First Half of 2017 Offers a Healthy Diagnosis for Healthcare M&A Activity
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In this issue, we analyze a select group of exciting recent healthcare transactions that caught our attention. We highlight a recent increase in large-scale hospital transactions, describe a merger that could produce the next great revenue cycle management platform, and assess the potential disruptive impact of Amazon’s rumored entry into the pharmacy sector. We also provide an in-depth analysis of why we are seeing tremendous interest in addiction treatment services transactions. However, let’s begin with a brief review of one of the sectors we believe is experiencing game-changing growth investment and M&A activity: genetic diagnostics.

Throughout the national debate on healthcare, one fact remains true: technology and innovation will be major drivers to enhance the delivery of care, reduce costs, and improve patient outcomes. Genetic diagnostics are enabling medical professionals and patients to better predict, diagnose, and understand cancers and inherited and acquired diseases. We are still in the early innings of market adoption of genetic diagnostics with massive untapped potential to radically change the way our healthcare system determines care pathways.

Intrepid is proud to be representing Ambry Genetics, a leader in genetic diagnostics, in its pending sale to Konica Minolta in a transaction valued at US$1 billion. Ambry offers the world’s most comprehensive suite of genetic testing solutions for inherited and acquired diseases, as well as for numerous clinical specialties, including oncology, cardiology, pulmonology, neurology, and general genetics.

Other exciting transactions in diagnostics this quarter include Transgenomic’s reverse merger into Precipio Diagnostics, which will now trade on the NASDAQ as Precipio (NasdaqCM:PRPO) and market its liquid biopsy technology for early cancer detection across multiple genetic sequencing platforms. In addition, CDx Diagnostics, which utilizes neural-network-based 3D microscopy to find dangerous abnormal cells before they can develop into cancer, sold a majority interest to Galen Partners, a healthcare-focused growth equity firm. Also, Kailos Genetics, a provider of genetic tests, including breast and ovarian cancer risk screening as well as companion diagnostics to test for a patient’s potential interactions with specific drugs, announced a growth capital investment from In-Q-Tel, a nonprofit private equity and venture capital firm. Lastly, Guardant Health, which develops a blood test that enables real-time tracking of a patient’s cancer without the need for a biopsy, announced a $360 million capital raise from SoftBank, Sequoia, OrbiMed, Tamasek, and others.

Intrepid’s Healthcare Group is excited to be a part of this transformative increase in genetics M&A activity, which has the potential to change the face of healthcare for generations to come.

Jonathan Bluth
Head of the Healthcare Group
jbluth@intrepidib.com

Adam Abramowitz
Managing Director
aabramowitz@intrepidib.com
For several years, private equity sponsors and strategic industry consolidators have aggressively targeted substance abuse treatment facilities. What is driving ongoing interest in the sector? Will these factors continue or are they showing signs of abatement?

Large Population in Need
Today, an estimated 23 million Americans face some form of substance addiction. Opioids and alcohol are the two largest segments, accounting for over 68% of the affected population. Unfortunately, these two populations are seeing dramatic increases and unmet patient demand remains high, thereby creating an environment where the top treatment programs are juggling long waiting lists and the industry overall should experience a long runway of opportunity. The proportion of opiate admissions alone has increased from 18% in 2005 to 34% in 2015.

Highly Fragmented Market
The industry is highly fragmented with the nation’s two largest players accounting for only 8% market share. There are an estimated 28,600 treatment clinics operated by more than 19,200 enterprises, creating a long-term horizon for consolidation. Substantial opportunities exist to consolidate and leverage key corporate functions across a broader revenue base, while taking advantage of a broader marketing and patient intake funnel with more treatment programs and options available to incoming addicted individuals. Many operators have successfully grown by developing robust consumer marketing efforts and then building out the treatment capacity to treat a growing waitlist of patients.

Sources: S&P Capital IQ, PitchBook, and various company press releases.
Favorable Regulatory Tailwinds Driving Expanded Insurance Coverage
Coupled with the increasing number of affected individuals is the more comprehensive commercial insurance coverage environment available to fund treatment. Nearly 90% of mental health treatment facilities indicate that they currently accept Medicaid for services. The Mental Health Parity and Addiction Equity Act (MHPAEA) of 2008 and certain provisions in the Affordable Care Act (ACA) created dynamics whereby mental health and substance abuse insurance benefits must be offered to covered individuals and such benefits need to be in parity with other medical benefits. Furthermore, the latest federal health reform legislation contemplates expanding funding for opioid treatments in the future. Offsetting the growing covered population are challenges with insurance reimbursement levels and shorter lengths of approved treatment driving down revenue per patient.

Profitability of In-Network Reimbursement Models Continues to Evolve
Substance abuse treatment brings with it a multitude of payors including CMS, commercial insurance (including both in-network and out-of-network reimbursement), and private cash pay. Such diversity enables treatment providers to target a broad cross-section of the population and create programs that meet the needs of each payor population thereby mitigating risk and driving opportunities for growth. Due to the strong demand for treatment services from Medicare and in-network commercially insured patients, the most successful addiction programs are developing alternative lower-cost models that allow them to maintain strong profitability by offsetting lower revenue with higher volume.

Attractive Unit and Growth Economics
Unlike many other healthcare settings, substance abuse treatment offers lower initial capital requirements and facility startup costs, thereby generating a high return on investment. Such dynamics create compelling de novo growth opportunities, especially when combined with long patient waiting lists and in-network insurance referral volume.

As macro drivers continue to demonstrate primarily favorable tailwinds, we expect interest in the sector to remain strong, especially as new and innovative treatment models emerge to drive growth.
Recent Healthcare Industry Transactions

Intrepid Acts as Financial Advisor to Ambry Genetics, Deal Valued at US$1 Billion – July 2017
Konica Minolta recently announced its plans to acquire U.S.-based Ambry Genetics in a deal valued at US$1 billion. Intrepid’s Healthcare Group is acting as financial advisor to Ambry Genetics. This is a powerful combination that will bring the world’s most comprehensive genetic-diagnostic solutions to Japan, Europe, and throughout the world. “This acquisition is the first in a series of strategic initiatives to secure a leading position for Konica Minolta in precision medicine,” said Shoji Yamana, President and CEO of Konica Minolta. “As a part of Konica Minolta, we will have the resources, technology, and scale to advance biomedical research and enable the matching of more patients in more countries with specialized medicines that target the underlying cause of their illness,” said Charles Dunlop, President and Chairman of Ambry Genetics.

Best Doctors Sale Furthers Adoption of Virtual Healthcare and Telemedicine – June 2017
Teladoc, Inc. (NYSE: TDOC), the nation’s largest telehealth platform, announced that it has entered into an agreement to acquire Best Doctors, a second-opinion medical consultation company consisting of a global network of over 50,000 medical experts. Teladoc currently serves more than 20 million members, and is looking to expand its comprehensive virtual healthcare delivery platform to the global market through Best Doctors’ widespread connections. The continued maturation of telemedicine, both in terms of improved diagnostic and treatment capabilities as well as improved company financial performance, should lead to a telehealth land grab in the years to come.

Latest Verity Deal May Signal That Mega Hospital Transactions Are on the Rebound – June 2017
Los Angeles-based healthcare entrepreneur Dr. Patrick Soon-Shiong announced that he has acquired a significant equity interest in Integrity Healthcare, which manages the six-hospital Verity Health System. This comes only 18 months after Blue Mountain Capital acquired the then-named Daughters of Charity Health System in a highly-publicized distressed auction. While it is uncertain if Verity had made a rapid financial turnaround under Blue Mountain’s stewardship, this latest deal signals a recent uptick in hospital M&A interest, as it is on the heels of a series of recent sizable deals. In May, Steward Health System of Boston acquired eight hospitals in Ohio, Florida, and Pennsylvania. In March, Minneapolis-based Fairview Health Services, an operator of nine hospitals in the Midwest, agreed to merge with St. Paul-based HealthEast, a four-hospital system. Also in March, Pennsylvania-based PinnacleHealth announced its intent to buy four smaller hospitals and to affiliate with UPMC Health System, solidifying UPMC’s position as the largest health system in Pennsylvania with nearly 30 facilities. This increase in large hospital transactions could be brought on by growing confidence that hospitals will be beneficiaries of pending health reform and could mark the beginning of a new wave of multi-hospital transactions.
Recent Healthcare Industry Transactions (cont.)

Cognizant Acquisition of TMG Health Underscores Demand for Cost Containment Tools – June 2017
Cognizant Technology Solutions Corp. (NASDAQ: CTSH) announced the acquisition of TMG Health, a leading national provider of business process outsourcing solutions for Medicare Advantage, Medicare Part D, and Managed Medicaid plans. Since 2008, TMG Health has been a subsidiary of diversified health and life insurance products company, Health Care Service Corp. The acquisition will build on Cognizant’s 2014 acquisition of healthcare technology provider TriZetto, extending Cognizant’s market leadership and expanding the breadth of its digital transformation solutions for payors and providers. This deal highlights continued interest by investors, payors, and multi-specialty provider service organizations to build or acquire leading Medicare cost containment capabilities.

Amazon’s Entry Into Pharmacy Services Drives Speculation – May 2017
CNBC reported in May that Amazon.com, Inc. (NASDAQ: AMZN) has hired a new general manager to lead their entry into the online pharmacy industry. According to the article, Amazon has held multiple senior-level strategic planning meetings at its Seattle headquarters to formulate a strategy for how to best enter the pharmacy business. The company already started selling a limited selection of non-prescription medical supplies in the U.S. However, it remains to be seen whether Amazon will compete directly with local and regional specialty pharmacies for prescription medications or target the uninsured or high deductible insured with preferable out-of-pocket pricing. Regardless, pharmacy and distribution companies across the country will be highly focused on Amazon’s upcoming moves in this sector.

Varsity Healthcare Scores Again With Sale of Leading Eye Care Services Platform – May 2017
Harvest Partners announced the acquisition of Varsity Healthcare Partners’ majority ownership interest in EyeCare Services Partners (ESP), the nation’s largest vertically integrated ophthalmologic services company. ESP’s affiliated ophthalmologists and optometrists serve communities in California, Colorado, Delaware, Illinois, and Maryland. Since Varsity’s initial investment in May 2014, ESP has grown rapidly through de novo openings and acquisitions, affiliating with more than 20 new practices. ESP represents Harvest Partners’ sixth addition to their healthcare services portfolio, having recently acquired Dental Care Alliance in July 2015, and Varsity’s second major exit in the past 18 months, following their sale of Forefront Dermatology to OMERS in February 2016.

Newly Formed Meduit Could Become the Next Great National RCM Platform – March 2017
NexPhase Capital (formerly Moelis Capital Partners) invested in and led the merger of two leading revenue cycle management (RCM) companies, MedA/Rx of Charlotte, NC, and Receivables Management Partners (RMP) of Indianapolis, Ind. The two companies will be joined under the parent company, Meduit, to deliver patient pay solutions to hospitals and healthcare providers across the country. With MedA/Rx’s strength in early-out and extended business office solutions and RMP’s experience in aggregating successful late stage A/R and bad debt collections business, Meduit appears to be positioning itself to fill a void created by previous years’ consolidation of mid-sized RCM companies and gain significant market share while improving health systems’ patient liability collections.
### Select Healthcare Transaction Experience

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*Represents transactions executed by principals of Intrepid while at previous securities firms.
About Intrepid’s Healthcare Group

Intrepid’s Healthcare Group is dedicated to providing strategic advice in capital raises and mergers and acquisitions across a broad range of healthcare sectors, including behavioral health, devices, diagnostics, hospitals, IT, pharmacy, physician practice management, post-acute care, and revenue cycle management. Our team maintains extensive relationships with strategic buyers and institutional investors across these sectors.