Intrepid
HEALTHCARE

Healthcare M&A Checkup – Q3'18

Healthcare Deals Continue, But Preparation Is More Important Than Ever

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11755 Wilshire Blvd., 22nd Floor, Los Angeles, CA 90025 T 310.478.9000 F 310.478.9004 Member FINRA/SIPC

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Dear Friends,

As we head into the homestretch of 2018, Intrepid's Healthcare Group is happy to share with you some of the deals and trends drawing our attention amid a crowded M&A landscape. Even though healthcare transaction activity is progressing at a feverish pace, and valuations are at record-setting levels, we have noted that buyers and investors are becoming increasingly diligent in identifying specific areas in which they are willing to make valuation-stretching deals.

This past September, Intrepid led a dynamic panel discussion about "Opportunities and Pitfalls in Healthcare M&A". The discussion focused on carefully managing your M&A decision-making process to drive success in a constantly changing healthcare sector.

Clearly the volume of healthcare M&A activity continues to impress, and we shall cover in this issue a handful of newsworthy items from Q3'18. However, we also want to offer a deeper dive analysis into a critical factor in improving a transaction's likelihood of success: getting your financial house in order with the right team. We outline what healthcare providers should seek when hiring senior financial leadership, especially if they are contemplating a near-term M&A event.

We value your support and look forward to connecting on a new deal soon. Please feel free to contact us if we can be a resource for you.

Best regards,

Jonathan Bluth
Head of the Healthcare Group
jbluth@intrepidib.com

Adam Abramowitz
Managing Director
aabramowitz@intrepidib.com

In This Issue

Read our Banker Insights

Preparing Your Provider Group for Sale – Is A CFO Necessary?

One of the most frequent questions we encounter when healthcare providers contemplate a transaction is whether they need to bolster their internal finance or accounting functions to complete an M&A event. We frequently hear: "Is a CFO necessary?" Over the years, we have seen how strong provider group CFOs can add considerable value both in preparation for a transaction as well as during the transaction process itself (not to mention potential profit improvements!).

When provider groups lack a CFO with deep healthcare experience, we have seen organizations struggle to deliver a buyer's required transaction diligence. Even several of our clients with highly-regarded and experienced financial teams have elected to add full-time executives or seasoned interim M&A professionals on a part-time basis to support their internal capabilities during the rigors of a transaction process. The following are some of the core competencies that differentiate a strong CFO capable of driving substantial value in the healthcare industry:

Managing a Chargemaster: Accurately predicting contractual allowances and a true net revenue

A unique challenge in healthcare that many companies struggle with is accurately predicting the collections they can expect tomorrow from the gross charges billed today, typically inventoried for each charge by payer in what is referred to as a chargemaster. Absent this visibility, many organizations find it difficult to report net revenue in real time and instead rely upon payers dictating what should be paid. Quality healthcare CFOs understand the complex contractual payment terms that each of their payers utilize, thereby enabling effective management of potential underpayments, overpayments and recoupments. Without a strong mastery of a company's chargemaster, revenue can be difficult to estimate in real time and payer-specific changes to a company's financials can be difficult to identify, making a transaction an uphill battle to complete.

Conducting Code-Based Analyses: Gaining important insights about the drivers of a healthcare business through CPT or ICD-10 code reviews

Healthcare organizations need to properly capture valuable data to analyze trends in the types of conditions they are treating (ICD-10s) or the types of clinical activities they are providing to their patients (CPTs). Gaining an in-depth understanding of this mix over time can help a company identify leading indicators of future financial performance and optimize everything from managing marketing spend, decreasing outmigration and hiring the appropriate medical professionals in the right geographic locations. At the center of all these optimizations, yet again, is an experienced healthcare CFO.

Shifting to Value-Based Care: Transitioning from retrospective fee for service billing to prospective capitation, bundles or quality-based payments

Like the electric car to traditional car companies, value-based care models can seem daunting and far off in the future to traditional providers. However, widespread adoption of value-based care models seems to be reaching a tipping point and preparation is critical for success. We find that knowledgeable healthcare CFOs can help their organizations navigate the complex actuarial calculations needed to design their next-generation payment models and oversee the systems improvements critical to successfully implementing value-based care without taking on undue financial exposure.

These are some of the most value-additive functions that a talented CFO can provide to help successfully navigate a healthcare business. Regardless of whether a transaction is on your near-term horizon or completely off your radar, investing in a high-quality CFO can pay dividends through improved business visibility and bottom-line profits. We recommend that a company evaluate its in-house finance and accounting functions when they contemplate a transaction. And, if companies do not believe their professionals have the experience and know-how to lead initiatives like the ones aforementioned, we encourage them to consider augmenting their team in either a full-time or temporary capacity. Proper preparation is critical for a successful transaction and a CFO will play an instrumental role in driving a great outcome. So hire wisely!

Recent Healthcare Industry Transactions

Implications of Optum Joining Summit Partners in Buying Sound Hospitalists

This past April, private equity firm Summit Partners announced its intentions to acquire Sound Inpatient Physician Holdings (Sound) from Fresenius Medical Care for $2.2 billion. Sound provides physician staffing services for the emergency room, acute inpatient stays and transitional care, and is best known as one of the country's largest hospitalist practices. The initial announcement was notable because it signaled that the historically dialysis-focused Fresenius was pivoting to once again narrow its specialization, after as recently as 2014, expanding into several new specialties with its initial Sound acquisition as well as the purchase of several cardiology practices. However, the most fascinating aspect of this transaction came to light just a few weeks ago, when Summit revealed that it would be joined on this investment by Optum, a diversified subsidiary of insurer United Health. Optum provides a broad array of care management, decision support and benefits administration services, and recently expanded its leading position in physician practice management with the $4.4 billion acquisition of HealthCare Partners from DaVita, another dialysis platform that had previously attempted a diversification strategy. While legacy dialysis businesses are electing to narrow their focus, Optum is finding opportunities to bolster its financial performance in nearly every corner of the healthcare ecosystem.

OPTUM®

SUMMIT PARTNERS

SOUND PHYSICIANS®

Launch of New Investment Firms Targeting Healthcare Highlights Continued Investor Appetite

In the last month, two new healthcare-focused private equity groups raised inaugural funds: Regal Healthcare Capital Partners and Town Hall Ventures. Regal, founded by former Jefferies Healthcare Chief Jon Santemma and serial healthcare services entrepreneur David Kim, is focused on investing across the healthcare services landscape, including companies in the fertility, dental, autism and revenue cycle spaces. Regal launched at an extraordinary pace, completing four undisclosed platform investments in its first nine months. Town Hall Ventures was founded by Andy Slavitt, the former Administrator for the Centers for Medicare and Medicaid Services, along with several executives from Oxeon Ventures, and has raised $115 million to invest in healthcare technology and services solutions for underserved communities. Regal and Town Hall join other experienced deal professionals who launched maiden healthcare funds, such as Havencrest, LightBay and NaviMed. Despite uncertainty surrounding the long-term future of the overall economy, there is clear enthusiasm for the potential upside of middle-market healthcare investing.

Regal Healthcare Capital Partners

town hall VENTURES

Healthcare Excitement Draws Mega-Funds to Target Middle-Market Healthcare Investments

As interest and investment in healthcare continues to proliferate across the small- to mid-cap private equity environment, mega-funds like The Carlyle Group and The Blackstone Group have notably been similarly growing the share of their private equity investments in the healthcare space. In the past 12 months alone, Carlyle, which also raised its largest U.S. buyout fund ever at $18.5 billion this year, has made more than 10 investments in healthcare companies, most recently including a number of pharmaceutical companies like Abacus Pharma and Probiotec, as well as novel primary care delivery model, One Medical, and health insurance master general agency, BenefitMall. Similarly, Blackstone has increasingly been turning its sights to the healthcare space, having launched a dedicated life sciences fund and completing at least five healthcare acquisitions this year alone, adding companies like Compass Professional Health Services and Woodland Hills-based Center for Autism & Related Disorders to their extensive portfolio. The heightened focus of these mega-funds on healthcare is sure to further bolster the already strong momentum in healthcare M&A that has built up over the past several decades. Given that healthcare investing already saw its share of overall U.S. private equity fund investments grow from 16% to 21% in 2017, one can only imagine how much this growing momentum will benefit future healthcare entrepreneurs driving innovation.

The Carlyle Group

The Blackstone Group®

Recent Healthcare Industry Transactions (cont.)

NEMT Benefits From Continued Innovation in Related Transportation Sectors

In recent years, non-emergency medical transportation (NEMT) services have increasingly shifted from traditional specialized transportation providers to alternative NEMT providers like Lyft and other ridesharing platforms. Recent surveys and reports have indicated that these alternative NEMT services not only achieve higher user satisfaction than traditional services but are also more responsive and cost effective. Given the remarkable benefits of this shift, NEMT companies like CareMore Health have recently been forming, developing and expanding partnerships with ridesharing platforms like Lyft, leveraging logistics coordination from former Intrepid client American Logistics Corporation. Although the partnership between CareMore and Lyft only began in 2016, by 2017 Lyft rides accounted for more than 90% of CareMore's total curb-to-curb NEMT services. Moreover, the increased efficiency and utilization of ridesharing platforms for NEMT services has also forced major NEMT companies to adapt and improve through strategic acquisitions, as was demonstrated in September by LogistiCare's acquisition of Circulation, an NEMT logistics solutions company. With the pace of technological innovation across sectors continuing to increase every year, this recent trend in NEMT services demonstrates how healthcare can and will continue to benefit from innovation.

Why Is Orthopedic Surgery So Hot?

The age of orthopedic buyouts appears to be in full-swing. In September 2018, Atlantic Street Capital acquired OrthoBethesda, an operator of four comprehensive musculoskeletal care practices in the greater Washington, DC area. This comes after last year's acquisition of Florida-based The Orthopaedic Institute by Varsity Healthcare Partners seemingly opened the doors to a new wave of investment into orthopedics. Increasingly, surgical services are now covered in-network by commercial insurance carriers in free-standing outpatient surgery centers or even office-based surgical labs. This change of venue enables free-standing orthopedic practices to offer surgical services at a lower cost than insurers could achieve if the same services were provided in a hospital, while still being highly profitable. The most successful orthopedic practices, who also offer a wide variety of supplemental ancillary services, such as imaging, pain management, and physical therapy, are commanding high multiples from capital-rich financial sponsors.

Private Equity Activity in Clinical Trial Support Services on the Rise

Both private equity and strategic consolidators are actively-seeking clinical trial support service providers. In August, Webster Capital invested in JBR Clinical Research, a Utah-based clinical research site manager conducting post-op pain studies. In September, Ampersand Capital Partners, a Massachusetts-based healthcare PE group, acquired clinical immunology lab NEOMED-LABS. In the same month, DFW Capital Partners acquired a new platform, Lotus Clinical Research, a provider of contract research, testing and sampling services. These new private equity platform investments are validation of the exciting growth opportunities in the clinical trial support services industry.

Recent Healthcare Industry Transactions (cont.)

Diagnostics Supplies Continuing to Attract PE Suitors

Private equity has demonstrated further interest in the diagnostics supplies space following the acquisition of LifeSpan Biosciences by Thompson Street Capital in September. LifeSpan offers a variety of antibodies, kits and biological reagents to pharmaceutical companies. Also in September, Gemini Bio-Products was acquired by BelHealth Investment Partners, a healthcare-focused PE group. Gemini supplies biological reagents to biotech, biopharma, and university end markets. BelHealth will partner with Gemini to develop more diagnostic instruments for their pharma clients as well as augment their manufacturing capabilities. It seems clear that investments in diagnostics supplies business will continue to be positively correlated with the growth in their underlying lab customers' businesses.

THOMPSON STREET CAPITAL PARTNERS

LSBio LifeSpan BioSciences, Inc.

BELHEALTH Investment Partners

GEMINI BIO-PRODUCTS

General Atlantic Making Waves in Medical Oncology

Private equity sponsor General Atlantic's $200 million roll-up is a groundbreaking deal in the oncology sector, and a signal of future add-ons/roll-up transactions to come in cancer care. Three cancer practices, with the help of software provider Flatiron Health and General Atlantic, have partnered to form OneOncology, a patient-centric, physician-driven oncology practice striving to transform the future of cancer care. Tennessee Oncology, New York Cancer & Blood Specialists, and West Cancer Center together create a 225-physician-run practice, capable of treating over 150,000 cancer patients each year. Flatiron's suite of software services will power OneOncology's clinical and operational research through their cloud-based network.

GENERAL ATLANTIC

OneOncology™

Select Healthcare Transaction Experience

ALC (American Logistics Company)
has completed a dividend recapitalization with
Comerica
and
Fifth Third Bank
Advisor to American Logistics Company

Acutronic
has been acquired by
Vyaire Medical
a portfolio company of
Apax Partners
Advisor to Acutronic**

Ambry Genetics
has been acquired by
Konica Minolta
with participation from
INCJ
$1,000,000,000
Advisor to Ambry Genetics

Southwestern Eye Center
has completed a recapitalization with
H.I.G. Capital
Advisor to Southwestern Eye Center

avaap (innovation | solutions | outcome)
has completed a growth recapitalization with
New MainStream Capital
Advisor to Avaap

Science Care
has received a majority investment from
American Capital Equity
Advisor to Science Care

Primary Critical Care Medical Group
has been acquired by
TEAMHealth
Advisor to Primary Critical Care*

CRT Medical Systems
has been acquired by
Medical Mastermind (Intelligent Practice Management)
a portfolio company of
Brook Venture
Advisor to CRT Medical Systems*

Promises Treatment Centers
Westside Sober Living Centers, Inc.
has completed a recapitalization with
Subacute Holdings, Inc. a newly formed holding company established by
Frazier Healthcare Ventures and NEA (New Enterprise Associates)
Advisor to Promises*

AST Autism Spectrum Therapies
has been acquired by
Learn It Systems
Advisor to Autism Spectrum Therapies

The Specialty Pharmacy Division of
A-Med Health Care Rx (Solutions for living. Service for life.)
has been acquired by
Modern HC Pharmacy, Inc.
a portfolio company of
Altamont Capital Partners
Advisor to A-Med Health Care

Newport Medical
has been acquired by
Covidien
(NYSE: COV)
Advisor to Newport Medical

**Represents transactions executed by principals of Intrepid while at previous securities firms.*
***Served as co-advisor, leading outreach efforts.*

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Senior Vice President
Head of the Healthcare Group

Adam Abramowitz
Managing Director
Founding Partner

Kyle Berkman
Associate

Kyle Kearney
Associate

About Intrepid's Healthcare Group

Intrepid's Healthcare Group is dedicated to providing strategic advice in capital raises and mergers and acquisitions across a broad range of healthcare sectors, including behavioral health, devices, diagnostics, hospitals, IT, pharmacy, physician practice management, post-acute care, and revenue cycle management. Our team maintains extensive relationships with strategic buyers and institutional investors across these sectors.

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