London Business School

Paton Medical Group

PATON MEDICAL GROUP MERGER AND ACQUISITION BY APEX GROUP

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1. Private Equity Firms

Overview

In the last two decades, the private equity industry has grown markedly and has promoted the virtue of *active ownership*[1]—the hands-on approach that distinguishes it from traditional portfolio investments. PE financing aims to fill the gap between internally generated financing and public equity. Essentially, these firms sit between public equity and outright ownership in terms of investment horizon and the degree of corporate control. Unlike public equity, PE ties the investor close to the company through the acquisition of a considerable equity stake that involves membership in the board and some control rights. This allows the investors to espouse hands-on tactic when managing their investments and implementing operational changes to the acquired firm.

This risk capital investment is normally provided to companies with high potential for growth, young business at an early stage, start-ups with foreseeable potential, and in some cases, profitable businesses that require financial turnaround.

The dramatic growth of PE opportunity has largely been driven by the increased availability of control positions. Characteristically, funds in PE investment are raised by offering prospectus to potential investors whose key interest is to provide capital to promising investment, take some control, and eventually make returns with time. This investment mainly comprises of PE funds and investors who invest directly into privately own businesses or otherwise make buyouts of firms that have been listed publicly. PE funds are typically invested in unquoted securities and necessitates signing of contractual funding agreement between the investment firm and the firm seeking PE funding. While such investments have been hit with unending challenges and heavy pressures, Bain & Company report that PE global industry continues to expand in investment.[2]

[1] Heel, J. and Kehoe, C., 2005. Why some private equity firms do better than others. *The McKinsey Quarterly*, *1*, pp.24-26.
[2] Bain and Company. 2019. Global Private Equity Report 2019. Accessed from: https://www.bain.com/contentassets/875a49e26e9c4775942ec5b86084df0a/bain_report_private_equity_report_2019.pdf [27.08.2019]
[3] Chen, J. 2019. Private Equity. Investopedia. Available From: https://www.investopedia.com/terms/p/privateequity.asp [28.08.2019]

1. Private Equity Firms

While rising asset prices and fierce competition continue to constrain deal count, 2018 reports show that the total buyout value soared 10% to £478 billion (US$482 B), which includes add-on deals), capping the strongest five-year run in the industry's history, see *Figure 1*.

However, as seen in the figure, the number of transactions has decreased for about 13% to 2936 globally from the previous year due to increased number of PE firms [hence competition] and rising asset prices. Companies and start-ups in the current markets are increasingly looking for PE funding for a number of diverse reasons. As noted by Investopedia, PE funds are favoured by companies because they allow for access to liquidity as an alternative to conventional financial mechanisms such as public equity and high-interest bank loans.[3]

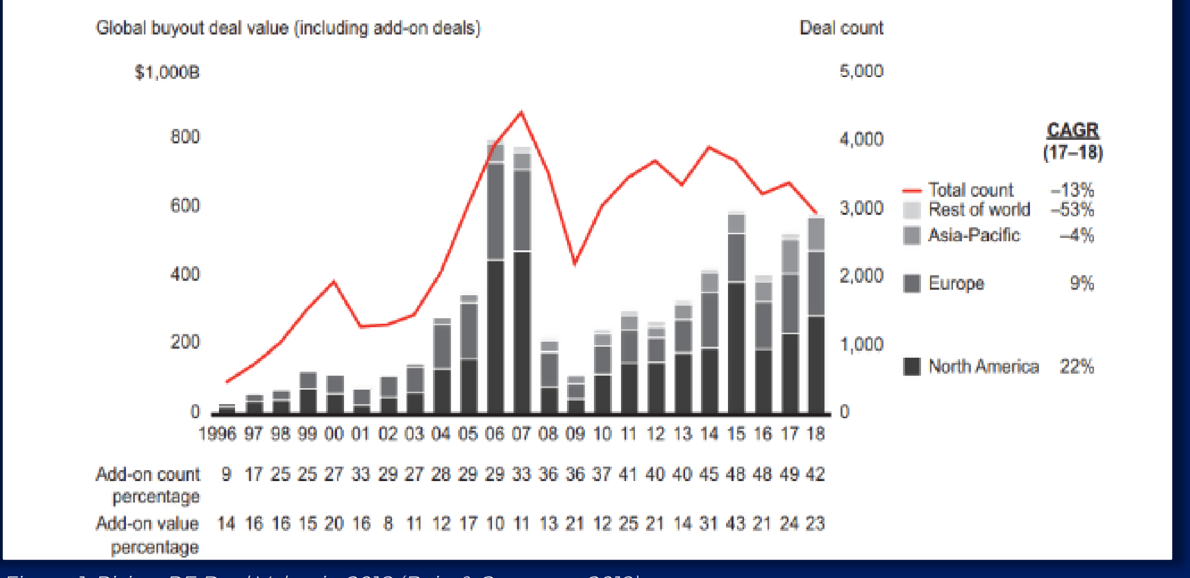

Figure 1: Rising PE Deal Value in 2018 (Bain & Company 2019)

These forms of PE investments, especially venture capitals, can also finance ideas and early-stage companies and start-ups. In cases where a business is de-listed, PE firms can also help such a business attempt unorthodox growth approaches towards financial turnaround. On the other hand, PE firms generally receive a return on their investment through recapitalisation, merger, and acquisition (M&A), or initial public offering (IPO).

In recapitalisation, cash is usually distributed to the shareholders and its PE funds either from cash flow generated by the firm or through raising debt and other securities. M&A deals are straightforward deals where the PE firms either buys a company for cash or shares. Lastly, in IPOs, are shares of a company offered to the public; in the public market such shares are institutional investors [such as PE firms] or individual [retail] investors.

[1] Heel, J. and Kehoe, C., 2005. Why some private equity firms do better than others. *The McKinsey Quarterly*, *1*, pp.24-26.
[2] Bain and Company. 2019. Global Private Equity Report 2019. Accessed from: https://www.bain.com/contentassets/875a49e26e9c4775942ec5b86084df0a/bain_report_private_equity_report_2019.pdf [27.08.2019]
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1. Private Equity Firms

PE Firms in Healthcare

Acquisition of hospital groups by private equity firms has increased dramatically over the past few years. For over two decades now, PE firms have continued to invest in healthcare, but recent years has seen this pace accelerate.

Recent reports indicate that PE firms are stepping up their presence in this highly fragmented industry by seizing on consolidation opportunities to build better business models. Such acquisitions are primarily centred on hospital groups that show great potential for additional income.

PE firms focus on acquiring medical groups that are large, well-managed, and reputable with the community anticipating an average annual return of about 20% or more. PE healthcare firms' acquisitions and investments are increasingly diversified and infrequent encompassing such things as ophthalmology and dermatology practices, clinical research organizations, and new entrants in technology and convenient delivery care. Professional services companies such as PwC, expects this trend to skyrocket in 2019 and going forward. This trend gives traditional healthcare institutions a chance to double down on their core competencies, sell all or part of non-core assets, or partner with PE in acquisitions.

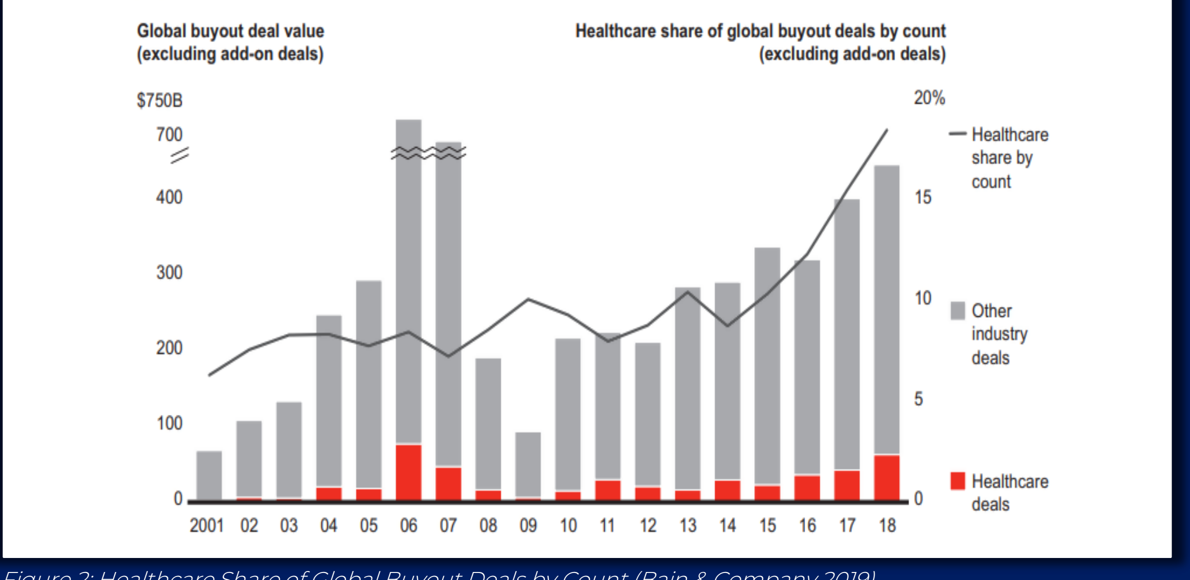

Figure 2: Healthcare Share of Global Buyout Deals by Count (Bain & Company 2019)

In 2018, global healthcare PE activity set a record with 316 announced deals valued at approximately £52.2 billion - a significant increase of over £35.3 billion across 265 deals in 2017. Figure 2 shows that, as PE deals continue to rise, healthcare assets continue to become increasingly popular. Across various sectors, the provider segment was the most active, accounting for more than half of the total deal activity and disclosed value.

In Europe, deal activities remain robust as the deal count rose from 70 in 2017 to 73 while the disclosed value nudged to a record £14.7 billion. This rise in value come mainly from large deals such as Zentiva and Recrdati, cumulatively worth over £8.1 billion.

[1] Heel, J. and Kehoe, C., 2005. Why some private equity firms do better than others. *The McKinsey Quarterly*, *1*, pp.24-26.
[2] Bain and Company. 2019. Global Private Equity Report 2019. Accessed from: https://www.bain.com/contentassets/875a49e26e9c4775942ec5b86084df0a/bain_report_private_equity_report_2019.pdf [27.08.2019]
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2. Paton Medical Group

History and Corporate Culture

Having been established in 1964, Paton Medical Group remains one of the longest standing medical groups in the country. It was founded by a prominent neurologist and businessman, Dr Henry Paton who initially established the Paton Memorial Hospital in 1958 in honour of his late father.

He is considered to be one of the pioneers of foundations towards helping people with Parkinson's and Other Movement Disorders in the UK. He is notably affiliated with National Hospital for Neurology and Neurosurgery towards the same course. Dr Paton has closely affiliated his neurology work to James Parkinson, a British surgeon, palaeontologist, geologist, apothecary, and political activist.

Dr Parkinson is greatly remembered for believing that the brain is the 'most incredible thing in the known universe.' His best-known work is titled An Essay on the Shaking Palsy, in which the condition that later came to be known as the Parkinson's disease was first mentioned. Dr Paton's works in this field are greatly based on the hypotheses, experiments, and teachings of Dr Parkinson.

Dr Paton's idea of Paton Medical group was born after he acquired Mount Sinai Hospital in 1964. This medical group has grown to become a colossal group, employing over 3000 people and operating 28 hospitals and day surgery facilities across the UK. This makes Paton Medical Group one of the largest and most diverse private healthcare company in the UK.

The Group is highly proud of the high quality of care that it provides, its excellent relationship with both its patients and doctors and its outstanding commitment to excellence in service in all areas, and its bold vision for the future. The company is driven by the maxim, 'The Paton Way,' a culture that recognises people, the doctors, and other staff—are [and will always be] the most important assets of the company.

Through Dr Paton's visions and ideas, Paton Medical Group has brought together a unique blend of premises development and patient care deliver solutions that offer value, quality, and resilience to patients, GPs, GP networks, as well as commissioners and federations. Today, this medical group is well-respected in the healthcare industry in the UK for operating quality private hospitals and for its tremendous record in patient care and hospital management. Such features has helped in attracting leading healthcare practitioners to work in Paton Medical Group facilities.

2. Paton Medical Group

Paton Medical Group IPO

Based on its track record and corporate culture, Paton Medical Group is one of the most well-managed hospital groups in the United Kingdom and has been attracting PE firms' interests for the past several years. This interest intensified after the Paton Group initial public offering (IPO) in November last year, thus officially becoming a publicly-traded and owned entity.

Paton
Medical
Group

This decision came after the shareholders agreed to go public as a means of increasing prestige, intensifying the company's reputation, and attracting investors.

This exit strategy involved contracting several investment banks and making certain fundamental decisions such as determining the number and prices of the shares that were to be issued. Two investment banks were involved in this IPO, including CVC Capital Partners and Bridgepoint Advisers. The two banks took on the task of underwriting Paton Medical Group shares and were to oversee the selling of these shares to potential investors.

3. Apex Acquisition of Paton Medical Group

Apex Group is one of the biggest PE firms today managing a portfolio of over £60 billion in assets through private equity, hedge funds, credit, real estate, and now, healthcare. The company was founded in 1989 and has completed over 200 transactions. For over 30 years now the group's mission has been to generate exceptional investment returns by providing growing companies and talented managers with capital, ideas, encouragement, and industry resources needed to help such businesses reach full potential. The group's exclusive focus on the mentioned sectors has provided them with the expertise and relationships needed to help management teams develop and implement winning strategies across varying economic cycles.

£60 billion in assets

over 200 transactions

annual revenue of over £350 million

For the last few years, Apex has been looking to expand its activities towards Europe, specifically in the UK. With an approximated annual revenue of over £350 million, deep understanding of their targeted sectors, proven strategies for driving growth and increasing equity value, flexible approaches to investing in the upper middle market, and history of building industry-leading businesses, Apex Group thought the time was ripe for them to invest in UK's evergreen healthcare market. For the past few years, they have been monitoring several medical groups within the UK, Paton Group being one of them. After going public in 2018, Apex Group intensified its interest in acquiring Paton Group. Traditionally, Apex has invested in leveraged buyouts (LBO) and growth equities because there are fewer risks involved as compared to other types of investments such as venture capitals and distressed private equities.

They have been particularly interested in Paton Medical Group for a variety of reasons. Firstly, it is classified as a 'growth equity' meaning that it is already a well-established, well-managed company, and thus, requires low capital expenditure.

This fast-growing company has had a proven track record and has been operational and successful for several decades. Secondly, the medical group already operates in a non-cyclical industry, so there is low volatility. Thirdly, Paton Medical Group already has a steady and reliable cash flow in a lucrative industry. The company has a strong management team, which means Apex Group wouldn't require a team to replace the current management team.

3. Apex Acquisition of Paton Medical Group

Apex Group appears to have a clear idea of what they are looking to benefit from this M&A; gain access to a new market and expand. Although this acquisition process is still at its early stages, they already have an in-depth analysis of Paton's customer base, financial metrics, human resources, assets and liabilities, and trends within UK's healthcare sector. Paton has already provided substantial company information allowing Apex to further evaluate the company and subsequently construct a reasonable offer. This assessment has focused on volume, cost, revenue, forecasts, and balance sheet considerations.

After the go/no-go discussions, Apex identified that the strategic value-added case for a combined entity was compelling enough to make a premium purchase.

After evaluating the value of Paton Group using share price and involving the necessary regulatory bodies, Apex tabled a lucrative offer that convinced the shareholders to sell. Since this will be an acquisition premium, it will be recorded as 'goodwill' on the acquirer's balance sheet. As such, the value of Paton's brand name, remarkable customer relations, solid customer base, excellent employee relations, as well as any patents or proprietary technology that will be acquired will be factored into the goodwill. By purchasing the majority of Paton Group shares, Apex will also acquire considerable control of the medical group with plans to take them private and ultimately delist it from the public stock exchange.

4. Communication with Paton

With increased rumours about this acquisition, employees are likely to be worried and be concerned about their job security, especially with new management. The main issue for employees is that M&As normally involves reducing the workforce to eliminate redundancies while at the same time streamlining and reducing costs. Other issues include lowered employee confidence, job security concerns, probable change of executive roles, and affected corporate culture. Historically, most PE firms are shown to be exclusively driven by profits, find greater returns while limiting the money they have at risk. This is often to the detriment of the company and everyone involved, particularly the employees.

As mentioned previously, Patton Medical Group is already well-established and well-managed; that's why it has attracted considerable PE interest over the past years. On the other hand, Apex has a proven track record of not only growing businesses and building strong partnerships but do it without significantly changing the corporate culture and the working business. Apex group look for growth equities such as Paton Group, offer growth capital, support management during key strategic choices and make their international network available. These are the hallmarks that typify their investments. It is also a firm that promises to be patient-centric care as it looks to make its name in the healthcare sector. Apex will be keen to maintain the Paton Way philosophy as it makes financial sense and contributes to profitability.

As such, the employees here need to remain calm as it is very unlikely that their positions in the company will be affected.

This will only be a change of ownership, and almost everything else will remain unaffected. Being arguably the most valuable component of Paton Medical Group, employees need to be notified and affirmed about this acquisition via internal communication. As the special advisory committee to the board, please formulate an internal news release to announce the imminent deal and to rest assure the employees that business will be as usual. This announcement will be crucial to avoid risking employee loyalty and trust, retention, corporate culture, and long-term success of Paton Medical Group. This information should be disseminated professionally and effectively detailing some of the important minutiae of the acquisition to ensure that everyone is on the same page.