Deal activity continues amidst uncertainty, while the industry watches potential inflection point transactions

Executive summary

Despite lingering regulatory uncertainty, the US Health Services industry witnessed over 200 deals for the fifteenth quarter in a row. Growth trends were mixed, with total deal volume decreasing over the prior quarter, but increasing over prior year. Total deal value declined by double-digits versus Q1 2018 and Q2 2017, but both past periods had seen exceptional megadeal activity.

Megadeals continued in Q2 2018, with KKR & Co.’s announced acquisition of Envision Healthcare Corporation – the third largest transaction since 2016. Several factors suggest that additional megadeals, including across verticals, could be forthcoming. In addition to continuing income pressure and focus on consumer retention, two large deals are being watched: Amazon.com, Inc.’s announced acquisition of PillPack and the proposed AT&T Inc.-Time Warner Inc. merger (which the Justice Department appealed as we went to press).

At the sub-sector level, Long-Term Care had the highest deal volume, continuing a multi-year trend. Physician Medical Groups’ deal value increased significantly due to the KKR-Envision deal.

In terms of valuations, mean EV/EBITDA multiples increased across all sub-sectors except Managed Care.

No IPOs have been announced since Q2 2016.

Trends and highlights

- In Q2 2018, 255 deals were announced, representing a decline of 7.3% over prior quarter but an increase of 9.4% over prior year. Total deal value declined by double-digits in both prior quarter and prior year terms to $24.6 billion, but the declines are a function of megadeal activity in the comparison periods.

- Continuing a multi-year trend, Long-Term Care represented the largest sub-sector in terms of deal volume (104). In terms of deal value, Physician Medical Groups was the largest sub-sector ($12.2 billion), accounting for 49.4% of total deal value.

- Over prior year, Q2 2018’s most-rapidly growing sub-sectors were Managed Care (100.0% volume growth) and Physician Medical Groups (1502.4% growth in value).

- In terms of EV/EBITDA multiples, the Labs/Imaging sub-sector experienced both the greatest change and highest absolute level, increasing 5.8x to 23.5x.

- No IPOs occurred in Q2 2018.

Total Deal Value

| $24.6B | 66.1% | 50.7% |
| Q2 2018 | Decrease in deal value, versus Q1 2018 | Decrease in deal value, versus Q2 2017 |

Total Deal Volume

| 255 | 7.3% | 9.4% |
| Q2 2018 | Decrease in deal volume, versus Q1 2018 | Increase in deal volume, versus Q2 2017 |

Mean EV/EBITDA multiples

| 1.5x | 1 | 6 |
| Industry-wide increase, versus LTM 2017 | Sub-sectors decreased, versus LTM 2017 | Sub-sectors increased, versus LTM 2017 |

“Quarterly Health Services deal volume continues to be robust, having exceeded 220 deals for the previous several years. Similar to Q1 2018, multiple factors are contributing to the deal activity, including both private equity fund raising/investment and corporate strategic initiatives. We don’t anticipate these trends to slow during the remainder of 2018.”

Thad Kresho,
US Health Services Deals Leader,
PwC
As of the Year-end 2017 edition of this publication, we have revised our definition of megadeals from the previous $1 billion threshold. Source: The Health Care M&A Information Source, www.healthcareMandA.com, Welltower press release

No IPOs in Q2 2018

According to our analysis of Dealogic data, there were no Health Services IPOs in Q2 2018, continuing a trend of muted IPO volumes in recent years. There were no IPOs observed in 2017, and only one each in 2015 and 2016 (Surgery Partners Inc and American Renal Associates Holdings Inc, respectively).

Source: S&P Capital IQ

Additional notable transactions

Other major announced transactions on a deal value basis included:

• Welltower Inc.’s acquisition of Quality Care Properties, Inc. for $4.0 billion. Concurrently, two related transactions were announced:
  1. Welltower and ProMedica formed an 80/20 joint venture, containing the real estate of QCP’s principal tenants, HCR ManorCare and Arden Courts.
  2. ProMedica announced it would acquire the operations of HCR ManorCare and Arden Courts.

• WellCare Health Plans, Inc.’s acquisition of Meridian for $2.5 billion.

• Amazon.com, Inc.’s acquisition of PillPack for an estimated $1 billion.


Four P.E. deals priced over $500 million

In Q2 2018, there were several major private equity deals, including three priced over $1 billion:

• KKR-Envision, the quarter’s largest transaction ($9.9 billion).

• The divestiture of Fresenius Medical Care’s controlling interest in Sound Inpatient Physicians Holdings, LLC to an investment consortium led by Summit Partners ($2.5 billion).

• A consortium of 3 companies (Humana Inc.; TPG Capital; and Welsh, Carson, Anderson & Stowe) announced it would acquire Curo Health Services LLC for $1.4 billion.

• GI Partners announced it would acquire and combine simultaneously the Cord Blood Registry (transaction priced at $530 million) and California Cryobank (price not disclosed).

Source: S&P Capital IQ

Trading multiples increased

Industry-wide mean EV/EBITDA multiples increased by 1.5x to 14.9x, with a significant increase in Labs/Imaging multiples (see next page for details).

Source: S&P Capital IQ

Megadeal activity continues

In Q2 2018, there was one deal exceeding $5 billion2, matching the average megadeal volume seen in the preceding seven quarters.

Q2 2018’s total megadeal value was lower than the 2017 quarterly average of $26.2 billion (which was impacted by the CVS Health Corp.-Aetna Inc. megadeal), but higher than the 2016 quarterly average of $6.2 billion.

Largest transaction: KKR-Envision

KKR & Co.’s announced acquisition of Envision Healthcare Corporation was the quarter’s sole megadeal, but its price was significant. The $9.9 billion megadeal was the third-largest transaction since 2016, behind only CVS Health Corp.-Aetna Inc. and Cigna Corporation-Express Scripts Holding Company.

KKR & Co.’s acquisition of Envision Healthcare Corporation ($9.9B)

1 megadeal valued at $9.9B Q2 2018

Highlights of Q2 2018 deal activity

Average volumes but value down versus prior quarters’ megadeal highs

For the fifteenth quarter in a row, M&A volume exceeded 200 deals. The total deal volume of 255 matched the average volume seen in the preceding seven quarters. Deal volume declined by 7.3% over prior quarter but increased by 9.4% over prior year.

Versus prior quarter and prior year – periods of exceptional megadeal activity – total deal value declined by 66.1% and 50.7%, respectively. For comparison, in Q2 2018, one megadeal (see below for details) accounted for approximately 40% of the quarter’s total deal value; in Q1 2018, one megadeal accounted for 92%, and in Q2 2017, four megadeals accounted for 56%.


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Source: S&P Capital IQ
Key sub-sectors: LTC, Physician Medical Groups, Managed Care, and Home Health

In terms of volume and value:

- In volume terms, Long-Term Care was the most active sub-sector in Q2 2018 (104 deals, or 40.8% of deal volume), continuing the trend seen in recent years.
- Deal value was highest in the Physician Medical Groups sub-sector. Its total spend of $12.2 billion represented 49.4% of total deal value, with the KKR & Co. acquisition of Envision Healthcare Corporation megadeal accounting for the majority of that spend.

In terms of year-over-year growth:

- In volume terms, Managed Care and Home Health Care grew the most (100.0% and 66.7%, respectively).
- In value terms, Physician Medical Groups grew the most (1502.4%).
- There were some notable declines: by deal volume, Labs, MRI & Dialysis declined the most (61.5%); by deal value, Other Services and Hospitals declined the most (95.3% and 94.4% respectively). Behavioral Care's deal value declined 100%, but this trend was due to no deal values being reported.

Slightly higher trading multiples, with Labs/Imaging remaining elevated

Industry-wide mean EV/EBITDA multiples increased by 1.5x to 14.9x.

The Labs/Imaging sub-sector had the highest mean EV/EBITDA multiple in Q2 2018 (23.5x), as well as the largest increase in multiple value versus LTM 2017 (5.8x*).

The Managed Care sub-sector EV/EBITDA multiple decreased by 0.5x² to 11.1x.

*Differs from chart’s depicted increase of 5.7x due to rounding.
²Differs from chart’s depicted decrease of 0.4x due to rounding.


Trading multiples, LTM 6/30

Source: S&P Capital IQ
### Top 5 deals of Q2 2018, by deal value

<table>
<thead>
<tr>
<th>Rank</th>
<th>Deal Value ($B)</th>
<th>Target</th>
<th>Target Sub-Sector</th>
<th>Acquirer</th>
<th>Acquirer Sub-Sector</th>
<th>PE deal?</th>
<th>Date announced</th>
</tr>
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<tbody>
<tr>
<td>1</td>
<td>$9.9</td>
<td>Envision Healthcare Corporation</td>
<td>Physician Medical Groups</td>
<td>KKR &amp; Co.</td>
<td>Private Equity</td>
<td>Yes</td>
<td>11 Jun 2018</td>
</tr>
<tr>
<td>2</td>
<td>$4.0</td>
<td>Quality Care Properties</td>
<td>Long-Term Care</td>
<td>Welltower Inc.</td>
<td>REIT</td>
<td>No</td>
<td>25 Apr 2018</td>
</tr>
<tr>
<td>3</td>
<td>$2.5</td>
<td>Meridian</td>
<td>Managed Care</td>
<td>WellCare Health Plans, Inc.</td>
<td>Managed Care</td>
<td>No</td>
<td>29 May 2018</td>
</tr>
<tr>
<td>4</td>
<td>$2.2</td>
<td>Sound Inpatient Physicians Holdings, LLC</td>
<td>Physician Medical Groups</td>
<td>Summit Partners</td>
<td>Private Equity</td>
<td>Yes</td>
<td>21 Apr 2018</td>
</tr>
<tr>
<td>5</td>
<td>$1.4</td>
<td>Curo Health Services LLC</td>
<td>Home Health &amp; Hospice</td>
<td>Consortium of 3 companies: Humana Inc.; TPG Capital; and Welsh, Carson, Anderson &amp; Stowe</td>
<td>Managed Care</td>
<td>Yes</td>
<td>23 Apr 2018</td>
</tr>
</tbody>
</table>


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### Uncertainty and income pressure continue to encourage deals and disruptive models

The Health Services sector has experienced 200-plus transactions per quarter for 15 consecutive periods. We expect a similar rate of deal activity is likely to occur throughout the remainder of the year, given the following:

- Regulation and policy uncertainty, including ACA's future, are exacerbating reimbursement and cost pressures, making income predictability more challenging and increasing the appeal of inorganic growth. At the same time, Health Services companies are considering tax reform's impact on capital and organizational decisions, which could influence deal criteria.

- Cross-industry and vertical integration-focused megadeals such as Cigna Corporation-Express Scripts Holding Company and CVS Health Corp.-Aetna Inc are driving Health Services companies to rethink corporate strategies and alliances. In addition, if the proposed AT&T Inc.-Time Warner Inc. merger is approved (as we were going to press, the Department of Justice was appealing June’s federal approval), the transaction could be seen as a sign that additional such megadeals could follow.

- Evolving technologies and disruptive models from new entrants could portend systemic structural changes that require new strategies (both organic and inorganic). In Q2 2018, Amazon’s announcement of a CEO for its previously-announced venture with Berkshire Hathaway and JPMorgan Chase & Co., as well as their announced acquisition of PillPack, added urgency to competitors’ consideration of new strategies.

- Inpatient volume pressure and high costs – particularly in drug and labor line items – are driving reevaluation of facility mixes, supply chains, and staffing processes. This trend could lead to new or modified partnership models. Additionally, divestitures are likely to remain a key strategy, as Health Services companies shed non-core assets.

- As the Health Services industry continues to focus on value-based care and population health management, patient and consumer retention becomes ever-more important, requiring new capabilities. Health Services companies could focus on deal targets with assets that facilitate data collection, mining, and interpretation, as well as user-friendly experiences.
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Smart deal makers are perceptive enough to see value others have missed, flexible enough to adjust for the unexpected, aggressive enough to win favorable terms in a competitive environment, and circumspect enough to envision the challenges they will face from the moment the contract is signed. But in a business environment where information can quickly overwhelm, smart deal makers look to experienced advisors to help them fashion a deal that works.

PwC’s Deals Practice can advise health services companies and health services-focused private equity firms on key M&A decisions, from identifying acquisition or divestiture candidates and performing detailed buy-side diligence, to developing strategies for capturing post-deal profits and exiting a deal through a sale, carve-out, or IPO. With more than 20,000 deals practitioners worldwide, we can deploy seasoned teams that combine deep health services industry skills with local market knowledge virtually anywhere your company operates or executes transactions.

Although every deal is unique, most will benefit from the broad experience we bring to delivering strategic M&A advice, due diligence, transaction structuring, M&A tax, merger integration, valuation, and post-deal services.

In short, we offer integrated solutions, tailored to your particular deal situation and designed to help you extract value within your risk profile. Whether your focus is deploying capital through an acquisition or joint venture, raising capital through an IPO or private placement, or harvesting an investment through the divestiture process, we can help.

For more information about M&A and related services in the health services industry, please visit www.pwc.com/us/deals or www.pwc.com/us/health-services.

About the data

Deal volumes and value: We defined US M&A activity as mergers, acquisitions, shareholder spin-offs, capital infusions, consolidations and restructurings where acquisition targets are primarily 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.

Multiples: Data on EV/EBITDA multiples was sourced from S&P Capital IQ (a division of McGraw-Hill Financial) and includes publicly-traded companies in the following sub-sectors: Acute Care, Ambulatory Care/Rehab/Dental, Home Health/Hospice, Labs/Imaging, Managed Care, Outsourcing, SNFs(ALFs/LTACHs. Information provided by or through third parties is provided “as is”, without any representations or warranties by PwC or such third party. PwC and such third party disclaims any contractual or other duty, responsibility or liability to Client and any person or entity that receives such Information.

IPOs: IPO information was sourced from Dealogic Equity Capital Markets Analytics, for the following sectors: Healthcare-Practice Management, Hospitals/Clinics, Healthcare-Miscellaneous Services, Outpatient Care/Home Care, Insurance-Multi-line.