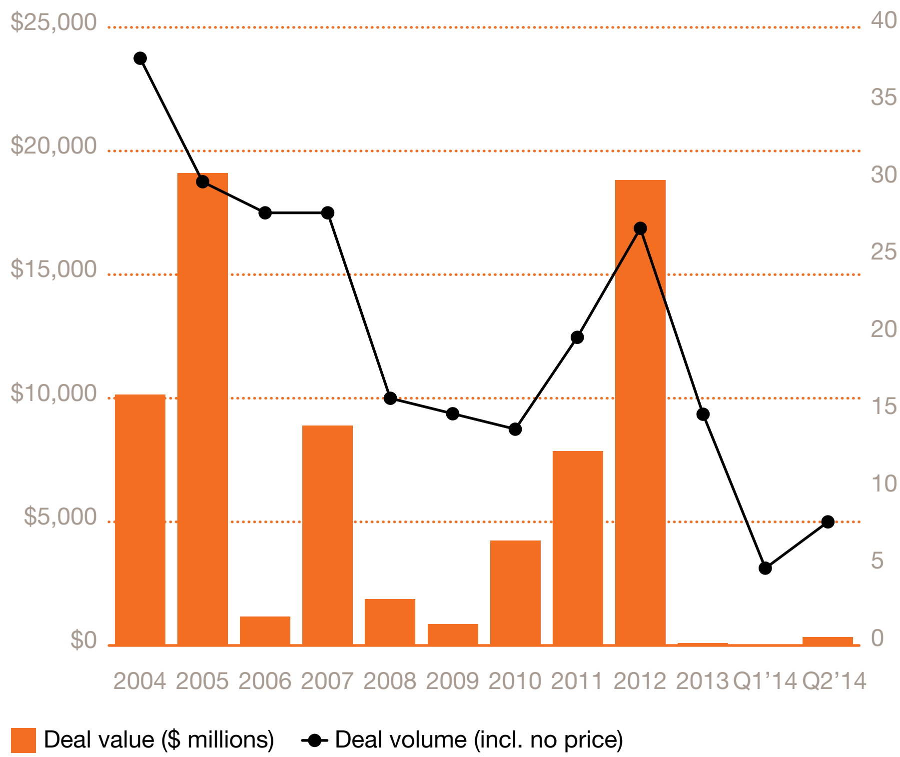
Source: *The Health Care M&A Information Source*, www.healthcareMandA.com

Managed care

M&A activity in the managed care sector showed improvement in the first half of 2014 as deal volume more than doubled when compared to the first half of 2013 (13 deals in the first half of 2014 versus 5 deals in the first half of 2013). Dollar value for deals with a disclosed value was $330 million in Q2 2014. Of the $330 milion, $125 million related to Centene's acquisition of Community Health Solutions of America Inc's Lousiana Medicaid contract.

Moving forward into 2014, an increase in M&A activity is still likely as managed care companies comply with the necessary regulatory and operational requirements and seek opportunities through acquisitions to balance uncertainty and potential financial losses as a result of ACA.

Figure 2: Managed care



Source: *The Health Care M&A Information Source*, www.healthcareMandA.com

Q2 2014 selected deals

Table B

Announcement date	Target	Acquiror	Deal value $ (million)
02-Apr-14	QualChoice Holdings	Catholic Health Initiatives	NA
09-Apr-14	Premier Access Insurance Company	The Guardian Life Insurance Co.	NA
14-Apr-14	North American Partners in Anesthesia	FOAA Anesthesia Services	NA
05-Jun-14	Louisiana State Contract	Centene Corporation	$125

Source: *The Health Care M&A Information Source*, www.healthcareMandA.com

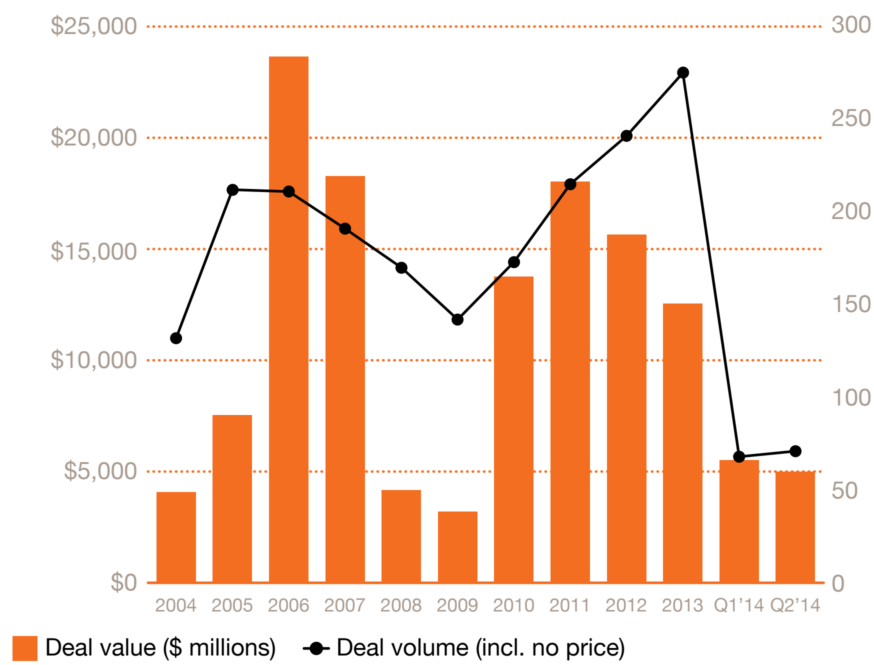
Post-acute care

Long-term care: This sector is still leading the health services market in both deal volume and deal value, but has remained fairly level in volume as compared to Q2 2013 numbers, but achieving a 70% increase in deal value. Both volume and value have dropped in comparison to Q1 2014.

The largest transaction was by Ventas, Inc, and their acquisition American Realty Capital. This one transaction accounted for over half of the total deals that occurred by value.

Home health and rehabilitation: Rehabilitation has picked up from the previous quarter largely due to an $11 million deal by U.S. Physical Therapy. Home health and hospice have also increased in volume from the previous quarter (values were not released), but have again fallen short of the previous years' comparison.

Figure 3: Post-acute—Long term care, home health and rehabilitation



Source: *The Health Care M&A Information Source*, www.healthcareMandA.com

2014 selected deals

Table C

Announcement date	Target	Acquiror	Deal value $ (million)
02-Jun-14	American Realty Capital	Ventas, Inc.	$2,600
02-Jun-14	29 senior living communities	Ventas, Inc.	900
20-May-14	7 retirement communities	Regal Lifestyle Communities, Inc.	147
18-Jun-14	4 senior living communities	Focus Healthcare Partners, LLC	136
Other			1,011
Long-term care			4,984
# of deals			57
Home health care & hospice			N/P
# of deals			9
Rehabilitation			11
# of deals			5
Total post-acute			4,995
# of deals			71

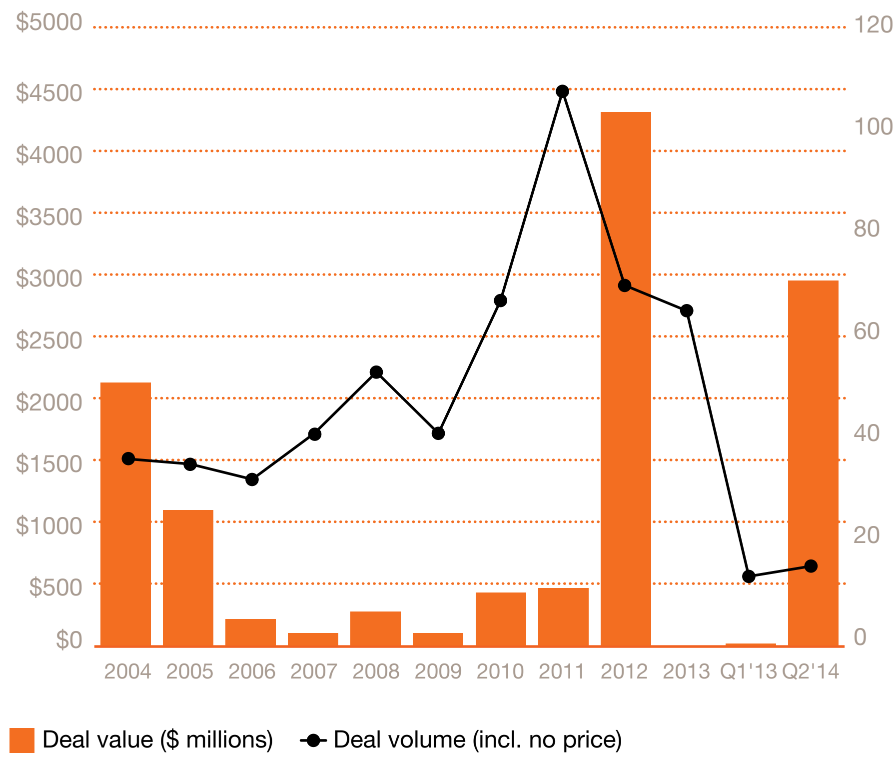
Source: *The Health Care M&A Information Source*, www.healthcareMandA.com

Physician practices

Announced deal volumes of 15 deals in Q2 2014 was up slightly from the 13 deals reported in Q1 2014; however, announced deal values increased substantially due to the acquisition of Sheridan Healthcare, Inc. by Amsurg Corp. for $2.35 billion. This acquisition represents the largest announced deal in the sector since Davita's 2012 acquisition of Healthcare Partners, LLC.

Additionally, MEDNAX and IPC The Hospitalist Company each announced three deals in Q2 2014 continuing their recent trend of several announced deals per quarter.

Figure 4: Physician medical group



Source: *The Health Care M&A Information Source*, www.healthcareMandA.com

Private equity

Private equity transactions in Q2 2014 increased to 18 announced deals from 8 in Q2 2013. Investor appetite continues to be for healthcare services other than hospitals and payers. The majority of transactions continue to be auction processes involving many interested parties as opposed to proprietary sourced transactions. Sellers are generally being rewarded for putting their businesses for sale through frothy auction processes with fairly high expectations on price. Indeed, we have observed that many private equity firms have decided to opportunistically sell portfolio companies that otherwise may have been held for a few more years given that current multiples are high and the appetite for deals is large. Our outlook for transactions in the second half of 2014 therefore looks robust, however for private equity the more exciting news might be for sale processes involving portfolio companies rather than new deal origination.

This quarters transactions are headlined by Clayton, Dubilier & Rice ("CD&R") approximate $910 million acquisition of Jacksonville, FL based Healogics. Healogics was formed in 2011 with the merger of National Healing Corp and Diversified Clinical Services. The company operates 600 outpatient wound-care centers and treated 215,000 patients in 2013. In addition, the company operates Sechrist Industries the leading global manufacturer of hyperbaric oxygen therapy chambers. Healogics was previously owned by an arm of Citigroup's private equity division.

Additionally headlining this quarter is Summit Partners $550 million investment into ABILITY Network Inc. Minneapolis based ABILITY Networks is a healthcare technology company providing web based management tools that assist customers in their administrative and clinical processes. Key solutions include Medicare direct data entry, Medicare revenue cycle management, payor eligibility verification, Medicare claims submission and Medicare eligibility. The Company is a CMS approved Network Service Vendor. Three years ago, ABILITY received $27 million in funding from Bain Ventures and Lehmi Ventures and grew through product development and its acquisition of IVANS, Inc. in 2013. Lehmi will exit with this transaction while Bain and ABILITY management will rollover.

Q2 2014 announced deals

Table D

PE dealer by type	Transaction count		Announced deal value ($million)	
	Q2 2013	Q2 2014	Q2 2013	Q2 2014
Healthcare providers & services	3	14		
Healthcare equipment & supplies	5	4		
Hospitals	–	–		
Payers	–	–		
Total announced deals	8	18	$50	$1,460

Source: Thomson Reuters

Other services

In Q2 2014, there were 17 transactions with total announced deal value of $1.05 billion. This compares to 24 deals with announced transaction value of $730 million in Q1 2014.

The largest announced deal of the quarter was the Symbion Holdings acquisition by Surgery Center Holdings. Together, the combined company will be one of the largest ambulatory surgery center operators in the country. The combined company will operate 100 health care facilities in 27 states. Both companies are private equity owned with Surgery Partners owned by H.I.G Capital and Symbion owned by Crestview Partners. Crestview will exit as part of the merger.

RiteAid Corporation accounts for two of the deals included in the Other category with un-announced deal value. In April, RiteAid acquired Houston based RediClinic, an operator of 30 retail clinics. The clinics are staffed by nurse practitioners and physician assistants who treat common conditions and provide preventative services. Also in April, RiteAid announced its acquisition of Health Dialog Services Corporation.

Health Dialog Services is a provider of healthcare analytics and decision support. Its customers include health plans, employers and physician groups all with the goal of reducing costs. RiteAid, along with other retail pharmacies, have the potential to change the landscape of the provider market in the years to come and acquisitions are to play a major role in their strategy to provide low cost health care alternatives.

Q2 2014 selected deals other services

Table E

Acquisition date	Target	Acquiror	Deal value $ (million)
14-May-14	Cymetrix Corporation	Navigant	75.0
2-Jun-14	Oso Biopharmaceuticals Mfg	Albany Molecular Research Inc	110.0
2-Jun-14	Medical Staffing Network	Cross Country Healthcare Inc	48.0
3-Jun-14	Refine Technology	Repligen Corporation	25.0
16-Jun-14	Symbion Holdings Corp	Surgery Center Holdings Inc	792.0
Total value			**1,050.0**
Others			N/A
# of deals			17

Source: *The Health Care M&A Information Source*, www.healthcareMandA.com

Spotlight article

The impact of M&A and innovation on the shift from traditional to consumer-driven Healthcare

Innovation in the health services industry long focused on improvements in patient care, new innovative medical procedures, and state of the art facilities as these factors were amongst the most likely to drive patient volume as well as brand value. However, as healthcare spending continued to grow and cost sharing arrangements continued to shift cost to the healthcare consumers, consumers began seeking new alternatives for care delivery that was more value driven and consumer centric.

Traditional healthcare players were slow to respond to this shift, largely due to the highly fragmented nature of the industry and its focus on patient care. Rather than focusing on the consumer, the industry focused its innovation on cost containment to offset the onslaught of reimbursement rate pressures.

While traditional players reacted to the changing reimbursement and consumer landscape, new competitors crept into the market place, opening up facilities that shifted large portions of the healthcare spend away from traditional acute care settings to new outpatient centers such as same day surgery centers and urgent care facilities. These outpatient settings provided patients with more convenient and cost effective access to healthcare.

In order to preserve their patient base and recapture patient procedure volume needed to support their expansive infrastructure, hospitals quickly looked to M&A to consolidate amongst themselves as well as acquire their new outpatient competitors.

Just one of many examples, in 2013, LifePoint Hospital, Inc. (LPNT) successfully completed the $250-million merger of Fauquier Health System which operates a nursing home, an assisted living center and a range of affiliated clinics and medical practices. In addition to these services, the Company expanded its existing footprint increasing its total number of hospitals to six in the state of Virginia[1]. This acquisition provided LifePoint with access to larger population of patients as well as the ability to service the patients for a longer period in the total continuum of care.

However, as traditional players continue to focus on industry consolidation and maintaining their patient base, we believe there is a new evolution in healthcare that will continue to shift the care delivery model. Once again traditional players have left the door open for non-traditional players to enter the health and wellness services market and innovate new solutions that are focused on improving the patient's overall experience.

This time, the new competition does not come from familiar foes. Rather competition comes from businesses that are traditionally considered telecommunications, technology, retail, or consumer products companies.

These new entrants are emboldened by the fact that more and more patients are open to alternative means of care delivery. A recent survey by PwC's Health Research Institute found that "nearly one in two respondents said they would choose new options for more than a dozen common medical procedures, such as using an at-home kit to diagnose strep throat or having chemotherapy administered at home. This simple shift in the market threatens at least $64 billion of traditional provider revenue."

For example, ear pain accounts for approximately 20-30 million doctor visits a year. Cellscope, a San Francisco based company, was established in 2010 with the goal of building a home medical kit of sophisticated devices taking advantage of the patient's smartphone capabilities. The company's debut product is the Oto, a smartphone otoscope that takes digital images of the ear canal. The tool is expected to replace in-person, follow-up visits for ear infections, which will ultimately save time and money for the consumer.[2] The physician, on the other hand, is left to choose to accept the new technology and potentially lose incremental office visits or further disenchant their patient base that is already tired of the inefficient healthcare system.

Innovation put forth by new entrants, such as Cellscope, shows that traditional healthcare players will need more than a strong internet presence to compete. Instead they will need to shift their focus to help create a more personalized experience for the consumer. As such, companies are responding to this disruption in the marketplace by forming strategic partnerships to get access to the new technologies and care delivery models. Already we are seeing new partnerships and ventures form with industry mainstays such as the Cleveland Clinic and the Mayo Clinic leading the way.

In 2013, Time Warner Cable BusinessClass announced a "virtual visit" experiment where Cleveland Clinic caregivers can interact with patients through televisions using secure video technology. The solution is part of the Company's Home Health monitoring strategy that enables providers to engage and interact with patients in their homes. Time Warner's press release quoted Dr. Eiran Gorodeski, MD, Director of Center for Connected Care at Cleveland Clinic, who said, "To truly transform the healthcare system of today and prepare us for the healthcare needs of tomorrow, we have to rethink how, and where, we deliver care to patients.[3]

BroadcastMed, Inc. and the Mayo Clinic are also partnering to create physician directed content. Through BroadcastMed, Inc.'s on-line portal, healthcare professionals can access the Mayo Clinic's "Medical Professional Video Center". This portal will feature physician-directed content across a variety of medical specialties. An alliance such as this provides patients with the comfort that their local physician will have access to wealth of knowledge and experience of the Mayo Clinic much closer to home.[4]

And it's not only the traditional players vying for the strategic partnerships. Through the Alliance for Connected Care, two of the largest retail pharmacy companies in the nation, Walgreen Co. and CVS Caremark, will promote and advocate for telehealth and remote patient monitoring. Walgreen Co. and CVS Caremark have teamed with US lawmakers, medical device manufacturers and suppliers, telecommunication companies, and telehealth companies to create this alliance.[5]

However, we believe that the traditional players are not only trying to change how care is delivered, but also how to utilize consumer data to refine their business model, connect with the patient, and increase the quality of care.

Consider, as an example, the Mayo Clinic. In 2014, it announced its partnership with Apple, Nike, and Epic Systems to integrate their products and services with Apple's HealthKit. With the growing number of apps and gadgets, the app aims to centralize the data, including glucose readings, heart rates and blood pressure. The information will be assimilated with the Mayo Clinic's existing information systems and will offer providers a repository to transmit and store data from regular checkups and deliver more timely and continuous care.[6]

We expect this evolution in care delivery to continue. However, just like the traditional healthcare market, this new consumer focused market place is likely to be highly fragmented. While many players will try to address this new market with homegrown options, we expect that companies will use M&A to consolidate the necessary technology and intellectual property needed to capture the consumer.

1 http://www.lifepointhospitals.com/news/fauquier-health-signs-definitive-agreement-with-lifepoint-hospitals
2 PwC's Healthcare's new entrants: Who will be the industry's Amazon.com? April 2014
3 http://www.timewarnercable.com/en/about-us/press/twc_businessclass_announces_virtual_visit_telemedicine_trial.html
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About the data

We defined US M&A activity as mergers, acquisitions, shareholder spin-offs, capital infusions, consolidations and restructurings where acquisition targets are US-based companies acquired by US or foreign acquirers. Transactions are based on announcement date, excluding repurchases, rumors, withdrawals and deals seeking buyers.

We consider deals to be mergers or acquisitions when there's a change of control or the makeup of the controlling interest changes. In the instance of an acquisition, one company takes effective control over another company or product. In a merger situation, two boards are combined and/or monies are combined. An affiliation or collaboration is neither considered a merger nor an acquisition.

The merger and acquisition data contained in various charts and tables in this report has been included with the permission of the publisher of *The Health Care M&A Information Source,* www.healthcareMandA.com.

Acknowledgments

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