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# Q2 2010: Healthcare Quarterly

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## Second Quarter Highlights

- Middle market M&A deal volume increased by 30% in Q2 2010 on a year-over-year basis. Aggregate deal value rose by 51% during the same period.
- The national unemployment rate fell to 9.5% in Q2 2010.
- According to the Bureau of Labor Statistics, Healthcare employment levels increased by 38,000 in Q2 2010.

## Overview of Q2

Activity in the Healthcare space has continued the Q1 trend of strategic acquirers exercising strong balance sheets to make key product and platform acquisitions and larger deals that open up new markets. Acquirers continue their measured approach seeking out targets with approved products rather than companies with development-stage technology. Credit remains tight, but there are signs that leveraged deals can still get done. We anticipate the slow return of private equity players throughout the next several quarters.

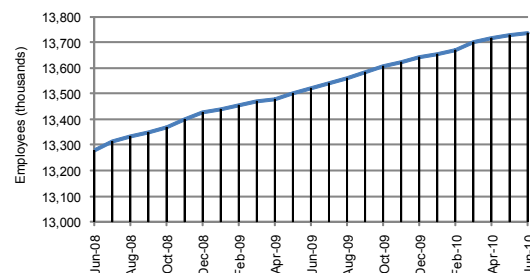
## Specialty Pharma and Generic Drugs Activity Prominent in Q2

Q2 saw a number of notable deals among companies developing, manufacturing and commercializing specialty pharmaceuticals and generic drugs. Notable middle-market transactions include Hospira's acquisition of Javelin Pharmaceuticals, Valeant's acquisition of Aton Pharma (Valeant itself was acquired by Biovail in a stock deal valued at \$3.2 billion), and Cephalon's deal for Mepha.

## Encouraging Trends in VC Funding

According to the MoneyTree™ Report from PricewaterhouseCoopers and the National Venture Capital Association, the Life Sciences sector (Biotechnology and Medical Device industries combined) saw a notable increase in VC investing during Q2 increasing 52% in dollars and 36% in deals from the prior quarter to \$2.1 billion across 234 deals. As was the case in Q1 2010, Biotechnology again received the highest level of funding across all sectors rising 59% in dollars and 34% in deal volume in the second quarter with \$1.3 billion going into 139 deals. Medical Device investing in-

## US Healthcare Employment



Source: Bureau of Labor Statistics

creased robustly by 40% in both dollars and deals over Q1 with \$755 million going into 95 deals in the second quarter.

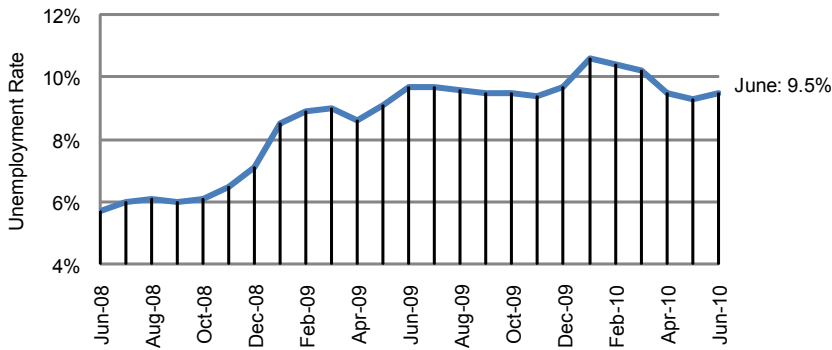
## Prognosis

Key sectors in which to watch for continued consolidation are medical devices and diagnostics. The push for more accurate diagnosis – even to the extent that we call it personalized medicine – and the development of devices that enable minimally invasive procedures with reduced complications, will be key growth areas. In the diagnostics sector we expect a continued push by traditional life sciences companies looking to expand into the rapidly growing molecular diagnostics market, such as Perkin Elmer's acquisition of Signature Genomics. There will be continued consolidation in the biopharma market as the few remaining large pharmaceutical companies look to enhance product pipeline through strategic acquisitions and licensing. Indeed at the beginning of Q3 the M&A rumor mill churned with the news that Sanofi-Aventis is on the prowl for a \$20 billion acquisition. As July comes to a close several sources indicate that Sanofi is indeed targeting Boston-based Genzyme. We expect that acquisition of later stage biotechs (such as Roche's deal for Medingo) will continue to increase with licensing of early-stage compounds being less favorable due to the risk and time for development.

Middle market M&A will continue to improve for those companies that can address the key concerns of the post-ObamaCare market: efficacy and cost. Renewed interest from the private equity community, driven by improvement in the general credit markets, could lead to a period of increased, and even sustainable, middle market Healthcare M&A activity.

# Macroeconomic Factors

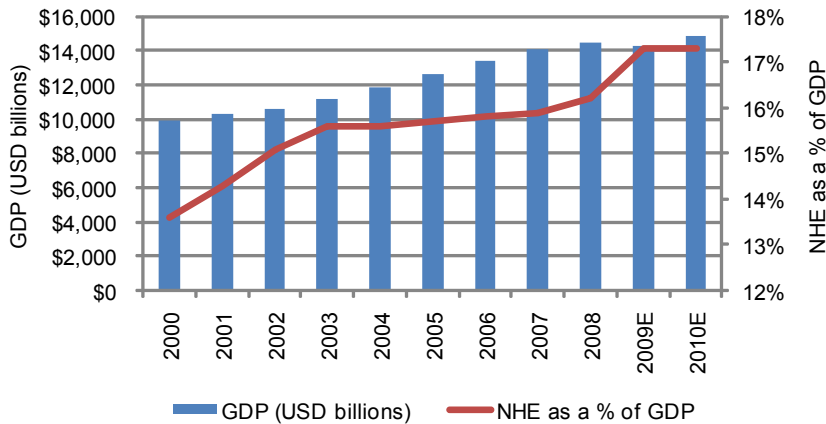
## US Unemployment



Source: Bureau of Labor Statistics

The national unemployment rate edged down to 9.5% in June 2010, after rising to 9.9% in April 2010. Employment rose 596,000 throughout the second quarter. Hiring of temporary workers for the Census 2010 strongly influenced the Q2 2010 employment numbers. The Census Bureau added 410,000 jobs in May and concluded 225,000 of those temporary positions in June, thus ending June 2010 with a decline of employment by 125,000 overall. Private-sector employment increased 357,000 this quarter, according to the Bureau of Labor Statistics. Over the past 12 months, the Healthcare sector gained 217,000 jobs. The professional and business services employment rose by 18,000 positions in June and added 379,000 temporary jobs over the past 9 months.

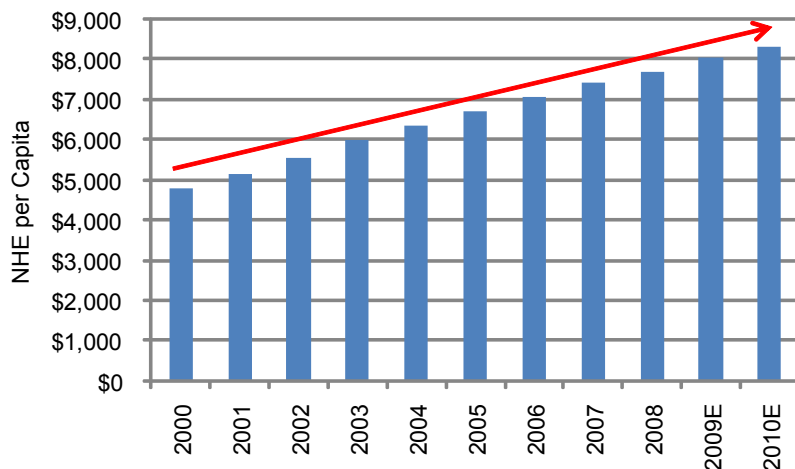
## National Health Expenditures (NHE) vs. GDP



Source: Centers for Medicare and Medicaid Services

National Health Expenditures (NHE) have outpaced GDP growth over the past decade. In 2009, NHE nearly surpassed \$2.47 trillion, or 19% of GDP. A number of factors, including an aging population, rising Healthcare costs, and the expansion of coverage will only accelerate the growth of health expenditures. Additionally, innovative techniques and breakthroughs in technology continue to improve the survival rate of critically ill or injured patients, who, in turn, require extensive (and expensive) therapy and care as they recover from their injuries.

## National Health Expenditures per Capita

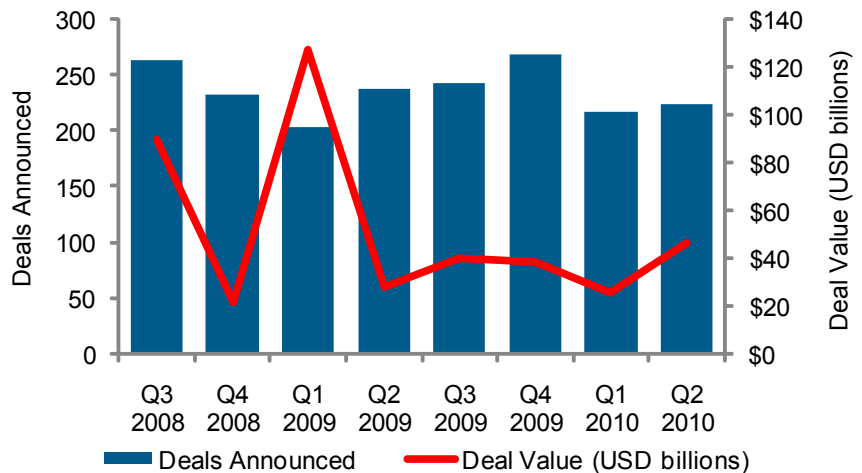


Source: Centers for Medicare and Medicaid Services

NHE per capita has increased by a CAGR of 5.6% over the past decade. In 2009, NHE per capita exceeded \$8,000, up from \$7,000 just three years earlier. As previously mentioned, the population of the US is aging, as many baby boomers enter the latter stages of life. Older people tend to have a higher incidence of injury and illness, leading to more frequent visits to doctors, hospitals, and care facilities. Combined with rising Healthcare costs and expensive care for critically ill patients, this trend should continue for the foreseeable future.

## Healthcare M&A Activity

Healthcare M&A has continued to increase through the second quarter of 2010. A total of 223 deals were announced worth \$46.2 billion. This is a 77% increase in deal value over Q1 2010 and a 62% increase over the year-ago quarter. A broadening of the market is indicated by the upswing of healthcare services deals in Q2. Services deals account for 47% of the total deals in the second quarter compared to 40% in Q1 2010 and 37% in Q2 2009. The first half of 2010 has produced 440 M&A deals in healthcare at a value of \$72 billion and the second half of the year is expected to continue the upward trend.



Source: Irving Levin Associates

The second quarter of 2010 has been dominated by three main sectors, medical devices with 42 deals, pharmaceuticals with 41 deals, and biotechnology with 25 deals, which account for 53% of the total Q2 healthcare M&A volume. Sanofi-Aventis expanded its reach into the vascular pharmaceutical arena in June with the acquisition of TargeGen for \$560 million. Cardinal Health is reinforcing the market expansion into services by acquiring Health Solutions Holding, a company that provides tools and services to improve patient outcomes and increase efficiency in health care delivery, for \$667 million.

## Selected Middle Market Healthcare Transactions

Category	Announced Date	Target	Acquirer	Enterprise Value (\$USDmm)	EV to LTM Rev	EV to LTM EBITDA
BioPharma	Jun-10	TargeGen <i>Vascular biopharmaceutical</i>	Sanofi-Aventis <i>General pharmaceutical products</i>	\$560	NA	NA
BioPharma	May-10	FuturaGene <i>Agricultural bio-technology</i>	Suzano Papel e Celulose <i>Forestry-based company</i>	70	264.1x	NA
BioPharma	Apr-10	Javelin Pharmaceuticals <i>Pain management products</i>	Hospira <i>Pharmaceuticals and medication delivery systems</i>	147	72.2x	NA
BioPharma	May-10	Sigma Pharmaceuticals <i>Generic pharmaceutical products</i>	Aspen Pharmacare Holdings <i>Global pharmaceutical products</i>	800	0.3x	5.5x
Diagnostics	Apr-10	RedPath Integrated Pathology <i>Oncology laboratory services</i>	ExonHit Therapeutics <i>Molecular diagnostic tests and therapeutics</i>	32	5.9x	NA
Healthcare IT	Apr-10	Phase Forward <i>Clinical trial and drug safety monitoring</i>	Oracle <i>Enterprise software</i>	591	2.7x	20.0x
Medical Devices	Apr-10	ATS Medical <i>Structural heart disease products</i>	Medtronic <i>Medical device manufacturer</i>	349	4.6x	NA
Medical Devices	May-10	BioSphere Medical <i>Embolotherapy products</i>	Merit Medical Systems <i>Interventional and diagnostic products</i>	66	2.1x	NA
Medical Devices	Apr-10	Medingo <i>Diabetes treatment products</i>	F. Hoffmann-La Roche <i>Diagnostics and pharmaceuticals products</i>	200	NA	NA
Medical Devices	May-10	SenoRx <i>Breast cancer diagnosis and treatment products</i>	CR Bard <i>Medical and diagnostic equipment</i>	193	3.4x	46.3x
Medical Devices	Jun-10	Somanetics <i>Real-time blood oxygen monitoring systems</i>	United States Surgical <i>Medical devices and equipment</i>	291	5.4x	25.4x
Services	Apr-10	American Homepatient <i>Home healthcare services, equipment, and supplies</i>	Highland Capital Management <i>Investment management firm</i>	226	1.0x	21.3x
Services	Apr-10	Dialysis Corp. of America <i>Outpatient kidney dialysis centers</i>	U.S. Renal Care <i>Outpatient kidney treatment centers</i>	119	1.2x	12.4x
Services	Apr-10	Signature Genomic Laboratories <i>Diagnostic cytogenetic services</i>	PerkinElmer <i>Healthcare research and development</i>	90	NA	NA
Tools and Equipment	Apr-10	GENEART <i>DNA engineering and processing</i>	Applied Biosystems Deutschland <i>Global biotechnology tools</i>	61	2.6x	27.8x

Sources: Capital IQ and 451 Group

# Public Trading Comparables

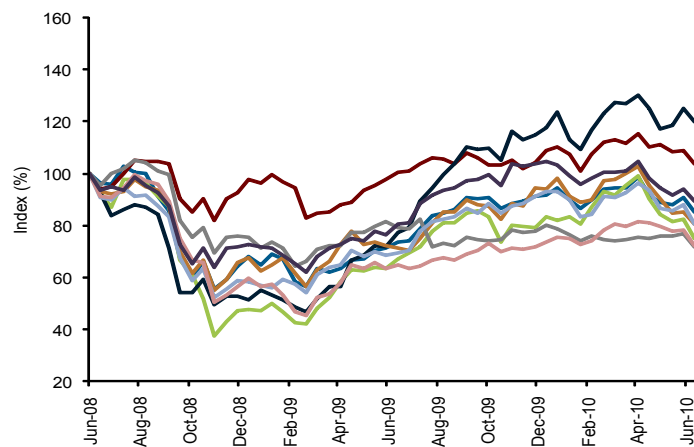
	Stock Price Change			EV / Revenue			EV / EBITDA			P / E		
	3 months	6 months	12 months	LTM	2009E	2010E	LTM	2009E	2010E	LTM	2009E	2010E
BioPharma - Large Cap	(10.7%)	(7.5%)	8.6%	2.8x	2.9x	2.6x	8.1x	8.2x	7.3x	16.2x	17.1x	12.1x
BioPharma - Small/Mid Cap	(14.4)	(12.2)	(10.3)	3.5	3.6	3.3	5.7	6.0	8.2	14.9	14.9	13.3
Diagnostics	(16.3)	(11.8)	(14.0)	2.4	2.5	2.7	9.3	10.0	10.5	17.5	19.8	18.4
IT Services - Healthcare	(5.5)	(3.4)	10.8	2.0	2.1	1.7	12.9	11.1	9.7	29.7	28.2	24.1
Medical Devices - Large Cap	(9.9)	(0.6)	27.3	2.6	2.7	2.5	9.4	9.5	8.4	20.3	21.7	15.7
Medical Devices - Small/Mid Cap	(6.8)	(6.4)	10.5	1.4	1.4	1.5	9.5	8.9	9.8	17.8	19.1	21.0
Services	(11.7)	(4.2)	10.1	1.2	1.2	1.4	8.9	8.7	8.7	21.3	19.7	17.3
Tools & Equipment	(9.9)	(1.4)	11.8	1.9	2.1	1.9	10.3	11.6	9.5	22.6	23.5	15.9
<b>Overall Median</b>	<b>(10.3%)</b>	<b>(5.3%)</b>	<b>10.3%</b>	<b>2.2x</b>	<b>2.3x</b>	<b>2.2x</b>	<b>9.4x</b>	<b>9.2x</b>	<b>9.1x</b>	<b>19.1x</b>	<b>19.8x</b>	<b>16.6x</b>

	Index Price Change		
	3 months	6 months	12 months
NASDAQ Composite Index	(12.2%)	(7.0%)	14.9%
Dow Jones Industrial Average	(10.6)	(6.3)	15.7
S&P 500 Index	(12.5)	(7.6)	12.1

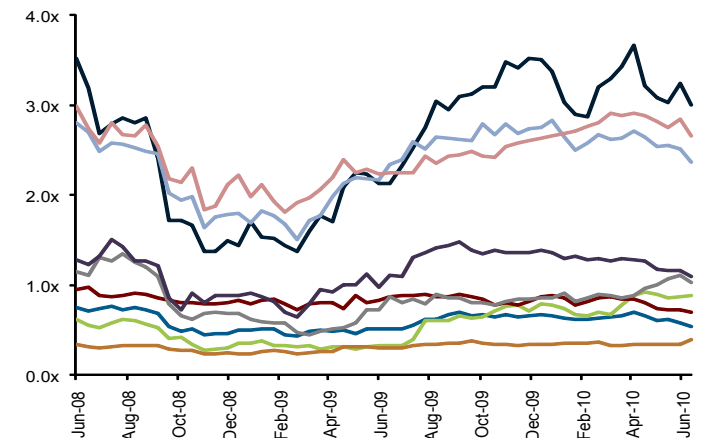
(1) Large Cap defined as market capitalization of more than \$1 billion as of March 31, 2010.

Note: Large Cap defined as market capitalization of more than \$1 billion as of March 31, 2010

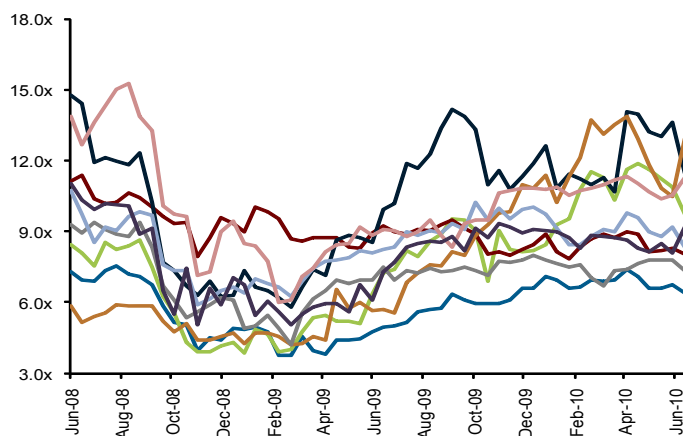
## Stock Performance



## EV/Revenue Multiples



## EV/EBITDA Multiples


















## Legend

- BioPharma - Large Cap
- BioPharma - Small/Mid Cap
- Diagnostics
- IT Services - Healthcare
- Medical Devices - Large Cap
- Medical Devices - Small/Mid Cap
- Services
- Tools & Equipment

Sources: Capital IQ and company filings

# Covington Associates

## Recent Transactions

 <p>acquired by</p> <p>NEW ENGLAND CAPITAL AND CLARKSTON MERCHANT PARTNERS</p>	 <p>has acquired</p> 	 <p>acquired by</p> 	 <p>entered into a development partnership with</p> 
 <p>acquired by</p>  <p>\$133,000,000</p>	 <p>acquired by</p> 	 <p>HEMODIALYSIS CATHETER BUSINESS</p> <p>acquired by</p>  <p>\$12,500,000</p>	 <p>acquired by</p>  <p>\$6,500,000</p>

## Industry Expertise

### Business Services

- Consulting
- Government
- Payment & Transaction Processing
- Real Estate Services
- Research

### Healthcare

- Clinical Trial Services
- Diagnostics
- Disease Management
- Healthcare Information Technology
- Medical Product Outsourcing
- Medical Devices
- Tools and Reagents
- Therapeutics

### Consumer and Industrial

- Analytical Instrumentation
- Consumer Products
- Energy
- Manufacturing & Distribution
- Transportation & Logistics

### Technology

- Communications
- Digital Media Technologies
- Enterprise Software
- Hardware
- IT Services
- Reseller/Distribution

## About Covington

Covington Associates is a specialty investment banking firm founded in 1991 serving business services, consumer & industrial, healthcare, and technology companies throughout the country.

Focused on mergers and acquisitions, debt and equity capital raising, debt and equity restructuring, and strategic advisory assignments for middle market companies, Covington Associates has completed transactions ranging in value from \$10 million to close to \$2 billion for both private and publicly traded companies.

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