Inside the Deals:
Recent Mergers & Acquisitions in the Healthcare Industry

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Eric Klein

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- Physician Group M&A and Alignment
  - DaVita’s $4.4 billion merger with HealthCare Partners, involving CA, FL and NV (2012)
  - Healthcare Partners merger with ABQ Health Partners in New Mexico (largest independent medical group in NM) (2012)
  - Facey Medical Foundation alliance with Providence Health & Services (Los Angeles) (2012)
  - Greater Newport Physicians transaction with MemorialCare Medical Foundation (2012; Orange Cty)
  - 5 of 6 completed United Optum deals in CA
Other Physician Group Deals:

- Affinity Medical Group transaction with Stanford University UHA medical foundation (Northern CA)
- CA deals: Bristol Park, Axminster, Talbert, Lakeside, Northridge and others
- Multiple single-specialty deals nationally

Hospital M&A: 21 hospital purchase or sale transactions in last 7 years

HMO M&A: Purchases and sales of Medicare Advantage, Medicaid and specialty HMOs nationally

Represents multiple ACO clients

Multiple multi-million dollar EMR/EHR projects

Teaches advanced negotiating skills nationally
Sheppard Mullin: HealthCare

- More California physician group transactions than any other law firm in the last 4 years
- Recognized by Chambers and The Legal 500
- 70+ attorney National Healthcare Team
  - Transactions: M&A, Clinical Integration, Foundations
  - Knox-Keene Licensing & ACOs
  - Reimbursement & Regulatory
  - Managed Care Contracting
  - Investigations & Enforcement Defense
  - Healthcare Information Technology & Privacy
  - Healthcare Real Estate
  - Healthcare Litigation
  - Antitrust – Arcadian/Humana transaction
The Consolidation Continues

- Continuing – and accelerating – trend in healthcare industry of consolidation
- Response to:
  - Healthcare reform and economics/rates
  - Uncertainty in market
  - Payor consolidation
  - IT burdens and opportunities
  - Regulatory burden
  - Private equity
What Sectors are Active?

- Physicians
- HMOs
- Hospitals
- Cost-Containment Support
- Post-acute
- Ancillary Services
Physician Groups

- Physician Groups
  - Multi-Specialty
  - Certain Single-Specialty
    - Ex., Cardiology, Anesthesiology

- New Entrants
  - DaVita Inc. purchase of HealthCare Partners
  - McKesson buys MED3000

- Accelerating alignment of hospitals & physicians
  - Effect on payors and pricing?

- Payor vertical integration – Optum, Anthem, CIGNA

- Dual eligibles and Medicaid expansion?
HMOs

- Medicare Advantage
  - Aetna/Coventry (2012)
  - Anthem/Caremore (2011)
  - United/XL Health
  - Humana/Arcadian and MDCare (2011-12)
  - CIGNA/HealthSpring (2012)
  - Wellcare/Easy Choice (2012)
  - UnitedHealth/Preferred Care Partners & Medica (2012)

- Medicaid
  - WellPoint/Amerigroup
  - Inova/Amerigroup Virginia
  - BCBS Michigan/AmeriHealth Mercy

- Specialty/Carve-Out
  - Behavioral Health
Hospitals

- Continuing active market - 12% increase in 2011 to 92 deals
- 1st half 2012 – 48+ deals
- Ascension
  - Marian & Daughters of Charity
  - Oak Hill Capital joint venture
- Many “strategic affiliations”
  - CA: St. Joseph/Hoag
Inside a Hospital/Physician Deal

- Southern California
  - Greater Newport Physicians aligns with MemorialCare
    - Follows the 2012 purchase of Bristol Park
    - Merger of Nautilus Healthcare Management
    - IPA, practice management and group model
      - Medicare and Commercial lines of business
      - Realignment of Market
Regulators Are Watching….

- FTC is active in investigating hospital mergers and HMO deals
- Renown Health – merger of 2 cardiology groups in Nevada
- California Attorney General issues subpoenas to Dignity, Sutter, Sharp, Scripps & Cottage systems re: pricing and physician consolidation/alignment
Growing national awareness of need for expertise/experience in population health management (payors, health systems) and in physician aggregation and alignment

- Where is this skill set? --- Clearly in California
- Build or Buy decision
- How many groups truly have this skill set?
- Is there an opportunity to scale nationally, either with financial backing or in partnership with a national player (payor or hospital system)?
Trends to Watch…Private Equity?

- Still a lot of money allocated by Private Equity to the Healthcare sector
  - How will we see that deployed?
- Continuing strong interest by major Private Equity funds in Managed Care/Population Health Management
- After Prospect, what’s next?
  - Assets of scale?
  - Why hasn’t private equity had more impact?
Physician Group Deal Terms

- Seeing longer indemnification periods in some deals in last 18 months, but mostly related to HCC-RAF or deal-specific issues (3-5 years)
  - With March 2012 HCC-RAF notice from Medicare, unlikely to have material liability for pre-2011
  - Will this change buyers’ previous focus on HCC-RAF exposure?
- Still absence of liability for physician shareholders for $$ above escrow or earn-out
Deal Terms

- **Earn-Outs**
  - Continue to be prevalent
  - 2-3 year terms
  - 20-40% of total consideration
  - Focused on quality, EBITDA, utilization criteria
  - Often with both downside and upside corridors

- More focus on establishment of “upside” compensation arrangements for multi-year periods post-closing.

- Payor actions putting more pressure on noncompetes and exclusivity arrangement
2011: Generally pricing held steady at 2010 EBITDA multiples, with some significantly increased EBITDA multiples over 2010

California and other larger group acquisitions at increasing multiple of EBITDA
  – Historically, 4-6x current or TTM EBITDA
  – 2010-2011, most deals at least 6x EBITDA

2011: Range seen from 6-10x, with outliers from 12-18x

Anthem/CareMore: Reported at 8.9x EBITDA

2012: Multiple transactions at 7-8+x EBITDA
Outlook for Pricing - Physicians

- Expect pricing to remain in same range with individual variability by market/group
- Declining number of independent groups
  - Scarcity of sellers
  - Increasing number of buyers, with accelerating activity by hospital systems
- Prospect of reimbursement cuts still not materially affecting valuation
- Dodged valuation bullets (so far) on HCC-RAF, physician rate cuts and ICD-10
According to published reports:

- ~$10,000/MA life in CIGNA/HealthSpring deal
- ~$15,000/MA life in WellPoint/Caremore
- Other 2011-2012 transactions in the $12,000-$16,000 range
- Historical pricing in the $3,000-$5,000 range
  - 3-4x increase in recent years!
Aware of current transactions involving sale of majority control of an ACO
- ACO not primary focus of transaction

Valuation mechanism for ACO?
- Uncertainty
- Valuation approaches
Questions?

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