



HEALTHCARE TRANSACTIONS:

Year in Review

JANUARY 2018

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OVERVIEW

On December 3, 2017, CVS Health Corp. (NYSE: CVS) announced it would purchase health insurer Aetna Inc. (NYSE: AET) for \$67.5 billion, a transaction that would be one of the biggest healthcare mergers in the past decade. The proposed deal would combine the largest U.S. drugstore chain with one of the country's largest health insurers. Although consolidation is not a new trend in healthcare, the merger between CVS and Aetna would present a new type of framework, a vertically consolidated company that offers healthcare services through CVS's pharmacies, Minute Clinics and pharmacy benefit manager services, while also providing managed care services to Aetna's millions of plan members.

The transaction raises an intriguing question: is this the beginning of a transformational shift in healthcare? With 2017's failure of the proposed horizontal mergers between health insurance giants still fresh, the CVS-Aetna deal could be the first of many cross-sector mergers. Indeed, only a few days after the announcement, UnitedHealth Group Inc. (NYSE: UNH), the largest U.S. health insurer, announced that it would expand its OptumCare business by acquiring approximately 300 physician practices from DaVita Inc. (NYSE: DVA). If the CVS-Aetna deal is in fact the beginning of a new era, the integration of different healthcare sectors and service lines would be a possible response to the government's emphasis on value-based care, and could serve as a solution to the challenges of traditional reimbursement models.

Below, we've outlined 2017 M&A activity and drivers in the following hot sectors:

- ✦ Managed Care
- ✦ Hospitals
- ✦ Post-Acute Care-Home Health & Hospice
- ✦ Ambulatory Surgery Centers (ASCs)
- ✦ Healthcare Information Technology (HIT)
- ✦ Behavioral Health
- ✦ Physician Practice Management

Managed Care

Even as the Aetna-Humana (NYSE: HUM) and Anthem (NYSE: ANTM)-Cigna (NYSE: CI) mega-mergers faltered as a result of antitrust scrutiny, the managed care industry remained active for mergers and acquisitions in 2017. In a time when the continuing availability of the Affordable Care Act's Medicaid expansion and the repercussions from the Tax Cuts and Jobs Act's repeal of the individual mandate remain uncertain, strategic acquisitions can protect health plans by expanding plan membership and diversifying plan offerings. For example, the \$3.75 billion acquisition of Fidelis Care by Centene Corporation (NYSE: CNC), announced in September, will expand Centene's offerings into the State of New York. Already a major presence in the California, Florida and Texas Medicaid markets, Centene's entry into New York is expected to add nearly 1.6 million new members when it closes in the first quarter of 2018. WellCare Health Plans, Inc. (NYSE: WCG) completed several acquisitions in 2017, including the \$800 million acquisition of Universal American Corp. in April, which strengthened WellCare's Medicare Advantage membership by adding approximately 119,000 Medicare Advantage members in Texas, New York and Maine. Just a few days later, in May, WellCare announced the completion of its acquisition of assets from Phoenix Health Plan, increasing WellCare's presence in the Arizona Medicaid market. In addition, Anthem, Inc. (NYSE: ANTM) expanded its Medicare Advantage portfolio with the announcement of the acquisition of two Medicare Advantage health insurers in Florida - America's 1st Choice and HealthSun.

Hospitals

In the hospital landscape, 2017 was notable for the consolidation and merger of major nonprofit systems. In December, after more than a year of negotiations, Catholic Health Initiatives and Dignity Health announced a definitive agreement to merge and create a new nonprofit system estimated to have \$28.4 billion in combined revenue across 139 hospitals

operating in 28 states. The deal is expected to close in the second half of 2018 and is subject to federal, state and church approvals. Advocate Health Care and Aurora Health Care also announced in December their plans to merge to create Advocate Aurora Health, the 10th largest nonprofit, integrated healthcare system in the United States, estimated to have revenues of \$11 billion annually and operations in 27 states. Not to be outdone, Ascension is currently in talks with Providence St. Joseph Health about a possible merger to create the largest owner of U.S. hospitals—with the potential for \$44.8 billion in combined revenues.

The aforesaid hospital systems cite increased negotiating power with payers and suppliers, as well as the ability to expand access and scale innovation, as the impetus for these mega-mergers. With such large transactions pending, 2018 could be a transformative year for the hospital sector.

Interestingly, in the midst of these mega-mergers, we are also seeing examples of the challenges of expansion and scalability. In 2017, several major healthcare systems divested hospital assets. For example, Community Health Systems, Inc. (NYSE: CYH) recently sold two hospitals in the Houston area and Jourdan, Texas, to HCA Healthcare, Inc. (NYSE: HCA), which followed the sale of eight hospitals located in Florida, Ohio and Pennsylvania to Steward Health Care System LLC. In addition, Steward added an additional 18 hospitals with the acquisition of Nashville-based IASIS Healthcare LLC in September. Like Community Health Systems, Tenet Healthcare Corporation (NYSE: THC), sold three of its Houston hospitals to HCA, and recently announced the sale of its two Philadelphia-based hospitals—Hahnemann University Hospital and St. Christopher's Hospital for Children—to Paladin Healthcare.

Post-Acute Care—Home Health & Hospice

Tenet also sold certain of its home health and hospice operations in 2017, reflecting Tenet's desire (and a re-emerging trend in healthcare) to refocus on developing core competencies and achieve operational efficiencies through economies of scale. In March, Amedisys Inc. (NYSE: AMED) announced it was acquiring six of Tenet's home health and hospice operations in Arizona, Illinois, Massachusetts and Texas for an undisclosed amount. The home health and hospice sectors continue to grow at a rapid pace and the dominant players—which along with Amedisys include Addus Homecare Corporation (NYSE: ADUS), Almost Family, Inc. (Nasdaq: AFAM) and LHC Group, Inc. (Nasdaq: LHCG)—continue to expand their geographic base, driven by an increasingly aging demographic as baby boomers enter their golden years. Indeed, according to the U.S. Census Bureau, by 2050, those age 65 and older are projected to be 83.7 million; almost double the estimated "senior" population in 2012.

Almost Family and LHC Group are capitalizing on this growing opportunity, as the two entities recently announced their plans to merge, and in so doing, will create a combined company with 781 locations in 36 states, with estimated annual revenues of \$1.8 billion. The deal is expected to close in the first half of 2018.

Several other industry players also are capitalizing on the opportunity presented by an aging demographic. In December, a consortium of three companies, Humana Inc. (NYSE: HUM), TPG Capital and Welsh, Carson, Anderson & Stowe (WCAS), announced their plans to purchase Kindred Healthcare, Inc. (NYSE: KND), which operates home health, hospice and community care businesses, long-term acute care hospitals, inpatient rehabilitation facilities and provides contract rehabilitation services. Immediately following the acquisition, the home health, hospice and community care businesses are to be spun off into a separate company, Kindred at Home, which, according to reports, is to be owned 40% by Humana, with Humana having the right to buy the balance from TPG and WCAS over time through a put/call arrangement. This deal is expected to close during the summer of 2018 and represents not only another example of a significant transaction in this sector, but also an example of an insurer crossing sectors and growing more involved in the delivery of care.

Ambulatory Surgery Centers (ASCs)

Not to be forgotten, 2017 started the year with a notable transaction in the ASC space as UnitedHealth's OptumCare announced the acquisition of then publicly traded Surgical Care Affiliates, Inc. for \$2.3 billion. The transaction was cited as creating a comprehensive ambulatory care services platform for OptumCare, which includes primary care, urgent care and surgical care services. Following this announcement, in August, KKR & Co. L.P. announced plans to acquire Nashville-based Covenant Surgical Partners, Inc. - an owner and operator of ambulatory surgery centers and physician practices with 37 facilities in 17 states - from DFW Capital Partners, Iroquois Capital Group, PineBridge Investments and other existing shareholders. This announcement came just a day after KKR's portfolio company, Air Medical Group Holdings, Inc., announced that it would acquire Envision Healthcare Corporation's (NYSE: EVHC) medical transportation subsidiary, American Medical Response, in a \$2.4 billion transaction.

Healthcare Information Technology (HIT)

With the shift to value-based payment and regulators' increased emphasis on electronic health record (EHR) management, data, interoperability and cybersecurity, the information technology sector continues to be an attractive target for mergers and acquisitions. The Department of Health and Human Services' policy requirements under the Medicare Access and CHIP Reauthorization Act (MACRA), Merit-based Incentive Payment System (MIPS) and Advanced Alternative Payment Models (APMs) will create a need for new data exchange solutions and interoperability projects. In August, Allscripts Healthcare Solutions, Inc. announced it would buy McKesson's health information technology unit, gaining access to McKesson's Enterprise Information Solutions portfolio, consisting of the Paragon EHR, Star and HealthQuest revenue cycle technologies and OneContent content management tools. Allscripts expects that the \$185 million transaction will double its EHR hospital client count in the United States.

Other notable transactions included the announcement of the merger of Medsphere Systems Corporation and Stockell Healthcare Systems, Inc., combining Medsphere's subscription-based EHR system and Stockell's revenue cycle management tools, and the merger of revenue cycle management companies, ZirMed, Inc. and Navicure, Inc. In addition, in June, athenahealth, Inc. (NYSE: ATHN) announced that it had entered into an agreement to acquire Praxify Technologies, Inc., a company that seeks to innovate the way clinicians work with health data through machine learning and natural language processing. This \$63 million deal is representative of how companies are using strategic acquisitions to stimulate and improve research and development.

Behavioral Health

The behavioral health and addiction treatment sector also saw major acquisition activity in 2017. In maybe the largest of such acquisitions this year, AAC Holdings, Inc. (Nasdaq: AAC) purchased AdCare, Inc. and its affiliated entities, one of the leading providers of addiction treatment services based in New England. Investment banking firms suggest the fragmented nature of this market, coupled with the growing demand for behavioral healthcare services, has made the industry an attractive investment opportunity. Private equity-backed deals are also fueling activity in this sector. In another notable transaction this year, Summit Behavioral Healthcare, LLC (Summit BHC) - a national provider of addiction treatment and behavioral health services launched by Acadia Healthcare Company, Inc. (NYSE: ACHC), founder Trey Carter and backed by Lee Equity Partners and FFL Partners - acquired two facilities located in Arizona and Tennessee. Behavioral health activity is on an upward trend, and while residential treatment and substance abuse centers were the initial focal point, acquisition interest has emerged in other areas of the behavioral health spectrum as the ongoing opioid and mental health crises are thrust into the national spotlight.

Physician Practice Management

The expansion of private equity investment in the physician practice management sector continued in 2017. Dermatology continued to see activity with the launch of new platforms by Frazier Healthcare Partners (United Derm Partners) and Sheridan Capital Partners (Dermatologists of Central States), among others, while existing private equity-backed companies sought to aggressively execute add-on acquisitions. Radiology also saw growth in 2017. While publicly traded MedNax (NYSE: MD) launched its own radiology division with the acquisition of Tennessee-based Radiology Alliance, Radiology Partners, Inc. - the largest on-site physician-led radiology practice - announced an additional \$200 million investment from its existing investor, New Enterprise Associates, Inc. and new investor Future Fund. However, ophthalmology may have seen the most robust activity this past year with Flexpoint Ford, LLC (Southeast Eye Specialists), H.I.G. Capital (Barnet Dulaney Perkins and Southwestern Eye Center), Shore Capital Partners, LLC (EyeSouth Partners), Sterling Partners (Great Lakes MSO), and Waud Capital Partners L.L.C. (United Vision Partners) all investing in platform companies in 2017. Expect to see continued activity in these specialties in 2018, along with emerging specialties such as gastroenterology, orthopaedics and urology.

Conclusion

As always, expansion and consolidation remain significant drivers of transactions in healthcare, and 2017 saw the announcement of several blockbuster mergers. But 2017 also saw the emergence of healthcare companies looking for cross-industry opportunities. As we look ahead to 2018, we can expect this trend to continue.

If you have questions about any of the information presented in this review, please contact the authors or any member of our Healthcare team.

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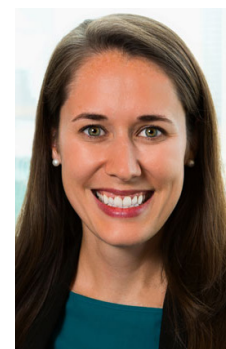
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FEATURED SECTOR EXPERIENCE

- ✦ Academic Medical Centers
- ✦ Ambulatory Surgery Centers
- ✦ Anesthesiology
- ✦ Behavioral Health
- ✦ Cancer Therapy
- ✦ Clinical Laboratories
- ✦ Dermatology
- ✦ Diagnostic Imaging
- ✦ Health Plans and Benefit Management Companies
- ✦ Healthcare Information Technology
- ✦ Home Health
- ✦ Hospice
- ✦ Hospitals and Health Systems
- ✦ Life Sciences
- ✦ Managed Care
- ✦ Medical Device
- ✦ Nonprofit Providers
- ✦ Orthotics and Prosthetics
- ✦ Pharmaceuticals and Pharmacies
- ✦ Physician Practices and Management Companies
- ✦ Private Equity
- ✦ Radiology
- ✦ Real Estate Investment Trusts (REITs)
- ✦ Revenue Cycle Management
- ✦ Senior Housing and Long-Term Care
- ✦ Specialty Pharmacy and Pharmaceuticals
- ✦ Telemedicine
- ✦ Urgent and Retail Care Clinics
- ✦ Wellness and Disease Management



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