Healthcare Insider



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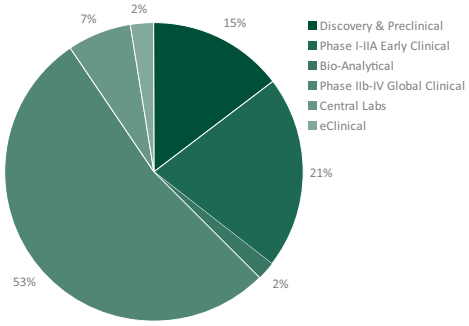
Industry Spotlight: Pharma Services

The outsourced drug-development market, broadly referred to as the contract research organization (CRO) industry, is large and growing, estimated at more than $20 billion of a $50 billion-plus addressable market globally. The industry has expanded at a brisk pace, with industry revenues of $1.6 billion in 1993, equating to growth in excess of 13 percent per year over the period. Looking ahead, industry growth is forecasted to moderate but remain strong, as pharma companies look to increase outsourcing to reduce costs and optimize R&D spend, tackle complex global regulatory requirements for drug development, and improve time-to-market.

Sizing the Market

Global CRO Market:	~$20.2 billion
Addressable Market:	~$52.5 billion
CRO Penetration:	~38.5 percent

Global CRO Market Breakdown



Source: Equity Research.

Industry estimates of market size vary. Consensus estimates indicate a CRO market that is large and growing:

Market research firm visiongain, in its report *Pharma Clinical Trial Services: World Market 2011-2021*, estimates the global CRO market will grow from $21.7 billion in 2010 to $32.7 billion by 2015 and will exceed $65.0 billion by 2021, at which time the ten largest CROs will hold more than 50 percent of the global market.

Contract Research Annual 2011, an annual study of the pharmaceutical industry, sized the CRO market at $28.0 billion in 2010. The same study reported $68.0 billion spent on drug development that year, amounting to an outsourcing penetration rate of more than 40 percent.

Frost and Sullivan (F&S) estimates the CRO market in the United States will grow from $11.4 billion in 2010 to $20.1 billion by 2017. F&S estimates the current outsourcing penetration rate stands at less than 25 percent of total R&D spending today.

Notable trends impacting CRO performance and consolidation:

Outsourced contract research spending has been growing at a faster pace than internal research and development spending in recent years, as drug sponsors look to cost-effectively advance innovation and speed time-to-market to enhance return on investment from drug discovery and development (D&D). Industry statistics report average annual CRO spending growth of 13 percent over the last decade, compared to 9 percent growth in global D&D spending[1]. Given the intense focus of sponsors on reducing costs and accelerating new product development, the trend toward strategic outsourcing is only expected to increase. Today, with roughly a 40 percent penetration rate of outsourcing as a percentage of total R&D spending, significant opportunity exists for CROs to broaden their value proposition as strategic partners to their customers by expanding their scope of services, geographic presence, and efficiency.

Drug sponsors are looking to enhance the productivity of the R&D value chain. They are reducing their vendor base to fewer but deeper relationships, and are increasingly looking to full-service CROs with an international presence. As relationships advance from transaction-based to long-term strategic alliances, geographic footprint will become critical. Findings from a recent survey[1] conducted by the Economist Intelligence Unit (EIU) and Agilent Technologies note that 13 large pharmaceutical companies have announced 22 major alliances just within the last two years, including headline partnerships announced by Bayer with Covance in 2012; Pfizer with ICON and PAREXEL in 2011; Sanofi with Covance in 2010; and Eli Lilly's ongoing commitment to outsourcing. Respondents in the EIU survey cited an increasing preference in the industry toward CRO relationships structured as alliances or partnerships

NOTE: [1] Economist Intelligence Unit, *"Finding Alignment. Opportunities and Obstacles in the Pharma/CRO Relationship," January 2012.*

SOURCE: Equity Research; Company Filings, and BGL Research.

Industry Spotlight: Pharma Services (continued)

that are regional or disease-specific. Some insiders expect the trend toward alliances will drive consolidation in the short-term, creating a bifurcated market where large, full-service CROs coexist with small, differentiated niche players, leaving providers that lack scale, breadth, or specialization under pressure to compete.

As sponsors have become increasingly global in their operation, so has the global outsourcing model gained acceptance. Clinical trials are growing in complexity and becoming increasingly global in scope, with market participants vying for access to patients, supported by the continuing trend to "offshore" services to lower-cost, emerging pharmaceutical markets that provide access to growing and naive patient pools. Developing markets, particularly India and China, as well as Latin America and Eastern Europe, are cited as targeted regions for growth.

Demand for late-stage development services is expected to outpace the need for early stage services, a trend observed in recent years, as pharma companies increasingly focus on near-registration projects in the face of slower drug approvals and looming patent expirations.

Participants speak to increasing competitive pressures amid a highly-fragmented landscape and overcapacity in certain preclinical areas, with toxicology seeing facility closures and intense pricing pressure.

The trend toward outsourcing routine laboratory testing has gained momentum in recent years, particularly in the United States. As pharmaceutical companies increasingly outsource non-core functions in an effort to maximize return on investment from D&D activities, chemical and microbiology laboratory functions are being outsourced for both routine testing for manufacturing and preclinical method development and validation. Consolidation in the industry has led companies to combine or close internal laboratories in order to limit overhead and redundant resources. On Page 6, we spotlight our interview with Peter Strothman at Water Street Healthcare Partners and the private equity sponsor's recent acquisition of Celsis Analytical Services. BGL served as the exclusive financial advisor to Celsis International in its divestiture of the Celsis AS division to Water Street.

Strategic M&A is continuing as providers look to build out broad, differentiated service offerings and expand geographic reach as a means to increase scale and secure long-term customer relationships.

Celsis International Ltd.

— has sold —

Celsis | Analytical Services

to

AAIPHARMA SERVICES

— a portfolio company of —

WATER STREET

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Company Description:

Celsis International Ltd. is a global diagnostics company with three divisions: Analytical Services (since divested to AAIPharma Services Corp.), In Vitro Technologies, and Rapid Detection.

Celsis Analytical Services provides cost-effective, outsourced cGMP-certified laboratory services with industry-leading sample turnaround times. Celsis AS has a broad set of analytical chemistry and microbiology capabilities in its operations in Edison, New Jersey and St. Louis, Missouri.

AAIPharma Services Corp. supports global drug product development and manufacturing through its broad set of capabilities in formulation development, analytical chemistry, manufacturing services, packaging and distribution, and other support services. AAIPharma is a portfolio company of Water Street Healthcare Partners.

Transaction Details:

On December 30, 2011, Celsis International sold its Analytical Services division to AAIPharma Services. Celsis AS will substantially increase AAIPharma's analytical chemistry and microbiology capabilities and scale. The combined entity offers a comprehensive suite of drug product development and manufacturing services. Financial details of the transaction were not disclosed.

Brown Gibbons Lang Role:

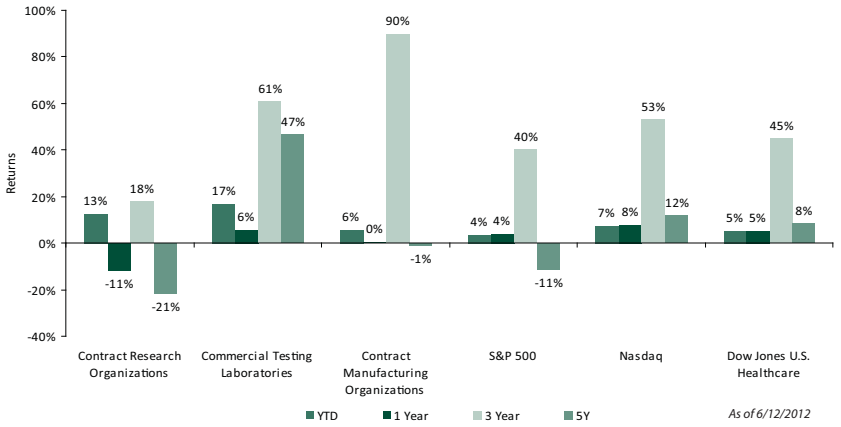
Brown Gibbons Lang acted as exclusive financial advisor to Celsis International. BGL's Global Healthcare and Life Sciences team, with a presence in Europe and pan-Asia, executed a formal sale process on behalf of Celsis International. BGL and Celsis ultimately advanced the process with AAIPharma and completed the transaction in December 2011.

Industry Spotlight: Pharma Services (continued)

Poor general economic trends combined with the pharmaceutical industry's focus on consolidation in 2009 and 2010 drove valuations down in that timeframe in the Pharma Services sector. Sector valuations have rebounded in 2011 and YTD 2012, as evidenced in the charts below:

Pharma Services stocks came under pressure amid macroeconomic uncertainty but showed improving trends through Q1 '12.

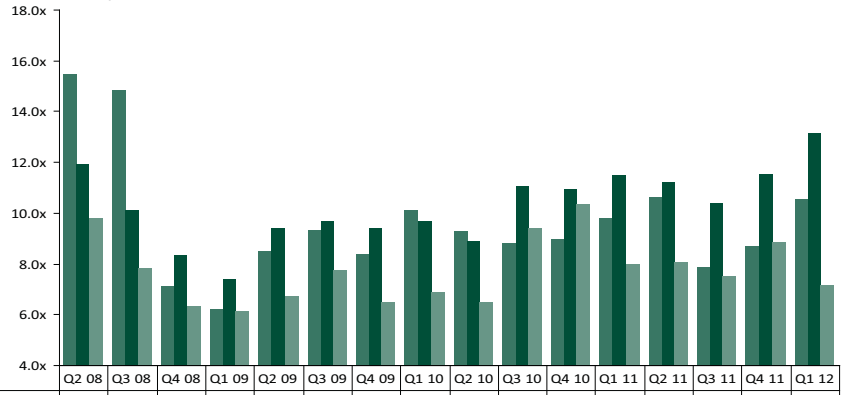
Index Performance



Industry Valuations

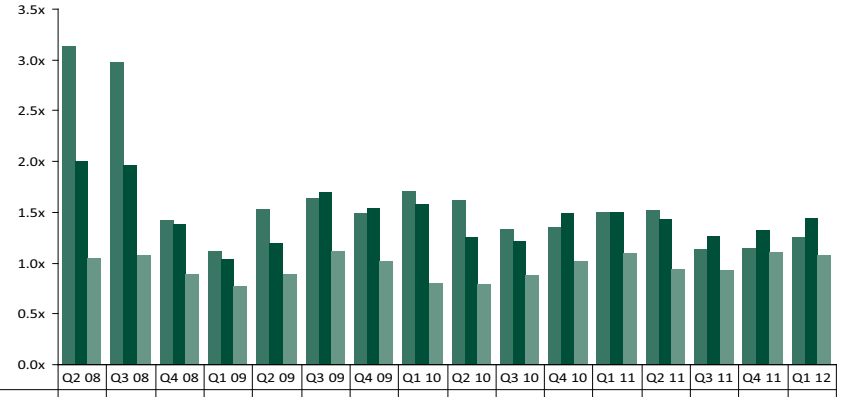
LTM EBITDA multiples in Q1 '12 ticked up from Q4 '11 levels under improving economic conditions.

Enterprise Value / EBITDA



	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
Contract Research Organizations	15.5x	14.9x	7.1x	6.2x	8.5x	9.3x	8.4x	10.1x	9.3x	8.8x	9.0x	9.8x	10.6x	7.9x	8.7x	10.6x
Contract Testing Laboratories	11.9x	10.2x	8.3x	7.4x	9.4x	9.7x	9.4x	9.7x	8.9x	11.1x	11.0x	11.5x	11.2x	10.4x	11.6x	13.2x
Contract Manufacturing Organizations	9.8x	7.8x	6.3x	6.1x	6.7x	7.7x	6.5x	6.9x	6.5x	9.4x	10.4x	8.0x	8.1x	7.5x	8.9x	7.2x

Enterprise Value / Revenue



	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
Contract Research Organizations	3.1x	3.0x	1.4x	1.1x	1.5x	1.6x	1.5x	1.7x	1.6x	1.3x	1.3x	1.5x	1.5x	1.1x	1.2x	1.3x
Contract Testing Laboratories	2.0x	2.0x	1.4x	1.0x	1.2x	1.7x	1.5x	1.6x	1.2x	1.2x	1.5x	1.5x	1.4x	1.3x	1.3x	1.4x
Contract Manufacturing Organizations	1.1x	1.1x	0.9x	0.8x	0.9x	1.1x	1.0x	0.8x	0.8x	0.9x	1.0x	1.1x	0.9x	0.9x	1.1x	1.1x

SOURCE: S&P Capital IQ.



Industry Spotlight: Pharma Services (continued)

M&A market remains active

M&A activity in Pharma Services is continuing into 2012, building on momentum which began in 2010 and 2011, with the sector seeing a number of high profile transactions, as well as steady flow in the smaller deal market. Notable transactions so far in 2012 include the $410 million acquisition of the clinical trial supplies business of Aptuit by Catalent Pharma Solutions, completed in February, and the $350 million purchase of BioReliance Corporation by Sigma-Aldrich Corporation, completed in January. Both represent private equity exits: Welsh, Carson, Anderson & Stowe selling the Aptuit business, a CRO it has held in its portfolio since 2005; and Avista Capital Partners selling BioReliance, a company it acquired in 2007.

Globalization and the changing nature of sponsor-CRO relationships will drive consolidation as companies pursue strategic buys to increase scale, broaden scope, and build out an international presence to stay close to customers and gain access to high-growth regions. Some insiders speculate that late stage CROs will begin looking at acquiring early stage/discovery assets in an effort to provide full end-to-end development services.

Given the fragmented landscape and need for scale to secure customer relationships, increased consolidation among small- to mid-tier providers is expected. Some estimates put the count of CROs worldwide at over 1,100, with the ten largest companies commanding a 75 percent share of the global outsourced market. Other sources forecast a lower concentration, estimating the share held by the top 10 will grow to 50 percent over the next decade.

Niche players with strong therapeutic experience are better positioned given increased demand for specialized clinical trial services, with oncology and central nervous system disorders among the fields in high demand.

IT-enabled offerings are growing in importance, as demand is increasing for electronic data management, analytics, and centralized services in the clinical research field. CROs are increasing their investment in IT capabilities as a point of differentiation, with data management and analytics integral to providing higher-value services.

Selected M&A Transactions in Pharma Services

($ in millions)				Enterprise Value / TTM	
Date	Target	Acquirer	Enterprise Value	Revenue	EBITDA
Feb. 2012	SeraCare Life Sciences, Inc. (NasdaqCM:SRLS)	Linden LLC	$62.6	1.4x	11.7x
Jan. 2012	Clinical Trial Supplies Business (Aptuit)	Catalent Pharma Solutions	410.0	nd	nd
Jan. 2012	BioReliance Corporation	Sigma-Aldrich Corporation	350.0	2.8x	nd
Jan. 2012	Celsis Analytical Services	AAIPharma Services Corporation	nd	nd	nd
Dec. 2011	Pharmaceutical Product Development, Inc.	Hellman & Friedman, The Carlyle Group	3,394.5	2.1x	10.4x
Sep. 2011	Clearstone Holdings Ltd.	Laboratory Corp. of America Holdings	nd	nd	nd
Jul. 2011	PharmaNet Development Group, Inc.	inVentiv Health, Inc.	600.0	nd	nd
Jul. 2011	Kendle International Inc.	INC Research	346.3	0.8x	14.2x
Jun. 2011	Medpace, Inc.	CCMP Capital Advisors	740.6	nd	11.8x
Jun. 2011	Ingenix, Inc. (i3 Clinical Development Businesses)	inVentiv Health, Inc.	140.0	nd	nd
Apr. 2011	Theorem Clinical Research (fka Omnicare Clinical Research, Inc.)	Nautic Partners	nd	nd	nd
Feb. 2011	Research Pharmaceutical Services, Inc.	Warburg Pincus	253.9	0.9x	15.4x
Feb. 2011	Hill Top Research Corporation	BA Research India Limited	nd	nd	nd
Sep. 2010	United BioSource Corporation	Medco Health Solutions, Inc.	733.1	nd	nd
Aug. 2010	Phase Forward	Oracle	584.3	2.6x	18.4x
Aug. 2010	INC Research, LLC	Teachers' Private Capital; Avista Capital	600.0	nd	10.0x
Aug. 2010	inVentiv Health, Inc.	Thomas H. Lee Partners	1,189.0	1.1x	8.7x
Feb. 2010	Discovery and Preclinical Operations (MDS Pharma Services)	Ricerca Biosciences	35.0	nd	nd
Feb. 2010	IMS Health	TPG, Leonard Green, CPP Investment Board	4,893.4	2.2x	10.1x
Nov. 2009	Life Sciences Research, Inc. (82.5% stake)	Management Buyout (Lion Holdings)	157.8	0.8x	4.7x
Jul. 2009	Late-stage Clinical Operations (MDS Pharma Services)	INC Research	50.0	nd	nd
Mar. 2009	PharmaNet Development Group, Inc.	JLL Partners	188.0	0.4x	8.6x
Aug. 2008	ClinPhone Limited	PAREXEL International Corporation	184.8	2.1x	17.3x
Jun. 2008	Premier Research Group plc.	ECI Partners	173.6	1.4x	11.2x
Apr. 2008	Lege Artis	Ingenix Pharmaceutical Services, Inc.	nd	nd	nd
Jan. 2008	Quintiles Transnational Corp.	3i Group plc., TPG Capital, Temasek Holdings, Bain Capital	nd	nd	nd
Jan. 2008	AppTech Laboratory Services	WuXi PharmaTech	151.0	2.2x	nd
Dec. 2007	PRA International, Inc.	Genstar Capital, LLC; Genstar Capital Partners V, L.P.	758.4	1.9x	17.1x
Jul. 2007	WIL Research Laboratories, LLC	American Capital	500.0	3.2x	12.6x
Jul. 2006	Chiltern International	Czura Thornton	150.0	nd	nd
Jul. 2006	Phase II-IV Business (Charles Rivers)	Kendle International Inc.	215.0	1.6x	6.4x

SOURCE: S&P Capital IQ, PitchBook, Equity Research, and Company Filings.



Industry Spotlight: Pharma Services (continued)

Private equity active in consolidation

Historically acquisitive in the CRO space, private equity continues to play an active role in industry consolidation, as evidenced by the number of significant recent platform investments, particularly within the last two years. Add-on acquisitions have also been an important avenue of growth for sponsors, as evidenced in the table below highlighting recent private equity activity in the industry. This growing level of interest suggests an optimistic outlook on future growth opportunities in the industry.

Recent high profile transactions involving private equity include private equity-backed Catalent's acquisition of Aptuit in 2012 and the take-private transactions of PPDI ($3.4 billion) in December 2011 and Kendle International ($346 million) in July 2011. InVentiv Health, another take private completed in August 2010, closed the $600 million acquisition of PharmaNet Development Group in July and Ingenix ($140 million) in June, both in 2011. Several of the largest CROs, most notably Quintiles, PPDI, InVentiv Health, QPS, Medpace, and PRA International, are all backed by private equity sponsors.

Conclusion

We expect to see growth in the Pharma Services sector at levels in excess of the overall growth in drug discovery and development, as drug companies outsource an increasingly greater percentage of their capabilities. This will encourage further industry consolidation as companies look to expand scale and increase scope of their operations to meet this demand. Private equity will be prominent in this activity, providing capital and expertise to facilitate consolidation and rationalization of operations.

Private Equity Platforms in Pharma Services

Investment Year	Date	Company Name	Investors	Platform Add-ons	Recent Transactions (Since 2011) Date	Company Name
2012	Apr-12	SeraCare Life Sciences, Inc.	Linden LLC			
2011	Dec-11	Pharmaceutical Product Development	Hellman & Friedman, The Carlyle Group			
2011	Jun-11	Medpace	CCMP Capital Advisors			
2011	Apr-11	Theorem Clinical Research	Nautic Partners			
2011	Mar-11	Wake Research Associates	Gemini Investors, Timepiece Capital			
2011	Feb-11	Blue Sky Biotech	Ampersand Capital Partners			
2011	Feb-11	NextPharma Technologies	Sun Capital Partners			
2010	Dec-10	ReSearch Pharmaceutical Services	Warburg Pincus			
2010	Sep-10	INC Research	Avista Capital Partners, Teachers' Private Capital	2	Jun-11	Trident Clinical Research
					May-11	Kendle International
2010	Aug-10	inVentiv Health, Inc.	Thomas H. Lee Partners, Liberty Lane Partners	3	Mar-12	Kforce Clinical Research
					Jul-11	PharmaNet Development Group
					Jun-11	Ingenix (i3 Clinical Development Businesses)
2010	Mar-10	Celerion	Bain Capital Ventures, SV Life Sciences Advisers			
2009	Jul-09	AAIPharma Services	Water Street Healthcare Partners	1	Jan-12	Celsis Analytical Services
2008	Nov-08	Emphusion (fka Pacific Data Designs)	DW Healthcare Partners	1		
2008	Sep-08	MPI Research	TA Associates			
2008	Sep-08	Synteract	Gryphon Investors			
2008	Feb-08	QPS Holdings	First Analysis Securities, The Argentum Group	4	Mar-11	Qualitix Taiwan
					Feb-11	Center of Toxicology & Preclinical Sciences
					Jan-11	Bioserve India
2008	Jan-08	Quintiles Transnational Corp.	3i Group, Aisling Capital, Bain Capital, Temasek Holdings, TPG Capital	5	Nov-11	Advion BioSciences
					Oct-11	Outcome Sciences
					Oct-11	VCG & Associates
2007	Dec-07	PRA International	Genstar Capital	1	May-11	Kinship Technologies (P) Ltd.
2007	Oct-07	CRI Worldwide	Ampersand Capital Partners, SV Life Sciences Advisers	1	Jan-11	Lifetree Clinical Research
2007	Sep-07	Altasciences Company	Kilmer Capital Partners	2		
2007	Jul-07	WIL Research Laboratories	Undislosed Private Equity Investor	1		
2007	Jun-07	Radiant Research	ICICI Ventures			
2007	Apr-07	Catalent Pharma Solutions	The Blackstone Group	2	Feb-12	R.P. Scherer GmbH & Co.
					Feb-12	Clinical Trial Supplies Business (Aptuit)
2007		Ricerca Biosciences	Bain Capital Ventures, Cowen Capital Partners, SV Life Sciences Advisers, Trinity Equity Investors			
2006	Dec-06	Apex Laboratories International	Huron Capital Partners			
2006	Jul-06	Chiltern International	Czura Thornton, Greenhill Capital Partners	4		
2006	Jul-06	Aptiv Solutions	Comvest Investment Partners, SV Life Sciences Advisers	7	Oct-11	SRA Global Clinical Development
					Aug-11	Medical Device Consultants, Inc.
2006	Jun-06	Biotix Holdings	Ferrer Freeman, Grotech Ventures	3		
2006	Jan-06	Cetero Research	KRG Capital, Summit Partners, Weinberg & Bell Group	4		

Source: PitchBook and S&P Capital IQ.



Industry Spotlight: Pharma Services (continued)

In December 2011, BGL completed the sale of Celsis Analytical Services, a division of Celsis International, Ltd. to AAIPharma Services Corp., a portfolio company of Water Street Healthcare Partners. Following is an interview that BGL conducted with Peter Strothman, a principal at Water Street who oversaw the transaction. Peter shares his insights on the industry and the company's growth plans.

WATER STREET

AAIPHARMA SERVICES

What are trends driving growth in the industry?

Pharma companies no longer have the old blockbuster model available to them, so they are trying to outsource their fixed costs and turn them into variable costs as a way to preserve margins, which is creating substantial tailwinds for the outsourcing industry in pharmaceutical services. Looking ahead, the growth in the outsourced component of R&D is projected to be fairly substantial. Even if growth in global R&D spending slows, the outsourced component is growing at a much faster rate because of that dynamic. Valuation multiples for companies have been pretty frothy over the last decade, in part because of the growth prospects for the industry.

There are pockets of drug development outsourcing that are very competitive and well-defined by the large players in the industry. There are the publicly-traded CROs that are the best at what they do in their core areas, and they are developing long-term strategic relationships with pharma companies. There are also other pockets that have less definition and are more fragmented, both in terms of the number of competitors and the service offering. Water Street is focusing on those niche areas of pharma services where there is the opportunity to develop a market leader.

What do you perceive to be challenges facing the industry in the coming years?

The traditional capabilities are ultra competitive across all of the firms, so companies are searching for ways to differentiate their services and maintain margin and grow. The industry is moving toward higher-margin, adjacent services that can be bolted on, e.g. imaging capabilities for clinical trials; data and analytics; and greater focus on improving patient access and maximizing any dollar of revenue available to a pharma company, even if it is on a post-launch basis after a product has been approved or commercialized.

The other lever is therapeutic excellence. There are many firms that are focused on establishing these strategic provider relationships. And it can go by therapeutic area and by capability. You have to be the best at what you deliver in terms of your service and your capabilities. You might be the best at oncology for a clinical CRO and have a preferred provider relationship with an oncology-based pharma company, but if your infectious disease team or division at a CRO is nonexistent or is a C-team versus another firm's A-team, you are not going to have a preferred provider relationship in that area.

The challenge now for a lot of these companies is to build the A-class team across their organization in all of the therapeutic areas. Acquisitions will play a role in that.

Can you offer your perspective on your investment in AAIPharma Services?

Water Street had been looking at the pharma services industry for several years and has also been disciplined about the multiples that we have been willing to pay for companies. We formed AAIPharma Services in a corporate carve out in July 2009. The parent company was facing financial issues and was marketing the company in a sale process but could not find a buyer for the entire business. The core AAI business unit that we acquired had consistently been producing revenue and earnings. However, the parent company corporate strategy did not involve growing that core business, and the cash flow it had been generating had been used to fuel initiatives outside of that part of the business.

We saw an opportunity in AAI on a number of levels. Two critical components in outsourced drug development are scientific expertise and customer service. AAI had both of those. We saw a real differentiated asset in drug development. It was a business with a 30-year history and a reputation as

> *"Valuation multiples for companies have been pretty frothy over the last decade, in part because of the growth prospects for the industry."*
>
> *—Peter Strothman*
> *Water Street Healthcare Partners*

Industry Spotlight: Pharma Services (continued)

a high-science, customer-service oriented provider with scientific expertise that was second to none.

We also looked at the competitive landscape, which is highly fragmented. There are hundreds of smaller companies (revenues of $20 million or less) in the space that lack the sophistication to really grow into meaningfully-sized businesses. With AAI as a platform, we saw the opportunity to continue to build scale by growing organically and through acquisition. The core business that we were buying was a great platform for that.

Our thesis was very simple. We said let's go back to the core—focus the business on its fundamental strengths and reinvest the cash flows to build out capabilities, management and people, and sales and marketing. At its core, AAI is a problem solver for drug development companies—pharma companies that either want to outsource their business to us or solve drug formulation issues they can't on their own—whether it is analytical services or formulation development, laboratory services related to drug development, or clinical and commercial manufacturing that we perform as a result of that capability. With that, we saw another value proposition in AAI. Pharma companies would like to cull their vendor base to simplify the number of partners that they have. AAI is in a position relative to drug development to provide a full suite of services, and that resonates with our clients in a meaningful way. We are one party that they have to deal with as opposed to multiple parties.

The investment has been a tremendous success. We are growing our customer base, increasing our penetration in existing relationships and adding new customers—the "who's who" of pharma and biotechs. When you look at the financial performance, it verifies it.

What led you to the decision to pursue a transaction with Celsis Analytical Services?

Water Street has a focus on value creation through growth. It can be in the form of organic growth, through the addition of new services and capabilities and new customer introductions. We also rely heavily on growth through strategic acquisitions. Sometimes the acquisitions are transformational, and others are bolt-on acquisitions that are immediately additive to the business. Celsis AS was a competitor and on our radar screen. Its business fit strategically with what we have at AAI.

Celsis AS augmented our capabilities and provided new customer access. AAI has a growing presence in the material testing space, and Celsis AS brought additional capabilities in that area and capacity with the addition of two new sites. Importantly, it also gave us access to many new customers, increasing our customer base across the organization nearly two-fold.

What are your future acquisition interests?

We acquired AAI as a platform for additional acquisitions. We have looked at and continue to look at many acquisition opportunities. The landscape as we see it will also allow us to consider other options that would not involve investing further in M&A. We can add new capabilities or augment current capabilities; we can expand geographically; we can expand internationally. There is no one right answer. It all depends on fit and what the growth prospects are for a given asset.

The hold period for Water Street is not a defined period of time. If the right acquisition comes along that would require integration and then execution, we are content holding AAI for a much longer period. Water Street acts as an outsourced business development arm for AAI, and we are extremely active in dialogues with some of the industry players. It is just a matter of what is right for AAI in the timeframe.

What do you see as the most promising therapeutic areas going forward?

If you look at the specialty drug trends, innovation in the R&D pipeline is heavily focused on biologics, and spending on specialty drugs continues to grow at double-digit annual growth rates. There is much more emphasis by big pharma on smaller patient populations with an increasing number of targeted therapeutics developed for specific patient groups. There are many segments across the pharma outsourcing industry trying to harness that trend, whether it is on manufacturing or services for CROs before commercial approval or post-launch.

"With AAI as a platform, we saw the opportunity to continue to build scale by growing organically and through acquisition."



Industry Spotlight: Pharma Services (continued)

One of the other areas seeing significant activity is genomic services, next generation sequencing. It is a hot space right now. And it is hot for a reason. Personalized medicine is getting adopted on a more globalized scale in terms of drug development, and it is still in its infancy. The valuation multiples in the space are oriented more toward venture capital and strategic takeouts, which you are seeing in large transactions, Illumina in the public market, and even in smaller businesses, those with less than $10 million in revenue. You are required to pay many multiples of revenue even for sub-scale businesses.

In what areas are you focusing?

We are looking more at some of the specialty diseases that are getting treated, those involving orphan drugs or small patient populations. It doesn't have to be in one particular therapeutic space. It is really interesting to see businesses like Gilead that were built on that proposition. That is where we are spending a significant amount of our time. It is not necessarily for traditional CRO services.

Why approach it that way?

We are focusing on services that can help maximize patient access and reimbursement for critical therapies or accelerate the advancement of a product through drug development—areas where there is less price sensitivity—so higher-margin specialty niches with greater barriers to entry. There is an increasing competitive play in the base outsourcing services segment of the market, so we are looking more around the edges, niche spaces where you can still create market leaders.

There are therapies that can cost over six figures a year for one patient. If you add one more patient or one more unit of a therapy, it significantly enhances the profitability for the manufacturer. But importantly, it is also delivering care to an individual that otherwise isn't receiving it. And these are individuals that are very sick and need these therapies. There is a reason why they are that expensive.

Do you have concerns about the impact of ongoing budget pressures on reimbursement for these high dollar therapies?

The dollars are significant. The cost of development is also extremely high; however, the therapies cannot be priced that much lower or manufacturers will no longer have the financial incentives required to continue to develop innovative drugs. Ultimately, there has to be a dialogue between the manufacturers and payors and the other constituents in the care continuum. There is an opportunity to start that dialogue today and there is the opportunity to do it later through personalized medicine where you are pricing based on patient outcomes.

At some point in the future, there will be a limit as to how much can be charged for those therapies. However, there is a much bigger opportunity to go after over-utilization of a basic set of services or misuse of services where the delivery of care and patient outcomes are not being improved. The political fallout you would have as a payor or as an employer by denying an individual coverage because of the expense of a therapy would almost be catastrophic. There are probably much easier buckets to attack than that bucket of spend.

How is globalization impacting your business?

AAI is a global business. We have a global customer base, and we offer services that are consumed around the world. Our locations are in the United States. For AAI, having a footprint in Western Europe or India is less important than having the capabilities that utilize our capacity and give us access to new customers. The challenge is growing out the capability set the right way. We are approaching international expansion in that way as opposed to establishing a beachhead in a particular country just to say that we have an international facility.

How critical are international facilities to expansion?

It is a matter of opinion. We do not view it to be nearly as critical as others might. We have a very attractive, differentiated capacity. We have a sterile manufacturing facility, as well as other laboratory capabilities that are very meaningful to our customer base. Those are the drivers of our discussions. The location is less important.

"There is an increasing competitive play in the base outsourcing services segment of the market, so we are looking more around the edges—niche spaces where you can still create market leaders."

Industry Spotlight: Pharma Services (continued)

You mentioned data and analytics as an area of opportunity. Is it becoming more important to customers to have data management capability?

Obviously, it is a huge area of opportunity for investment. It is a market that is expected to grow dramatically over the next five years. The challenge is investing in data and analytics that others do not provide today that is useful and in a niche for clients that want to use it. It is not healthcare IT; it is niche technology as opposed to patient recruitment or regulatory consulting. The data and analytics turns into more of a technology and capability discussion.

Technology is continually being replaced, and innovation continues to accelerate. In clinical trials, the industry is moving to a much more efficient, compliant, quality-based model—take some of the paperless systems that CROs are using. Many of the businesses are trying to provide those solutions.

If you don't understand the technology or the capability and are just investing in it because the industry is growing, you will lose. Everybody cannot be a winner in this space. In fact, very few people are going to be the winners because eventually one technology or capability gets adopted. The challenge is finding the right business.

Can you build a business that is a broad scope, high-margin provider of services that isn't actually running a trial?

Yes, and it would be a natural takeout by one of the low-margin providers looking to diversify to acquire growth and margin. The challenge is getting brought into any given trial. You have to have the relationships and the customer access. If you wanted to build an imaging and data analytics firm, it would be difficult because many CROs already offer those services.

How do you see consolidation shaping the industry going forward?

There will continue to be consolidation. There are major revenue and cost synergies that can be achieved by combining like-for-like CROs. There have been a number of large CRO take privates in the industry, PPD being one example. There have also been a number of recent acquisitions involving private equity-backed CROs acquiring and integrating other CROs. You have seen it in InVentiv and Thomas H. Lee acquiring i3 and PharmaNet and a number of smaller scale but strategically important businesses; INC Research and Avista Capital acquiring Kendle and other businesses.

You can look at the buyer universe for a company like AAI. It is strategically important to a variety of different constituencies that are looking to grow in drug development. There is a natural strategic play for clinical CROs. Our customers are the same, and the value proposition is the same. The difference is we are touching drugs and they are touching patients. There are the companies that are involved in some form of manufacturing. There it would be a play to build scale in existing or adjacent areas. There are also companies looking to grow internationally and gain a Western presence. Such a buy would bring access to new customers and industry leading quality that they may deem important for their base business.

If you look at the drug development space in particular for pharma services outsourcing, there are a variety of U.S. opportunities. There is tremendous international opportunity. And it is a fragmented landscape. The challenge is being able to gauge the direction the industry is moving and identifying the best platform upon which to build additional capabilities and be there five years from now when these services are very important to the customers that are innovating. That is why we invested in AAI and why we are going to continue to invest in the space. The tailwinds are there. It is all about picking the right investments.

Water Street Healthcare Partners is a strategic private equity firm focused exclusively on the healthcare industry. For more information about Water Street, visit waterstreet.com.

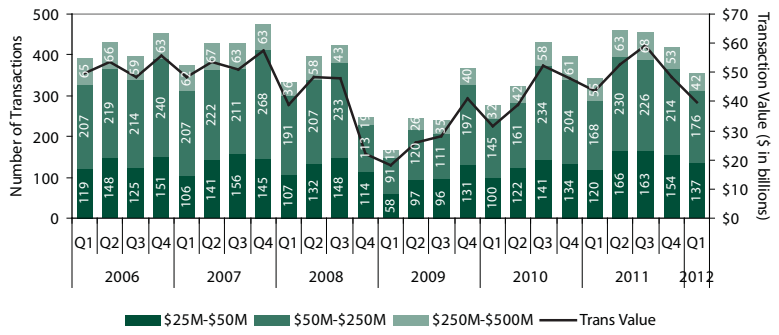
"The challenge is being able to gauge the direction the industry is moving and identifying the best platform upon which to build additional capabilities and be there five years from now when these services are very important to the customers that are innovating."



Mergers & Acquisitions: Total M&A Activity

Mergers & Acquisitions Activity

Middle Market M&A Activity

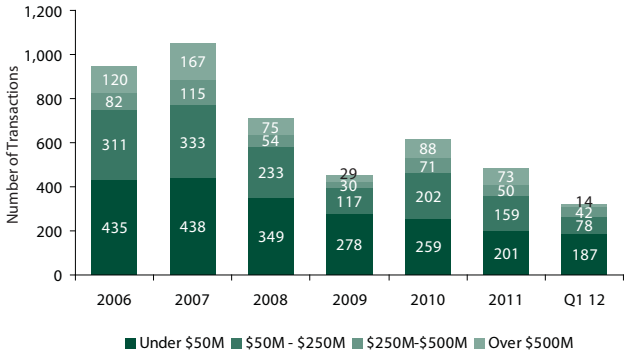


Based on announced deals, where the primary location of the target is in the United States.
Middle market enterprise values between $25 million and $500 million.

Source: S&P Capital IQ.

Private Equity Transaction Activity

Transaction Count by Deal Size

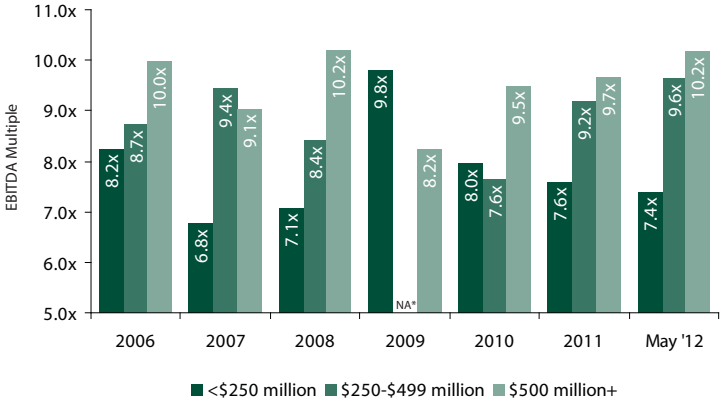


Counts only include deals with disclosed transaction values.

Source: PitchBook.

Trends in Valuation

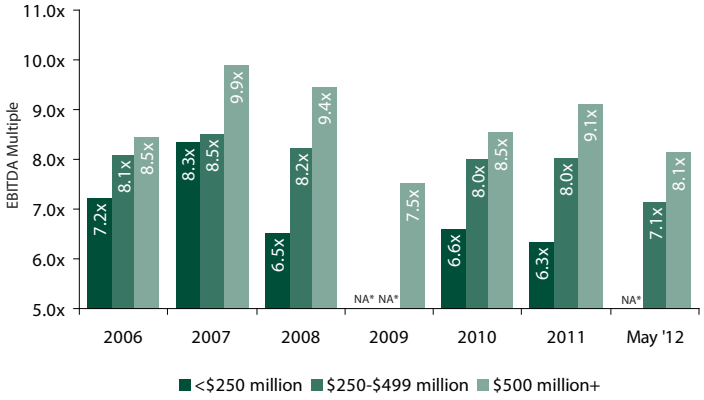
Transactions with Strategic Buyers



**NOTE: Data not reported due to limited number of observations for period.*

Source: Standard & Poors LCD.

Transactions with Financial Buyers

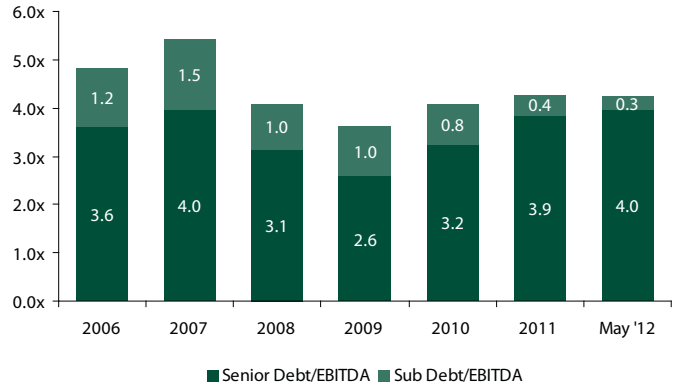


**NOTE: Data not reported due to limited number of observations for period.*

Source: Standard & Poors LCD.

Acquisition Financing Trends

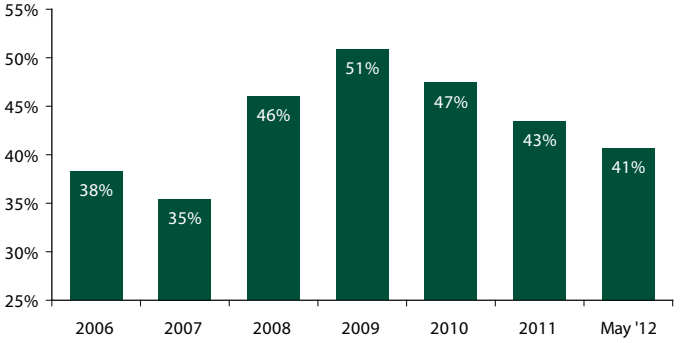
Leverage



Middle market enterprise values between $25 million and $500 million.

Source: Standard & Poors LCD.

Equity Contribution



Middle market enterprise values between $25 million and $500 million.

Source: Standard & Poors LCD.

Mergers & Acquisitions: Healthcare M&A Activity

2011 YEAR IN REVIEW

Healthcare is continuing to show a strong level of deal activity. A total of 990 M&A transactions were announced in 2011 for a total deal value of $225.3 billion. Technology brought in $145.8 billion, or 65 percent of funds committed in 2011, with Services bringing in $79.5 billion.

Services led healthcare M&A in 2011, based on number of announced transactions, with 554 reported deals in 2011. Long-Term Care was the most active segment, with 167 transactions, representing 30 percent of deal flow in the sector, followed by Home Health with 101 transactions, accounting for 18 percent. Medical Devices was the most active sector in Technology with 171 transactions, accounting for 39 percent of the 436 announced transactions for the year.

Q4 ’11 was the most active with 260 announced transactions. Deal flow ramped up after a slowdown in Q3 ’11 resulting from the broader market dislocation in August.

Source: Irving Levin.

Q1 ‘12 IN REVIEW

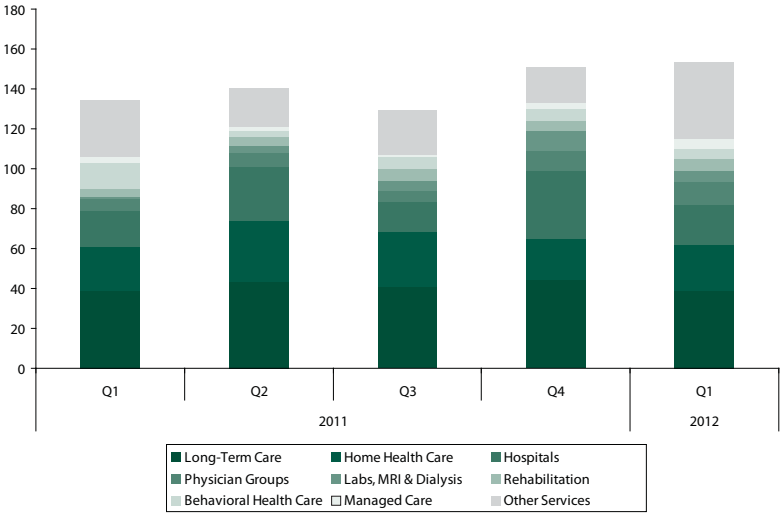
Quarterly deal flow continues to trend up, with Q1 ’12 showing the highest level of activity over the last four quarters. A total of 276 transactions were announced in the quarter, up from 260 transactions in Q4 ’11 and 251 in the year-ago period. Long-Term Care (39 transactions) and Medical Devices (43 transactions) generated the most deal flow in their respective sectors.

Total deal value declined sharply in Q1 ’12, with $29.1 billion in funds committed for the quarter, which compares to $40.1 billion in Q4 ’11 and $51.0 billion in Q1 ’11.

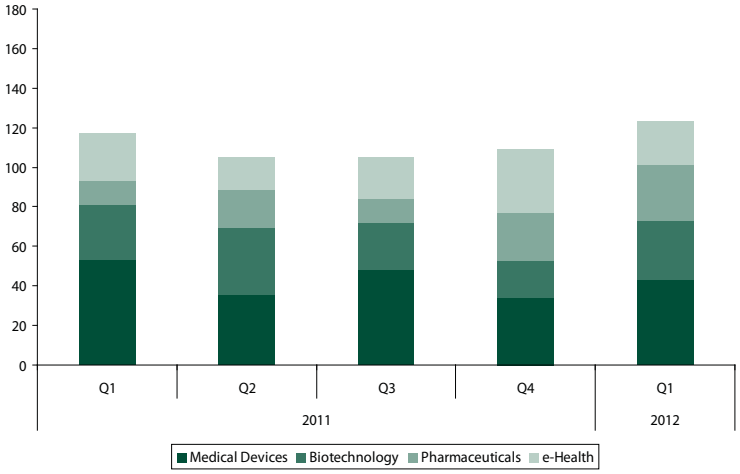
Historical Healthcare M&A Activity

Quarterly M&A Activity by Sector

SERVICES



TECHNOLOGY



Source: Irving Levin.

Mergers & Acquisitions: Healthcare M&A Activity (continued)

NOTABLE ACTIVITY IN PROVIDERS

In February 2012, **JLL Partners** closed the acquisition of **American Dental Partners, Inc.** (NasdaqGS: ADPI) in a deal valued at $390 million. Founded in 1995, American Dental provides support staff, dental facilities, and business services to dental group practices in the United States. In 2010, the company was affiliated with 26 dental group practices comprising 576 dentists practicing in 278 dental facilities in 21 states. American Dental grew revenue by 2.6 percent to $289.3 million for the LTM period ended September 30, 2011 and has generated consistent EBITDA margins of ~17 percent since 2007. **Transaction Multiples: 1.3x Revenue; 8.0x LTM 9/11 EBITDA**

In February 2012, in a deal valued at $1.7 billion, **Fresenius Medical Care AG & Co. KGAA** (DB: FME) closed the acquisition of **Liberty Dialysis, LLC**, a leading private developer, owner and operator of dialysis clinics in 22 states in the United States. As part of the acquisition, U.S. antitrust authorities mandated the sale of 60 of Liberty's outpatient dialysis clinics; competitor **DSI Renal, Inc.**, in partnership with **Golub Capital**, acquired 54 of those entities. In addition to Liberty, Fresenius closed a deal on **American Access Care, LLC**, which operates 28 interventional radiology centers focused on vascular access, in November 2011. Despite the forced divestiture of 60 units, Fresenius has made an aggressive push into the U.S., and expects to benefit from continued profitability and a new U.S Medicare reimbursement system that gives an advantage to larger dialysis chains. **Transaction Multiples: 1.7x LTM Revenue**

In January 2012, **Ascension Health, Inc.** acquired **Alexian Brothers Health System**, an owner and operator of hospitals and senior care centers in the Midwest, for $625 million. Ascension is the largest Catholic healthcare system in the United States with $15 billion in revenue; the deal further expands Ascension's network, adds several senior-care facilities to its portfolio, and establishes an Ascension presence in Illinois, with two former Alexian hospitals.

In November 2011, **Acadia Healthcare Company, Inc.**, a behavioral health provider with 32 inpatient and outpatient facilities in 19 states, closed its acquisition of **PHC Inc.** through a reverse merger (NasdaqGM: ACHC). The merger allows Acadia to further grow its footprint of inpatient and outpatient facilities in the United States providing behavioral health services. In total, PHC will contribute three substance abuse treatment centers, two psychiatric hospitals, one residential treatment facility, and eight outpatient psychiatric centers. Acquisitions have played an important role in Acadia's growth in 2011 and 2012: Acadia acquired **Youth & Family Centered Services, Inc.** (5.6x 2010 EBITDA) and **Lakeland Regional Hospital** in April 2011. Most recently, in March 2012, the company acquired three hospitals (**Sonora Behavioral Health**, **Rolling Hills Hospital**, and **Red River Hospital**) for a combined value of $91 million (7.5x 2011 EBITDA). **Transaction Multiples: 7.5-8.0x NFY EBITDA**

In September 2011, **Health Management Associates, Inc.** (NYSE: HMA), a hospital operator with 66 entities in 15 states, closed the acquisition of **Mercy Health Partners, Inc.** valued at $525 million. This strategic acquisition of Mercy Health's seven Tennessee hospitals helps further build the HMA footprint and network in the state. **Transaction Multiples: 0.9x Revenue**

NOTABLE ACTIVITY IN MEDICAL & LIFE SCIENCE PRODUCTS

In January 2012, **Gilead Sciences, Inc.**, (NasdaqGS: GILD) a biopharmaceutical company that produces human therapeutics for life threatening diseases, acquired **Pharmasset, Inc.**, in a transaction valued at $10.8 billion. While Pharmasset is a clinical-stage pharmaceutical company with only $900,000 in revenue (LTM 9/11), the company is on track to create the first all-oral regimen for treating hepatitis C and thus eliminating the need to take interferon injections with ribavirin pills. Gilead is banking on successful Phase III trials, in hopes to get to market by 2014 and replicate the kind of success it had with its HIV drug Emtriva. Gilead recorded 2011 revenue and EBITDA of $8.4 billion and $4.1 billion, respectively.

In April 2011, **Johnson & Johnson** (NYSE: JNJ) announced it had entered into a definitive agreement to acquire **Synthes, Inc.**, (SWX: SYST) in a transaction valued at $19.6 billion. Synthes, which develops, produces and markets instruments, implants and biomaterials for the surgical fixation, correction, and regeneration of the skeleton and its soft tissues, offers J&J a high operating margin business that already controls nearly 50 percent of the market for sales of screws, plates, bone grafts and other products to treat skeletal injuries. In April 2012, J&J was granted regulatory approval from the European Union on the condition it divests **DePuy Orthopaedics Trauma**, a device making business that treats bone fractures. J&J plans on divesting DePuy to Biomet in Q2 '12 and is currently awaiting U.S. regulatory approval to close the deal. **Transaction Multiples: 5.2x Revenue; 12.1x LTM 3/11 EBITDA**

SOURCE: S&P Capital IQ, PitchBook, Equity Research, and Company Filings.



Mergers & Acquisitions: Healthcare M&A Activity (continued)

NOTABLE ACTIVITY IN OUTSOURCED SERVICES & INFORMATICS

In April 2012, **Express Scripts Holding Co.** (NasdaqGS: ESRX) closed the acquisition of **MedcoHealth Solutions Inc.** (NYSE: MHS) in a deal valued at $33.5 billion. The deal marks a wave of consolidation in the PBM sector, due in part to the planned overhaul in health insurance regulation. The merger creates the largest drug benefits manager, managing approximately 1.5 billion prescriptions, making it 50 percent larger than CVS Caremark in 2013 and 3x the size of UnitedHealth. Express Scripts expects savings of up to $1 billion in costs from the merger. **Transaction Multiples: 0.5x Revenue; 10.7x LTM 6/11 EBITDA**

In January 2012, **Sigma-Aldrich Fine Chemicals, Inc.**, a subsidiary of **Sigma-Aldrich Corporation** (NasdaqGS: SIAL), completed the acquisition of **BioReliance Corporation** for a transaction value of $350 million. The acquisition was highly complementary for Sigma-Aldrich, given BioReliance's wide array of safety testing and Sigma-Aldrich's biologics and chemicals manufacturing and distribution, giving it a broader product offering. Additionally, both companies serve some of the same customer base, including biopharmaceutical and pharmaceutical companies. Sigma-Aldrich has been actively seeking acquisitions. In March 2012, the company completed another acquisition, **Research Organics, Inc.**, a biochemical manufacturer and supplier. **Transaction Multiples: 2.8x Revenue**

In December 2011, **The Carlyle Group** and **Hellman & Friedman** (H&F) took private **Pharmaceutical Product Development Inc.** (PPDI) (NasdaqGS: PPDI) in a deal worth $3.4 billion. With offices in 44 countries and more than 11,000 professionals worldwide, PPDI is a leading CRO, providing drug discovery, development, and lifecycle management services. PPDI's clients and partners include pharmaceutical, biotechnology, medical device, academic, and government organizations. The deal follows bullish expectations for the CRO industry, in part due to increased outsourced R&D demand from pharmaceutical and biotechnology companies; there were 18 deals in the CRO space through Q3 '11. PPDI likely will be used by Carlyle and H&F as a platform to participate in both the continued growth and consolidation of the CRO industry. **Transaction Multiples: 2.1x Revenue; 10.4x LTM 9/11 EBITDA**

In July 2011, **INC Research, LLC**, a therapeutically focused contract research organization (CRO), completed the $346 million acquisition of **Kendle International Inc.**, (Nasdaq: KNDL). The combination of INC and Kendle, the #10 and #6 CROs, respectively (according to Scrips Clinical Research 25), will bring INC closer to its goal of being a top 5 CRO by 2016. In addition, the Kendle acquisition gives INC greater scale in services and geographic scope to compete as a viable strategic partnership alternative to Quintiles, Covance, and PPDI. **Transaction Multiples: 0.8x Revenue; 14.2x LTM 3/11 EBITDA**

In November, 2011 **Blackstone Capital Partners** acquired a controlling interest in **Emdeon Inc.** from General Atlantic LLC, Hellman & Friedman LLC, and other investors, in a transaction valued at $3.3 billion. Hellman & Friedman will retain a significant minority stake. Emdeon, incorporated in 2006 in Nashville, Tennessee, provides healthcare revenue and payment cycle management and clinical information exchange solutions. The company operates in three segments: Provider Services, Pharmacy Services, and Payer Services. **Transaction Multiples: 3.1x Revenue; 13.1x LTM 6/11 EBITDA**

NOTABLE ACTIVITY IN PAYORS

In January 2012, in a move to better compete in the high growth Medicare space, **CIGNA Corporation** (NYSE: CI), the fifth-largest U.S. health insurer, purchased **HealthSpring Inc.** (NYSE: HS) in a transaction worth $3.1 billion. The deal signals an aggressive diversification effort for Cigna into the private Medicare space, which is led by Humana and UnitedHealth, which have 2.2 million and 1.6 million Medicare subscribers, respectively. The baby boom generation is expected to swell the ranks of privately-run Medicare Advantage plans, which now account for 25 percent of seniors. HealthSpring will bring a total of 1.14 million new Medicare customers to Cigna; HealthSpring has approximately 340,000 Medicare Advantage members (compared to Cigna's current 46,000 Medicare Advantage members) in 11 states and 800,000 enrollees in stand-alone Medicare prescription drug plans. **Transaction Multiples: 0.6x Revenue; 6.2x LTM 9/11 EBITDA**

SOURCE: S&P Capital IQ, PitchBook, Equity Research, and Company Filings.

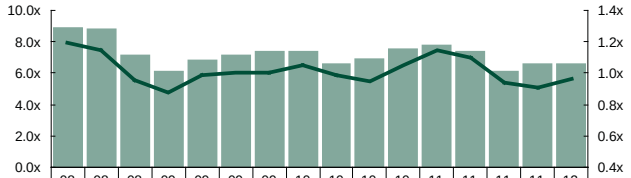


Healthcare Insider

Health and Life Sciences Industry Valuations

Relative Valuation Trends

Providers

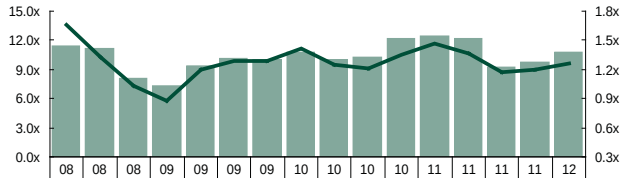


	08 Q2	08 Q3	08 Q4	09 Q1	09 Q2	09 Q3	09 Q4	10 Q1	10 Q2	10 Q3	10 Q4	11 Q1	11 Q2	11 Q3	11 Q4	12 Q1
EV/EBITDA	8.9x	8.8x	7.1x	6.1x	6.8x	7.1x	7.4x	7.4x	6.6x	6.9x	7.5x	7.8x	7.4x	6.1x	6.6x	6.6x
EV/Revenue	1.2x	1.1x	1.0x	0.9x	1.0x	1.0x	1.0x	1.0x	1.0x	0.9x	1.1x	1.1x	1.1x	0.9x	0.9x	1.0x

Medical & Life Science Products

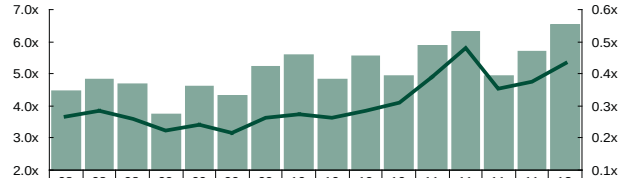
	08 Q2	08 Q3	08 Q4	09 Q1	09 Q2	09 Q3	09 Q4	10 Q1	10 Q2	10 Q3	10 Q4	11 Q1	11 Q2	11 Q3	11 Q4	12 Q1
EV/EBITDA	11.5x	11.1x	8.4x	7.5x	8.6x	9.7x	10.1x	9.8x	8.4x	8.7x	9.2x	9.4x	9.6x	8.0x	8.2x	8.9x
EV/Revenue	2.8x	2.7x	2.1x	1.9x	2.0x	2.4x	2.4x	2.5x	2.2x	2.2x	2.5x	2.5x	2.6x	2.2x	2.2x	2.4x

Outsourced Services & Informatics



	08 Q2	08 Q3	08 Q4	09 Q1	09 Q2	09 Q3	09 Q4	10 Q1	10 Q2	10 Q3	10 Q4	11 Q1	11 Q2	11 Q3	11 Q4	12 Q1
EV/EBITDA	11.4x	11.2x	8.1x	7.2x	9.3x	10.1x	10.0x	10.8x	10.0x	10.3x	12.1x	12.4x	12.2x	9.2x	9.7x	10.8x
EV/Revenue	1.7x	1.3x	1.0x	0.9x	1.2x	1.3x	1.3x	1.4x	1.3x	1.2x	1.4x	1.5x	1.4x	1.2x	1.2x	1.3x

Payors



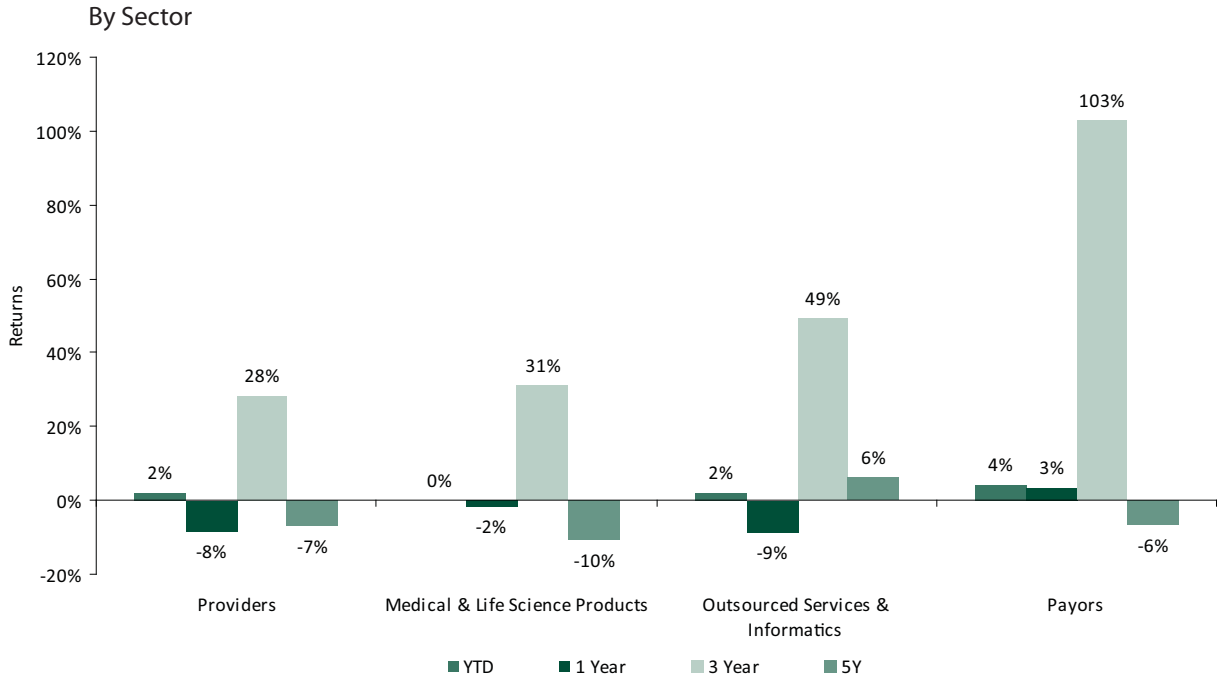
	08 Q2	08 Q3	08 Q4	09 Q1	09 Q2	09 Q3	09 Q4	10 Q1	10 Q2	10 Q3	10 Q4	11 Q1	11 Q2	11 Q3	11 Q4	12 Q1
EV/EBITDA	4.4x	4.8x	4.7x	3.7x	4.6x	4.3x	5.2x	5.6x	4.8x	5.5x	4.9x	5.9x	6.3x	4.9x	5.7x	6.5x
EV/Revenue	0.3x	0.3x	0.3x	0.2x	0.2x	0.2x	0.3x	0.3x	0.3x	0.3x	0.3x	0.4x	0.5x	0.4x	0.4x	0.4x

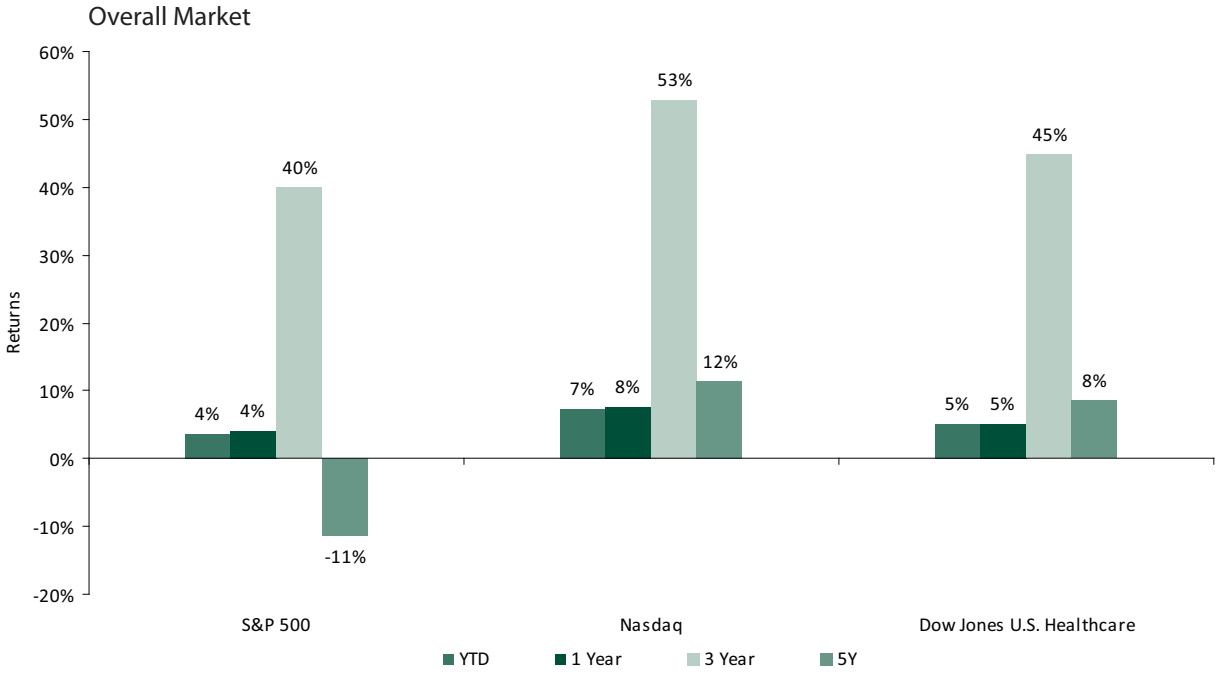
SOURCE: S&P Capital IQ.



Health and Life Sciences Industry Valuations (continued)

Sector Performance





Source: S&P Capital IQ.
As of 6/12/2012.



Global Healthcare and Life Sciences Practice

Medical & Life Science Products
- Medical and Consumer Health Supplies
- Disposables
- General Devices and Equipment
- Surgical Tools

Provider Services
- Health Facilities
- Alternative Site Providers
- Behavioral Health
- Physician Services
- Home Healthcare
- Retail Medicine Strategies

Outsourcing & Informatics
- Drug and Medical Product Distribution
- Payer Services
- Functional Outsourcing
- Clinical Solutions and Outsourcing
- Staffing

Diagnostics & Research Tools
- Instruments, Controls, Reagents
- Lab Equipment & Supplies
- Point-of-Care Diagnostics
- Niche Device Markets
- Clinical Diagnostics
- Telemedicine

About BGL

Leading Independent Firm

- Independent investment banking advisory firm focused on the middle market
- Senior bankers with significant experience and tenure; partners average over 20 years of experience
- Offices in Chicago, Cleveland, and Salt Lake City
- Founding member and the exclusive U.S. partner of Global M&A, the world's leading partnership of investment banking firms focusing on middle market transactions
- Deep industry experience across core sectors of focus, including: Business and Environmental Services, Basic Industrials, Consumer Products, Healthcare and Life Sciences, and Real Estate

Comprehensive Capabilities

M&A Advisory	Private Placements	Financial Restructuring
Sell-Side Advisory	All Tranches of Debt & Equity Capital for:	Balance Sheet Restructurings
General Financial & Strategic Advice	Growth	Sales of Non-Core Assets or Businesses
Acquisitions & Divestitures	Acquisitions	§363 Auctions
Public & Private Mergers	Recapitalizations	
Special Committee Advice	Dividends	
Strategic Partnerships & Joint Venture Formation		
Fairness Opinions & Fair Value Opinions		

Representative Transactions

Celsis International Ltd.
— has sold —
Celsis | Analytical Services
to
AAI PHARMA SERVICES
— a portfolio company of —
WATER STREET
BROWN GIBBONS LANG & COMPANY
PHARMA SERVICES

PharMedCorp
— obtained financing provided by —
OXFORD FINANCE
BROWN GIBBONS LANG & COMPANY
INSTITUTIONAL PHARMACY

BHP Management
and affiliated skilled nursing facilities
Aristocrat West • West Park • Crestmont North HEALTHCARE
— obtained financing provided by —
OXFORD FINANCE
BROWN GIBBONS LANG & COMPANY
SENIOR LIVING

Ganeden
Improving Quality of Life
— sold certain assets to —
Schiff NUTRITION INTERNATIONAL
Rendered a Fairness Opinion to the Board of Directors of Ganeden Biotech, Inc.
BROWN GIBBONS LANG & COMPANY
NUTRACEUTICALS

The CSC Group
Capture · Integrate · Automate
— acquired by —
HYLAND SOFTWARE
— a portfolio company of —
THOMA BRAVO
BROWN GIBBONS LANG & COMPANY
HEALTHCARE IT

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