
Healthcare M&A Post-Affordable Care Act: Front-Row Insights from California to Inside the Beltway

On October 3, 2013, Duff & Phelps hosted an interactive discussion on the healthcare M&A environment post-initial implementation of the Affordable Care Act (ACA), drawing perspectives from top leadership across the healthcare industry. The diverse panel included experts from the healthcare information technology sector (HCIT); a view from inside the Beltway; and insights from a prominent practicing physician who administers a medical enterprise at the forefront of what many believe will become a new model for healthcare delivery – an entity that serves as both provider and payor.

Led by Duff & Phelps Managing Director Brooks Dexter, panelists included:

- Paul Holt, Chief Financial Officer of Quality Systems, Inc., which provides EHR solutions to approximately 85,000 physicians, with over 4,000 group practice customers nationwide;
- Darin LeGrange, Chief Executive Officer of Aldera, a leading provider of cloud-based and on-premise core administration solutions for healthcare payors and administrators;
- John Kelliher, Senior Managing Director of the Marwood Group, a healthcare-focused strategic advisory and financial services firm with offices in Washington, D.C., New York and London; and
- Dr. Howard Fullman, Area Medical Director of Kaiser Permanente West Los Angeles.

Panelists discussed a number of important issues related to healthcare implementation in the post-Affordable Care Act (ACA) era, the highlights of which are summarized in this report.

The Real-time Landscape and Tangible Drivers of Change

While opinions of the ACA vary widely and are considered a cause of unprecedented political discord, the one point most everyone will agree on is that technology can – and will – play a tremendous role in reshaping our nation's healthcare system. Since passage of the Health Information Technology for Economic and Clinical Health Act (HITECH) as part of the 2009 Stimulus Bill, healthcare providers and eligible physicians have been working diligently toward implementation of full Electronic Health Records (EHR) and the Centers for Medicare & Medicaid Services' (CMS) Meaningful Use (MU) Rule.

With implementation of MU's Stage I data capture and sharing requirements well underway, most providers have shifted their focus to Stage II's advanced clinical processes, including the exchange of more rigorous health information; increased requirements for e-prescribing and incorporation of lab results; electronic transmission of patient care summaries across multiple settings; and more patient-controlled data. These Stage II requirements, along with conversion to ICD-10 protocols, have set the stage for increased reliance on information technology and are a source of increased M&A activity across the healthcare services industry.

Structural issues such as scale, efficiency and costs also are driving change. Many expect consolidation, especially in the acute care setting, to continue in the post-ACA environment. In just the last 12 months, the median market value of the acute care hospital sector has risen 65.9 percent (Duff & Phelps Healthcare Update, November 2013).

Our panelists believe these changes in our healthcare system are being driven by a number of intangible shifts in the industry, including aging of the US population; cyclical reform tied to future election cycles and federal budget cuts; the convergence of financial and clinical risks across the continuum of care; and an increasingly robust demand from consumers for greater access to, information from and integration among healthcare payors and providers – all giving rise to an increase in mergers, acquisitions and other transactions.



Marwood Group Senior Managing Director John Kelliher believes the first of these shifts represents significant uncertainty for the healthcare industry, with both the 2017 and 2021 post-

election cycles having major potential to disrupt the system as cost savings are pursued and changes to the healthcare system are incorporated. Despite a concerted effort among providers to eliminate unnecessary costs from the system, the uncertainty remains strong, as government analysts expect healthcare spending as a percent of GDP will continue to grow from the current 17.9% to 19.5% by 2021 (Centers for Medicare & Medicaid Services, Office of the Actuary, September 2013).

With respect to the convergence of financial and clinical risks, Kaiser Permanente Area Medical Director Dr. Howard Fullman notes that because healthcare has become so expensive, government and commercial payors can no longer afford the current levels of payment and reimbursement rates will shrink. As a result, payors are increasingly moving away from volume-oriented reimbursement and developing reimbursement models based on improved outcomes and quality of care. Similarly, Aldera Chief Executive Officer Darin LeGrange

and Quality Systems, Inc. Chief Financial Officer Paul Holt agree that the lines between clinical and financial risk will continue to blur through the convergence of providers and payors, and the establishment of Accountable Care Organizations (ACOs). Like most, Fullman, LeGrange and Holt believe that for payors, the future of healthcare must extend beyond simple transactions and claims processing to actually tracking patients through the continuum of care. With the help of highly-functional and integrated technology, adherence to a post-discharge plan, for example, can be tracked through a technology-enabled exchange with the patient-centered medical home view, and ultimately, help contain the future cost of caring for that patient. Whether it's through the general shift from fee-for-service to fee-for-performance, or through increased integration across settings, technology and consolidation will play a significant role in reshaping the system.



Fullman attributes the third shift to rising consumerism among the American public and a demand for greater information, integration and improved service and outcomes. Though the marketplace has

talked about consumer-driven healthcare for the better part of a decade, Fullman predicts greater access to care will lead to a much-increased awareness among consumers around wellness and disease prevention as part of the care continuum. Fullman and others believe this higher level of engagement also will contribute to containing costs.

Though each shift is uniquely powerful in its own right, collectively (and alongside the ACA's legislative mandates), they are leading industry players to seek unprecedented solutions – and opportunities – through increased transactional activity in both healthcare IT and delivery.

Is This “New” Model of Healthcare Delivery Really All That New?



LeGrange thinks Kaiser Permanente may have had it right all along. The model they began building more than 65 years ago is more or less what we're seeing emerge as a result of the shifts described

above, especially in terms of managing clinical and financial risk under a single umbrella. Benefits of Kaiser's "early ACO" laid the groundwork for transforming the United States' highly-disparate healthcare system into a more integrated one by bringing together hospitals, payors and providers.

In addition to streamlining the process for patients, this more-integrated approach facilitates better preventative care and management of patient populations – both of which ultimately result in lower costs for patients, payors and providers.

Having invested in technology early on, Kaiser quickly learned that not all technology automatically adds value, so it's important that the industry select carefully and deliberately as it invests. In addition to the high capital costs, users cannot overlook the amount of time and human capital required to fully leverage their investments in technology. Moving forward, the enormous advantage and long-sought ROI of a more integrated healthcare delivery system – at Kaiser and elsewhere else – will come from convergence, technology and analytics.

Post ACA Sub-Sector Growth and Consolidation

As the industry continues to evolve in the post-ACA environment, the panelists expect we will see a great deal of activity – transactional and otherwise – in two distinct sectors and for virtually opposing reasons.

Growth in the first sector, healthcare IT, is being spurred by a number of demand drivers (such as the implementation of MU and conversion to ICD-10), prioritization for efficiency and interoperability and patient tracking. Aldera's Le Grange recently completed a roadshow with private equity investors where 30 out of 30 private equity groups approached were interested in investing in this convergence thesis. Ultimately, Aldera raised \$14 million from two investors in a placement that was oversubscribed. He attributed this investor interest in the company's future to the anticipated growing demand for IT platforms – like Aldera's – that have unlimited configurability and are



capable of mass customization. Growth among HCIT companies is – and, according to the above panel of experts – will continue to be – strong.

On the other hand, while acute care hospitals also are experiencing increased transactional activity, it's not because the sector is growing – it's because consolidation is a way to enhance economies of scale, rationalize capacity and manage reduced payor reimbursements. In just the last 12 months, the acute care hospital sector has seen more than 40 M&A deals (Capital IQ as of December 5, 2013).

What Legacy Companies Need to Consider Now

Our panelists agree that if legacy players hope to survive the changing face of healthcare, they must consider where, in the reimbursement environment, they stand, and then adjust accordingly regardless of whether they're a payor, provider or services company. As Medicare dollars become increasingly scarce, there will be clear winners and losers.

Legacy players must also think about their respective customer bases. Are their customers being impacted similarly by reimbursement risks? And if so, does that provide more opportunity or risk for you? Either way, it's important to always think a step ahead. In other words, it's not too soon to begin thinking about the implications of MU Stage III.

Risk Insights

As investors look for opportunities within the industry, Kelliher suggests they must first determine their tolerance for risk. Kelliher has observed investors with significant tolerance focusing on the post-acute care space (home health companies, inpatient rehab facilities, long-term care hospitals and skilled nursing facilities). Despite having the highest direct reimbursement risks, the sector appears to be providing value. Kelliher notes that investors with a moderate tolerance for risk are more apt to consider managed Medicare plans or durable medical equipment, where risks to reimbursements largely are behind them (Medicare), or where competitive bidding processes are already in place and known (durable equipment). And finally, he sees investors who want to avoid government reimbursement risks altogether investing in outsourced service providers such as HCIT companies, or outsourced hospital services or in payors, sectors somewhat removed from direct reimbursement risk.

So whether it's through an existing entity or an emerging one (think ACOs), Kelliher believes there is plenty of opportunity, especially in the areas of case management, cost management and population management. The question for investors, according to Kelliher, really becomes, "Who can create the next-generation company that's going to provide a real material impact in these areas?"

Healthcare IT Insights



With more than three-quarters of eligible physicians having already adopted some form of EHR, Holt believes many mid- to large-sized practice groups are now looking for

technology solutions to help mine data from all those health records. This next wave of investment in healthcare IT will be around ACOs and how you manage the analytics, data sharing and interoperability to actually deliver better healthcare – how a payor or provider reaches out to patients, for example, to remind them about taking their medicines, coming in for appointments and doing all the things that they need to do for their healthcare. Meeting the population where they are – including social media – may be the future of increasing touches within the healthcare system. Holt proposes the HCIT companies that can support these efforts are the ones set to benefit the most.

The pending conversion to ICD-10's expanded set of billing codes also provides tremendous opportunity for HCIT companies. Because conversion to ICD-10 presents a monumental challenge to virtually everyone across the healthcare spectrum, Holt anticipates an increase in demand for outsourced collections and revenue cycle management services.

What's Next?

Despite all the noise surrounding the ACA and healthcare exchanges, our panelists are confident that abundant transactional opportunities lie ahead. The demand is there. The money is there. And payors, providers and health IT and services companies see a need to be part of the “post-ACA” solution. Technology and consolidation were driving improvements in our nation’s healthcare system before implementation of the Affordable Care Act began and they will continue driving opportunity post implementation (particularly as we draw closer to the 2015 MU penalty). As LeGrange deftly notes, “The proverbial cat has been out of the bag for quite some time, and there’s no way it’s going back.”

Recent Healthcare Investment Banking Transactions

Duff & Phelps' Healthcare team provides investment banking and financial advisory services to Fortune 500 corporations, middle-market growth companies and financial sponsors. As a firm, Duff & Phelps stands alone in its objectivity, deep technical and industry expertise, and breadth of advisory services. Our recent healthcare experience is included below.

<p>Sell Side Advisor</p> <hr/> <p>Comprehensive Clinical Development's Early Development Division has been acquired by Actavis, Inc.</p>  <p>Exclusive financial advisor to Comprehensive Clinical Development</p>	<p>Sell Side Advisor</p> <hr/> <p>eHealth Solutions, Inc. (d/b/a/ SigmaCare) has been acquired by Marlin Equity Partners, Management and Existing Investors</p>  <p>Exclusive financial advisor to SigmaCare</p>	<p>Sell Side Advisor</p> <hr/> <p>Comprehensive Clinical Development's Late Phase Division has been acquired by Clinical Research Advantage, Inc.</p>  <p>Exclusive financial advisor to Comprehensive Clinical Development</p>
<p>Solvency Opinion</p> <hr/> <p>National Dentex Corporation, a portfolio company of Welsh, Carson, Anderson & Stowe, has completed a leveraged dividend recapitalization transaction</p>  <p>Financial advisor to the board of directors of National Dentex Corporation</p>	<p>Sell Side Advisor</p> <hr/> <p>United Therapies has been acquired by an investor group led by Bison Capital and senior members of its management team</p>  <p>Exclusive financial advisor to United Therapies' shareholders</p>	<p>Solvency Opinion</p> <hr/> <p>Air Medical Group Holdings, a portfolio company of Bain Capital, LLC and Brockway Moran, has completed a leveraged dividend recapitalization transaction</p>  <p>Financial advisor to the board of directors of Air Medical Group Holdings</p>
<p>Fairness Opinion</p> <hr/> <p>Catholic Health Partners, Inc. has acquired a 30% equity interest in Summa Health System Inc.</p>  <p>Financial advisor to the board of directors of Summa Health System Inc.</p>	<p>Solvency Opinion</p> <hr/> <p>Carestream Health, Inc., a portfolio company of Onex Corporation, has completed a leveraged dividend recapitalization transaction</p>  <p>Financial advisor to the board of directors of Carestream Health, Inc.</p>	<p>Solvency Opinion</p> <hr/> <p>Harvard Bioscience, Inc. has completed the spin-off from its regenerative medicine business, Harvard Apparatus Regenerative Technology, Inc.</p>  <p>Financial advisor to the board of directors of Harvard Bioscience, Inc.</p>

Recent Healthcare Investment Banking Transactions

Solvency Opinion

Strategic Healthcare Programs, L.L.C., a portfolio company of Cressey & Co., has completed a leveraged dividend recapitalization transaction



STRATEGIC HEALTHCARE PROGRAMS, LLC

Financial advisor to the board of managers of Strategic Healthcare Programs, L.L.C.

Solvency Opinion

ReNew Life Formulas, Inc. a portfolio company of Swander Pace Capital, has completed a leveraged dividend recapitalization transaction



Financial advisor to the board of directors of ReNew Life Formulas, Inc.

Solvency Opinion

Matrixx Initiatives, Inc. a portfolio company of H.I.G. Capital, has completed a leveraged dividend recapitalization transaction



Financial advisor to the board of directors of Matrixx Initiatives, Inc.

Solvency Opinion

Sheridan Holdings, Inc. a portfolio company of Hellman & Friedman, has completed a leveraged dividend recapitalization transaction



SHERIDAN

Financial advisor to the board of directors Sheridan Holdings, Inc.

Solvency Opinion

NuSil Technology LLC, a portfolio company of New Mountain Capital, has completed a leveraged dividend recapitalization transaction



Financial advisor to the board of managers of NuSil Technology LLC

Solvency Opinion

CT Technologies Holdings, LLC, a portfolio company of ABRY Partners, has completed a leveraged dividend recapitalization transaction



Financial advisor to the board of managers of CT Technologies Holdings, LLC

Solvency Opinion

Aptalis Holdings Inc., a portfolio company of TPG Capital, has completed a leveraged dividend recapitalization transaction



Financial advisor to the board of directors of Aptalis Holdings Inc.

Debt Opinion

Hamilton Ambulatory Surgery Center, Inc. has assumed certain debt obligations from Hamilton Medical Center, Inc.



Financial advisor to Hamilton Health Care System

Financial Advisor

St. Joseph Health System has invested in the formation of Datu (formerly Bick Health)



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