



M&A TRENDS AND DYNAMICS

April 29, 2014



2

Introduction



Who is Crosstree Capital?

3

- Specialized provider of M&A and capital raising advisory
- Exclusive focus on diagnostics, life sciences tools and pharmaceutical outsourcing
- 50+ transactions completed over past 10 years

ConVerge™
Diagnostic Services

Acquired by

Quest Diagnostics

October 2013

BioAgilytix Labs™
Ready Today to Enable Your Breakthroughs of Tomorrow™

Acquired by

RiversidePartners

May 2013

Pacific Physicians' Laboratory, Inc.

Acquired by

LabCorp
Laboratory Corporation of America

December 2012

Cytolab
PATHOLOGY SERVICES

Acquired by

LabCorp
Laboratory Corporation of America

December 2012

Predictive™
BIOSCIENCES

Anatomic Pathology Business
Acquired by

Miraca
Life Sciences

November 2012

Central Coast Pathology

Laboratory Business
Acquired by

SONIC HEALTHCARE

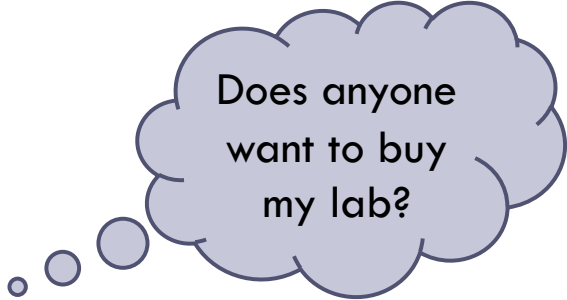
February 2011



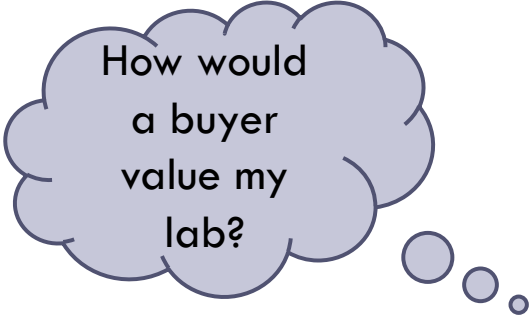
Frequently Asked Questions

4

- How active is M&A in the lab market today?



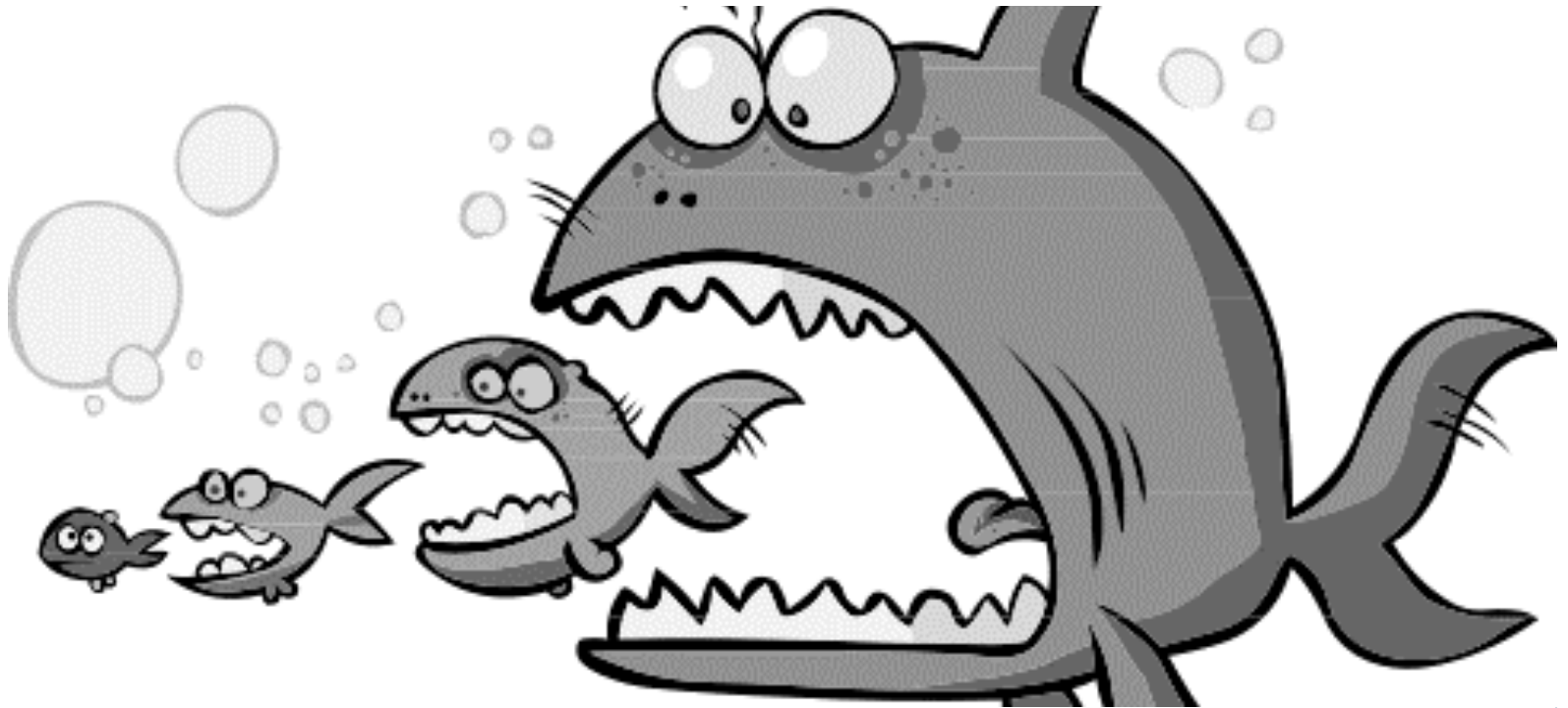
Does anyone want to buy my lab?



How would a buyer value my lab?

- What multiples are buyers paying?





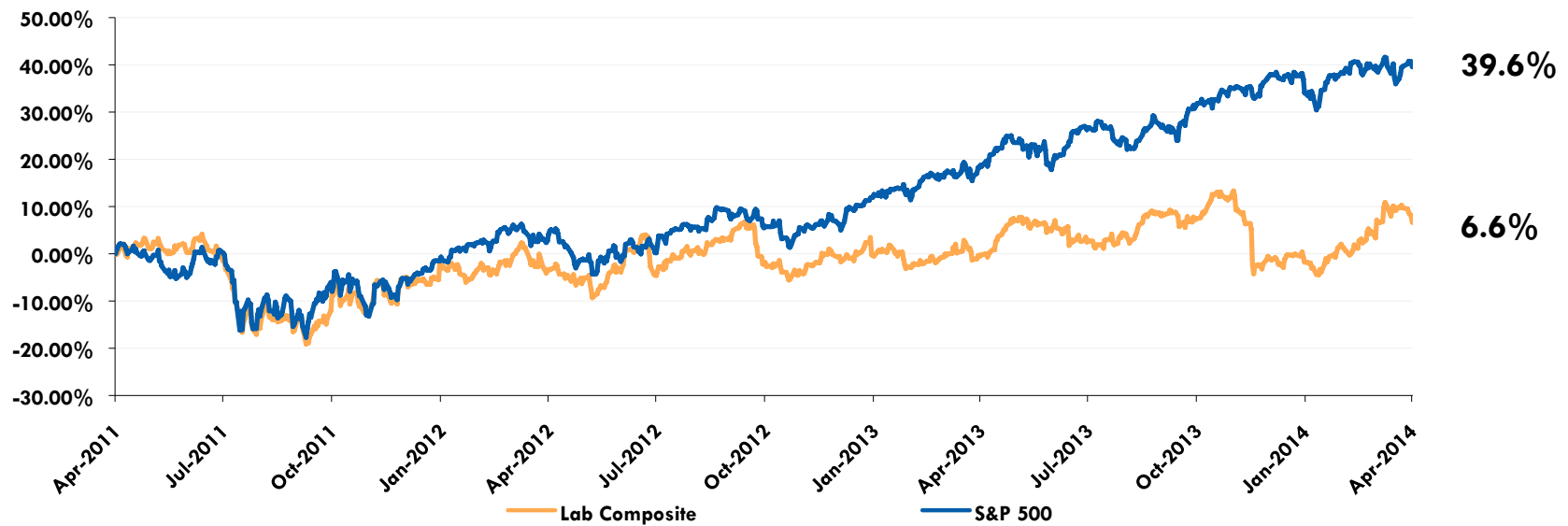
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Strategic Appetite for M&A



Big labs have underperformed

6



Note: The chart presents the market-capitalization weighted composites

Source: Capital IQ

Lab Composite:

Bio-Reference Laboratories, Inc. (NasdaqGS: BRLI)
Laboratory Corp. of America Holdings (NYSE:LH)
Quest Diagnostics Inc. (NYSE: DGX)
Sonic Healthcare Limited (ASX: SHL)



Organic growth is challenging

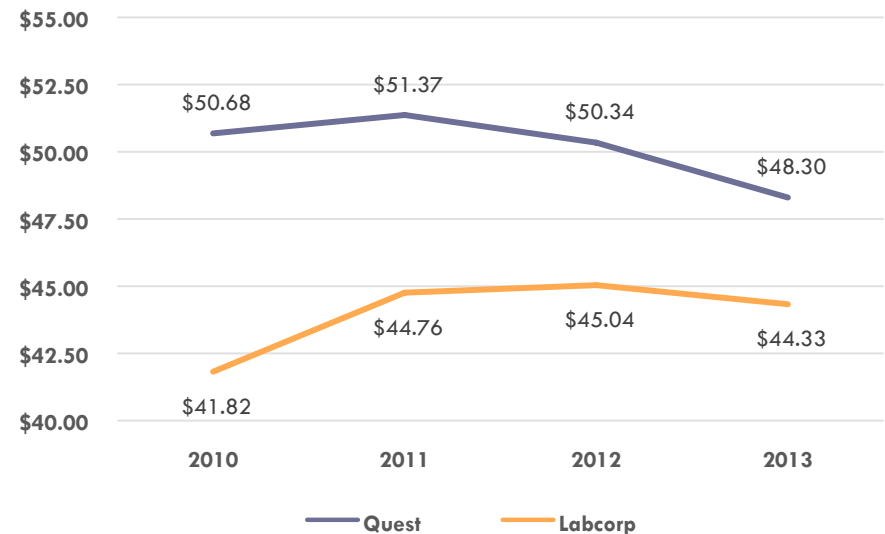
7

- Test utilization flat/ down
- 2013 Revenue growth after adjusting for acquisitions*
 - Quest – (4.6%)
 - LabCorp – ~flat
- Limited visibility on future improvement
 - ACA expanded coverage not having an impact yet



* Source: Laboratory Economics

Revenue per Requisition



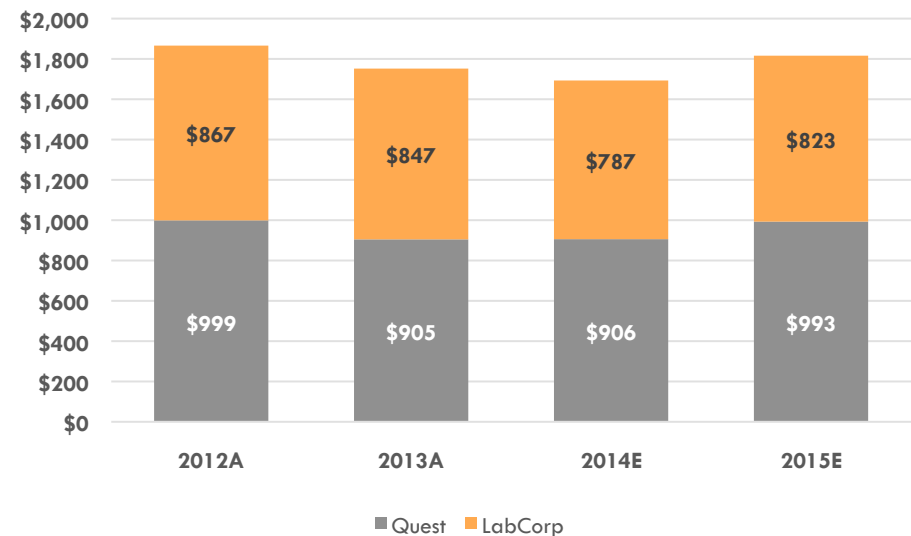
Source: SEC filings

What to do with all of this cash?

8

- Deploying cash in a slow-growth environment
 - Dividends?
 - Share repurchases?
 - M&A?

Historical and Projected Free Cash Flow*



Source: Wall Street Research

* Operating cash flow less capital expenditures

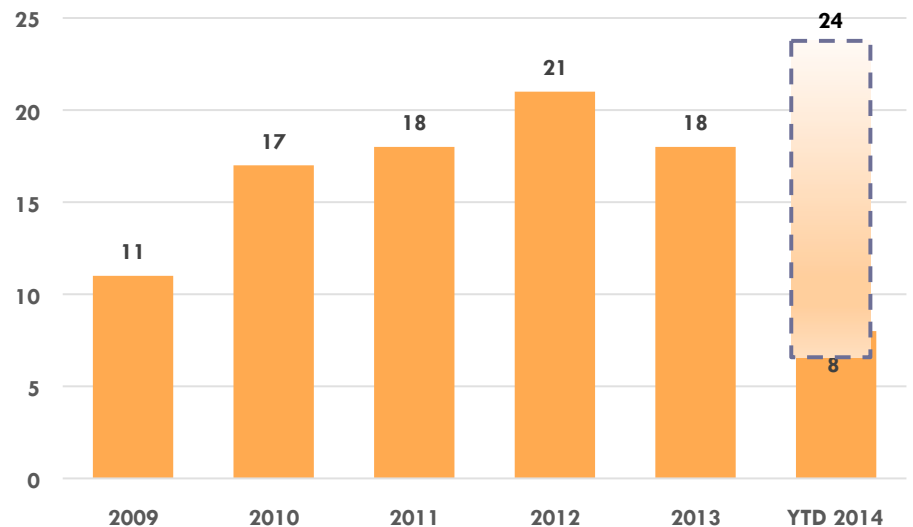


Strategic M&A is critical to growth

9

- Strategic buyers are actively hunting for synergistic acquisitions
- Eight already announced through April 2014

Strategic Lab Acquisitions



Source: Crosstree Capital Partners



What are strategic buyers looking for?

10

Big Labs

- Cost synergies
- Strengthening light geographic presences
- Specialized testing capabilities
- Sendouts

Mid-Sized Labs

- Scale to provide leverage with payors
- Geographic extension
- Specific client bases (i.e. OB/GYNs)
- Testing capabilities (i.e. AP subspecialty depth, etc.)

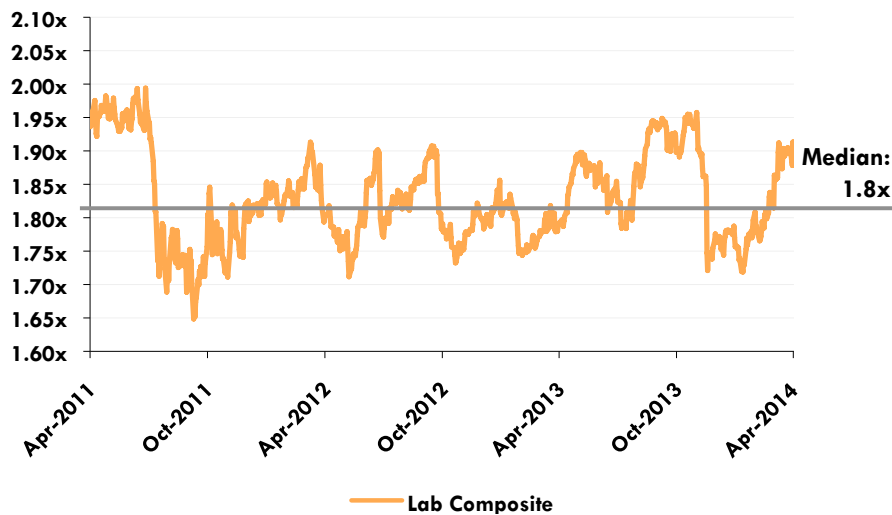
Specialized Labs / IVD

- Accelerate time-to-market
- Revenue synergies
- Quality lab operations / personnel
- Pharma relationships

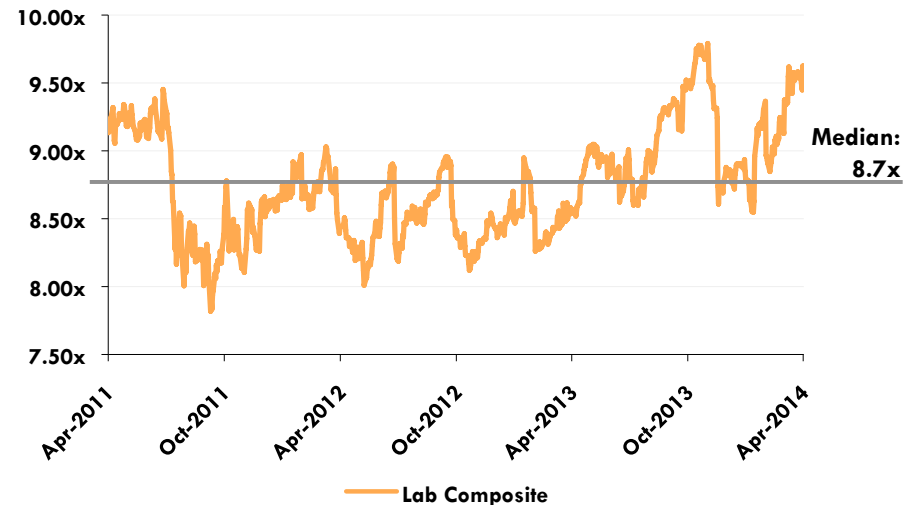


Publicly-traded lab valuation multiples

Enterprise Value / LTM Revenue



Enterprise Value / LTM EBITDA



Note: The charts present the market-capitalization weighted composite

Source: Capital IQ

Lab Composite:

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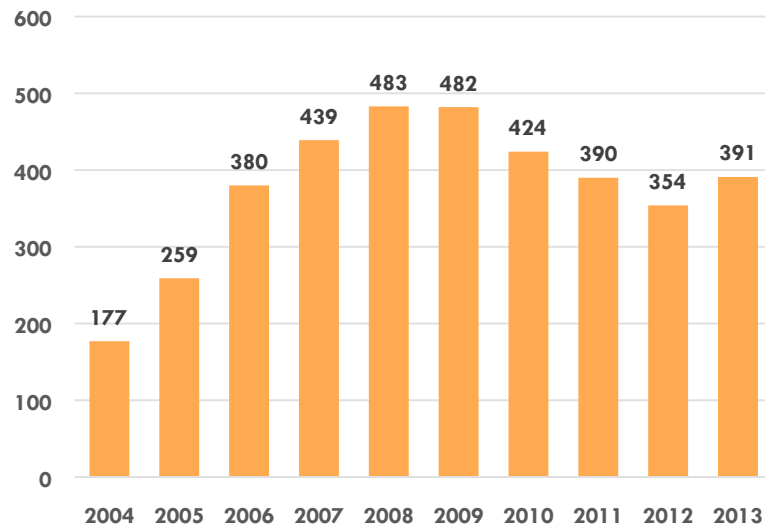
12

Private Equity Climate



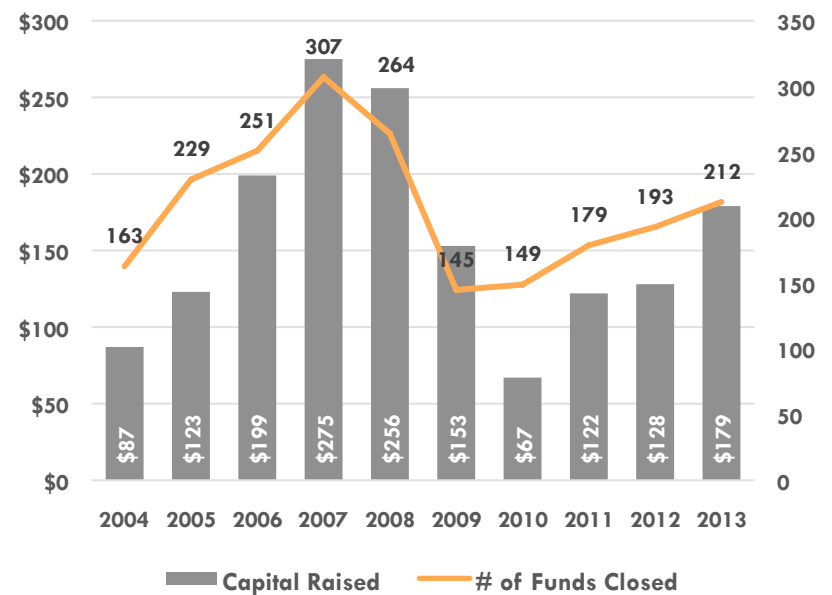
A mountain of capital

Global Buyout Fund Dry Powder (\$B)



Source: Pitchbook

New U.S. Fundraising (\$B)

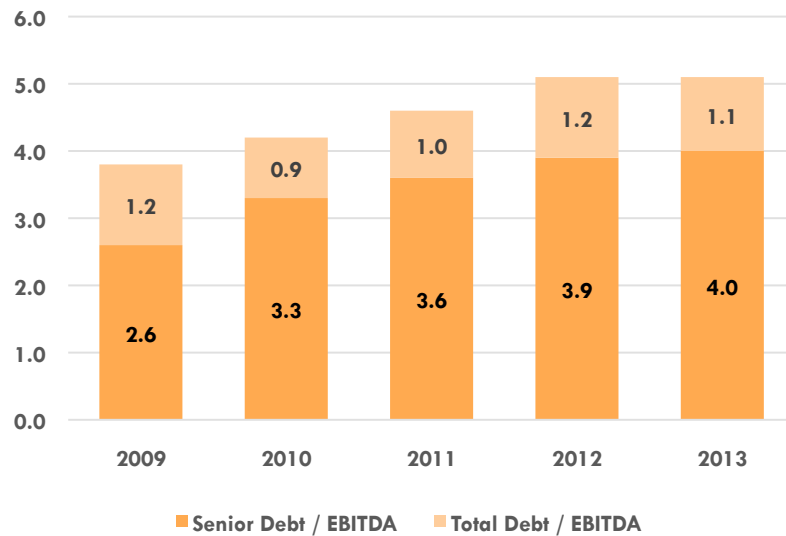


Source: Pitchbook



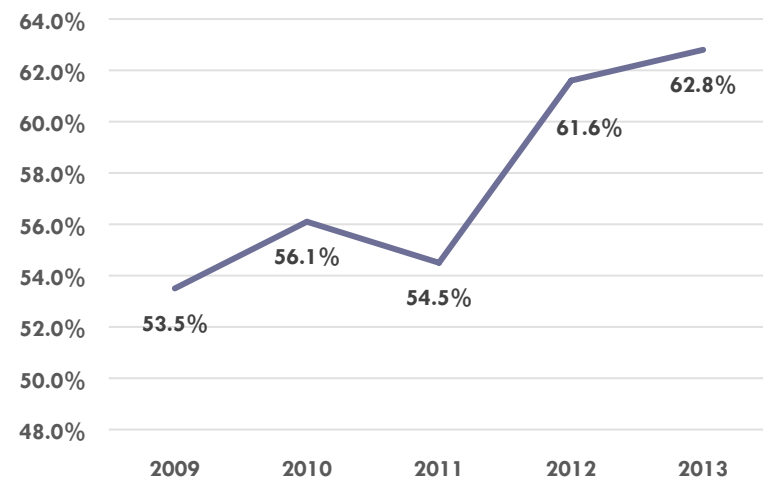
Inexpensive debt capital is abundant

Debt Multiples on PE MM* Loans



Source: Thomson Reuters LPC's Middle Market 4Q13 Review
* Middle Market, companies with under \$500 million in Revenue

Median Debt % for Buyouts



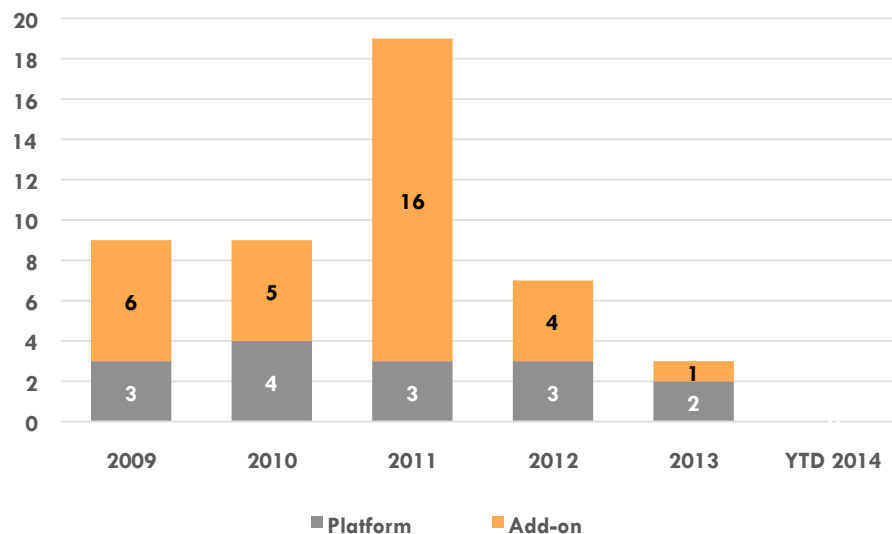
Source: Pitchbook



Private Equity Lab Investing Slows

15

Private Equity Lab Investments



- The “buy-and-build” strategy hasn’t been working as well
- Private equity needs to think more strategically to build value

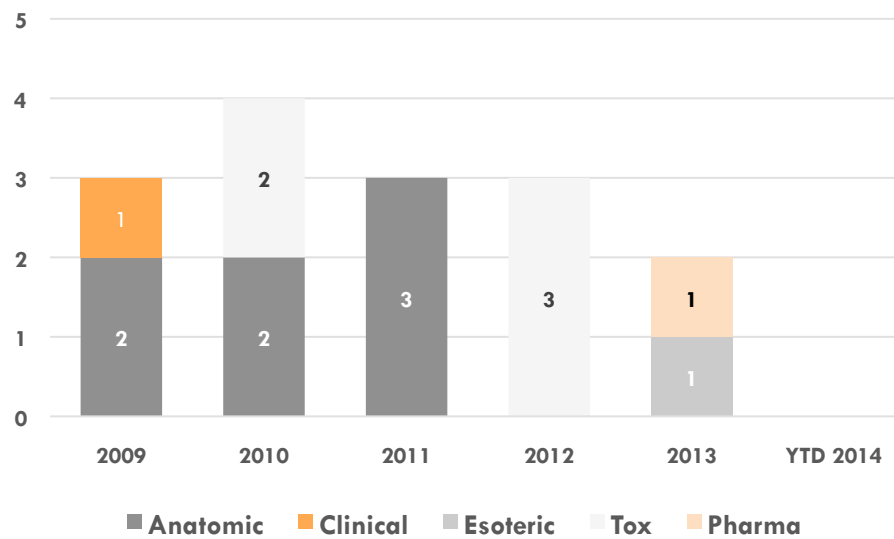


Source: Crosstree Capital Partners

Investing in 'Platforms'

16

Platform Lab Investments by Segment



Source: Crosstree Capital Partners

- Interest has shifted from anatomic pathology to...
 - Esoteric laboratories;
 - Pain management laboratories;
 - Pharmaceutical services laboratories





17

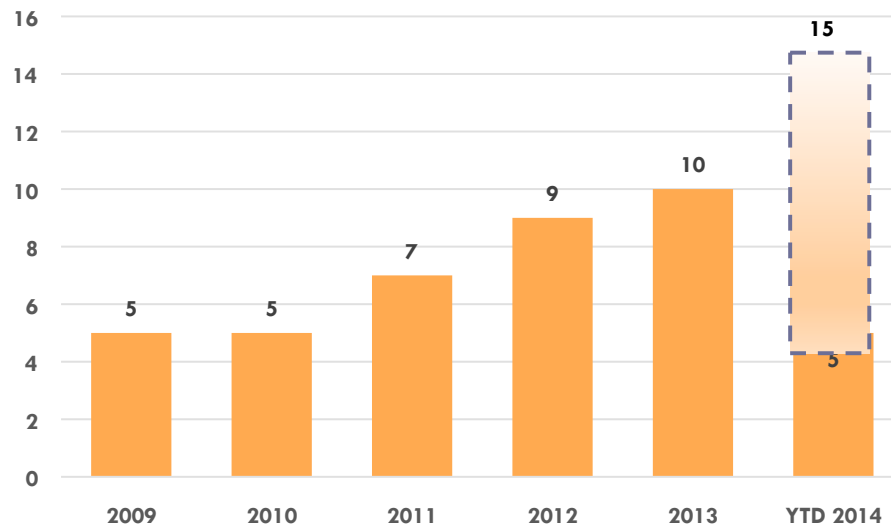
Clinical Pathology



Quality clinical labs in high demand

18

Clinical Lab Acquisitions



Source: Crosstree Capital Partners

- Demand coming from...
 - Large labs
 - Mid-sized labs
 - Specialized/ esoteric testing companies
 - Pharma services labs



What does 'quality' mean?

19

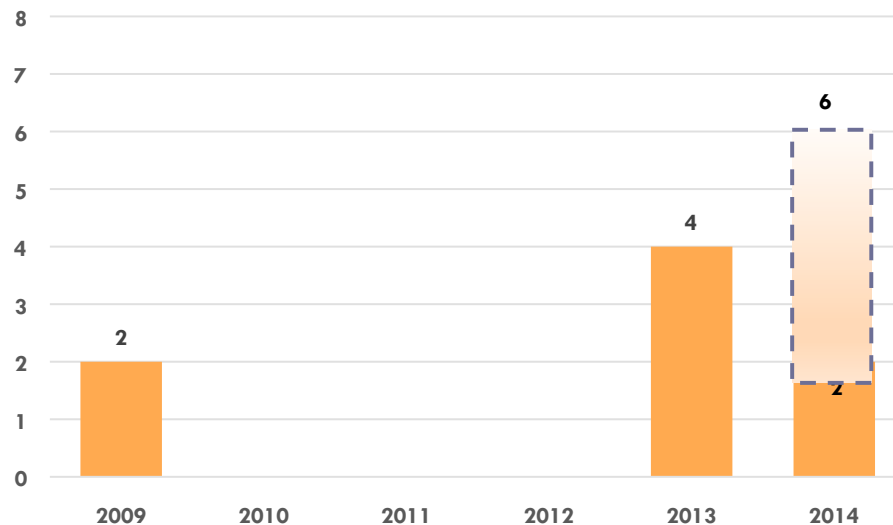
- Compliance, compliance, compliance
 - Your “minor” issues can become major issues to a large buyer
 - In-office phlebotemists, PSC leases, supplies, etc.
- Compelling client list – ability to service, meaningful retention
- Favorable payer mix – limited price compression
- For smaller buyers (mid-sized labs, specialty/IVD, etc.), management continuity can be important



Hospital outreach deals on the upswing

20

Outreach Lab Acquisitions



Source: Crosstree Capital Partners

- **2010 – 2012**
 - Is the lab core or non-core?
 - ACO strategy?
- **2013 –**
 - How can our lab possibly make money in this environment?!



Our observations

21

- Demand outstripping supply
 - Fewer and fewer mid-sized clinical laboratories available
 - Key outreach labs are being gobbled up
- Valuation multiples have been healthy in our experience
- We expect multiples may even rise modestly given the strategic demand for clinical labs





22

Anatomic Pathology

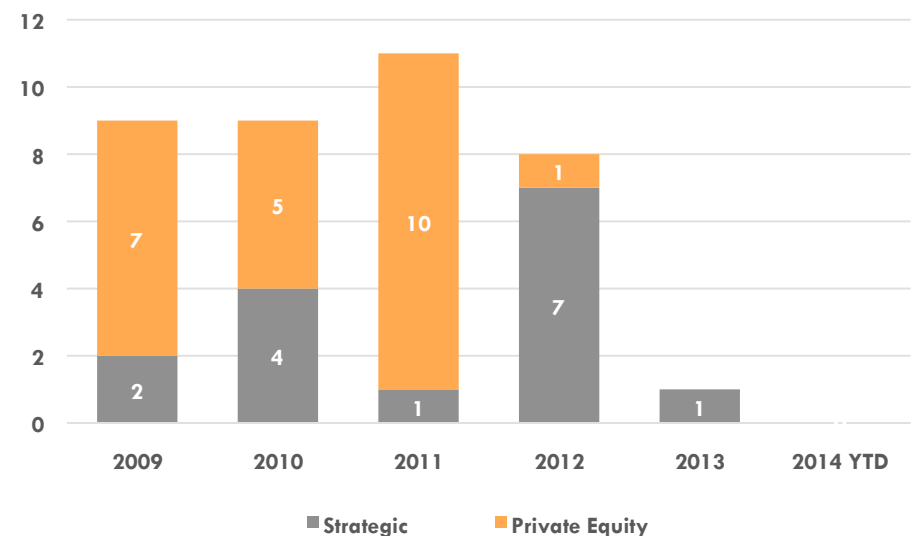


AP deal activity has stalled

23

- Massive 88305 cut
- Ripple-effect through commercial payor contract renewals
- Strategic interest in AP hasn't necessarily waned
- **Valuation disparity is the impediment**

Anatomic Pathology Lab Acquisitions



Source: Crosstree Capital Partners



For sellers, liquidity is a challenge

24

- Dearth of cash buyers
 - AP can be challenging for the big labs
 - Owner/ pathologist dependency
 - Potential for price compression
- Financial leverage hindering some private equity-backed buyers
- Large regional AP groups can provide a lifeline, but less likely to provide liquidity

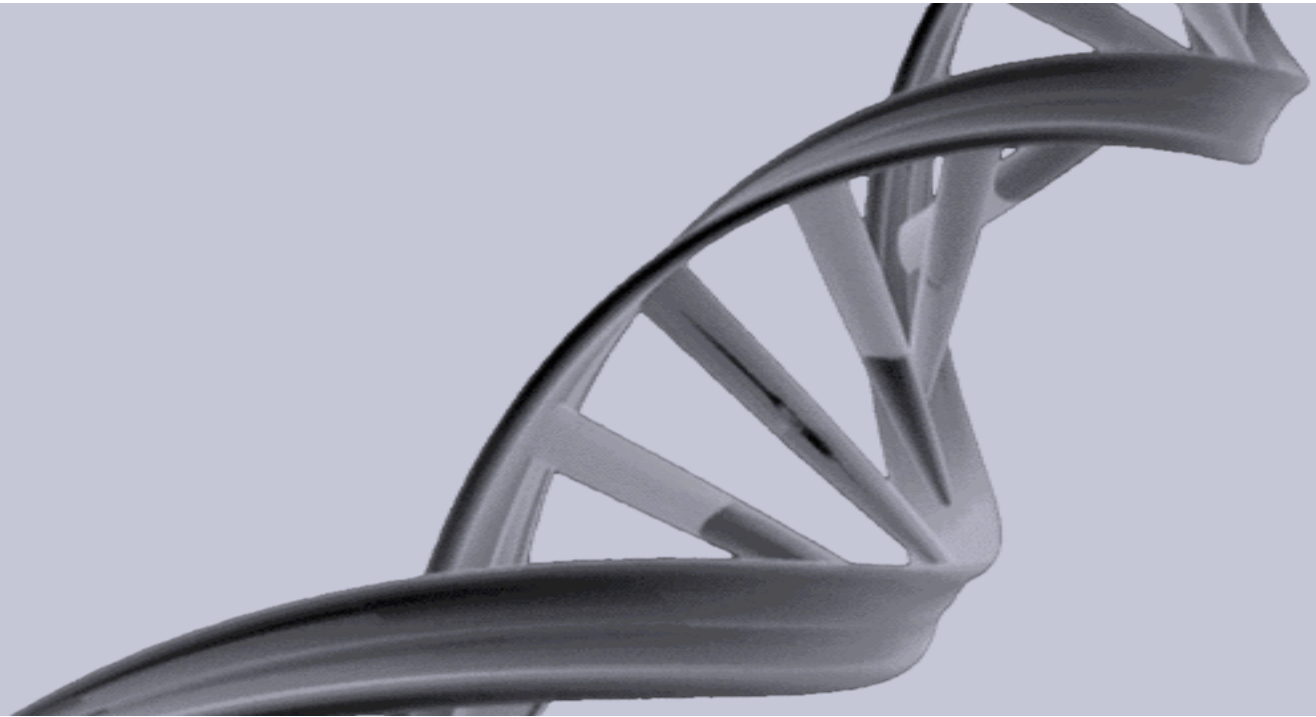


Buy low, Sell... ?

25

- *“Be fearful when others are greedy and greedy when others are fearful”* – Warren Buffett
- Scale is becoming increasingly important in anatomic pathology
- For smaller AP groups, status quo may be unwise
- Buyers have the leverage





26

Specialized Testing



IPO Dreamin'

27

- ***Foundation Medicine's IPO raised our collective eyebrows***
- September 25, 2013
- Initial range \$14 – 16 per share
- \$18 per share offering price
- \$35.35 close on first day of trading, a 96% increase
- Market cap nearly \$1 Billion
- \$100mm+ in venture capital invested
- Approx \$20mm in revenue



IPO investors getting more cautious

28

- CardioDx – cardiovascular genomics (coronary artery disease)
 - Filed October 12, 2013
 - Postponed IPO on November 13, 2013
- Biocept – circulating tumor cell capture for oncology testing
 - IPO on Feb 10, 2014 at low end of initial range (\$10/share)
 - As of April 25, 2014, trading at \$4.72
- Ariosa Dx – DNA-based prenatal test
 - Filed March 25, 2014
 - Priced April 25, 2014, pending launch

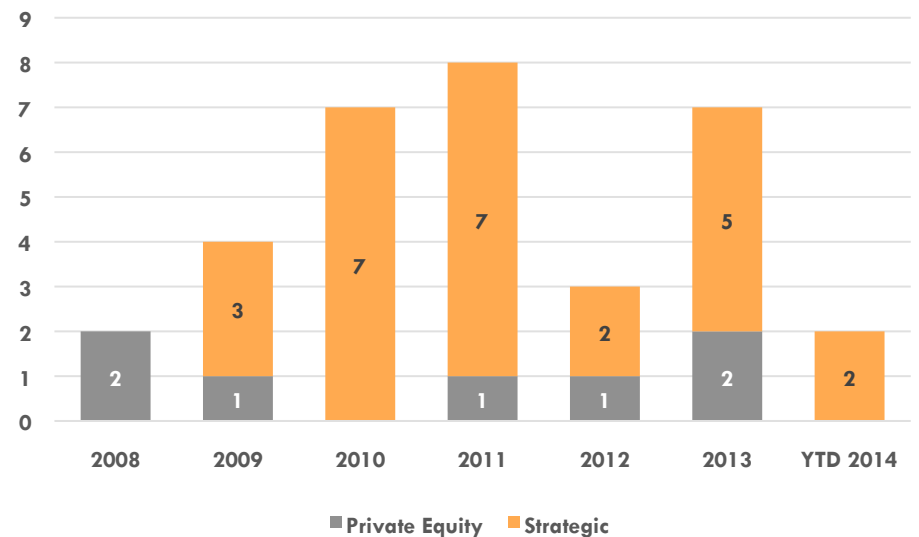


Specialty lab M&A activity

29

- Numerous CLIA lab upstarts with specialty tests
- Highly diverse group, some me-too while many have truly defensible, proprietary tests
- M&A activity is driven by strategic interest

Specialty Lab Acquisitions



Source: Crosstree Capital Partners





30

Pain Management/ Toxicology



Getting Long in the Tooth...

31

Pain Management Lab	Investor(s)	Year Invested	Current Year of Holding
Ameritox	Bain, Sequoia, Sterling, Sutter Hill	2007	7
DrugScan	Eureka Growth Capital	2008	6
Millennium Labs	TA Associates	2010	4
Aegis Sciences	Metalmark Capital	2010	4
Dominion Diagnostics	Riverside Partners	2010	4
Sterling Reference Laboratories	Waud Capital	2012	2
Calloway Laboratories	Ampersand Capital	2012	2
Willow Laboratories	Ampersand Capital	2012	2



Our observations

32

- A very busy M&A environment... many opportunities available, a handful getting done
- Concerns over future utilization/ reimbursement weighing on valuations and deal-making
- Private equity driving the market, given the robust profitability
- Potential for more future strategic exits as large labs' acquisition opportunities become more finite





Thank You

33

Crosstree Capital Partners

