

Highlights

Health Care IPO Forum 2014



Proskauer



highlights

Health Care IPO Forum

The health care IPO market continues to experience a remarkably robust period. This summary includes highlights from Proskauer's Health Care IPO Forum, where we introduced our groundbreaking health care IPO study and discussed its implications. Three high-level panels addressed the IPO process, the characteristics of the IPOs that were reviewed in the study, and the impact of the Affordable Care Act on investment trends and the capital markets.

Opening Remarks

Richard Zall, Partner and Chair of the Health Care Department and Health Care Industry Group, opened the event with an overview of the health care industry.

"There are three elements of the industry that I want to cover today," he began. "One is the change that's going on: there's really transformative change in the industry in a way that hasn't occurred in decades. The second is challenge: there are certainly many challenges that industry players are facing, however, they are surprisingly thriving in this important sector. Lastly, there is also tremendous opportunity – those that are meeting those challenges and taking advantage of opportunities – and that is where capital markets will help."

Rick went on to enumerate the main changes, challenges and opportunities for the industry.

Changes:

- **Payment methodology:** "is now moving to a value-based payment system, which has enormous implications for the industry."
- **Hospitals, patients and physicians:** "the relationship among them again is changing dramatically."
- **Data and technology:** "we're seeing an increase in the availability of electronic health records, electronic data exchange, and innovations like Telehealth."

Challenges:

- **Cost:** "The U.S. spends per capita two times what other countries spend keeping their people healthy."
- **Access:** "The United States is pretty much alone, in terms of developed nations, in having 15 percent – 45 million people – that don't have insurance."
- **Quality:** "We have some of the finest academic health centers in the world, but it hasn't resulted across the board for the population in improved quality and mortality rates."
- **Regulatory complexity:** "There is a lot of regulation on the federal level and the state level."

Opportunities:

- **Delivery:** "There are new delivery options available – retail health clinics, concierge medicine – these are all businesses that are in formation."
- **Technology:** "A lot of remote diagnosis and treatment is available, as well as Telehealth and electronic health records."
- **Consumer empowerment:** "The onset of health savings accounts and exchanges presents opportunities in terms of personal health records, self-care and home care."
- **Insurance market:** "The insurance market is certainly being overhauled; that was one of the big aspects of the Affordable Care Act in addition to coverage expansion."
- **Innovations:** "There's always innovation in the medical device, biotech and pharma world."

Health Care Reform

Peter Marathas, Proskauer Partner and head of the Boston Employee Benefits Practice, discussed health care reform and the effects of the Affordable Care Act on the health care industry.

- “Over the years as the penalties rise, individuals and employees who may have gone without insurance in the past will start to realize that they want to have insurance rather than pay the government a penalty. About three or four years out, the penalty they pay will get to be about equal to what it would cost them to buy a certain level of insurance.”
- “The Affordable Care Act forces employers to think out of the box if they’re focused on this at all. This includes thinking about how they use their workforces and how they deliver insurance, which, besides payroll, is the biggest employer-related cost. An example of this is whether or not employers can dive below the 30 hours-a-week mark required for full-time employees. What that has driven for discussion for many employers both within the health care space and outside of the health care space is: can we exist with a part-time workforce? And it has led to some creative thinking.”
- “If you’re eligible for affordable coverage under the Affordable Care Act as an individual, you are ineligible for a subsidy. This is what’s going to drive that part-time workforce. Employees are going to get smarter about this and they’re going to opt out. They’re going to say, ‘I don’t want to be eligible for your insurance, so make me part time.’”

Health Care IPO Study and Presentation

Proskauer Capital Markets lawyers **Frank Lopez** and **Robin Feiner**, along with guest speaker **Bernard Cooney**, discussed the health care IPO market and gave a preview of the findings from Proskauer’s 2014 IPO Study.

Bernard Cooney, Managing Director in UBS Investment Bank’s Equity Capital Markets Group, gave some of his thoughts on the current IPO market generally:

- “We saw a ton of deals get done in the first quarter; a ton of people rushed to get out.”
- “I hope we’re setting up for an environment in the second half where people are going to be looking to increase performance and I think that could be a pretty robust backdrop for equity capital market activity.”

Bernard also explained how “testing-the-waters” is being used by companies considering going public:

- “Testing-the-waters is a process in which you can go out and have investor meetings and basically get a feel for investors’ sentiments on the story. You don’t go into valuation; it’s really a way to get a feel for what investors are thinking about the name and the industry. Investors are savvy enough to know what those meetings are and the feedback that they give is usually pretty solid.”



Robin Feiner, Proskauer Senior Counsel and member of the Capital Markets Group, explained some of the findings of the IPO survey:

- “With the health care universe that we looked at, less than 20 percent of companies had an IPO deal size of over \$150 million. So, most of them – 58 percent – were less than \$100 million.”

Robin also touched on the Jobs Act and its effect on the market:

- “The Jobs Act was passed in April 2012, so we’ve been living with this for two years now. Its main purpose was to make it easier for smaller companies – they coined the term “emerging growth companies” – to go public, to make it faster and hopefully less costly. If your revenues are less than \$1 billion during your most recent fiscal year, you qualify as an emerging growth company.”
- “What we’re seeing in the marketplace is that a very large majority of the companies that are going public are qualifying as emerging growth companies.”

She also discussed the cost of going public:

- “Companies always want to know right away: how much is this going to cost me? For the deal expenses, the average expense was \$4.2 million. The good news is that, on the health care side, the costs were lower; the average cost for health care IPOs was \$3.3 million. I think that’s probably indicative of the fact that many times the companies are a lot less complicated or pre-revenue, so the accounting costs and legal costs are going to be less. Also, deals are getting done faster, which is another reason for the lower cost.”

Frank Lopez, Proskauer Partner and co-head of the Capital Markets Group, gave an overview of the IPO study:

- “We’re finally back to normality, historically speaking, as far as volume of IPOs per year.”
- “As a percentage of overall IPOs, health care IPOs are really at their highest percentage in the first half of 2014, at 35 percent of the overall IPOs that have closed.”
- “Health care was 31 percent of our study for deals last year, which is reflective of the overall market. From the deal size perspective, there haven’t been a ton of mega-deals lately, certainly not in 2013 and not this year either. Almost two-thirds of the deals were really small-cap or mid-cap – for the most part under \$250 million as far as the amount of money that they ended up raising.”

Frank also provided insight into what the study’s findings might mean for the health care IPO market:

- “One of the primary questions companies ask is how long it is going to take. So, we’ve always said about four months and that was sort of anecdotal. We now have the data to support that it is about four months.”
- “Health care deals are getting through the SEC much faster, so you’ll see that, on average, deals in our overall study took about 128 days from start to finish.
- “Is the Jobs Act bringing more deals to the market? While it’s hard to make a direct correlation, certainly issuers are utilizing flexibility that’s been provided, particularly emerging growth companies.”



Health Care IPO Process and Trends in the Market

Julie Allen, Proskauer Partner and co-head of the Capital Markets Group, moderated this panel, asking questions of our guest panelists, as well as offering some astute observations:

- “Certainly there were periods of time when if you could go public, you went public. I’m not sure that that remains how people evaluate their available alternatives today,” she said.
- Discussing the surprises and challenges that face companies going public, Julie added: “Your successes and failures are public and they’re quarter-to-quarter, so there’s really not a lot of room for management teams to recover from a bad event.”

James Elrod, Managing Director of Vestar Capital Partners, spoke on trends in the IPO market:

- “Pre-2007/2008 crash, everybody knew that going public was painful, but the question that often the investment committees came down to was, ‘can we?’ The underlying thought was that 19 times out of 20, the public markets were going to give you the highest possible valuation. So, the gating issue was, ‘can we pull this off?’ Now, the debate has shifted from ‘can we?’ to ‘should we?’ – and that’s probably healthier in the long run.”

James also shared some of the challenges of being a sponsor of an IPO company, based on his own experience:

- “The notion of who is the client or the perception of who is the client changes by definition in an IPO. It starts out with me, the private equity guy, because I’m the majority owner. But, by definition, over three or four transactions, it’s going to transition to management fully calling the shots along with the board.”

Ravi Sachdev, Managing Director, Health Care Investment Banking at J.P. Morgan, described the shift he has observed in the market and the new types of health care and biotech companies that are emerging:

- “The health care services side was not particularly active for a long period of time in the IPO market. Generally, what you were seeing was strategic sales and most of what I would describe as the next generation of health care companies hadn’t gotten to a point in their maturity cycle where they were ready to go public. But, over the past 24 months or so, we’ve seen a real uptick in the health care IPO market on the services side.”



- “What you’re seeing is a sprouting up of a whole new set of companies: people who are in the wearable space or in the consumer space and all kinds of health care IT companies. And what is different now in the health care business, and specifically the IPO market, you’re going to see the predominance of the pipeline on a go-forward basis — it’s not going to be businesses that we have thought about historically.”
- “I think the other thing that is going on in health care services – and it’s a dynamic we’re seeing in the equity markets – is a major supply-demand imbalance. Many of the sectors of health care services have gotten to a point of maturity where it’s very difficult to grow on an organic basis.”

Katherine Wolf, Co-Founder and CEO of health care strategic advisory firm Rocket Science, gave a list of five important things for companies considering going public to be aware of:

- **Management Team:** “The right management team for a private company is not necessarily the right management team for a company that’s in the process of going public and/or to manage the company after it is public.”
- **Board:** “The board that you have as a private company is a different board than you have as a public company; you need to have a certain number of independent board members.”
- **Cost:** “Once you’re public, you have an ongoing cost of being public, and, for some of these smaller biotech companies or medical device companies with market caps of less than \$300 million, that \$1-2 million a year can be quite onerous.”
- **Accountants:** “[Keep in mind] you have these accountants ongoing post-IPO, so you really want to make sure the team has a business sense of how to interpret the numbers and is not just locked into what the rules are.”
- **Lawyers:** “It is important for an investor to have a lawyer who is not only a good lawyer, but is also well-versed in the laws of the countries in which their portfolio company is currently listed.”

Peter Zippelius, Managing Director and co-head of Healthcare Services Investment Banking at Deutsche Bank Securities, Inc., touched on the current market, in addition to providing his predictions for the future of health care IPOs:

- “At a very macro level, the IPO backlog and IPO success really depends on big fund flows, which are very cyclical. And I’m happy to say that I think that we’re in a cyclical period that is supportive of IPOs.”
- “Health care services moves a lot with regulation. Ravi suggested that over the last 24 months there’s been a big increase in health care services IPOs, and I think a big part of that is driven by regulation. There were basically no health care services IPOs prior to the ACA. Good or bad, at the very least the ACA provided some form of certainty for investors as to what the environment may look like, and that really ushered in a wave of IPOs.”
- “I think we’re on the precipice of what I call industrialization of health care.”

Panelists

Julie Allen	Partner and co-head, Global Capital Markets Group	Proskauer
Bernard Cooney	Managing Director	UBS Investment Bank
James L. Elrod, Jr.	Managing Director	Vestar Capital Partners
Robin Feiner	Senior Counsel, Global Capital Markets Group	Proskauer
Frank Lopez	Partner and co-head, Global Capital Markets Group	Proskauer
Peter Marathas	Partner, Employee Benefits Practice, Executive Compensation & ERISA Litigation Practice Center	Proskauer
Ravi Sachdev	Managing Director, Health Care Investment Banking	J.P. Morgan
Katherine Wolf	Co-Founder and CEO	Rocket Science
Richard Zall	Partner and Chair, Health Care Industry Group	Proskauer
Peter Zippelius	Managing Director and co-head of Healthcare Services Investment Banking	Deutsche Bank Securities, Inc.



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2013 Proskauer IPO Study — Health Care Focus

Impact of the JOBS Act

- 29 of the 31, or 94%, of the health care IPOs studied qualified as an “Emerging Growth Company” (EGC)
 - 27 of the 29 EGCs elected to confidentially submit their first filing
- An EGC is an issuer with total annual gross revenue of less than \$1 billion during its most recently completed fiscal year
- Of the 29 health care EGCs, 76% included 2 years of audited financials
- Based on our market knowledge, we believe most health care companies are choosing to engage in testing-the-waters

SEC Timing and Trends

- Average number of days:
 - 59 days from confidential submission to public filing
 - 44 days from public filing to pricing
- SEC comments:
 - Average of 36 total initial comments
 - Average of 11 initial accounting comments
- Frequency of key SEC comments:
 - Testing-the-waters communications - 87%
 - Cheap stock - 61%
 - Revenue recognition - 48%
 - Segment reporting - 6%

Deal Structure

- IPO deal size ranged from approximately \$46 million to \$2.6 billion
- Of the 31 deals:
 - 10% had a secondary component
 - 6% included management as a selling stockholder
 - 35% included a directed share program
 - 61% had insiders purchasing in the IPO
 - 84% exercised the over-allotment option
- Lock-ups:
 - 180 day lock-up - 100%
 - Lock-up Release:
 - Lead left bookrunner - 16%
 - Subset of bookrunners - 48%
 - All bookrunners - 35%
 - Shares Locked-Up:
 - 99.3% average
 - 94.2% minimum
- Following the IPO, directors and executive officers held an average of 39% of the outstanding shares

Deal and Underwriting Expenses

- Average Deal Expenses:
 - Total deal expenses - \$3.3 million
 - Legal expenses - \$1.7 million
 - Accounting expenses - \$0.9 million
- Underwriting Discounts:
 - Average underwriting discount - 6.8%
 - 26 out of 31 deals - 7.0%

Corporate Governance

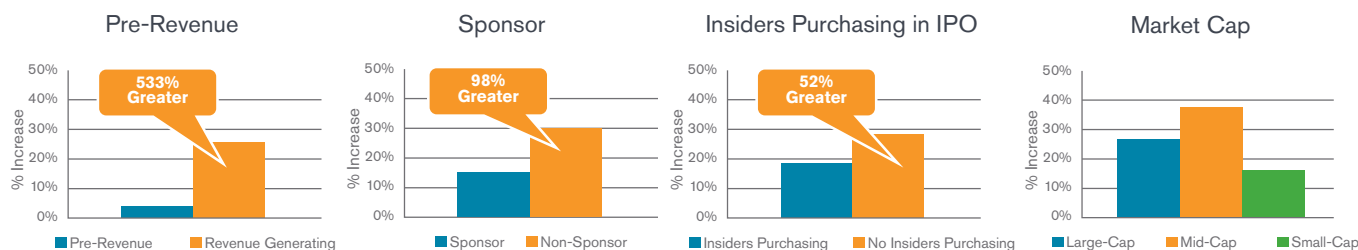
- At the time of the IPO pricing, the health care companies analyzed had an average of:
 - 8 board members
 - 6 independent directors
 - 1 audit committee financial expert
- 97% had a single class of common stock
- 68% separated the Chairman and CEO
- 90% had a classified board

Key Financial Stats and Presentation

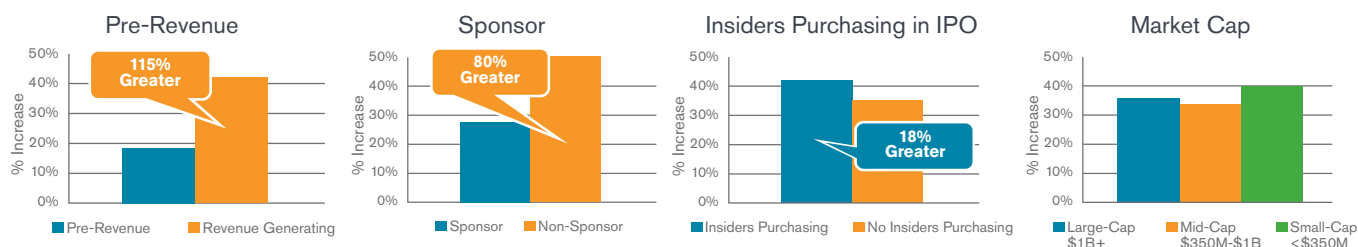
- Revenue and net income:
 - 13% were pre-revenue
 - 84% had a net loss
- Of the 31 deals:
 - 3% disclosed a material weakness
 - 3% had a restatement
 - 29% received a going concern opinion
- Health care companies used EBITDA/adjusted EBITDA less frequently compared to other sectors
- Adjusted EBITDA:
 - 3 of the 31, or 10%, of the companies reported adjusted EBITDA and all had positive adjusted EBITDA

Market Performance

Offer Price vs. Day 1 Closing Price



Offer Price vs. Day 30 Closing Price



2013 Proskauer Health Care IPO Study Methodology

Population

- 2013 health care IPOs priced through December 31st — “Health care” defined by Dealogic’s industry classification
- In total, the Proskauer health care IPO study analyzed 31 health care IPOs priced in 2013, of which 24 were biotech/biopharm IPOs
- All companies are headquartered in the U.S. and listed on U.S. exchanges
- Excludes IPOs with filing deal size less than \$50 million
- Excludes REITs, MLPs, BDCs and trusts

General

- Financial metrics were based on results from each issuer’s most recent fiscal year as disclosed in the final prospectus
- Market, industry subsector and performance information was sourced from Dealogic
- Financial sponsors determined using Dealogic methodology
- All data was compiled, reviewed and analyzed by Proskauer capital markets attorneys, a CFA charterholder and an analyst

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