Q2 2015 US health services deals insights

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The heart of the matter

Q2 2015 US health services deals insights

The second quarter of 2015 has shown significant changes from the first quarter's trends. In the Hospital sector, deal volume has continued to decline but at a slower pace. However, the announced $1.75 billion acquisition of Ardent by Ventas buoyed the sector's quarterly deal value as compared to the first quarter.

The Managed Care sector's deal activity was by far the most significant in terms of impact. In the wake of the King v. Burwell decision, payers' increased confidence in the future regulatory landscape have offered a platform for more aggressive deals strategies. By the first week of July, Aetna's pending acquisition of Humana, Inc. for $37.0 billion, along with Centene Corp.'s pending acquisition of Health Net, Inc. for $6.8 billion, serve as major moves toward a consolidated payer environment. Most eyes now turn toward Washington D.C. to watch regulators' reactions toward such consolidation.

With only a slight decrease from its first quarter volume of 70 deals to 64 deals in the second quarter, the Long Term Care sector continues to realize heavy deal volume and, more impressive, is the sector's climb in deal value to $4.1 billion for the quarter. Matching similar dynamics, the Home Health and Rehabilitation sector also realized consistent deal volumes but with a sharp uptick in value—mainly driven by the $730 million acquisition of Reliant Hospital Partners by HealthSouth Corp.

Lastly across the sectors' activity, we note the Physician Practice sector had consistent deal volume in the second quarter of 2015 compared to the first quarter. However, deal volumes are on pace to show an annualized decline from 2014 levels. With two quarters in 2015 remaining, there is still time for the sector to repeat its prior year volume. We note that MEDNAX, Inc.'s acquisition of Virtual Radiologic Corp. for $500 million may represent a trend to watch in the sector as large physician practice management companies expand to include complementary physician groups outside historical focus areas.

For our Spotlight Article this quarter, we provide our insights into the healthcare investment landscape of China. As a primary discussion point in any conversation regarding global expansion, we share our perspective on several of its market's dynamics. We also identify key factors to watch as the market matures and foreign investment builds to shape its healthcare delivery model.

An in-depth discussion

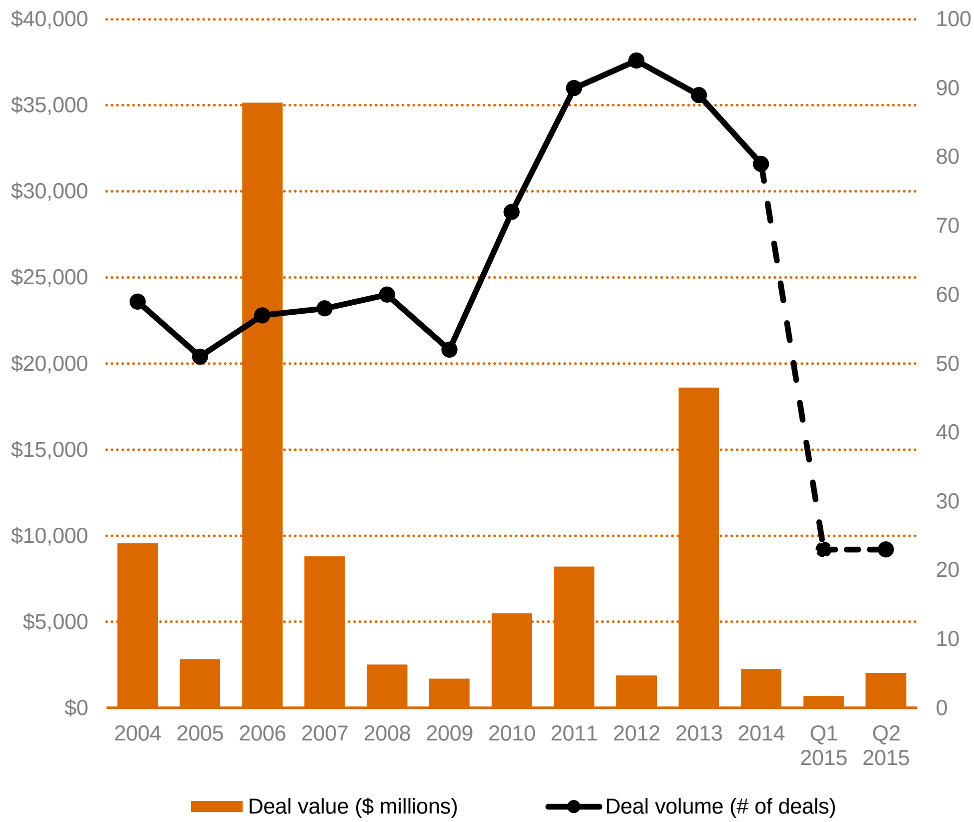
Deal activity in Q2 2015

Sector synopses: Hospitals

While Q2 2015 deal volume was down slightly as compared to Q2 2014, dollar volume was up approximately $1.5 billion from the $542 million in the second quarter of 2014. This is largely attributable to Ventas, Inc.'s $1.75 billion bid for Ardent Health Services. Overall, deal volume in the hospital sector continues to garner attention in both the for profit and not-for-profit arenas based on a variety of ongoing factors, including market/geographic forces, financial stability and strategic alternatives.

Not-for-profit targets also remain popular, with hospitals and health systems comprising the majority of these acquisitions. Approximately 11% of total 2014 health care transactions were for not-for-profit targets, and hospitals accounted for more than half. Similarly, hospitals and health systems accounted for 72% of not-for-profit acquirer deals in 2014. As these trends continue, hospital dollar volume could be impacted as monetary values are often not disclosed in such transactions, due to the structure of many affiliation transactions and the lack of shareholders. In many instances, a monetary value is assigned based on a capital commitment made to the target facility or its charitable foundation.

Figure 1: Hospitals



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

Q2 2015 selected deals

Table A

Announcement Date	Target	Acquirer	Deal value $ (million)
6-Apr-15	Ardent Health Services	Ventas, Inc.	1,750
15-Apr-15	Pennock Health Services	Spectrum Health	56
8-Jun-15	Lodi Health	Adventist Health	100

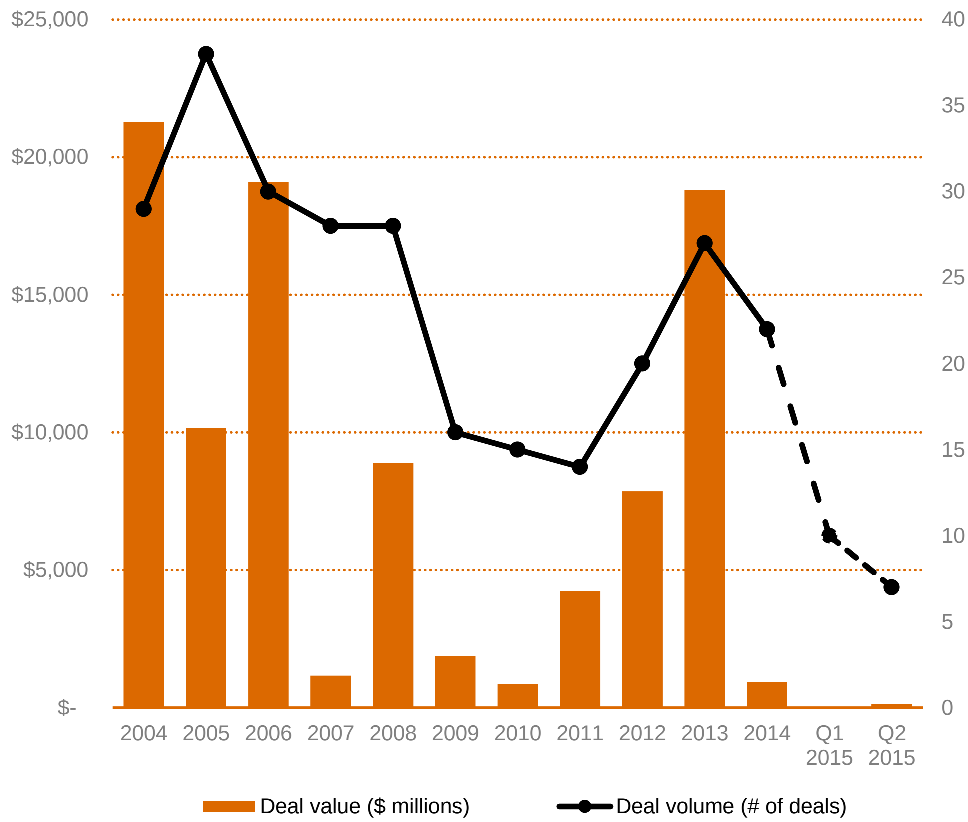
Source: *The Health Care M&A Information Source,* www.healthcareMandA.com

Managed care

The number of Managed Care deals in Q2 2015 remained relatively stable with seven deals announced, relative to eight being announced in Q2 2014. However, the volume of Managed Care transactions increased from 13 in the first half of 2014 to 17 in the first half of 2015, an increase of approximately 31%. The overall magnitude of announced deals in the first half of 2015 and in prior periods is not clear given the continued level of private acquisition activity and minimal disclosure of deal value. Total announced deal value in the first half of 2015 was $162 million.

Following the King vs. Burwell decision in late June 2015, Managed Care deal activity is expected to meaningfully change the sector landscape going-forward. Already announced in the first week of July 2015 were Aetna's pending acquisition of Humana, Inc. for $37.0 billion and Centene Corp.'s pending acquisition of Health Net, Inc. for $6.8 billion. Other deals of significant magnitude have also been rumored as the sector more aggressively responds to changes stemming from a healthcare environment that continues to evolve.

Figure 2: Managed care



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

Q2 2015 selected deals

Table B

Announcement date	Target	Acquirer	Deal value $ (million)
15-May-15	Medicaid and MIChild contracts	Molina Healthcare, Inc.	N/A

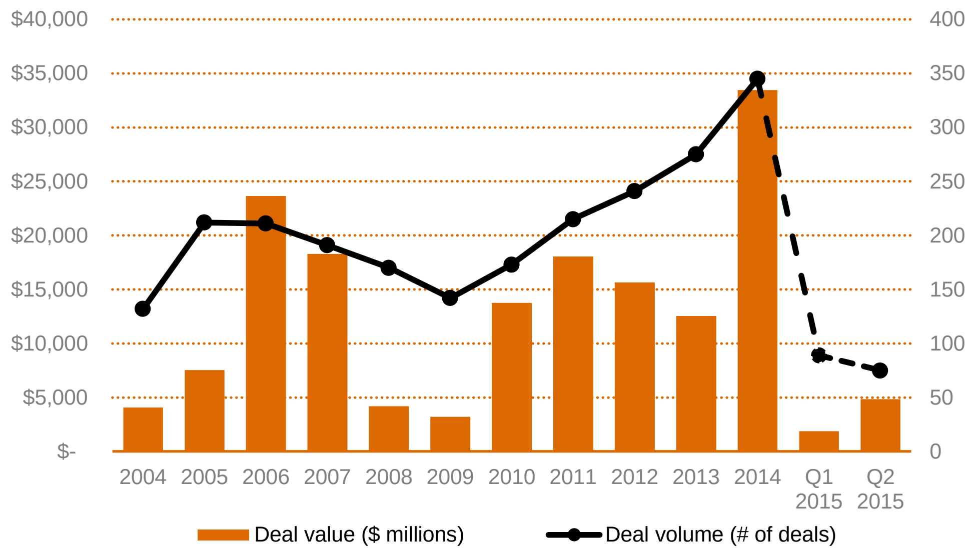
Source: *The Health Care M&A Information Source,* www.healthcareMandA.com

Post-acute care

Long-term care: While announced deal volume of 64 deals in Q2 2015 decreased slightly from Q1 2015 (70 deals), announced deal value rose substantially to $4.1 billion, an increase of 129% over the first quarter of 2015. The increase is primarily due to a handful of large deals valued over $600 million, but less than $1 billion. The two largest deals in Q2 2015 were made by companies affiliated with NorthStar Asset Management Group ("NorthStar"). NorthStar Realty Finance Corp. (an entity which NorthStar provides asset management services) acquired 32 independent living ('IL') communities from Harvest Facility Holdings LP for $875 million. The target consists of nearly 4,000 units across communities in 12 states. NorthStar Healthcare Income, a wholly-owned broker-dealer subsidiary of NorthStar, also acquired 15 continuing care retirement communities (CCRCs) from subsidiaries of Fountains Senior Living Holdings. The target consists of over 3,600 units across 11 states for $640 million. Finally, Ventas, Inc. announced a plan to spin-off most of its post-acute/skilled nursing facility portfolio into an independent, publicly traded REIT.

Home health and rehabilitation: While the announced deal volume in the rehabilitation sector decreased slightly over the past quarter, the announced deal value skyrocketed due to one mega deal. HealthSouth Corp., a publicly traded company, announced the acquisition of Reliant Hospital Partners, LLC and affiliated entities for $730 million. The target includes 11 inpatient rehabilitation hospitals in Texas, Massachusetts, and Ohio and three inpatient satellite locations in Massachusetts.

Figure 3: Post-acute care



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

Q2 2015 selected deals

Table C

Announcement date	Target	Acquirer	Deal value $ (million)
1-Apr-15	32 IL Communities	NorthStar Realty Finance Corp.	875
23-Apr-15	15 CCRCs	NorthStar Healthcare Income	640
15-Jun-15	24 Skilled Nursing Facilities	Genesis HealthCare LLC	240
18-Jun-15	Regal Lifestyle Communities, Inc.	Health Care REIT, Inc.	623
22-Jun-15	28 Senior Living Communities	New Senior Investment Group	640
25-Jun-15	4 Skilled Nursing Facilities	Sabra Health Care REIT	234
Other			856
Long-term care			4,108
# of deals			64
Home health care & hospice			-
# of deals			5
11-Jun-15	Reliant Hospital Partners LLC	HealthSouth Corp.	730
Rehabilitation			735
# of deals			6
Total post-acute			4,842
# of deals			75

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

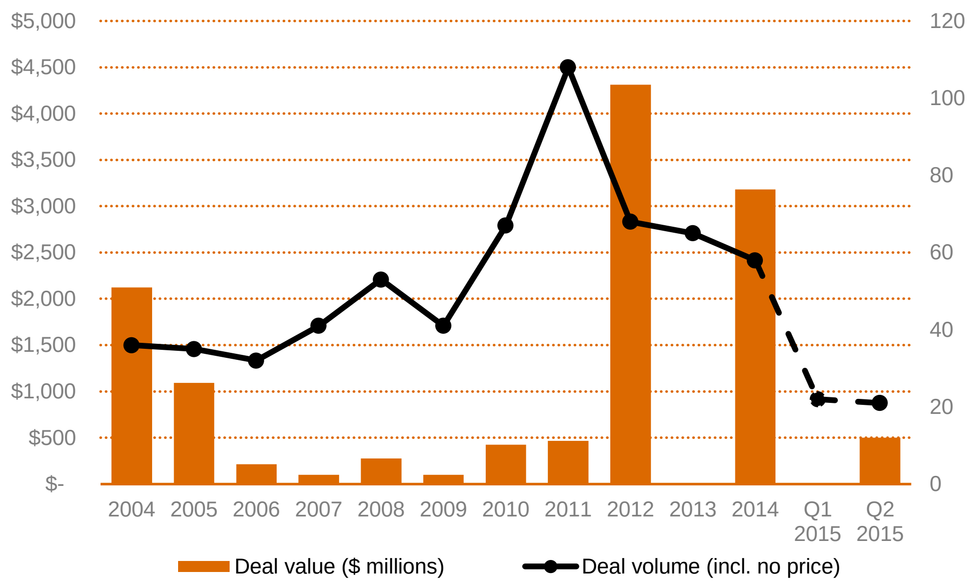
Physician practices

There were 21 announced deals in Q2 2015, up 31% from the 16 deals reported in Q2 2014. However, announced deal values of $500 million in Q2 2015 were significantly lower than the $3.1 billion reported in Q2 2014. One notable transaction in Q2 2015 was MEDNAX, Inc.'s acquisition of Virtual Radiologic Corp. for $500 million. This marked the company's first foray outside its traditional core services of neonatal, maternal-fetal, other pediatric subspecialty and anesthesia physician services.

Leading the way with announced deal volumes was IPC Healthcare, Inc. (formerly IPC The Hospitalist Company) with four deals. MEDNAX, Inc. was second with three deals. No other companies had more than one announced deal during Q2 2015.

The latest transaction by MEDNAX, Inc. highlights a recent trend of large physician practice management companies acquiring complementary physician groups. As these companies continue to attempt to gain scale and create more touchpoints with their existing customer base, look for this trend to continue, especially within non-referral based specialties.

Figure 4: Physician medical group



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

Private equity

The second quarter of 2015 lacked the large private equity transactions that were announced last quarter. The market remains challenging for private equity buyers despite the favorable debt markets. Price multiples remain high as strategic buyers are active.

Deals highlighting the quarter include Summit Partners acquisition of Paradigm Management Services from Lightyear Capital. Paradigm serves insurance companies, providers and injured person providing health care services for catastrophic and complex injury cases. Separately, ABRY Partners agreed to acquire FastMed Urgent Care from Comvest Partners. FastMed is the second largest independent urgent care organization in the U.S. providing services throughout North Carolina and Arizona.

Other services

There were 28 transactions in Q2 2015 with an announced deal value of $15.8 billion which compares to 17 transactions with an announced deal value of $1.0 billion in Q2 2014.

CVS Health Corp. highlights this quarter with two transactions. In May, CVS announced its agreement to acquire Omnicare for $12.7 billion. Omnicare is a leading provider of pharmacy services to long term care facilities. The deal enables CVS to expand its ability to dispense prescriptions to the senior patient population as well as within the fast growing specialty pharmacy business. Separately, in June, CVS agreed to buy 1,600 drugstores from Target for $1.9 billion. CVS will operate the pharmacies under the CVS brand name within Target stores and will operate CVS branded pharmacies in new stores.

Pharmacy service and pharmacy benefit manager ("PBM") deals have highlighted the other services section of this article in recent quarters. As reported by the Wall Street Journal, large PBMs are seeking deals with pharmaceutical companies to set prices on expensive drugs based on how well they work. The effort is part of a growing 'pay for performance' trend across the industry. While the model has the potential to lower drug costs, pay for performance contracts also necessitate the need for tracking health measures and outcomes in patients, and carries with it significant cost to track these measures. To date, contracts of this sort have been small. Given the wave of industry consolidation providing increased leverage of PBMs and payors, it will be interesting to track any shifts in drug pricing models, pay for performance or otherwise.

Q2 2015 selected deals

Table D – Other Services

Acquisition Date	Target	Acquiror	Deal value $ (million)
20-Apr-15	Accountable Health Solutions	Hooper Holmes	7
21-May-15	Omnicare, Inc.	CVS Health Corp.	12,700
5-Jun-15	The Harvard Drug Group	Cardinal Health	1,150
15-Jun-15	Targets Pharmacy Business	CVS Health Corp.	1,900
19-Jun-15	Burmans Specialty Pharmacy	Diplomat Pharmacy	82.8
Total value			15,839.8
Others			N/A
# of deals			28

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

Spotlight article

Investing in China's Dynamic Health Market

A dynamic health industry in China

With China on track to become the world's second largest life science market and ongoing reforms accelerating the industry's development path, we will see new and different market dynamics. The market landscape for all stakeholders is changing, bringing new opportunities to "catch the wave" (*see Exhibit 1*).

This is an exciting time to be in the China Health Market and various rising, yet turbulent, tides exist in the market

Exhibit 1
China's healthcare dynamics – key factors

Imbalanced supply and demand

- An aging population, unhealthy lifestyles and pollution are all driving up healthcare demand, while poor access to quality and affordable care are still key pain points for regular Chinese patients
- HNWIs and affluent consumers demand better care (e.g. better service, innovative drugs) but there is limited supply
- Chronic illnesses are a critical issue; however, there is a limited effective chronic disease management or end-to-end care

Hospital system issues and reform

- Limited public funding drive public hospitals to behave as for-profit organizations, so hospitals still rely on drug sales as a significant source of revenue
- A growing necessity for a holistic, coordinated classified treatment and referral systems
- Various challenges for private hospital development, but also rapid changes (e.g. gradually allowing multi-site physician practices)

Payer systems are still elementary

- Universal coverage of the public Basic Medical Insurance (BMI); however, out of pocket spending is still very significant
- Public payers (local governments) have limited expertise in managing hospital costs and quality, and are facing increasing funding pressure
- Private health insurance is still small and less profitable due to hospital moral hazard, but growing rapidly

Emerging impact of digital

- Digital players such as Tencent are entering into the health market with "new ways to play" and could become potential "game changers"
- Traditional players are also beefing up digital capability (e.g. digitization of service and offering, e-commerce channel)

Tightening compliance as well as pricing

- Compliance is increasingly important for all players in the market – particularly for pharma and device companies – calling for reconsideration of market focus and new commercial models as the traditional "feet on the ground" sales model is challenged both for compliance and economic reasons
- Pricing and access are still the key issues for pharmaceutical and device companies in China

The future evolvement of the China Health Market and potential business opportunities

Looking forward, the China health market will likely be very different in the next 5-10 years in five areas, and this evolution is creating various business opportunities.

1. Evolve from a unitary market to two segments – "High-end market" and "Mass market"

China has ~1 million high-net-worth individuals, ~70 million affluent and ~470 million middle-class, who are concentrated in large cities and demanding better healthcare services.[1] Meanwhile, the other ~920 million mass Urban and Rural populations[2] enjoy rapid income increase and demand for access to reliable healthcare services – though most of those are still price sensitive.

The emerging high-end market provides ample opportunities for differentiated, premium products and services for players. Even a growing mass market provides opportunity to further drive down the costs for large volumes, to ultimately achieve a lower price.

Broadly the government will likely need to focus investment on raising the bar for the "bottom of the pyramid" in China, leaving the mid-high-end market open for private investment. There is also a need for both quality and value to meet mass market needs better.

2. Evolve from basic public medical insurance dominant to balanced public and private insurance

Private insurance providers are expected to become an important supplement to public insurance and the private insurance opportunities exist in covering the urban workers (~240 million), urban residents (~200 million), and rural population (~840 million).[3]

Private insurance will likely gain more market share, especially in urban areas. The government is seeking to use the private sector to ease the financial burden on public funding. The pharma and medical device players are looking at opportunities for collaboration with payers (both government and private) to improve health service and quality and manage total cost – in return, to benefit from volume increases.

3. Evolve from large public hospitals dominating to a more balanced service provider structure

Booming demand for better health care service and government support is expected to drive the development of private hospitals and providers, so that more private general hospitals and large private hospital chains will emerge and the rapid growth of check-up chains and clinics will continue.

The private hospitals will likely become an important care delivery and drug dispensing channel, and there are business opportunities to collaborate with them. Focusing on a premium segment, private hospitals (particularly those foreign funded) can generate high demand for better quality, higher value products.

4. Evolve from focusing on communicable diseases to chronic disease management

China is expected to intensify efforts in prevention and control of chronic diseases through four forces: increased government direct special funds, attention on disease prevention, promotion of patient education, and establishment of integrated chronic disease control and treatment platform.

The demand for diagnosis, medicine and treatment products and services for chronic diseases (e.g. cardiovascular and cerebrovascular diseases, malignant tumors, diabetes) is expected to soar. The government encourages R&D investment (e.g. financial incentives, fast approval) in the prevention and treatment of chronic diseases. The opportunity of public private partnership (PPP) will likely emerge to help the government with chronic disease prevention and control, and manage total costs to gain volume.

5. Evolve from traditional ways of marketing and selling to more sophisticated ways with digital and analytics

Digital technology has the potential to become a "game changer" for the China health industry and change behaviors of all key stakeholders, including patient, physician, payer, distributor and pharmacy, and manufacturers.

Digital technology and analytics will likely play a critical role in improving the efficiency, effectiveness, and transparency of the overall health delivery system. The health IT market is growing rapidly, as more and more patients seek online channels, and providers are upgrading their health IT systems.

Sources: PwC Strategy& analysis

Investment opportunities in the China Health Market

There are various investment opportunities in China:

Healthcare Services

There is an insufficient supply of quality healthcare service in China today. The public healthcare system is a dominant force and will likely continue focusing on providing care service to mass populations with low service levels. There is a large demand for and supply gap of differentiated healthcare service; at the same time, the Chinese governments are increasingly encouraging private investment in this area.

There are a few themes of healthcare service investment:

- High-end hospitals and clinic chains providing superior service to HNWIs and affluent consumers, as well as those who have private health insurance in China.
- For specialty hospitals – such as orthopedics, cardiovascular, oncology hospitals – the entry barrier is higher as experienced doctors are a scarce resource and tied to large public hospitals. Investors usually partner with public hospitals, academic centers or foreign leading hospitals to get access to doctors, technology and brands.
- With senior care service and senior living, an aging population is an increasing challenge for the Chinese. The "one child policy" makes it very difficult for young couples to take care of their four parents at home, which has been the most common senior care approach in the past. The demand for quality senior care, including senior living, is huge. The market, however, is still in a relatively early stage (<2% in senior care) waiting for viable business models to be developed.

Medical Device and Diagnostics

Demand for MD&D continues to grow robustly, driven by increasing demand for healthcare, hospital development and upgraded hospital infrastructure. The Chinese government also supports local medical device innovation and replacement of imported products, which is the driving demand for "good enough" products made in China. Leading MNC players are making strategic investments in local Chinese players to beef up their product portfolios and position to compete in China.

A few hot areas:

- IVD, especially molecular reagents and gene testing
- High end implants, especially in cardiovascular and orthopedic products
- Household medical devices, driven by increasing consumer health consciousness – plus worries about the environment – and a rapidly aging population

Mobile and Digital Health

Digital is a key theme in health. There is a vast digital and mobile user base in China and very high prevalence of e-commerce and online payment. Digital has been leveraged across the entire value chain, such as providing information and access to doctors, teleconsultation, drug e-commerce, medical information for physician and patient groups, health management, etc. While there are many new innovative players, large companies such as internet giants Tencent, Baidu, insurance companies such as Ping'An and high tech and consumer electronic companies such as Xiaomi are all building their digital health businesses through partnership and M&A. You just need to reflect on what Alibaba did to life insurance last year (100 million customers with $100 billion FUM in 1 year through its Yue'bao product) to see the opportunity and / or the threat.

Health Insurance

The public Basic Medical Insurance covers almost the entire population; however, it only provides very basic coverage and out-of-pocket spending is still very high. Currently, private health insurance penetration is very low and it is at a tipping point for growth. Many players are trying to enter into this market, such as Chinese life and P&C insurance companies, foreign health insurance companies and also many new potential entrants from other industries. We expect to see new partnerships and JVs in this market, as well as new innovations in customer value propositions and products for health insurance and services.

To Recap

China is actively advancing it's "*da jiankang*" (big health) agenda so the window is open for investment to those who can make smart strategic choices, find the right deals and partners and execute to capture value.

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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