

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

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Eric Klein

- Partner and Leader, Sheppard Mullin National Healthcare Team
- 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

Eric Klein

- **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

- 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

Trends to Watch...

- 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

Transaction Pricing - Physicians

- 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

Transaction Pricing - MA HMO

- 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!

ACO Transactions – Valuation?

- 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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