

Q1 2015 US health services deals insights

May 2015

*A publication from
PwC's Deals practice*

Table of contents

The heart of the matter **2**

Q1 2015 US health services deals insights

An in-depth discussion **4**

Deal activity in Q1 2015

Hospitals **5**

Managed care **6**

Post-acute care **7**

Physician practices **8**

Private equity **9**

Other services **10**

Spotlight article **12**

5 pitfalls to avoid in managing the cultural aspect of health system integration

The heart of the matter

Q1 2015 US health services deals insights

The year is off to a rapid start with deal volume and disclosed value up 19% and 92%, respectively in Q1 2015, compared to the first quarter of 2014. Perhaps the most notable sector is Managed Care which had stable deal volumes in recent years; however, ten deals were announced in the first quarter of 2015—the sector’s strongest quarter in over three years and double the number of deals announced in the first quarter of 2014. Total announced deal value in Q1 2015 was \$15 million.

The Behavioral Health and Rehabilitation sectors also continued their strong 2014 showings with eight behavioral healthcare deals in the first quarter of 2015 (versus one deal in the first quarter of 2014) and eight rehabilitation deals in the first quarter of 2015 (versus two deals in the first quarter of 2014).

The Physician Practice sector showed strong continued performance as well with 21 deals announced in Q1 2015 as compared

to only 13 in Q1 2014. We saw the most striking activity from the acquisition of non-referral, specialty physician practices such as ER staffing and anesthesiology practices.

The sectors lagging behind the overall volume trends from Q1 2014 include Home Health (-16%), Hospitals (-8%), and Labs, MRI & Dialysis (-67%). However, as noted in our detailed analysis for the Hospital sector, the continued trend of non-traditional M&A structures (i.e. affiliations, joint ventures, etc.) and lack of value disclosure may be masking what remains an active Hospital sector for deals.

For the private equity buyers and sellers, the first quarter realized a notable uptick in activity. Madison Dearborn Partners purchased a majority interest in Walgreen’s Infusion Services business. Select Medical—in partnership with Welsh, Carson, Anderson, & Stowe—announced planned purchase of Concentra from Humana. Warburg Pincus agreed

to acquire a majority stake in Sterigenics International LLC, and KKR announced a transaction to acquire Air Medical Group Holdings from private equity firms Bain Capital and Brockway Moran & Partners.

Finally, as our Spotlight Article this quarter, we provide insight into common pitfalls facing health system executives and boards of directors when considering the cultural integration of two organizations through a transaction. Cultural “fit” is recognized widely as one of the critical success factors to realizing a merger or acquisition’s goals; however, culture is also often one of the least comfortable areas for management to address. As such, we provide five key considerations for any healthcare organization to put front of mind as they approach Day One and each day thereafter.

An in-depth discussion

Deal activity in Q1 2015

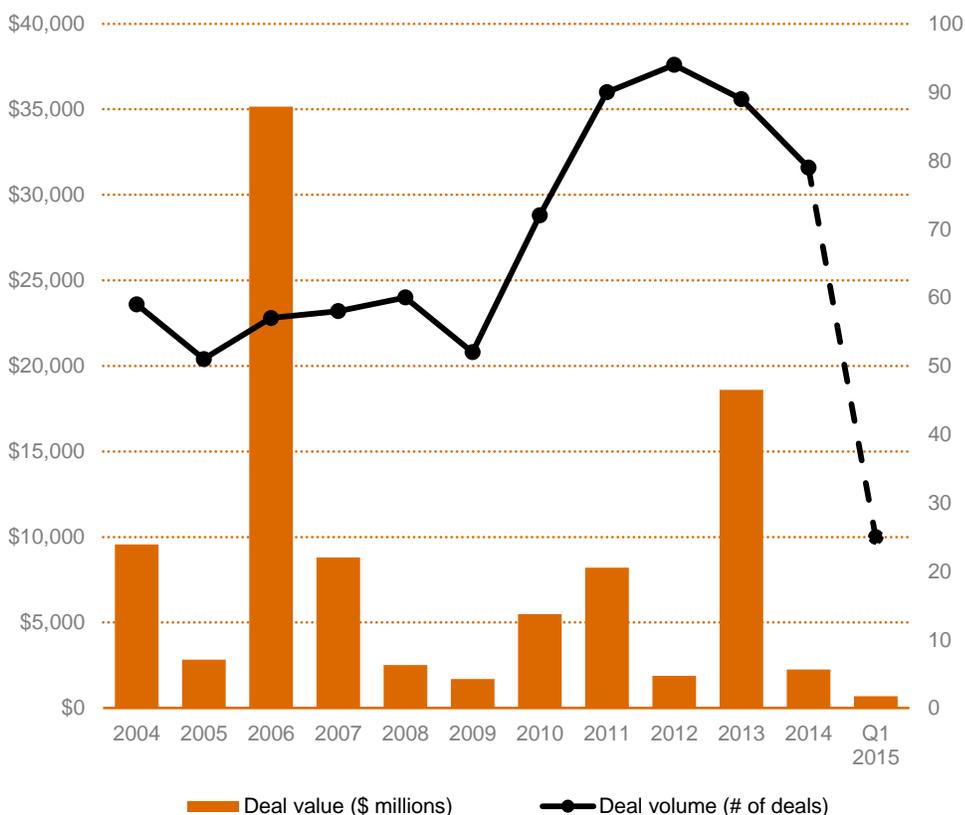
Sector synopses: Hospitals

During Q1 2015, overall healthcare deal volume increased 25% when compared to Q1 2014. The total volume of hospital transactions was down from 25 in Q1 2014 to 23 in Q1 2015, a decrease of nearly 8%. The sector continues to show strength in the first quarter. In January, ten deals were finalized, followed by three deals in February, and the announcement of nine deals in March. Deal value increased from \$608 million in Q1 2014 to \$693 million in Q1 2015, an increase of nearly 14%.

The shift from traditional mergers and acquisitions to affiliations, joint ventures and partnerships continues. There has also been a recent trend of for-profits and not-for-profits coming together as certain for-profits evaluate their current portfolios and determine the markets in which they want to devote resources.

Another change in the sector is the movement towards value-based reimbursement, whereby reimbursement is predicated on population health and outcome-based methods, as well as patient satisfaction metrics. CMS announced it will increase its value-based reimbursements to 50% by 2018. These factors, coupled with the threat of Medicare spending cuts, escalate the uncertainty surrounding the industry and the overall risk perception.

Figure 1: Hospitals



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

Q1 2015 selected deals

Table A

Announcement Date	Target	Acquirer	Deal value \$ (million)
4-Jan-15	Southlake Hospital	Griffin-American Healthcare	128
23-Mar-15	Aspen Healthcare Ltd.	Tenet Healthcare Group	215
27-Mar-15	Carroll Hospital Center	LifeBridge Health	250

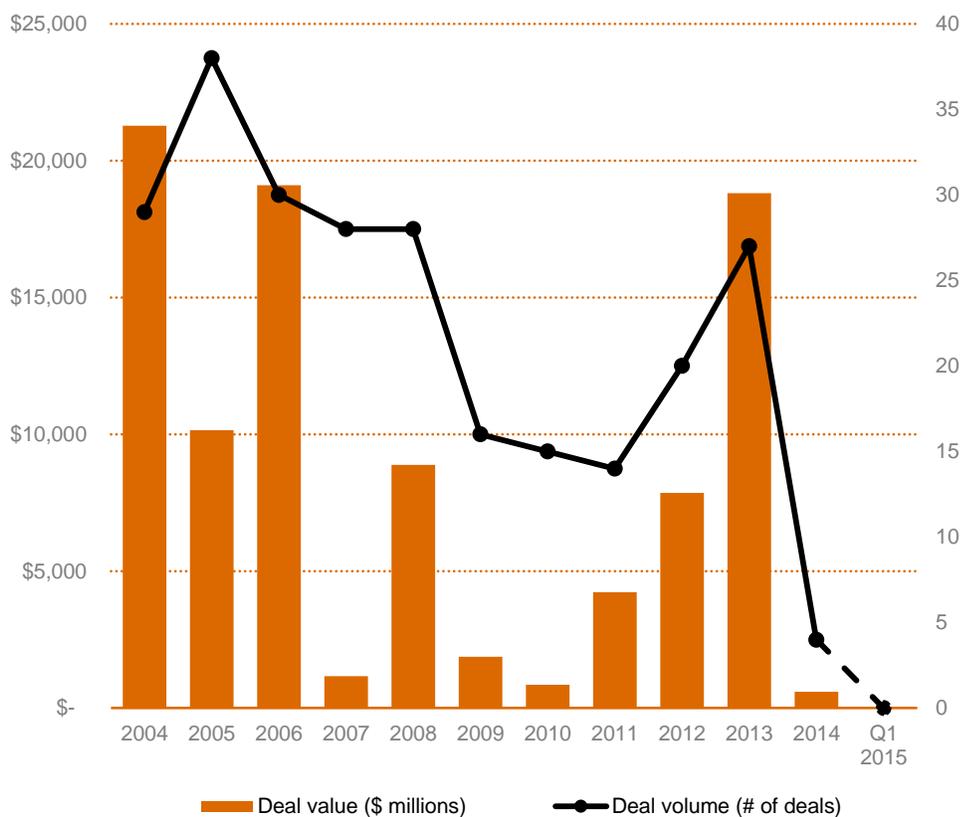
Source: *The Health Care M&A Information Source*, www.healthcareMandA.com

Managed care

Following a somewhat lack luster two years, Managed Care started off 2015 with a bang by announcing ten deals in the first quarter—its strongest performance since Q4 2011. This is double the amount of deals announced in Q1 2014 and nearly half of the total number of deals announced in full for the 2014. The overall magnitude of announced deals in the first quarter and in prior years is not clear given the continued level of private acquisition activity and minimal disclosure of deal value. Total announced deal value in Q1 2015 was \$15 million. However, most deals did not disclose a value.

More action is expected this year, as analysts predict some activity from the bigger players. Mid-sized players, including Centene Corp., Humana, Inc., and Molina Healthcare, Inc. are drawing attention with a focus on private healthcare management companies servicing Medicare and Medicaid programs around the US.

Figure 2: Managed care



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

Q1 2015 selected deals

Table B

Announcement date	Target	Acquirer	Deal value \$ (million)
5-Jan-15	LiveHealthier, Inc.	Centene Corp.	NA
21-Jan-15	Laya Healthcare	American International Group, Inc.	NA
26-Jan-15	Agate Resources, Inc.	Centene Corp.	NA
26-Jan-15	Healthcare Solutions Team LLC	National General Holdings	15
26-Jan-15	Qualcare Alliance Networks, Inc.	Cigna Corp.	NA

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

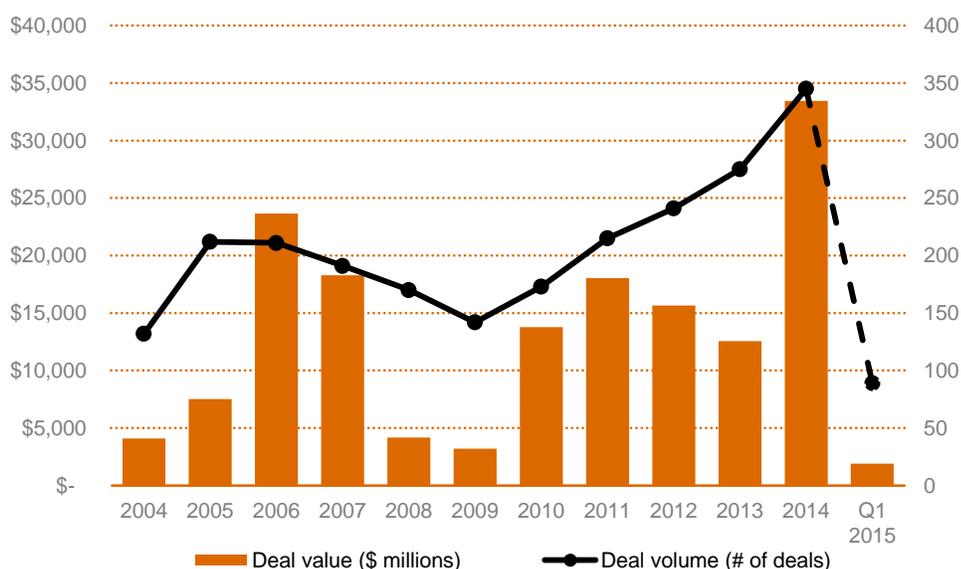
Post-acute care

Long-term care: This sector started off the first quarter of 2015 with the same exciting pace that it started Q1 2014, both with 65 deals. While the deal activity remains flat versus the prior year, total published deal value demonstrated a significant decrease from \$5.7 billion in Q1 2014 to \$1.7 billion in Q1 2015. Notably absent during the first quarter of 2015 were the billion-dollar-plus deals that seemed to dominate the sector in the prior year (five in total).

The largest and most notable transaction during Q1 2015 was by HCP, Inc. and their acquisition of 35 senior housing communities for \$849.0 million in March. This deal accounted for roughly half of the published deal value for the quarter and included 5,025 units across eight states with concentration in Florida, Texas, and Colorado. The deal was structured as a joint venture with HCP, Inc. owning 90% and Brookdale owning the remaining 10%. Brookdale operated these communities over the past several years and will continue to manage the properties post-close.

Home health and rehabilitation: The home health & hospice sector started off the first quarter of 2015 with 16 deals as compared to 19 in Q1 2014. Despite the slight decrease in deal activity, published deal value more than doubled as compared to Q1 2014 due to a \$83.0 million acquisition by Extencicare, Inc. of home health branches across Canada.

Figure 3: Post-acute care



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

Q1 2015 selected deals

Table C

Announcement date	Target	Acquirer	Deal value \$ (million)
25-Feb-15	WillCare Healthcare	Almost Family	50
17-Mar-15	35 senior living properties	HCP, Inc.	849
25-Mar-15	Assisted living portfolio	SilverStone Health Care	65
31-Mar-15	6 assisted living communities	Care Investment Trust LLC	55
Other			723
Long-term care			1,741
# of deals			65
20-Jan-15	Revera Home Health	Extencicare Inc.	83
Home health care & hospice			139
# of deals			16
Rehabilitation			7
# of deals			8
Total post-acute			1,887
# of deals			89

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

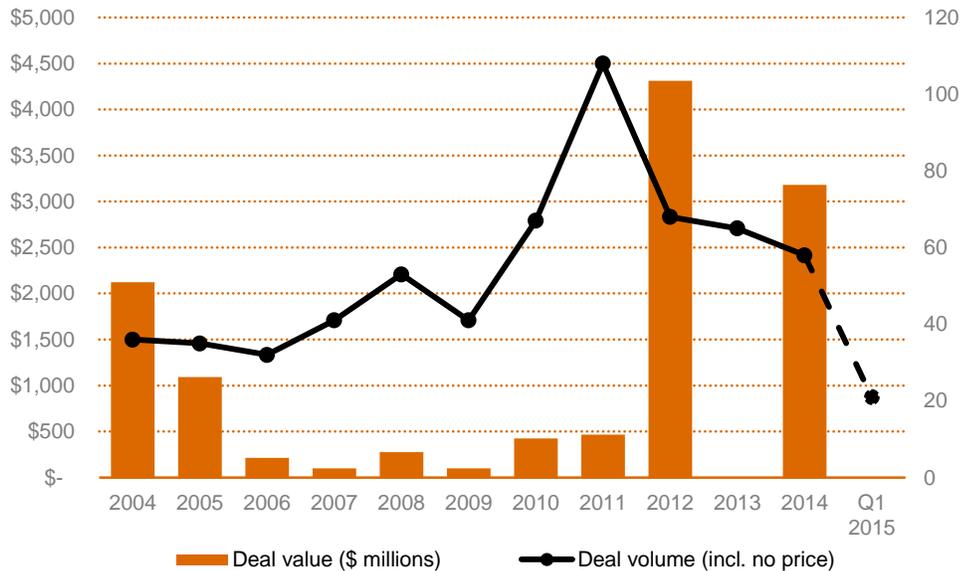
Physician practices

Announced deal volume was up significantly from Q1 2014, with 21 deals announced in Q1 2015 compared to only 13 in Q1 2014. Deal volume continues to be generated primarily from acquisitions by physician practice management companies. In Q1 2015, 18 of the 21 announced deals were consummated by physician practice management companies. MEDNAX, Inc., US Anesthesia Partners, Inc., and IPC The Hospitalists Company, Inc. were the most active acquirers, each announcing three deals in Q1 2015.

By single specialty, anesthesiology practices led the way representing six of the deals announced in Q1 2015. Acquisitions of Hospitalists and ER physician practices represented the second highest target in Q1 2015, with three announced acquisitions for both of the practice types. As we have noted in the past, physician practice management companies continue to focus their acquisition efforts on non-referral specialty physician practices.

While the pace of physician acquisitions by health systems appears to be decelerating, acquisitions by physician practice management companies shows no near term signs of slowing down.

Figure 4: Physician medical group



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

Private equity

High valuations, low interest rates, motivated strategic buyers and regulatory pressures are making for an interesting start to 2015 in the private equity sector. Regulators have continued to deter banks from financing transactions with high debt levels. As part of the leveraged-lending guidance issued following the financial crisis, regulators are urging banks to avoid putting debt of more than six times EBITDA and pushing back on 'covenant lite' credit agreements. As reported by the Wall Street Journal, 21% of US private equity deals in 2015 have been financed with leverage at or above levels regulators considered risky, down from 35% in Q4 2014 and 60% in the third quarter. Both Carlyle and Blackstone Group have now

included language in their annual reports highlighting the risk the leverage restrictions may have on their businesses. Nevertheless, the first quarter of 2015 was notable in the private equity sector not only for a few headline deals across some of the industry's largest players but also for the manner in which private equities are investing in the current market.

As mentioned in the 2014 newsletter, Madison Dearborn Partners ("MDP") announced an agreement to purchase a majority interest in Walgreen's Infusion Services business. This deal is unique in the significance of the partnership between MDP and Walgreen's going forward.

Furthering the theme of strategic / private equity partnerships, Humana announced that it was

divesting its urgent care division, Concentra, to a partnership of Select Medical and private equity sponsor Welsh, Carson, Anderson, & Stowe for \$1.1 billion. Welsh, Carson had previously sold Concentra to Humana.

Two significant private equity seller to private equity buyer transactions were announced this quarter. Warburg Pincus agreed to acquire a majority stake in Sterigenics International LLC. Warburg will own a majority stake with existing private equity owner GTCR continuing to own a minority interest. Separately, KKR announced a transaction to acquire Air Medical Group Holdings from private equity firms Bain Capital and Brockway Moran & Partners.

Other services

In the first quarter of 2015, there were 34 transactions with an announced deal value of \$16.4 billion, compared to 24 transactions with an announced deal value of \$730 million in Q1 2014.

OptumRx, UnitedHealth Group's free standing pharmacy care services business, announced an agreement to acquire Catamaran Corp., a leading provider of pharmacy benefit management ("PBM") services, in a deal valued at approximately \$12.8 billion. According to UnitedHealth, the

combined company is expected to deliver consumer and payer service offerings that will link demographic, lab, pharmaceutical, behavioral and medical treatment data to both engage individuals in making better decisions as they seek the most effective care, and also improve compliance with pharmaceutical use and care protocols. Catamaran expects to fulfill more than 400 million prescriptions in 2015; combining that with OptumRx's 600 million annual scripts will result in a large competitive player within the industry. Synergies are expected through enhanced purchasing and

administrative improvements. The announced price reflects an approximated 27% premium from Catamaran's share price before the announcement.

Furthering the PBM consolidation trend, Rite Aid announced a \$2.0 billion acquisition of Envision Pharmaceutical Services. Terms of the deal call for \$1.8 billion in cash and \$200 million of Rite Aid. Envision was a portfolio company of TPG and Rite Aid is a national, full service PBM.

Q1 2015 selected deals

Table D			
Acquisition Date	Target	Acquiror	Deal value \$ (million)
9-Jan-15	Vista Staffing Solutions	Envision Healthcare Holdings	123
7-Jan-15	6 Joint Corp franchisees	The Joint Corp	1.4
2-Feb-15	LCA Vision	Vision Acquisition LLC	40
2-Feb-15	MediMedia Pharma Solutions	ICON plc	120
11-Feb-15	Rite Aid	Envision RX	2,000
26-Feb-15	BioRX LLC	Diplomat Pharmacy LLC	315
26-Feb-15	Healthcare Solutions Inc.	Catamaran Corp.	405
18-Mar-15	4D Pharmacy Mgmt.	Magellan Health Inc.	55
23-Mar-15	United Surgical Partners	Tenet Healthcare Corp.	425
25-Mar-15	Entrust Specialty Pharmacy	Fred's Inc.	66
30-Mar-15	Catamaran Corp.	OptumRx	12,800
Total value			16,350.4
Others			NA
# of deals			34

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

Spotlight article

5 pitfalls to avoid in managing the cultural aspect of health system integration

These days it seems every health system is in the middle of a transformation — be it buying, selling or trying to integrate the assets it has amassed over time. Being in the business of transformation, this means we find ourselves invariably and repeatedly answering the question, "What are the big stumbling blocks to avoid?"

Without fail, our answer will include some version of, "Don't underestimate the power of culture." It's common wisdom, usually met with wizened nods and tales of past battles hard fought and lost. Then an awkward admission that, "We should have done more, but what?"

To quote Mark Twain, "Everyone talks about the weather, but nobody does anything about it."

Luckily, there's plenty to be done. Below we have listed five common traps we have observed — along with some suggestions on how to avoid them.

1. Blaming the culture. Why do transformations fail to achieve their objectives? One of the oldest tropes we hear is, "Our culture is one of our greatest strengths, and our greatest barrier to change." For example, "family-like" culture is blamed for not holding weak performers accountable or "mission-driven, community-oriented" culture is blamed for allowing sub-scale, low-quality service lines to persist. The real story is often quite different —

and points to a lack of clear objectives, lines of accountability and the will to make tough choices.

Where to start: Make the culture your ally. Use the deeply embedded, self-reinforcing behaviors, beliefs and mindsets that determine "how we do things around here" in order to change the conversation. No one cultural trait is ever all good or all bad, so emphasize the good. For example, a "family-like" culture is all about creating a supportive environment — but a strong family is also honest with its members and knows when to deploy a little "tough love."

2. Leaving the strategy on the shelf. Many health systems have thoughtful, aspirational, community-focused and mission-driven strategies. Unfortunately, some of these organizations have not taken the next step of translating that strategy into changes in how work actually gets done day in and day out. If we are now a "population health" system, how does this change the job description of a nurse? Until the implications are thought through, the strategy will stay on paper.

Where to start: Translate the strategic objectives into what actually needs to be done differently. A good first step is for senior executives to pick a few implications for themselves and how they lead to model the future in a visible way.

“The real story is often quite different — and points to a lack of clear objectives, lines of accountability and the will to make tough choices.”

3. Being unclear in setting new behavioral expectations.

Most organizations aspire to be more patient-centric, population-minded or quality-oriented. Defining processes and standards that get you there is straightforward. Where many fail is driving adoption of the behaviors that bring those processes, policies or standards to life. The common wisdom is to be very prescriptive about how you want individuals to behave every step of the way. In reality, when push comes to shove, no one will remember the memo — and everyone will revert to their tried and true pattern of behavior. The key to driving behavior change is to pick a few critical, shared behaviors that really matter. Well-chosen behaviors are easy to internalize, they're recognizable by others and they're easy to imitate.

Where to start: Identify a few key behaviors, three or four, that are emblematic of the larger change you're trying to drive. Focus on successfully adopting these, and then come back to add more.

4. Talking past one another.

The healthcare industry is already prone to jargon, and recent developments have only made the situation worse. It is hard to find a healthcare executive who does not talk about "population health," "patient experience," and "value-based care" — and don't even get us started on "disruptive innovation." Yet, very few organizations have defined what these things mean — or found a way to measure them in ways that are meaningful and relevant to their customers, such as consumers and employers. Without clarity around key terms, it is hard to have meaningful conversations, articulate a compelling and concrete future staff vision, or create effective incentives.

Where to start: Pare down the jargon and pick a few key ideas that are a clear part of your strategy. Communicate them in plain language and explain what they actually mean. (By the way, the irony of consultants recommending that you use simple English is not lost on us).

5. Leaving the hard conversations until the end.

Several conversations in healthcare are an equivalent of a third, electrified rail. Try asking physicians to improve their productivity and reduce the variability in their clinical practices. Try asking hospital leaders to give up a sub-scale service line to another facility in the system. Try asking everyone to get a flu shot.

The temptation is to put these conversations off for as long as possible. And yet, delaying these necessary conversations means trying to transform a health system with one hand tied behind your back. The most effective transformations are physician-led and nurse-led. Engaging them in the proverbial "sausage making" and starting a dialogue is crucial. Building physician and nurse alignment is a step that should be taken early — and often.

Where to start: Identify and start a conversation with the physicians, employed or aligned, as well as nurses, who are seen as authentic informal leaders. These individuals are unique in their willingness and ability to, with or without formal authority, motivate and influence others.

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

For a deeper conversation about health services deal considerations, please contact one of our industry leaders or your local health services deals partner:

Martyn Curragh
Principal, US Deals Leader
PwC's Deals Practice
646 471 2622
martyn.curragh@us.pwc.com

Steven Elek, III
Partner, Global Healthcare Leader
PwC's Deals Practice
267 330 2240
steven.elek@us.pwc.com

Brett Hickman
Partner, US Healthcare Leader
PwC's Deals Practice
312 298 6104
brett.hickman@us.pwc.com

Keith Bodnar
Partner, PwC's Deals Practice
617 530 6129
keith.e.bodnar@us.pwc.com

Jay Meldrum
Principal, PwC's Deals Practice
214 999 1444
jay.d.meldrum@us.pwc.com

John Frazier
Director, PwC's Deals Practice
267 330 1426
john.frazier@us.pwc.com

Nick Donkar
Partner, PwC's Deals Practice
213 217 3791
nick.donkar@us.pwc.com

Steve Moore
Partner, PwC's Deals Practice
646 471 6602
stephen.mark.moore@us.pwc.com

Lisa Jackson
Director, PwC's Deals Practice
312 298 4308
lisa.jackson@us.pwc.com

Jeffrey Dunne
Principal, PwC's Deals Practice
267 330 3449
jeffrey.d.dunne@us.pwc.com

Ross Richard Nelson, M.D.
Principal, Global Health Practice
PwC Strategy& (US) Inc.
312 578 4596
ross.r.nelson@strategyand.pwc.com

Dan Price
Director, PwC's Deals Practice
617 530 7694
charles.d.price@us.pwc.com

Dan Farrell
Partner, PwC's Deals Practice
267 330 1479
daniel.a.farrell@us.pwc.com

Shurjo Sen
Partner, PwC's Deals Practice
646 471 5199
shurjo.k.sen@us.pwc.com

Robert Rose
Director, PwC's Deals Practice
312 298 3305
robert.a.rose@us.pwc.com

Thad Kresho
Partner, PwC's Deals Practice
678 419 4151
thaddeus.kresho@us.pwc.com

Jim Tunney
Partner, PwC's Deals Practice
312 298 3230
jim.tunney@us.pwc.com

Melissa Sigmond
Director, PwC's Deals Practice
415 498 5267
melissa.sigmond@us.pwc.com

Gordon Medeiros
Partner, PwC's Deals Practice
612 596 6434
gordon.medeiros@us.pwc.com

Ejaz Elahi
Managing Director,
PwC's Deals Practice
312 218 1489
ejaz.elahi@us.pwc.com

Spotlight article:

Igor Belokrinitsky
Partner, Health Team
PwC Strategy& (US) Inc.
312 343 7250
igor.belokrinitsky@strategyand.pwc.com

Chase A. McCann
Principal, Change and Leadership Team
PwC Strategy& (US) Inc.
212 551 6516
chase.mccann@strategyand.pwc.com

About our deals publications:

Published by our health services specialists in our Deals practice, PwC's health services deals insights covers deal activity and trends in the US Healthcare industry.

For views on the Pharmaceuticals and Life Sciences sector refer to the US Pharmaceuticals and Life Sciences deals insights report on the Deals section of our website.