



Lab M&A Activity in a Tight Capital Market:
How Recent Deals are Impacting the Industry

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Christopher Jahnle

Kirk A. Rebane



Overview

- I. Factors That Influence Value and M&A Activity
- II. How the National Labs Can Justify Their Valuations of Acquisition Targets
- III. Where Are Lab Valuations Heading?



Factors That Influence Value and M&A Activity

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Value = Present Value of Future Cash Flows

What factors will impact future cash flows?

Factors That Influence Value and M&A Activity

Internal Factors:

- Growth Potential / Historical Growth Rate
- Size (net revenue, EBITDA, number of accessions, etc.)
- Profitability
- Stability / Reputation
- C-Corporation vs. S-Corporation vs. Partnership vs. LLC
 - Objective is to achieve capital gain treatment for sellers
 - Buyers prefer to buy assets

Factors That Influence Value and M&A Activity

Internal Factors (cont'd):

- Composition of Revenue – Clinical Lab
 - Price Per Accession
 - Physician office clients vs. Nursing Homes
 - Medical testing vs. Substance Abuse testing
 - Hospital outreach vs. In-patient
- Sustainability of Revenue
- Billing Compliance, Collection Rates, and Payor Mix
- Verifiability of Financial and Operating Data
- Level of Working Capital or Net Asset Value to Be Delivered at Closing

Factors That Influence Value and M&A Activity

External Factors:

- Opportunities for the Buyer, (i.e. "Synergies")
 - Revenue Growth from Existing Clients
 - New Marketing
 - New Services and Offerings
 - Subsequent "Fold-In" Acquisitions
- Taxation and Finance Theory Factors
 - Benefit from the lower tax rate on capital gains
 - Conversion of future earnings to lump sum distribution today
 - Value protection and asset diversification

Factors That Influence Value and M&A Activity

External Factors (cont'd.):

- Reimbursement Trends – pressures since 1983
- Industry Demographics
 - Paradigm Shift from Inpatient to Outpatient Setting
 - Rapidly Aging Population
 - Many Screening Tests are Performed Based on Age
 - Increased Incidence of Cancer
 - High Growth in New Technology and Tests, Such as Molecular
 - Strong Fundamentals Continue to Attract Investment From Large Consolidators and Private Equity

Factors That Influence Value and M&A Activity

External Factors (cont'd.):

- Industry Demographics (cont'd.)
 - Esoteric testing fuels growth of industry players
 - Shift from prognostic and monitoring tests to preventive medicine
- State of General Economy
 - Availability of Patient Funds for Healthcare
 - Credit Market for Buyers
 - 50% of hospitals losing money, according to a recent Thomson Reuters analysis of hospital finances

Factors That Influence Value and M&A Activity

External Factors (cont'd.):

- Government Stimulus Plan
 - Preventive Medicine => Diagnostics
 - EMR
 - Broader Healthcare Insurance Coverage => Volume Increases
 - Capital Gains

Factors That Influence Value and M&A Activity

External Factors (cont'd.):

- Valuation Theory

- $V = \frac{CF_1}{r_1} + \frac{CF_2}{r_2} + \dots + \frac{CF_t}{r_t}$

- Value = Sum of CFs into perpetuity

- Time Value of Money: $PV(CF_1) > PV(CF_t)$

- But, CFs after the first five years typically comprise > 50% of value

Factors That Influence Value and M&A Activity

Conclusion:

- No Change in Internal Factors Influencing Value
- No Change in External Industry and Demographic Factors Influencing Value
- Current Negative Economic Factors Mitigated by:
 - Not impacting all buyers
 - Valuation theory
 - Stimulus plan
 - Long term historical track record of success for industry participants



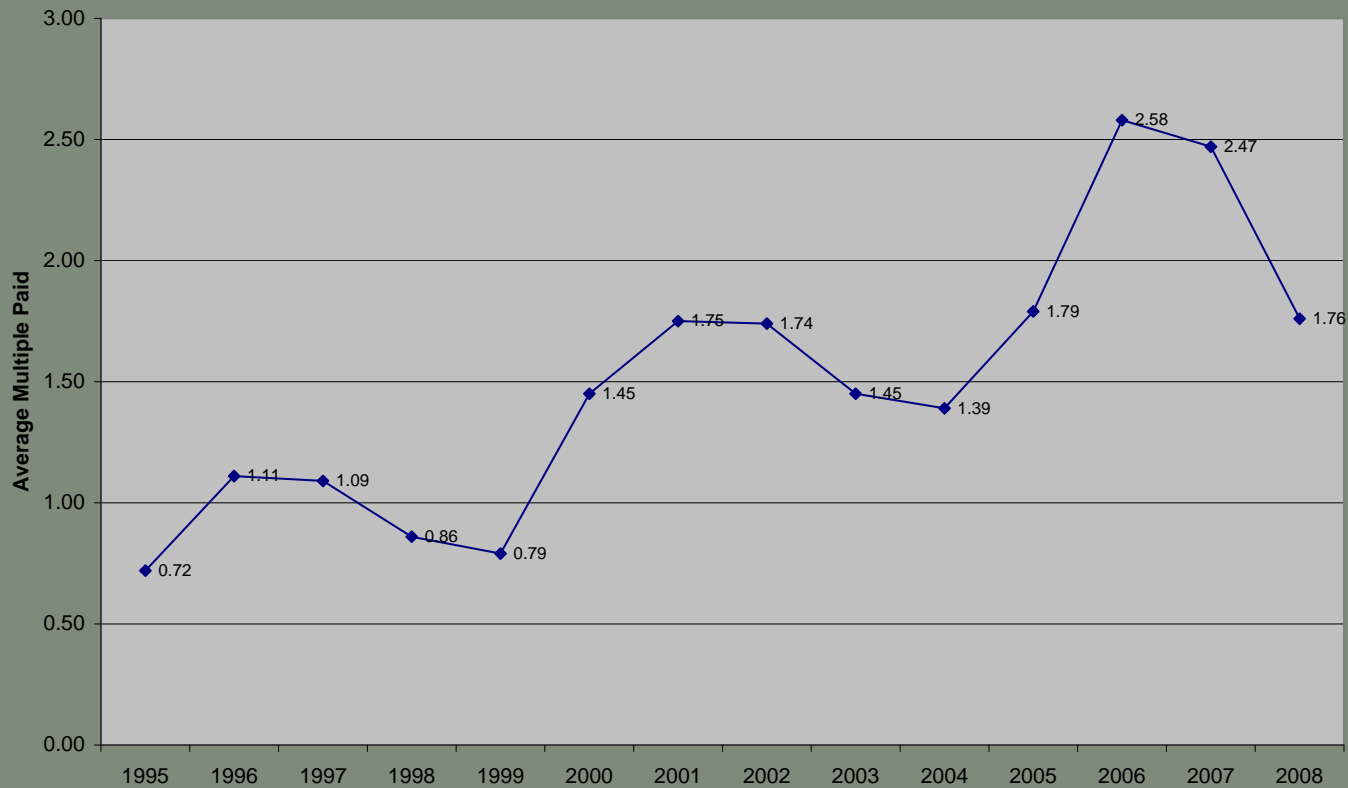
How National Labs Justify Their Valuations of Acquisition Targets

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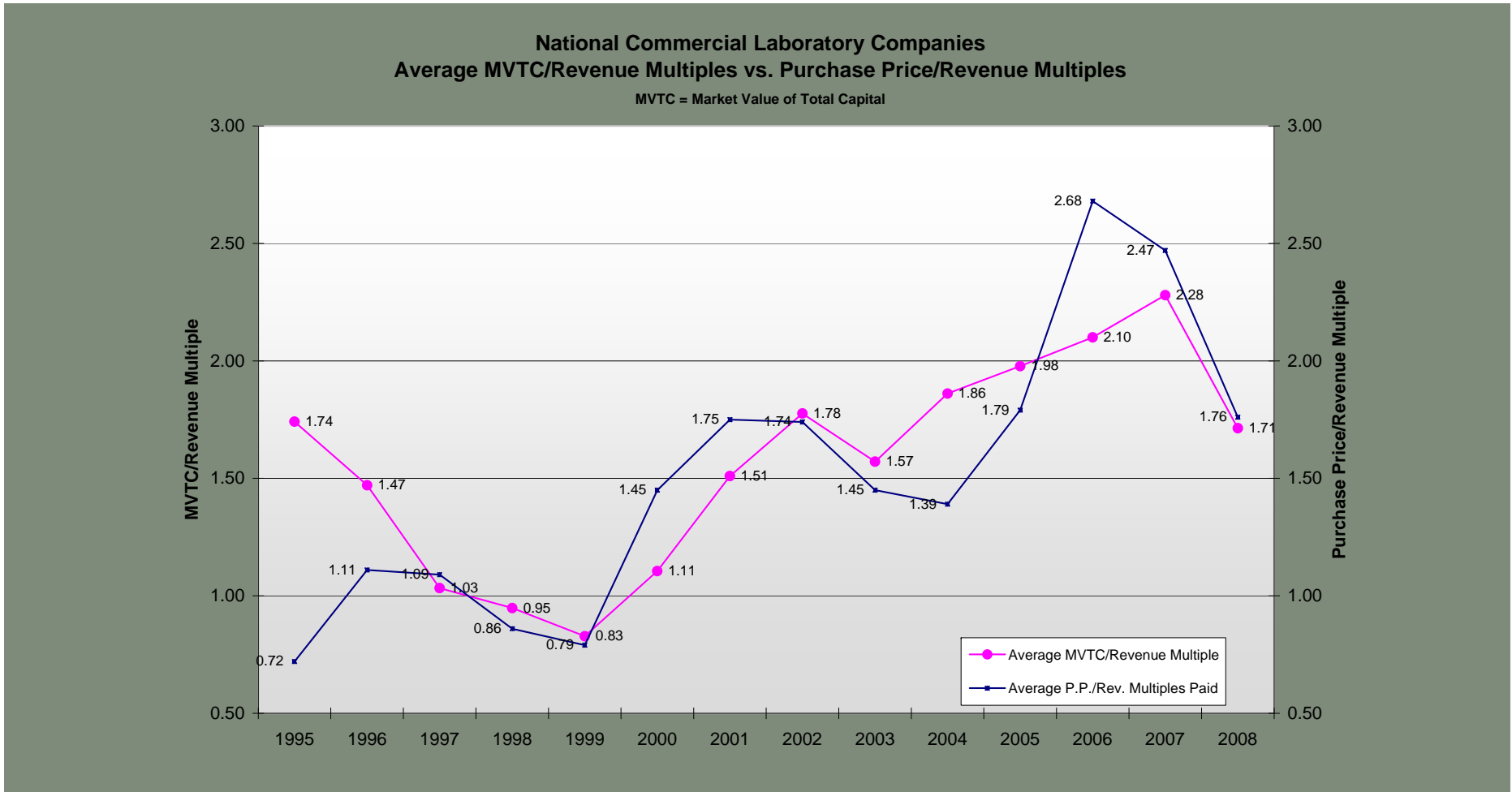
- An intelligent buyer will make an acquisition only if it adds to the value of the acquiring company. Such acquisitions are said to be “**accretive.**”
- Lab buyers can afford to pay *more* for an acquisition as the relative value of their own company *increases*.
- A direct relationship between laboratory acquisition valuations and publicly traded laboratory valuations has been clearly exhibited over the past 20+ years that Haverford has been following the lab industry.

Acquisition Trends

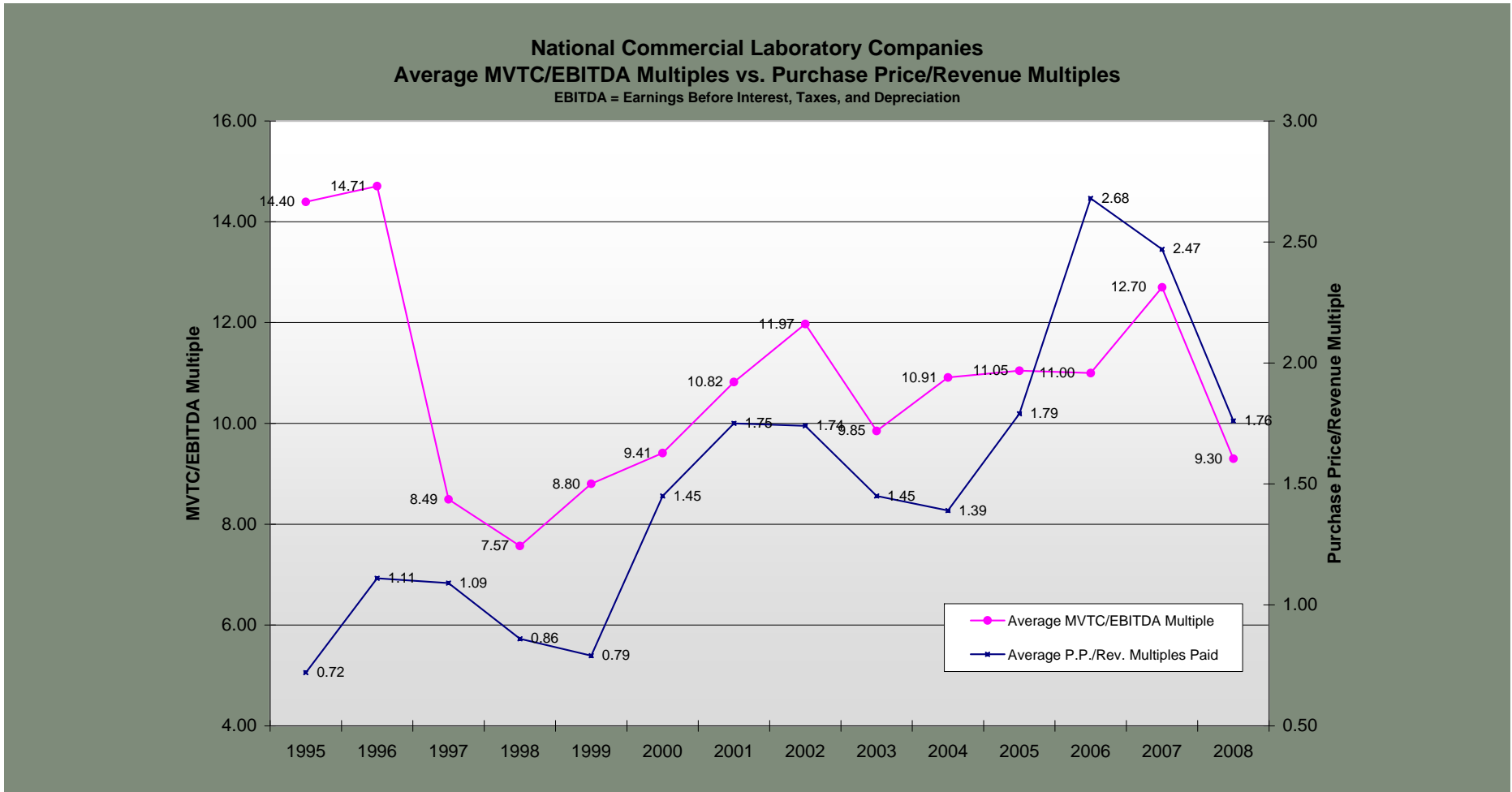
Average Purchase Price to Revenue Multiples Paid



How National Labs Justify Their Valuations of Acquisition Targets



How National Labs Justify Their Valuations of Acquisition Targets



How National Labs Justify Their Valuations of Acquisition Targets

- How can the same laboratory business be worth a different amount today than it was a year ago?
- It depends upon how badly the buyer wants to do the deal.
- Before completing a major transaction, a public company requires the approval of its Board of Directors. Frequently, the Board will seek the advice of an investment banking firm to confirm the reasonability of the terms of the transaction.
- In order to justify the purchase price paid in certain transactions, buyers and their investment bankers will take into account the **synergies**, or cash flow enhancing benefits, that will *potentially* result to the buyer post-transaction.

How National Labs Justify Their Valuations of Acquisition Targets

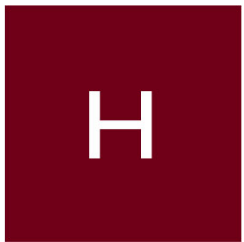
Case Study: Quest Diagnostics acquires AmeriPath, Inc.

Key Transaction Facts:

| | |
|-------------------------|---|
| Closing Date | May 31, 2007 |
| Purchase Price | \$2 billion (approx.) including \$770 million in assumed debt |
| AmeriPath's Data | Net Revenue: \$760 million EBITDA: \$114.8 million |
| Multiples Paid by Quest | 17.4x AmeriPath's 2006 EBITDA 2.63x AmeriPath's 2006 Net Revenue |
| Quest's Multiples | 8.6x Quest's 2006 EBITDA 1.8x Quest's 2006 Net Revenue |

How National Labs Justify Their Valuations of Acquisition Targets

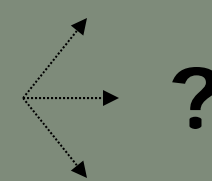
- In various investor presentations, Quest Diagnostics' management listed the integration of AmeriPath as one of a handful of top areas of focus for 2008 / 2009.
- Another stated top area of focus was the company-wide reduction of costs by \$500 million.
- As Quest streamlines AmeriPath's operations, the cost savings should generate incremental EBITDA for Quest.
- If one were to consider Quest's projected synergies from the AmeriPath transaction, the effective valuation multiple paid for AmeriPath would be much lower.

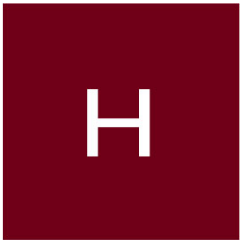


Where Are Lab Valuations Heading?

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Average Purchase Price to Revenue Multiples Paid





Haverford Healthcare Advisors

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Christopher Jahnle, ASA
cjahnle@haverfordcapital.com

Kirk A. Rebane, ASA, CFA
krebane@haverfordcapital.com

43 Leopard Road, Suite 102, Paoli, PA 19301
Telephone: (610) 407-4024 Fax: (610) 407-4028
www.haverfordhealthcare.com