



2014

MERGERS & ACQUISITIONS  
PERFORMANCE STUDY



HEALTHCARE  
TRANSACTION  
ADVISORS

## EXPERT REVIEWER PANEL

Healthcare Transaction Advisors solicited expert interpretation of the Study findings from a panel of the following experts with extensive experience in healthcare-focused mergers and acquisitions.



**Angela Humphreys**  
Member  
Bass, Berry & Sims PLC



**Jeff Cohen**  
Attorney  
Florida Healthcare Law Firm



**Bill Thompson**  
Chairman  
Hall, Render, Killian, Heath & Lyman, P.C.



**Tod A. Matuga**  
Manager  
HealthCare Appraisers, Inc.



**Edward G. Zacharias**  
Partner  
McDermott Will & Emery LLP



**Matt R. Fisher**  
Co-Chair of Health Law Group  
Mirick O'Connell

## EXECUTIVE SUMMARY

***Healthcare Transaction Advisors 2014 M&A Performance Study*** (the “Study”) analyzes the financial performance of a large sample of healthcare businesses before and after major ownership changes.

### Study Methodology

The researchers initially identified 6,773 unique changes of ownership (CHOWs) reported to Medicare for home health agencies (HHAs), hospitals, and skilled nursing facilities (SNFs) occurring between 1995 and 2012, as reported in June 2014 Provider of Services data set. If a subject reported multiple CHOWs, the most recent CHOW was selected during study period.

To ensure three years of financial performance was available for the study subjects, the Study excludes CHOWs between 1995 and 1998, as well as 2010 and 2012. Therefore, the Study examines financial performance between 1996 and 2012 for CHOWs occurring between 1999 and 2009.

### Excluded Transactions

The Study excludes 61 subjects from the original data set. Most of these (55) booked irregular net patient revenues (<\$0). Several of these excluded subjects posted identical balance sheets or net revenues for separate entities within an affiliated parent company or region.

Not all subjects reported financial activity during three years before and after the reported CHOW. After the initial exclusions, only Medicare filings for 5,800 businesses could be identified for the year immediately preceding each CHOW. Of these, 437 reported no financial activity, 2,533 reported a net loss, and 2,830 reported positive net income.

### Study Limitations

The Study is limited to HHAs, hospitals, and SNFs certified by Medicare, which reported a sale of business assets meeting Medicare's definition of a CHOW. The Study does not analyze businesses that are simply absorbed into another legal entity, thus operating under acquirers' Medicare provider number and tax identification number. Further, as a retrospective analysis, the findings are descriptive and do not prove causation. The interpretive analyses and conclusions herein are theoretical.

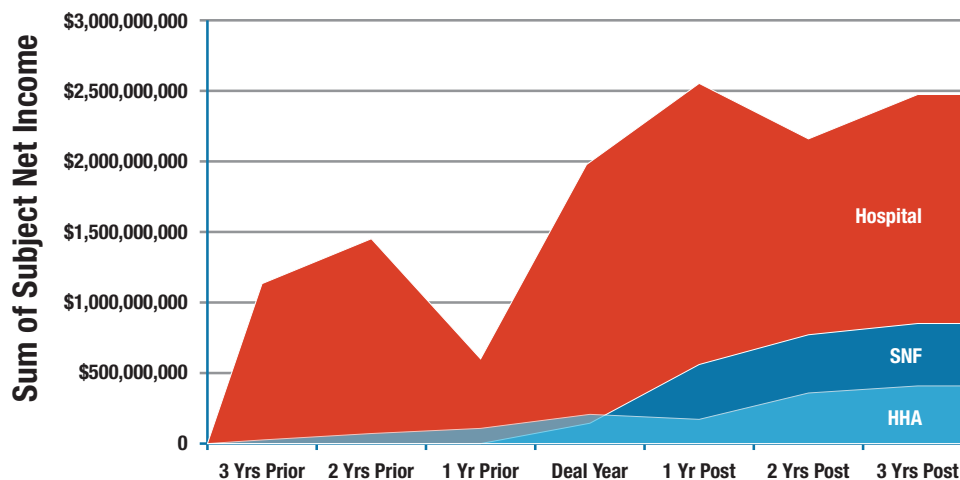
### Key Findings

Three factors were found to correlate with post-transaction profitability. First, when screening for two criteria, approximately 79% of subjects were profitable three years after a CHOW. These two criteria are (a) profitability the year before the CHOW and (b) either maintenance or growth of net revenues during the interim post-CHOW period. We found little evidence that cutting or scaling expenses was correlated with post-transaction profit.

Additionally, SNF and HHA subjects with progressively higher net revenues before the CHOW correlated with a progressively higher incidence of profitability three years after the CHOW. When screening for the former two factors, as well as pre-CHOW net revenues, the incidence of post-deal profitability at year three increases up to 86% for SNFs with over \$10 million in annual net revenues, and up to 96% for HHAs with over \$6 million in annual net revenues.

Pre-CHOW net revenues did not correlate as strongly with higher post-CHOW profitability for hospitals.

## PROFITABILITY TRENDS BY DEAL YEAR



### HCTA Commentary

These charts sum the profitability of the study participants relative to the timing of their respective ownership changes. Overall, as groups, all three types of organizations demonstrated substantial improvements in profitability after the change in ownership.

For nearly all study periods, hospitals tended to have an obvious “bad year” the year prior to their CHOW. HHAs and SNFs, as groups, demonstrate a very gradually improvement in profitability over time. As groups, overall profitability tended to increase during the year of the ownership changes.

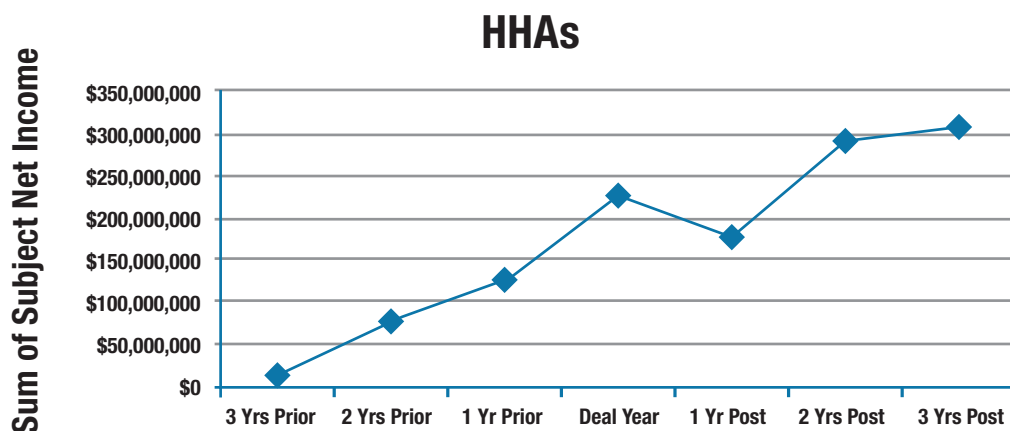
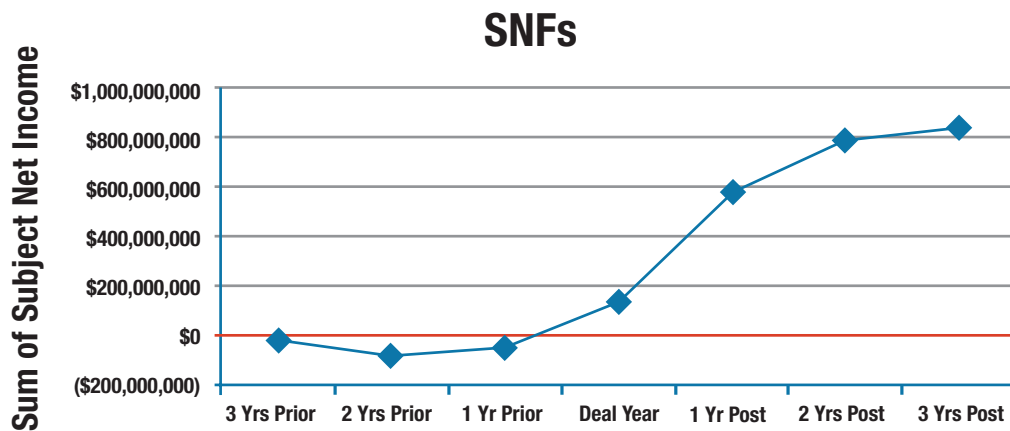
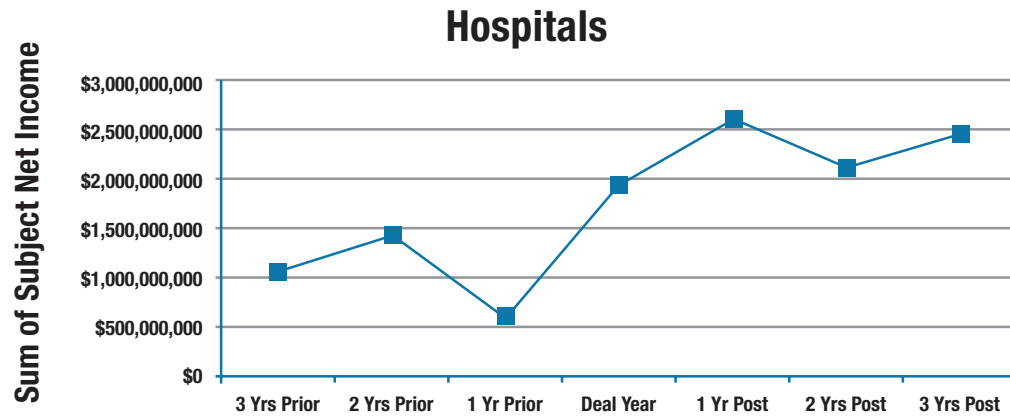
### Expert Panelist Commentary

...the findings from your study are pretty interesting. While not explicit in the findings, the study clearly shows that mergers and acquisitions are done with a purpose of increasing profitability and are generally quite successful in doing so. A next step that is likely not readily apparent from the data that you reviewed is what impact the merger had on the surviving entity's ability to extract better terms from payors.

**Matt Fisher,**

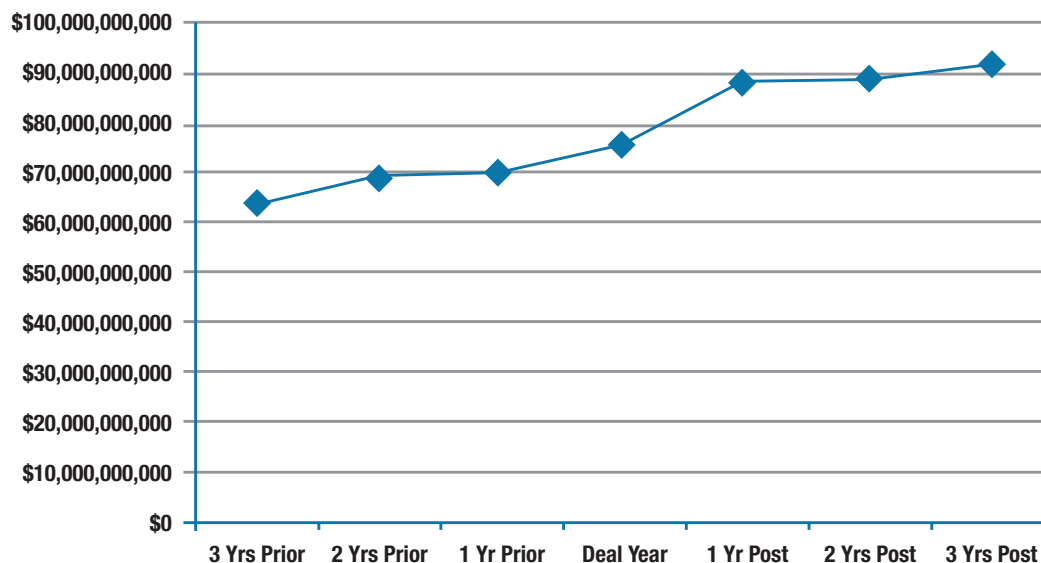
Co-Chair of Health Law Group — Mirick O'Connell

# PROFITABILITY TRENDS BY ENTITY TYPE

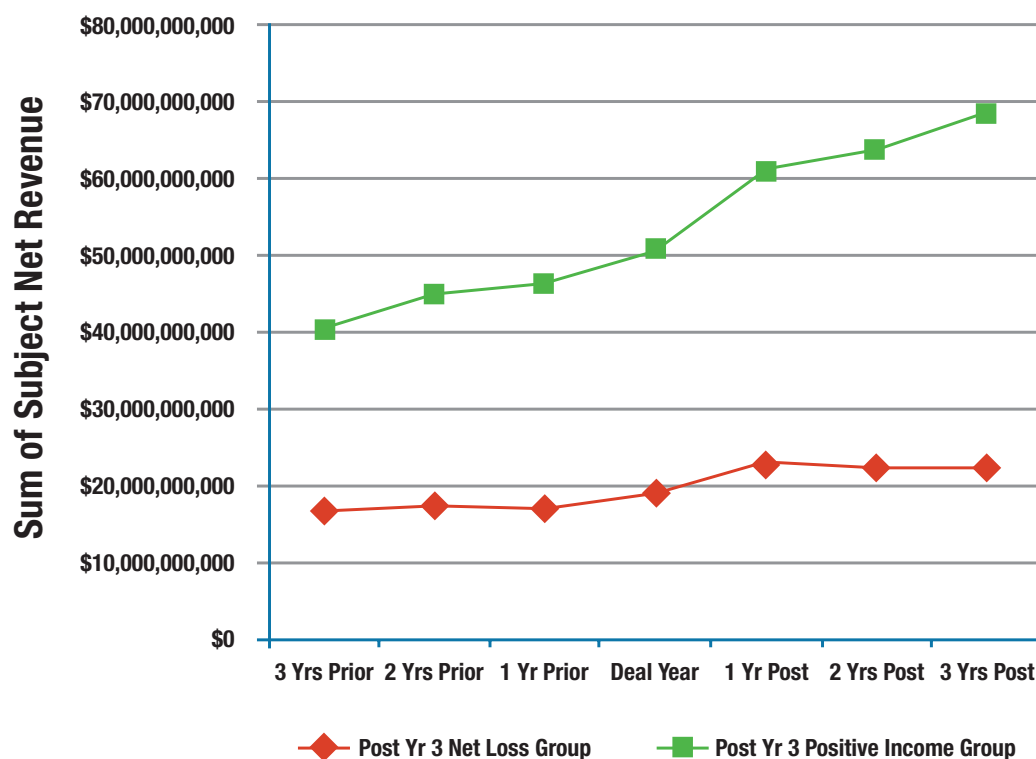




## OVERALL NET PATIENT REVENUE PERFORMANCE



## NET PATIENT REVENUES VS. 3 YEAR POST-DEAL PROFITABILITY



## HCTA Commentary

Overall revenues for the study group increase after ownership changes. Future profitability after a CHOW is highly correlated with future revenue growth. The revenue growth rate for the group of subjects demonstrating

profitability three years after a CHOW was approximately 50% higher than the group of subjects that did not achieve profitability.

## Expert Panelist Commentary

I see the Study participants all involved entity purchases that allowed the operating entities to remain intact, which I would have expected would have a stabilizing effect on revenues. I also notice that more than half of the entities booked losses or inactivity before the transaction. This could imply insufficient operational or marketing infrastructure that could have had a direct bearing on revenues.

Revenue drop in the HHA sector is normally related to patient retention issues. Personal relationships between HHA operators (marketers especially) and ordering physicians (and patients in the concierge space) are the key drivers. In the SNF space, same thing. Patient retention is key; and new facility owner relationships with admitting physicians is critical. In both situations, it's essential to implement a transition plan that entails as little disruption (with both patients and admitting physicians) as possible.

The other biggest second biggest factors we see that impact revenue streams are:

- Structure of the transaction. Structuring as an entity purchase (as opposed to asset purchase) is more likely to ensure minimal revenue disruption. Purchasers are less inclined to purchase entities due to concerns related to seller liabilities, but this often comes at a cost to asset purchasers, who are left to contract fresh with payers; and
- Continuity of payer relationships. Related to transaction structure, asset based transactions usually trigger the need to recontract with payers, which can disrupt revenue flow for a year or more. While entity purchases should pose less of a threat to cash flow, the trade off is greater liability exposure.

We do see this a lot, where sellers (especially with HHAs) experience a revenue crunch and then look for a way out of what they perceive to be a "sinking ship." I've assumed that financial rebound in the year following the sale is a function of the business being reinvigorated by new management and a commitment to the business that was waning before purchase.

### Jeff Cohen

Attorney — Florida Healthcare Law Firm

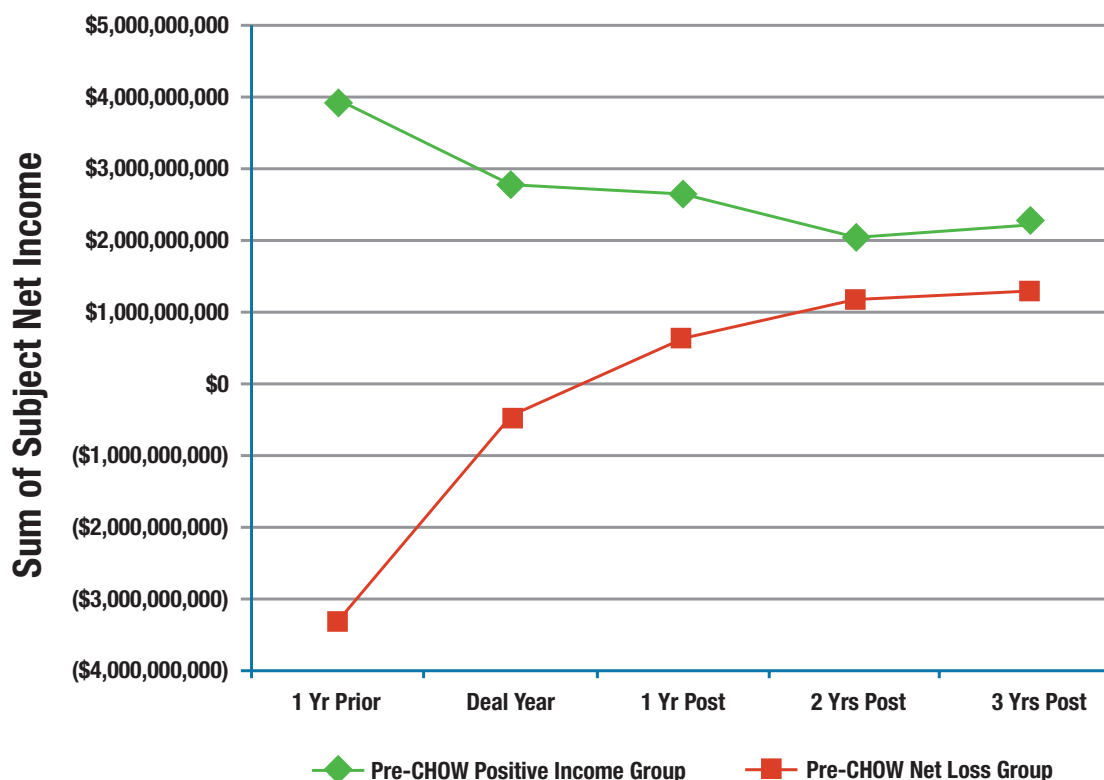
The study demonstrates that many organizations who find themselves with limited financial resources to recruit and retain employees, make capital expenditures and expand service lines may find it difficult to compete within the market, resulting in a dip in revenue and profitability. The natural response is for management teams and governing boards to then begin evaluating strategic alternatives ultimately leading to a sale.

It is not surprising that by the time a deal is underway, revenue and profitability may have dipped to an all-time low as overall performance may lag behind some of the early indicators. As expected, acquirors, who typically have greater financial and administrative resources and who deploy those resources immediately following a transaction, are able to improve top line revenue dramatically in the year following the transaction.

### Angela Humphreys

Member — Bass, Berry & Sims PLC

## 1 YEAR PRIOR VS. FUTURE PROFITABILITY PERFORMANCE



### HCTA Commentary

The subject group that was profitable one year before the transaction decreased in overall profitability during the Study period. Conversely, the subject group that was unprofitable one year before the CHOW increased

substantially in overall profitability. These overall group trends prompted the researchers to further analyze the distribution of improving and deteriorating performance within each group.

### Expert Panelist Commentary

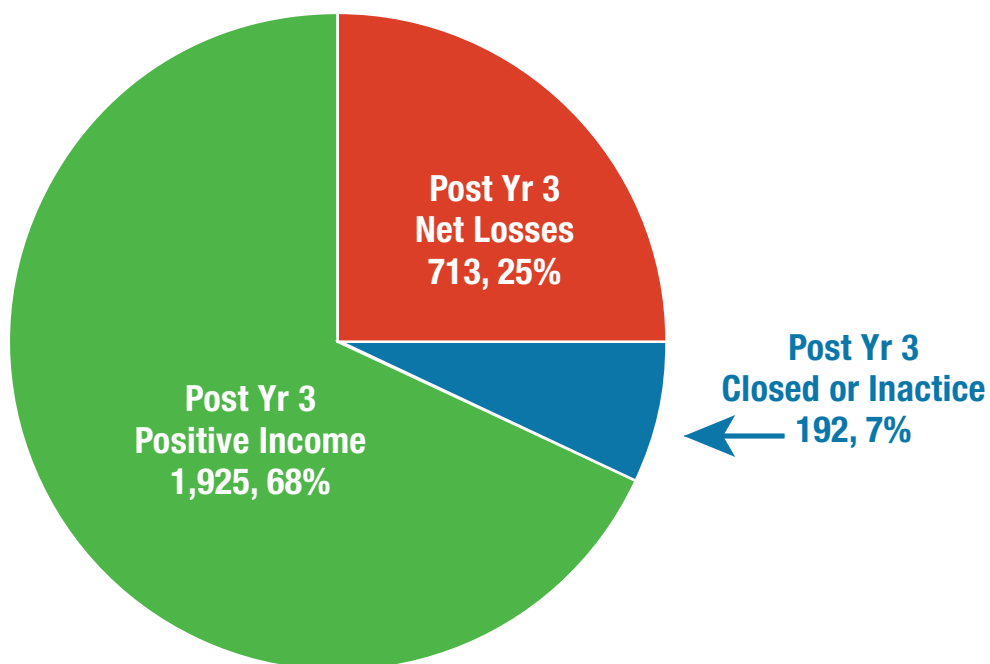
To me, your 3 year post transaction report seems to underscore what drove some sellers: hopelessness. It looks like, on average, 25% of these sellers ultimately go out of business. That's a sobering realization!

**Jeff Cohen**

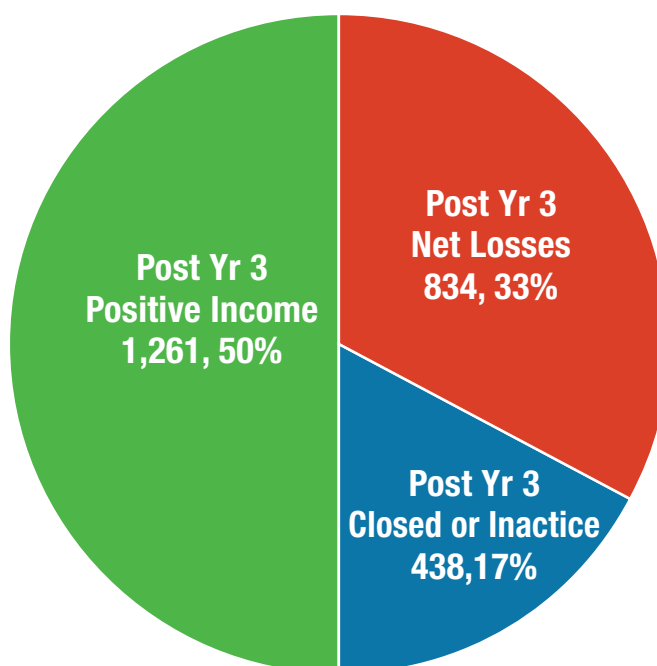
Attorney — Florida Healthcare Law Firm



## 1 YEAR PRE-DEAL PROFITABLE GROUP VS. YEAR 3



## 1 YEAR PRE-DEAL NET LOSS GROUP VS. YEAR 3



## DRILLDOWN OF PRE-DEAL POSITIVE INCOME GROUP

Type	Total #	3-Yr Post-Deal Status	Total #	Mix	Sum 1-Yr Pre-Deal Net Income	Sum of 3-Yr Post-Deal Net Income (Loss)
Hospital	427	Positive Income	282	66%	2,018,366,664	2,314,944,530
		Net Losses	97	23%	399,686,722	(840,246,699)
		Closed	48	11%	228,656,308	
SNF	2,016	Positive Income	1,400	69%	748,785,516	912,034,585
		Net Losses	520	26%	274,233,800	(316,142,144)
		Closed	96	5%	33,507,570	
HHA	387	Positive Income	243	63%	169,383,322	197,941,347
		Net Losses	96	25%	68,826,296	(31,226,071)
		Closed	48	12%	29,613,107	
	2,830		2,830		\$3,971,059,305	\$2,237,305,548

## DRILLDOWN OF PRE-DEAL NET LOSS GROUP

Type	Total #	3-Yr Post-Deal Status	Total #	Mix	Sum 1-Yr Pre-Deal Net Loss	Sum of 3-Yr Post-Deal Net Income (Loss)
Hospital	539	Positive Income	229	42%	(966,489,570)	1,600,080,676
		Net Losses	173	32%	(611,453,793)	(592,877,194)
		Closed	137	25%	(527,692,939)	
SNF	1,644	Positive Income	866	53%	(621,772,157)	485,093,956
		Net Losses	557	34%	(341,030,144)	(284,502,073)
		Closed	221	13%	(119,949,585)	
HHA	350	Positive Income	166	47%	(56,110,619)	100,267,690
		Net Losses	104	30%	(47,529,999)	(28,519,095)
		Closed	80	23%	(35,781,782)	
	2,533		2,533		(\$3,327,810,588)	\$1,279,543,960

*Note: As mentioned in the expert commentary, there are another 437 subjects that were financially inactive one year prior to their CHOW. The net loss and inactive groups together comprise over 50% of the total subjects.*

## HCTA Commentary

These tables summarize pre- and post-acquisition performance by entity type. An additional 437 subjects reported no financial activity one year before their CHOW. As indicated in the expert commentary, counting the 437 financially inactive subjects with the entire net loss group (2,533) constitutes a combined distressed group

of over 50% of the study subjects (2,970 out of 5,800). The different types of subjects show reasonably similar performance three years after CHOWs when grouped by pre-deal performance (i.e., pre-deal losses vs. positive income).

## Expert Panelist Commentary

The 2014 M&A Performance Study confirms what we all know—the healthcare industry is consolidating, and at a faster pace than ever before. When an industry is disrupted, participants often seek shelter by virtue of various merger and acquisition transactions. Sometimes, they have no other choice.

It is interesting to note that over half of the transactions cited in the Study involved Providers who suffered net losses the year before the transaction. The Study is a stark confirmation that cost-cutting and workforce reduction in response to declining revenues is a strategy sure to fail—at that point it's too late. The provider is left to either seek a partner or become obsolete.

I also read with interest the Study's finding as to the increased profitability of acquired providers post-transaction. One would surmise that this is the result of the scale, acumen, and access to capital of the combined enterprise. In other words, size matters. A more skeptical view would hold that such increased profitability is not the result of economies of scale, but instead a result of increased market leverage, allowing the combined enterprise to raise price. That is what keeps busy the FTC.

Great Study!

### Bill Thompson

Chairman — Hall, Render, Killian, Heath & Lyman, P.C.

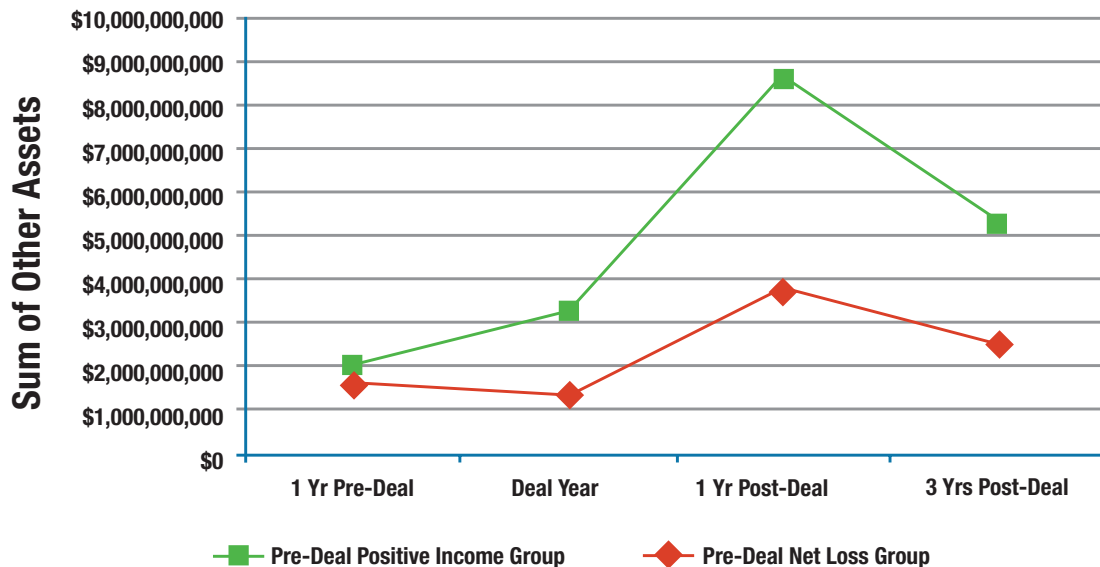
It's understandable that profitability tends to increase for many of the study subjects 2-3 years post-closing and, similarly, that subjects who experienced a net loss a year prior to the transaction dramatically improved their performance a few years following the transaction. Deals that progress to closing are traditionally subject to significant legal and financial due diligence and buyers are typically only motivated in moving forward where the projections are favorable (or at least, not terribly harmful). Moreover, the resulting entity's increased size provides opportunities to negotiate more favorable reimbursement rates with payors, take advantage of economies of scale, access improved management, and sustain a larger, more consistent patient base.

As noted, the analysis does not include data beyond 2009. As more recent data becomes available, it will be interesting to see the extent to which the trends identified in the study are affected by healthcare reform. There have certainly been a constant stream of health care M&A deals to learn from in the past five years.

### Edward G. Zacharias

Partner — McDermott Will & Emery LLP

## INTANGIBLE ASSETS



### HCTA Commentary

The researchers analyzed the reported change to “Other Assets” which are related to intangible assets on the balance sheets of the Study subjects. As expected, the group of subjects that booked positive net income during the year preceding a CHOW also booked substantial increases in Other Assets during the CHOW year. Conversely, the group of subjects that booked net losses during the year preceding a CHOW booked an overall decrease in Other Assets during the CHOW year.

The researchers were somewhat surprised to observe overall increases in Other Assets balances at one year and three years after the reported CHOWs for both income groups. While auditors may write-down intangible assets after sales that are deemed to be impaired, auditors would not increase intangible asset values associated with business sales at one year or three years after a CHOW.

### Expert Panelist Commentary

The delay in an observable increase to Other Asset balances may be the result of two primary factors. The first relates to the lag between closing the acquisition and reporting the acquisition on the financial statements. Specifically, post-acquisition accounting is not required until the purchaser’s fiscal year end, and, as such, there may be a period of time where the acquiring entity has consolidated operations with a target; however, it is not recorded on their financial statements (i.e., the one year lag). Secondly, the acquisition of one company may not “move the needle” on the Other Asset balances in the short term. However, if this particular acquisition is a platform for future “roll-ups” or “add-ons”, it will be the resulting subsequent transactions which may contribute to observable/material changes to the Other Asset balances (i.e., the three year lag).

**Tod A. Matuga , MAcc, CPA/ABV**

Manager — HealthCare Appraisers, Inc.

## PRE-DEAL PROFITABILITY, POSITIVE REVENUE GROWTH & PRE-DEAL NET REVENUES

1 Yr Pre-Deal Net Revenues	% Subjects Profitable at Year 3 Post-Deal		
	Hospitals	SNFs	HHAs
>\$200M	84% (16/19)	—	—
>\$100M	88% (56/64)	—	—
>\$50M	83% (99/120)	—	—
>\$20M	80% (159/199)	100% (5/5)	100% (3/3)
>\$10M	79% (217/274)	86% (208/242)	92% (12/13)
>\$6M	80% (239/300)	83% (645/776)	96% (25/26)
>\$3M	80% (257/321)	80% (1,150/1,445)	93% (57/61)
>\$2M	80% (258/322)	79% (1,274/1,614)	90% (86/96)
All	80% (259/323)	78% (1,315/1,688)	82% (187/229)

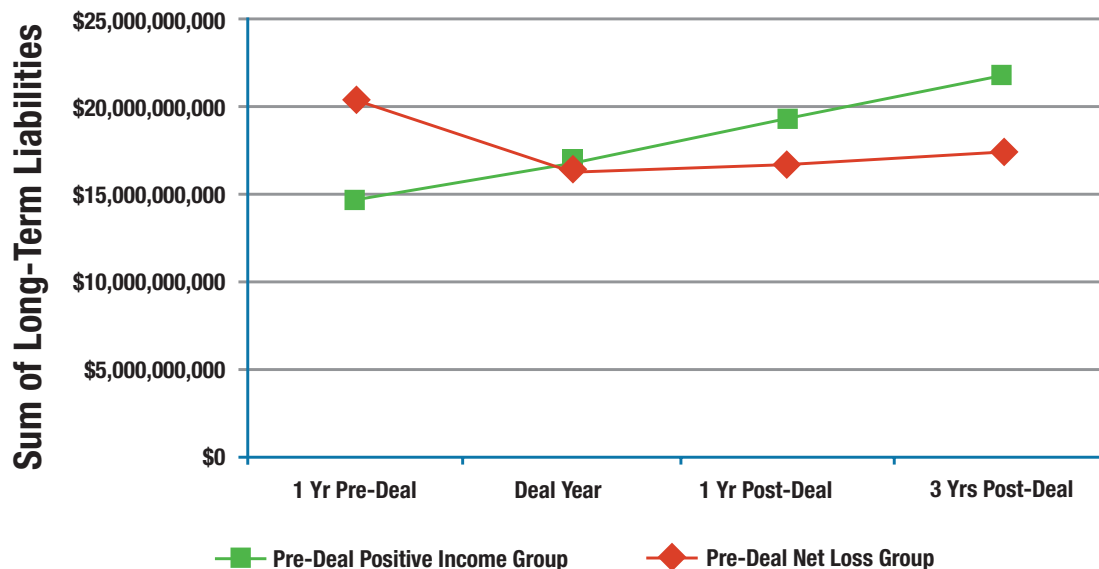
The Study indicates that pre-deal profitability and positive revenue growth during the interim period, together, are correlated with a high incidence of profitability at three years after a transaction. For this subset of subjects, approximately 79% were profitable three years after a CHOW.

SNFs and HHAs also appear to demonstrate a strong linear correlation between pre-deal net revenues and future profitability, while this correlation is not as strong for hospitals.

When screening for pre-deal profitability, positive revenue growth during the interim period, and pre-CHOW net revenue levels, the incidence of post-deal profitability at year three increases up to 86% for SNFs with over \$10 million in annual net revenues (n=242), and up to 96% for HHAs with over \$6 million in annual net revenues (n=26).

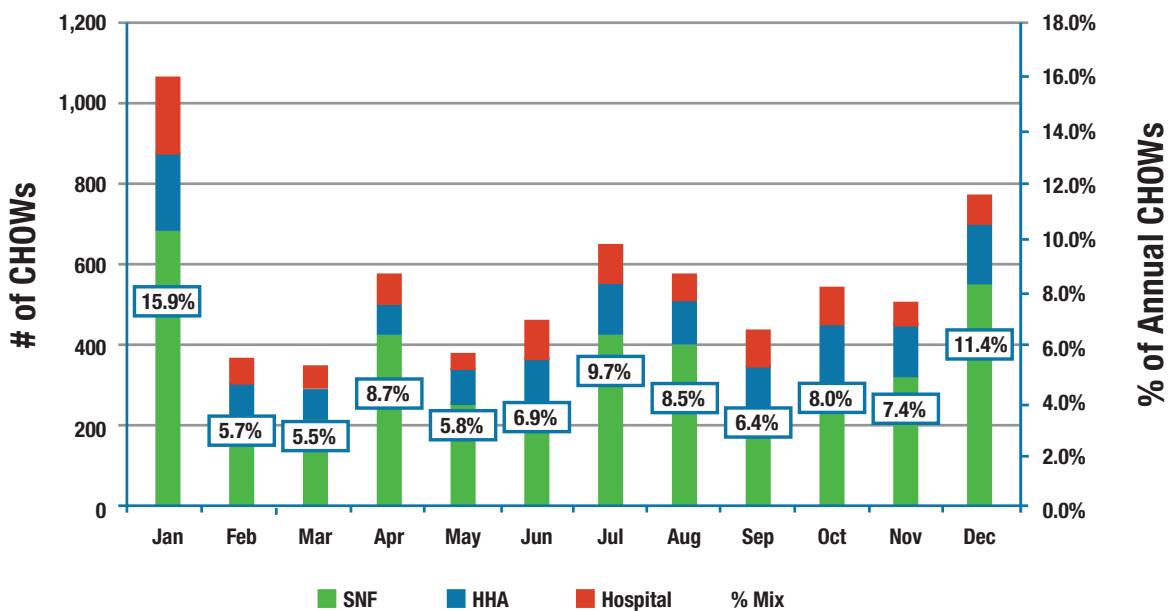


## DEBT



As groups, subjects that were profitable before a CHOW levered up on debt after their transactions, while subjects that were unprofitable before their CHOW did not.

## M&A SEASONALITY



For the entire study period the three highest volume months for CHOWs are January, December, and July.

## Disclaimer

This document has been prepared for general informational purposes only, based on the methods, limitations, and assumptions identified herein and upon data supplied by the Centers for Medicare & Medicaid Services (CMS). Healthcare Transaction Advisors has not verified the accuracy of the underlying data supplied by CMS.

While summarized findings have been generally reviewed by expert panelists to develop general comments for inclusion into this document, the expert panelists have not conducted a peer-review of the Study, nor have they audited the underlying data or analysis methods.

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HEALTHCARE  
TRANSACTION  
ADVISORS

9233 Park Meadows Drive, Suite 220

Lone Tree, CO 80124

Phone: 303.800.6444

[kylet@hctadvisor.com](mailto:kylet@hctadvisor.com)

[nnewsad@hctadvisor.com](mailto:nnewsad@hctadvisor.com)

[www.HCTadvisor.com](http://www.HCTadvisor.com)