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Mergers and Acquisitions

December, 2017

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Introduction



Warren E. Beck

Warren has nearly 40 years of experience in the healthcare industry, including 19 years as a CFO – providing financial leadership in operations management, regulatory and compliance, financial analysis, and data analytics – for a multibillion-dollar health system. He is skilled in addressing the challenges faced by health systems, academic medical centers, and ancillary providers.



Brian Kerby

Brian has 25 years of experience in healthcare and transactions and specializes in due diligence investigations, working capital analyses, and financial projections. He has spent most of this time managing and leading projects for clients on M&A and financing transactions in most sectors of healthcare ranging in size from \$5million in revenue to in excess of \$1 billion in revenue

Learning Objectives

Today's session will cover:

- Current healthcare merger and acquisition trends / drivers shaping the market;
- The potential seller motivations in the current healthcare merger and acquisition landscape;
- Due diligence considerations that are important to evaluate related to seller motivations. Buyer beware!
- Integration issues to be identified and planned for to ensure successful post transaction operations

Healthcare Consolidation Trends/ Drivers

Healthcare Deal Volume Q3:17 vs Q3:16

Services	Q1 2017	Q2 2017	Q3 2017	2017 annualized	2016	Annualized 2017 vs 2016	2015	2016 vs 2015
Behavioral Health Care	16	9	13	51	41	24%	40	2%
Home Health & Hospice	15	10	10	47	55	-15%	51	8%
Hospitals	20	22	15	76	90	-16%	102	-12%
Labs, MRI & Dialysis	12	13	14	52	41	27%	52	-21%
Long-term Care	76	76	71	297	337	-12%	359	-6%
Managed Care	4	4	8	21	21	2%	45	-53%
Physician Medical Groups	59	31	28	157	119	32%	100	19%
Rehabilitation	12	7	10	39	40	-3%	33	21%
Other	53	52	42	196	196	0%	170	15%
Service subtotal	267	224	211	936	940	0%	952	-1%
Technology								
Biotechnology	63	52	42	209	173	21%	160	8%
EHealth	48	29	42	159	155	2%	126	23%
Medical Devices	23	32	23	104	112	-7%	113	-1%
Pharmaceuticals	29	39	16	112	156	-28%	171	-9%
Technology subtotal	163	152	123	584	596	-2%	571	5%
Grand total	430	376	334	1520	1536	-1%	1523	1%

Healthcare Consolidation Trends / Drivers

■ Healthcare M&A Trends / Market Drivers

- Access to healthcare
 - Affordable Care Act added 14.7 million people to individual health plans
- Lack of healthcare capacity - Growing short of professions
 - Nursing
 - 2025 a shortage of 55,000 primary care physicians
- Emerging Markets – Innovative Technologies
 - Telemedicine
 - Robotics
 - Wearable monitoring devices
 - E-Health tools
- Demographic expansion
 - 73 million “Baby Boomers” are Medicare eligible between 2011 and 2029
 - 50% of these Medicare enrollees will have two chronic conditions by age 60
 - Boomers will consume 75% of their lifetime spend during the last six years of life

Healthcare Consolidation Trends / Drivers

■ Physician Practice Trends

- Benefits to sellers
 - Professionalization
 - Minimizing financial risk
 - Access to capital
 - Equity rollover for participation in future growth
- Benefits to buyers
 - Reduce Fragmentation of health services
 - Higher reimbursement rates for specialty practices
 - Volume growth

Seller Motivations in Current Healthcare M&A Landscape

■ Seller Motivations

- Financial distress
 - Declining volumes, labor shortages, cost of pharmaceuticals and implants, payer pressures
- Significant IT capex requirements
 - Electronic Medical Record, Patient Care systems
- Lack of transition plan for key physicians/owners
 - Lack of meaningful succession planning impacts volume, practice reputation, financial stress
- Administrative burdens
 - Contracting, Billing and collection, capture of quality data, workforce demands
- Regulatory changes
 - Pay for Value (MACRA),
- Reimbursement outlook
 - Declining reimbursement, value versus volume, ACO and other advanced payment models

Polling Question #1

Is your Company's growth strategy through acquisitions or organic growth and in what sector of healthcare are you growing in?

- 1) Growth through acquisitions – healthcare providers
- 2) Growth through acquisitions – healthcare services (non-provider)
- 3) Organic growth

Polling Question #2

Do you utilize internal teams to perform due diligence or do you outsource due diligence when contemplating an M&A transaction? If you outsource due diligence, what disciplines of due diligence are outsourced?

- 1) Outsource – financial
- 2) Outsource – legal
- 3) Outsource – other disciplines
- 4) Perform all in-house
- 5) Not applicable

Due Diligence Considerations

Goal - To uncover opportunities/risks/issues of a transaction

■ Accounting and Financial Due Diligence

- Understand significant accounting policies and procedures
- Perform quality of earnings analysis
 - Conversion of cash basis financial statements to accrual basis
 - Non-cash items
 - Personal expenses
 - Market compensation adjustments
 - Out-of-period transactions
 - Discontinued costs post-transaction
- Understand and analyze key business drivers
- Analyze quality of net assets and working capital
- Common working capital issues

Due Diligence Considerations

Tax Due Diligence

- Understand legal entity structure
- Identify Federal, State, and local employment tax issues
- Pending tax examinations
- Nexus
- Personal and real property
- Unclaimed property

Due Diligence Considerations

■ Information Technology

- Purpose: To provide a transparent objective view of IT, identify challenges and opportunities and minimize surprises post transaction

■ Operations Due Diligence

- Is business plan achievable
- Identify the potential for additional value creation
 - Staffing efficiencies
 - Administration consolidation
 - Supply and pharmaceutical discounts

■ Payer Contract Analysis

- Quantify potential benefits of converting seller's reimbursement rates to the buyers contracted reimbursement rates if a corporate transaction
- Change in control provisions in the contracts

Polling Question # 3

What type of organization do you work for and does your organization plan on doing an acquisition in 2018?

- 1) Medical service provider – yes
- 2) Medical service provider – no
- 3) Private equity group - yes
- 4) Private equity group - no
- 5) Provider of services to medical services providers - yes
- 6) Provider of services to medical services providers – no
- 7) Other

Due Diligence Considerations

- Insurance Review
- Contracts and Other Legal Review
 - Physician contracts
 - Debt agreements
 - Lease agreements
 - JV agreements
 - Employment agreements
- Regulatory and Compliance Assessment
 - Revenue at Risk - Bundled Payments, Readmissions, Hospital Acquired Conditions, Advanced Payment Models, Merit Based Incentive Payment Systems (MIPS)
 - Review sellers compliance program
 - HIPAA
 - Security Risk Assessment
 - Billing and coding compliance
- Human Resources

Due Diligence Considerations

■ Other Due Diligence Considerations

- Non-financial factors – successful acquisitions rely on more than just making the numbers work.
 - Pending key employee or physician departures.
 - Compensation model both pre and post transaction, especially for physicians.
 - History of fraud and abuse.
- Cash flow considerations – buyer should be aware of potential cash flow issues depending on whether stock or asset purchase.

Integration Considerations

- Compensation and Benefits for Staff
 - Identify special arrangements for key employees
 - Evaluate for discriminatory pay and benefit practices
 - Ensure that family relationships are identified and develop a plan for future management
- Information Technology
 - Develop a plan for transition of EMR on to buyers platform or if EMR is maintained ensure updates and versions are current;
 - Evaluate for efficiency in use of the EMR and if necessary develop a plan for re-training staff and physicians;
 - Be ready to modify work flow in order to optimize EMR tools
 - Evaluate IT infrastructure to ensure wiring, connections, Wi-fi is technologically advanced for new IT hardware and applications
- Supply Chain Optimization
- Cost Synergies and Improved Margin Opportunities

Polling Question # 4

How does your organization complete integration of acquired businesses or providers.

- 1) Integration with in-house team without Consulting Support
- 2) Integration without in-house team and with Consulting Support
- 3) Integration with both in-house team and Consulting Support

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