



HEALTHCARE TRANSACTIONS:
YEAR IN REVIEW

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OVERVIEW

2018 marked a year of continued robust healthcare merger and acquisition activity, with deal volume surpassing that of 2017. The dollar volume of healthcare deals also exceeded 2017, highlighted by CVS Health Corp. (NYSE: CVS) surviving regulatory scrutiny and finalizing its purchase of Aetna for \$69 billion, and Cigna (NYSE: CI) closing its \$67 billion merger with pharmacy benefit manager Express Scripts (Nasdaq: ESRX). Private equity firm KKR & Co. Inc. (NYSE: KKR) acquired Envision Healthcare Corporation (NYSE: EVHC) in a going private transaction for \$9.9 billion; and in November, LifePoint Health, Inc. (Nasdaq: LPNT) merged with Apollo Global Management-owned RCCH HealthCare Partners for an estimated \$5.6 billion.

Not only do these deals show the energy of the industry, but they also represent a seismic shift in healthcare. Cross-sector transactions, such as the CVS-Aetna and Cigna-Express Scripts transactions, are becoming more frequent and disrupt traditional industry models. By seeking alliances across industry lines, healthcare companies aim both to reduce costs and improve care coordination as well as realign incentives to better meet consumer demands. As providers fight to stay profitable in the wake of value-based reimbursement, these cross-sector combinations may foreshadow the future of the healthcare industry.

Many of these same drivers also have led to increasing private equity investment in the industry. The need for innovation and disruption via consolidation adds further appeal to investors. The injection of capital by private equity firms allows healthcare providers to cut costs and increase efficiencies, and the shift in reimbursement presents a unique opportunity for firms to help providers and systems reposition.

Below we've outlined 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
- ✦ Behavioral Health
- ✦ Physician Practice Management & Urgent Care

Managed Care

In the wake of the failed Aetna-Humana (NYSE: HUM) and Anthem (NYSE: ANTM)-Cigna deals, there remained healthy merger activity in the managed care space in 2018. Health plans continue to seek strategic acquisitions to remain competitive in a time of regulatory and economic uncertainty coupled with increasing consumer demand. These strategic acquisitions are noticeably extending across industry lines to form alliances that cut costs and realign business incentives. These transactions have the potential to uncover new solutions to fragmented care.

Perhaps most notable of these is the CVS-Aetna merger, which was finalized in late November at a purchase price of approximately \$69 billion. The combination of these industry giants came only after intense regulatory scrutiny. Not only does this deal bring Aetna together with CVS' retail pharmacies and walk-in clinics, but it also includes CVS' lucrative pharmacy benefit manager (PBM) enterprise. The deal potentially incentivizes the PBM to lower drug prices and push for competitive insurance premiums.

Cross-sector alliances and vertical integration continue to be a theme within the managed care space. In September, WellCare Health Plans, Inc. (NYSE: WCG) completed its acquisition of Meridian Health Plan of Michigan, Meridian Health Plan of Illinois and MeridianRx (a PBM) for an estimated \$2.5 billion. The transaction diversifies WellCare's presence in the market by increasing its Medicaid and Medicare Advantage presence as well as by adding a PBM platform. WellCare scored another win in December when it acquired Aetna's standalone Medicare Part D prescription drug plans, which were required to be divested in connection with the CVS

merger. The acquisition allows WellCare the opportunity to serve over two million additional Medicare Part D members nationwide and complements its long-term growth strategy within government-sponsored health plans.

Similarly, Cigna announced in March that it would acquire Express Scripts via merger for \$67 billion, and the parties reportedly closed the deal on December 20. The companies anticipate that the deal will bring expanded consumer choice by offering a broader array of medical, behavioral, specialty pharmacy and other services. Furthermore, the companies seek to achieve patient-provider alignment.

Optum, a branch of UnitedHealth Group, Inc. (NYSE: UNH), also recently announced that it would combine with DaVita Medical Group, Inc. (NYSE: DVA) for \$4.9 billion in an all-cash transaction. DaVita currently serves approximately 1.7 million patients each year in 300 medical clinics. DaVita's presence in several states will further expand Optum's market reach. Further, DaVita will benefit from Optum's data analytics, technologies and clinical expertise.

Hospitals

In 2018, Ascension and Providence St. Joseph Health called off their merger, which would have created the largest owner of U.S. hospitals with combined annual revenues of \$44.8 billion. Atrium Health Foundation (formerly, Carolinas HealthCare System) and UNC Health Care suspended their merger transaction first announced in 2017. Notwithstanding these failed deals, mega-mergers continued to mark the hospital landscape in 2018.

Advocate Health Care and Aurora Health Care finalized their merger in April 2018, creating the tenth largest nonprofit hospital system with a combined 27 hospitals and \$11 billion in annual revenues. In addition, after signing a definitive agreement at the end of 2017, Catholic Health Initiatives (CHI) and Dignity Health continued working toward obtaining the required approvals for their mega-merger, most recently and notably obtaining the approval of the Vatican and California Department of Justice. The CHI-Dignity merger is expected to close in January 2019 and will create a new nonprofit system under the name CommonSpirit Health, encompassing 139 hospitals and \$28 billion in annual revenues.

Following suit, in September 2018, nonprofits Mercy Health and Bon Secours Health System announced plans to merge to form a 43-hospital system serving seven states, including Maryland, Virginia, South Carolina, Kentucky, Florida, New York and Ohio, with combined annual revenues of \$8 billion. In October 2018, two of the largest nonprofit health systems in Texas – Baylor Scott & White Health and Memorial Hermann Health System – announced the signing of a letter of intent to merge to form a 68-hospital system, which would make it the largest in Texas and among the largest nationwide, with annual revenues in excess of \$14 billion. Shortly thereafter, Massachusetts' attorney general conditionally approved the merger between Beth Israel Deaconess Medical Center and Lahey Health System, Inc. that would create the second-largest system in the state, with eight hospitals and \$4.5 billion in annual revenues.

On the for-profit side, in November, LifePoint Health completed its merger with RCCH HealthCare Partners (backed by Apollo Global Management, LLC (NYSE: APO)), valued at \$5.6 billion, and will bring together their networks of hospitals and other healthcare providers. The merger includes 84 hospitals across 30 states.

The horizontal consolidation of hospitals and hospital systems is due, in part, to the desire to achieve efficiencies through elimination of redundant services and economies of scale, and the desire to innovate and improve quality of care through sustained capital investments.

Post-Acute Care—Home Health & Hospice

Healthcare companies and investment firms continue to capitalize on growth opportunities within the post-acute care space. It is an opportune time for investment in the industry, given an aging population, shifts in reimbursement models, the need to better coordinate care, and increasing consumerism. Along with strategic investments, post-acute care companies look to vertical integration to meet the demands of the ever-aging population that has exacerbated fragmented care and high costs.

In March, private equity firm General Atlantic LLC announced that it would make a strategic investment of an undisclosed sum into Landmark Health, LLC, a risk-based provider group that delivers home-based medical care to chronically ill patients. Landmark has grown to serve more than 80,000 patients in six states, and, with its investment from General Atlantic, has plans to expand into seven more states.

Private equity firm Clayton, Dubilier & Rice, LLC (CD&R) and healthcare services company Cardinal Health, Inc. (NYSE: CAH) announced in June a joint investment in privately-held naviHealth, Inc., a post-acute benefits manager for health plans. naviHealth currently serves over two million insured members and manages care for approximately 800 acute hospitals and 11,000 post-acute care facilities. naviHealth is one of the largest convener participants in the Centers for Medicare and Medicaid Innovation's Bundled Payments for Care Improvement Advanced program. Under the agreement, CD&R will acquire a 55% ownership stake in naviHealth, and Cardinal Health will retain a 45% stake in the company. According to the companies, the investment structure provides the resources naviHealth needs to support and accelerate its growth strategy.

In yet another effort to tear down industry barriers, in July, ProMedica Health System, a nonprofit healthcare system, and real estate investment firm Welltower, Inc. (NYSE: WELL) acquired HCR ManorCare, Inc., the nation's second largest post-acute and long-term care provider. The deal creates a \$7 billion network with ProMedica expanding its reach to 30 states to provide wellness, skilled nursing, memory care, hospice and home care services.


In July, Humana, Inc., together with TPG Capital (TPG) and Welsh, Carson, Anderson & Stowe (WCAS) completed the acquisition of Kindred Healthcare, Inc. for \$4.1 billion in a going private transaction. The deal formally separated Kindred's hospitals, inpatient rehabilitation facilities and contract rehabilitation services from its home health, hospice, and community care businesses, now known as "Kindred at Home." Kindred Healthcare is now operated as a separate specialty hospital company owned by TPG and WCAS. Humana owns 40% of Kindred at Home, and TPG and WCAS own the remaining 60%. The companies anticipate that the deal will increase quality, reduce costs, and enhance innovation. Further, it has the potential to help Humana modernize home healthcare and improve both member and provider experience.

Expect continued deal activity in the post-acute care space in 2019. In December, home health provider Civitas Solutions, Inc. (NYSE: CIVI) announced that it would be acquired by private equity firm Centerbridge Partners, L.P. in a going private transaction valued at \$641 million. Under the terms of the agreement, Centerbridge will purchase all outstanding Civitas shares for \$17.75 per share, representing a 13.5% premium and enterprise value of \$1.4 billion.

Ambulatory Surgery Centers (ASCs)

Following its 2017 acquisition of Covenant Surgical Partners, Inc., an owner and operator of ambulatory surgery centers and physician practices with 37 facilities in 17 states, KKR showed no signs of slowing down in 2018. In October, it completed its acquisition of Envision in a transaction valued at \$9.9 billion. Envision operates 261 surgery centers. KKR (through one of its portfolio companies, Air Medical Group Holdings) had earlier in 2018 completed





its acquisition of Envision's transportation subsidiary, American Medical Response, in a \$2.4 billion transaction.

Strategic buyers also entered the mix, with Medical Facilities Corporation announcing early in the year that it was teaming with NueHealth LLC to purchase seven ASCs from Meridian Surgical Partners for \$46.5 million.

These transactions demonstrate the continuing consolidation of the industry. VMG Health reported in May 2018 that 72% of free-standing ASCs are independently owned and operated, and the remaining 28% are controlled by large players, but the numbers are gradually tilting in favor of the latter as investors and strategic buyers alike seek to take advantage of the healthcare industry's and payors' increasing preference for outpatient offerings.

Healthcare Information Technology

Increasing emphasis on electronic health record (EHR) management, data and cybersecurity ensured continued merger activity in the healthcare information technology sector throughout the year. 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) create a need for data exchange solutions and interoperability projects.

Private equity also left its mark on the healthcare information technology space. Private equity firm Veritas Capital and Elliott Management Corporation announced in November that it would acquire athenahealth, Inc. (Nasdaq: ATHN) in an all-cash transaction valued at \$5.7 billion. In its early days, athenahealth offered a cloud-based alternative to the software system used by medical offices, and it has expanded to now include services for revenue cycle management and billing, EHR systems, patient engagement, care coordination, and population health services. Post-closing, athenahealth will combine with Virence Health, Veritas's healthcare services company, while keeping the athenahealth name.

In an effort to increase investment in provider-facing technology, Roche Pharmaceuticals acquired Flatiron Health, Inc. in April for \$1.9 billion. Flatiron is a healthcare technology and services company that specializes in oncology-specific EHR software and evidence for cancer research. The company has a technology platform designed to learn from the experience of each patient. The acquisition is part of Roche's strategy to achieve personalized healthcare, which involves using Flatiron's software products to position itself to advance the use of real-world evidence at the point of care. The acquisition will allow both companies to accelerate progress toward data-driven cancer care.

The year also saw traditionally non-healthcare companies breaking into the field using technology alliances. For example, Amazon (Nasdaq: AMZN) announced in June that it would acquire the online pharmacy PillPack for an undisclosed amount. PillPack is currently licensed to ship prescriptions in 49 states. The acquisition shows a movement toward online health services as well as companies' willingness to make bold moves to disrupt traditional healthcare service models.

There are no signs of healthcare information technology merger activity slowing in 2019. In December, technology giant 3M (NYSE: MMM) announced that it would buy the technology division of M*Modal, a clinical documentation company, for \$1 billion. M*Modal's platform includes a cloud-based documentation system supported by artificial intelligence, which seeks to improve information storage and ease the burden on physicians to document information. 3M will integrate this system into its own health information systems unit, which currently works with over 8,000 healthcare organizations. Pending regulatory approval, the deal is expected to close in the first half of 2019.

Behavioral Health

While overall M&A activity in the behavioral health sector leveled off in 2018, the types of deals within the sector are becoming increasingly concentrated. In 2018, the number of deals involving facilities that specialize in substance use disorder (SUD) treatment represented over 43% of the deals within the behavioral health sector, which, according to advisory firm The Braff Group, represents the largest share of the behavioral health deal flow that it has seen in 20 years of tracking this space. And private equity firms drove much of this activity. Indeed, through November, there were 26 private equity deals involving SUD treatment facilities totaling over \$320 million, including InTandem Capital Partners, LLC's acquisition of Utah-based Turning Point Centers and BelHealth Investment Partners, LLC's acquisition of Florida-based Beach House Center for Recovery. Clearview Capital demonstrated its commitment to the SUD space, as it closed a deal in March to acquire Community Health Services and the 14 treatment facilities it operates in and around Arizona, and subsequently announced in November that it had closed another deal to purchase (through its newly acquired portfolio company, Community Health Services) two more SUD providers with facilities in Ohio, Indiana, Michigan, Wisconsin and Texas.

The ongoing opioid crisis coupled with recent federal legislation should make the behavioral health sector a good investment opportunity into 2019 and beyond. On October 26, 2018, the Substance Use-Disorder Prevention that Promotes Opioid Recovery and Treatment (SUPPORT) for Patients and Communities Act was enacted, expanding Medicare and Medicaid coverage for substance abuse services and putting into place an all-payor kickback prohibition for referrals to certain clinical treatment facilities, including SUD treatment facilities, which, commentators believe, will have the effect of wiping out "bad operators" who heavily rely on these referrals and narrow the playing field. In the meantime, stakeholders will no doubt be interested to see what unfolds with Acadia Healthcare Company, Inc. (NYSE: ACHC) in the wake of its rumored buy-out and new leadership.

Physician Practice Management and Urgent Care

2018 marked a banner year for private equity investment in physician practice management platforms. Private equity dollars continued flowing to the usual suspects – dermatology, radiology and ophthalmology – but, as predicted in this firm's 2017 report, private equity investment activity grew in other specialty areas, including gastroenterology, orthopaedics, urology and oncology. For example, in September, private equity firm General Atlantic invested \$200 million in OneOncology, a physician-centric technology-powered company focused on community oncology practices that are facing enormous challenges, including increased pressure from hospital consolidation, limited resources to invest in innovation, and continued shifts to alternative payment models. OneOncology has partnered with three oncology practices to date. Flatiron Health's oncology software powers the OneOncology technology platform. Similarly, Frazier Healthcare Partners, well-known for its investment in dermatology and having also begun investing in orthopaedic practices (in January 2017, Frazier led an investment of The Core Institute, a 67-physician group providing orthopaedic services in Arizona), acquired Atlanta Gastroenterology Associates, one of the largest GI practices in the United States with more than 60 locations in the state of Georgia and 95 board-certified physicians, via its management company, United Digestive. Commentators note that investment in GI practices will no doubt continue to grow as the incidence of chronic conditions such as diabetes, obesity and high blood pressure continues to increase, and because of the favorable number of GI procedures approved for outpatient care settings. The same holds true for growth in orthopedics, which is being driven in large part by the shift of common procedures, like hip and knee replacements, to less expensive outpatient settings, and the increasing volume of such procedures (likely a result of the aging population). In October, KKR completed its acquisition of Envision and its emergency medicine, anesthesiology and radiology services businesses.

Gastroenterology, orthopaedics, urology and oncology – the new darlings of PE circles – are likely to garner more and more attention – and investment dollars – over the coming years.

Consolidation also continued in the urgent care sector in 2018, as consumers continue to look to retail healthcare for lower-cost services outside the hospital and ER settings. One of the largest deals was FastMed Urgent Care's acquisition of NextCare Holdings Inc., which was acquired by Alcentra Capital Corp. in 2016. 2018 also saw a private equity trade as Freeman Spogli & Co. recapped CRH Healthcare, a patient-focused operator of 38 urgent care centers in Georgia, Florida and Alabama.

Conclusion

If 2017 was the year of cross-sector transactions, 2018 was the year that industry players doubled-down, and with companies such as Amazon breaking into the healthcare industry, there's no telling what sort of innovative deals and delivery models 2019 will bring. All the while, private equity investors will no doubt continue to push boundaries and seek new, exciting opportunities for investment.

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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