

SheppardMullin

WHO'S NEXT?

**ANALYZING STRATEGIC TRANSACTIONS
& OPPORTUNITIES IN TODAY'S MARKET**

Eric Klein

November 2013

Eric Klein

- Partner and Leader – Sheppard Mullin National Healthcare Team
- Selected Physician Group M&A and Alignment
 - Tenet merger with Lakewood IPA and Premier Health Plan (2013)
 - 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)
 - Greater Houston Anesthesiology affiliation with private equity fund Welsh Carson – largest anesthesiology group in Texas (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 7 sellers in completed United Optum deals in CA

Eric Klein

- Advises hospital systems, multiple HMOs and strategic investors nationally on physician alignment strategies and strategic planning
 - Physician Group Mergers and Acquisitions
 - Primary Care, Multi-Specialty & Single Specialty
 - Commercial & Medicare ACOs, HCC-RAF programs and Innovative Contracting
 - Management Services Affiliations
 - Ambulatory Care Network Development
 - Post-Discharge Continuum of Care

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
 - Multiple single-specialty deals nationally
 - Cardiology, dermatology, anesthesiology, neonatology, oncology, vision
- Hospital M&A: 25 hospital purchase/sale projects in last 7 years
- Health Plans: Purchases and sales of Medicare Advantage, Medicaid and specialty HMOs nationally; formation and licensing of HMOs
- Represents multiple ACO clients
- Multiple multi-million dollar EMR/EHR projects
- Teaches advanced negotiating skills nationally

Introduction to Sheppard Mullin

- Global 100 full service law firm of 650+ attorneys with 90 year history
- Focused on middle-market and large-cap markets, such as healthcare, technology, aerospace and defense, and banking
- 11 US offices and 5 international offices
- Significant growth during the recession
- Priced below Wall Street law firms for the middle market

Sheppard Mullin: Health Care

- 85+ attorney National Healthcare Team
- More California and managed care/coordinated care physician group transactions than any other law firm in the last 4 years
- National Tier 1 Healthcare Practice ranking by US News & World Report
- Recognized by Chambers and The Legal 500
- Current President of ABA Health Law Section

Sheppard Mullin: Innovative Work

- We do cutting edge, creative work
- *Example:* The 1st New Mexico commercial ACO and 1st Medicare Advantage downstream risk-based payor contracting; previously only fee for service in NM
- *Example:* Public/Private partnership between a county health system and privately owned physician network
- *Example:* Medicaid dual eligible strategy through FQHC alignment strategy

Sheppard Mullin: Health Care

- Transactions: M&A, Clinical Integration, Joint Ventures, Private Equity
- HMO Licensing, Risk-Based Contracting and ACOs
- Reimbursement and Regulatory
- Managed Care Contracting
- Investigations and Enforcement Defense
- Health Care Information Technology and Privacy
- Health Care Real Estate
- Health Care Litigation
- Health Care Antitrust – Arcadian/Humana transaction

THE HEALTHCARE MARKET TODAY

Some Assumptions?

- Americans will get thinner and healthier soon?
- Seniors will require less medical care?
- Less lawyers and litigation?
- Republicans will win in 2016?
- ACA will stay in place?
- Reimbursement rates will increase?
- Continuing pressure on health care costs?
- Large increase in primary care MDs in the next 5 years?

Notable Recent Physician Transactions - November and December 2012

- DaVita merger with HealthCare Partners – \$4.4 billion
- Humana acquisition of Metropolitan Health Networks – ~\$850 million
- UnitedHealth Optum acquisition of North American Medical Management – price not disclosed, rumored to be just under \$1 billion
- Florida Blue acquires Diagnostic Clinic
- Welsh Carson/Greater Houston Anesthesiology

Recent Physician Transactions – 2013

- Tenet/Lakewood IPA and Premier Health Plan (2013)
- DaVita Healthcare Partners/Arizona Integrated Physicians (2013)
- Multiple other transactions in process now...

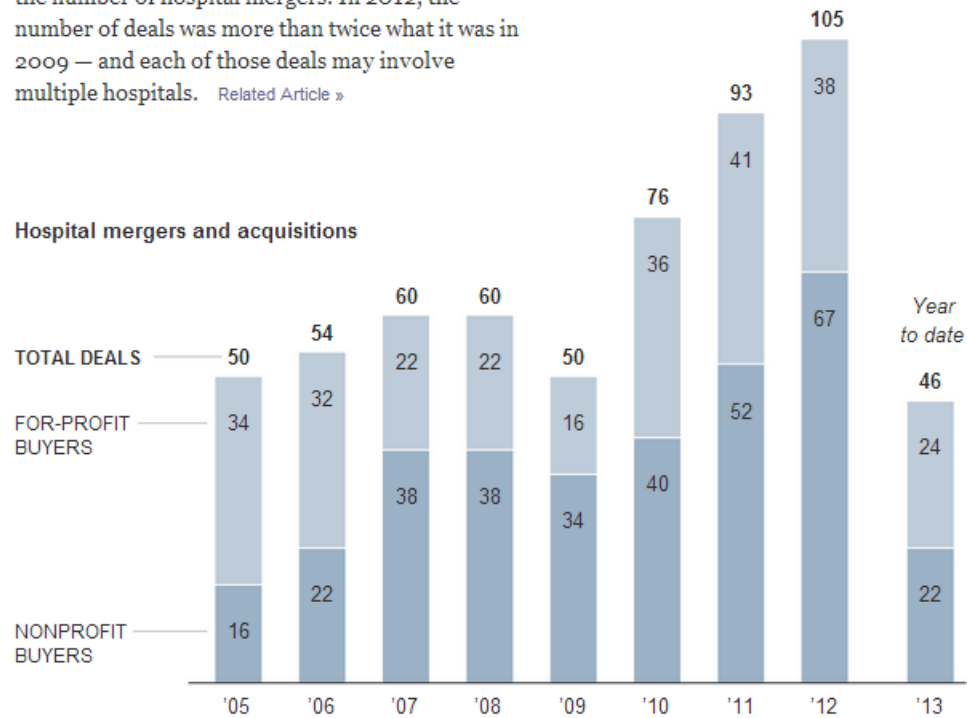
The Second Wave

- Long-term success depends on both “first-wave” physician group alignment and “second wave” smaller practice aggregation
 - Building or buying platforms
 - Clinical or other integration of community physicians
 - Equation: Direct control of physicians, alignment of economic incentives and culture, and applied data can change economics, patient experience and behavior

Continuing Wave of Hospital Transactions

A Wave of Hospital Mergers

Over the last four years, there has been a surge in the number of hospital mergers. In 2012, the number of deals was more than twice what it was in 2009 — and each of those deals may involve multiple hospitals. [Related Article »](#)



Continuing Hospital Acquisitions

- Selected Hospital Systems Transactions
 - Tenet/Vanguard
 - Community Health/HMA
 - Trinity Health/Catholic Health East
 - CHP/Peace Health (abandoned)
 - St. Joseph/Hoag Memorial formation of Covenant
 - Mount Sinai/Continuum (Beth Israel, St. Luke's)
 - AllSpire – 7 NJ & PA hospital systems in alliance (\$10.5B annual revenue)
- Booz & Company predicts 1,000 of the ~ 5,000 US hospitals could merge in the next 5-7 years

Hospital Affiliations

- We will see a wide range of hospital affiliations as different models are tested
- For-profit purchases of non-profit systems will continue
- Non-profit systems will merge with other non-profit systems
- Joint ventures will be utilized on a case by case basis
 - Yale New Haven Hospitals & Vanguard joint venture
 - Building population health management capabilities

Selected Recent Payor Transactions

- Medicare Advantage
 - Aetna/Coventry (\$5.7B)(2013)
 - WellCare/Windsor Health (2013, 4 states)
 - CIGNA/HealthSpring (\$3.8B)(2011)
- Medicaid
 - Anthem/Amerigroup (\$4.5B)(2012)
 - Many local or regional Medicaid plans being acquired
 - MI, NY, VA, SC, etc.
 - Example, Virginia – acquisition of Amerigroup plan by Innova, a leading No. Virginia hospital system

WHERE ARE WE GOING WITH ALL OF THIS?

Interesting Trends...

- Continuing Physician Alignment Efforts
 - Continuing efforts to align with established groups
 - 2013 Pricing is holding steady at 2012 levels
 - EBITDA Multiples for Managed Care/Managed Care Ready Physician Groups still in the 6-8x EBITDA range
 - Often, hospital system purchases push to the top of (or above) that range
 - For groups that are fee for service based and have started toward risk-bearing structures (ACOs, etc.), we are seeing multiples of 1-2x annual total physician compensation
 - Payor mix affects pricing algorithm
 - Recent purchase transactions that include ACOs do not allocate significant value to ACO

Interesting Trends...

- Vertical Integration of Physicians by Payors is continuing
 - Recent larger 2012 transactions by United's Optum group and Humana
 - Continuing interest in expanding payor physician relationships
- Vertical Integration of Hospitals by Payors?
 - Molina Healthcare recent transaction to manage community hospital in California (Orange County Register 10/8/13)
 - Provides opportunity for medical and cost management of members

Interesting Trends...

- Price Impact of Hospital Consolidation?
 - “nearly one-third of all the money that Massachusetts insurers spent on acute hospital care last year” went to one hospital group alone. (MA Center for Health Information and Analysis, 2013, per *Boston Globe*)
 - “[O]verall, 80 percent of insurance payments went to the providers that charge the highest prices...making it clear that cutting spending on medical care will depend in part on controlling payments to these systems.”
 - Northern California revenue per hospital day is 56% higher than in less consolidated Southern California (*Los Angeles Times*)

Interesting Trends...

- More Clinical Integration coming
 - Adding revenue through joint PPO contracting for network physicians
 - Common IT platform allows implementation of care protocols and point of care data-driven intervention
 - Opportunity to provide group purchasing, staffing support and other shared services
- Increasing Revenue and Reducing Costs equates to Value for Physicians

Interesting Trends...

- MOVE UP the “food chain”
 - Hospital systems seeking payor licenses
 - Go direct to employers
 - Offer insurance products
 - Eliminate third party margins (system employee health)
 - Not if, but when....
 - Sutter
 - Ascension
 - Tenet

Interesting Trends...

- GO WIDE in your “distribution channel” and capture new product revenue/margin
 - Look at Amazon – books, electronics, now food
 - Case Study: Ascension
 - Group Purchasing Organization (GPO)/supply chain
 - IT/Big Data (analytics)
 - Medical malpractice insurance
 - Facilities management
 - Asset management
 - Shared services
 - Only 50% of Ascension revenue comes from its hospitals

Opportunity: Population Health Management

- Not enough expertise nationally in Population Health Management
 - Lot of high level consulting, but how do you actually transition and operate successfully?
- Existing Knowledge Base being bought rapidly
 - HealthCare Partners, NAMM, others at high multiples
 - CareMore
- Private Equity is investing in PHM start-ups

Strategy Choices

■ GO BIG!

- Capture more market share
 - Market power – pricing and competition
 - Expand into higher reimbursement geographies
 - Lower unit cost
 - Economies of scale
 - Reduce cost of customer acquisition
 - Vertical integration to allow margin shifting
- How big is big? Regional or national possibilities?
- Natural result/driver of consolidation that has been occurring

Going National

- Goal Setting: DaVita HealthCare Partners, Ascension, Tenet
- Why? The Low Hanging Fruit is:
 - National payor contracting
 - National employer accounts
 - Spread infrastructure costs nationally
 - Ability to centralize shared services and eliminate duplicative expenses

Going National

- But wait, there's more....
 - Walmart, Amazon, Home Depot – what happened?
 - Effective national companies tilt the playing field
 - Brand awareness = market share/capture
 - Reduces/eliminates competition from local players
 - Drives supply chain reform
 - Sets the bar for “best practices,” but also for pay scales
 - Recruiting effect (look at Kaiser in California)

M&A Outlook

- Given the foregoing, there's much more M&A to come at all levels of the healthcare industry
- Expect a pause from time to time after large transactions as the market recalibrates
- Expect pricing (absent surprises) to stay consistent with current levels, except for distressed and game-changing transactions

Questions?

- Contact:

Eric Klein

310.228.3728

eklein@sheppardmullin.com

www.sheppardmullin.com