Recent Trends in Physician Alignment Transactions

The Doctors Company
October 4, 2013

Eric Klein
Eric Klein

- Partner and Leader – Sheppard Mullin National Healthcare Team

- Selected Physician Group M&A and Alignment
  - Tenet merger with Lakewood IPA and Premier Health Plan (2013)
  - DaVita’s $4.4 billion merger with HealthCare Partners, involving CA, FL and NV (2012)
  - Healthcare Partners merger with ABQ Health Partners in New Mexico (largest independent medical group in NM) (2012)
  - Greater Houston Anesthesiology affiliation with private equity fund Welsh Carson – largest anesthesiology group in Texas (2012)
  - Facey Medical Foundation alliance with Providence Health & Services (Los Angeles) (2012)
  - Greater Newport Physicians transaction with MemorialCare Medical Foundation (2012; Orange Cty)
  - 5 of 7 sellers in completed United Optum deals in CA
Eric Klein

- Advises hospital systems, multiple HMOs and strategic investors nationally on physician alignment strategies and strategic planning
  - Physician Group Mergers and Acquisitions
    - Primary Care, Multi-Specialty & Single Specialty
  - Commercial & Medicare ACOs, HCC-RAF programs and Innovative Contracting
  - Management Services Affiliations
  - Ambulatory Care Network Development
  - Post-Discharge Continuum of Care
Eric Klein

- **Other Physician Group Deals:**
  - Affinity Medical Group transaction with Stanford University UHA medical foundation (Northern CA)
  - CA deals: Bristol Park, Axminster, Talbert, Lakeside, Northridge
  - Multiple single-specialty deals nationally
    - Cardiology, dermatology, anesthesiology, neonatology, oncology, vision
- **Hospital M&A:** 26 hospital purchase/sale projects in last 7 years
- **Health Plans:** Purchases and sales of Medicare Advantage, Medicaid and specialty HMOs nationally; formation and licensing of HMOs
- Represents multiple ACO clients
- Multiple multi-million dollar EMR/EHR projects
- Teaches advanced negotiating skills nationally
Introduction to Sheppard Mullin

- Global 100 full service law firm of 650+ attorneys with 90 year history
- Focused on middle-market and large-cap markets, such as healthcare, technology, aerospace and defense, and banking
- 11 US offices and 5 international offices
- Significant growth during the recession
- Priced below Wall Street law firms for the middle market
85+ attorney National Healthcare Team

More California and managed care/coordinated care physician group transactions than any other law firm in the last 4 years

National Tier 1 Healthcare Practice ranking by US News & World Report

Recognized by Chambers and The Legal 500

Current President of ABA Health Law Section
We do cutting edge, creative work

*Example:* The 1st New Mexico commercial ACO and 1st Medicare Advantage downstream risk-based payor contracting; previously only fee for service in NM

*Example:* Public/Private partnership between a county health system and privately owned physician network

*Example:* Medicaid dual eligible strategy through FQHC alignment strategy
Sheppard Mullin: Health Care

- Transactions: M&A, Clinical Integration, Joint Ventures, Private Equity
- HMO Licensing, Risk-Based Contracting and ACOs
- Reimbursement and Regulatory
- Managed Care Contracting
- Investigations and Enforcement Defense
- Health Care Information Technology and Privacy
- Health Care Real Estate
- Health Care Litigation
- Health Care Antitrust – Arcadian/Humana transaction
TODAY’S DISCUSSION POINTS
Topics to be Discussed

- Overview of the Current Healthcare Market Consolidation Trend
- Why is the Healthcare Market Consolidating and Will it Continue?
- What Can Physicians Do To Survive and Succeed?
- What are Next Steps for the Healthcare Market?
THE RECENT PHYSICIAN GROUP CONSOLIDATION TRENDS
The Consolidation Continues

- Continuing – and Accelerating – Consolidation trend in Healthcare industry
- Includes Hospitals, Medicare and Medicaid HMOs
- Significant increase in large Physician Group Consolidation since 2009
  - Focus on physician groups with:
    - Population health management expertise
    - Medicare patient population
    - Interest in responding to healthcare reform (ACOs, moving from volume to value, risk-based systems)
Continuing Mergers and Acquisitions

- Hospital Systems
  - Tenet/Vanguard
  - Community Health/HMA
  - Trinity Health/Catholic Health East
  - CHP/Peace Health (abandoned)

- Payors
  - Medicare Advantage
    - Aetna/Coventry ($5.7B)(2013)
    - CIGNA/HealthSpring ($3.8B)(2011)
  - Medicaid – Anthem/Amerigroup ($4.5B)(2012)
Continuing Mergers and Acquisitions

- Physician Services (2012 deals except as noted)
  - DaVita/HealthCare Partners
  - United Optum/North American Medical Management
  - Humana/Metropolitan Health Networks
  - Welsh Carson/Greater Houston Anesthesiology
  - McKesson/Med3000
  - Tenet/Lakewood IPA and Premier Health Plan (2013)
  - DaVita HealthCare Partners/Arizona Integrated Physicians (2013)
Notable Recent Transactions

- DaVita merger with HealthCare Partners, closed November 2012 – $4.4 billion
- Humana acquisition of Metropolitan Health Networks – announced November 2012 – ~$850 million
- UnitedHealth Optum acquisition of North American Medical Management – closed December 2012 – price not disclosed
Physician Group Acquisitions

Increasing Physician M&A in Last 3 Years

* Half the Buyers are Hospitals

Source: Irving Levin Associates
Who is Buying?

- Hospitals and Integrated Delivery Systems
- Strategic Aggregators
- Health Plans – United, Anthem, Humana, others
- Private Equity – Still mostly single-specialty focused or hospital-focused
  - IPA Market: Leonard Green 2010 purchase of Prospect Medical for ~$383 million
- New Entrants
  - DaVita 11/12 $4.4 billion acquisition of HealthCare Partners
  - McKesson buys management services company Med3000
  - Others?
CONSOLIDATION TREND
DRIVERS
Why The Consolidation is Occurring

- Multiple Macro Reasons – Response to:
  - Healthcare reform and economics/rates
  - Uncertainty in market
  - Payor consolidation
  - IT burdens and opportunities
  - Regulatory burden
  - Private equity

- The Physician Access “Landgrab”
  - Role of PCPs in Coordinated Care
  - PCP shortage
Reimbursement Uncertainty

- Sequestration
- HCC-RAF rescaling
- Bundled payment pilot
- Dual eligibles
- Narrow networks
- Rate pressure
- Significant increase in enforcement activity
Hospital Physician Integration

- The trend toward Hospital employment or control of Physicians has accelerated – again
- Hospitals are buying the ability to manage Population Health and Managed Care risk
- Hospitals are anchoring their referral base and looking to grow revenue opportunities
- Significant market share in many markets
Physicians Leaving Independent Practice

"Late this decade, the majority, if not 85% to 90%, of all physicians will be integrated into some type of system. The kind of practice of independent medicine we once knew is dead." 1


Source: Medical Group Management Association

Note: Practices not owned by hospitals or physicians are owned by a variety of groups including the government, universities, and insurers.
Alignment Driver: Physician Access

- Half of all U.S. Physicians are employed by Hospital systems, per the New England Journal of Medicine 2011

- California’s Managed Care enrollees are highly concentrated in a handful of medical groups (CHCF: California Physician Facts and Figures (“CPFF”), 2010, using 2009 data)
  - Top 5 Largest Groups = 48%
Physician Access: CA Example

- Inadequate supply of PCPs; Baby Boom effect
- Number of California Medical School graduates flat over last 15 years, while 20% population growth (CHCF PFF)
- 30% of California Physicians are over age 60, largest proportion of any state
- Only 1/2 of California MDs work full-time in Patient care
Small Physician Practice Reactions

- Perception is more important than reality
- Expecting declining Reimbursement
  - Rate cuts
  - Issues with ICD-10 conversion
- Increasing Overhead costs
  - IT requirements
  - Administrative burdens of evidence-based medicine
  - Worries about continuing malpractice risks and increased fraud enforcement actions by government
  - HIPAA enforcement starting to occur
- Declining value of Practice – who will buy, difficulties in recruiting
- ACOs and Narrow Networks increase uncertainty as to access to patients and economic results – sense that being bigger increases Survivability
Need for a Safe Harbor

- Common theme: Need to find a Safe Harbor to ride out the storm of the next 3-5 years

- Who provides that Opportunity?
  - Clearly, hospitals are visible in the community and are actively consolidating physician practices
  - In some markets, other alternatives exist, like:
    - Physician group consolidators
    - MSO entities
    - Plans carrying out vertical integration initiatives

- Do local Physicians and Community Hospitals think of an insurance company as a viable alternative today?
Implications to Health Plans Are Significant

Provider Market

- Shortage of Physicians
- Accelerating Consolidation
- ACO Preparation

Health Plan Threats

- MLR Requirements (Reduced profits)
- Elimination of Underwriting
- Rate Reviews
- Exchanges and Shift to Retail
- Healthcare Affordability
- Erosion of Small Group Market

Analogies can be drawn to playing the game of Monopoly . . .

- As properties (i.e., Physicians) are consolidated, owners can increase rents to the other players
- Health Plans will increasingly need a place to “land” their members
- Greater integration and alignment with physicians is a key to mitigating consolidation and cost risks
Plan Rationale and Drivers for Physician Integration

- Mitigate PCP scarcity
- Gain guaranteed Access to Physicians and hedge against rising costs due to Provider Consolidation
  - Example: BCBS of South Carolina dominates the SC commercial insurance market. Per 2/11 study, they and other insurers reportedly are losing leverage in payment rate negotiations and reporting growing difficulty containing provider rate increases, given the high degree of hospital-physician consolidation (60%+ in some markets).
- Preserve/swap margins and comply with new 85% Medical Loss Ratio (MLR) rule
Payor Vertical Integration Strategy

- Manage Healthcare Costs more directly
  - Indirect cost management hasn’t worked
  - Disease state management hasn’t worked
- Directly implement “Best Practices”
- Directly affect Behavior Drivers
- Apply Purchased Technologies
  - Market for UnitedHealth’s software and technology systems recently acquired
- Position for expected continued Payor Consolidation – who’s next?
Recent Plan Vertical Integration

- UnitedHealth, through its Optum division, has been working on its vertical integration approach with physician groups since early 2010
- Has targeted spending $1.6 billion in at least 12 markets to achieve at least 1+ million members
- Recently closed transactions in multiple states with additional states in progress
  - California, Texas, Florida, Arizona
  - Adds to Nevada operations – Southwest Medical Associates
California Transactions

- Optum has completed 7 transactions in California to date, with additional transactions pending
  - (4) transactions are IPA structures
  - (3) transactions are smaller group models
  - Additional transactions are in process

- Sheppard Mullin has been across the table from Optum in 5 of 7 CA deals
United California Transactions

- Initial Transactions – 2010/early 2011:
  - AppleCare – managed care IPA and MSO in Southern California
  - Memorial Healthcare IPA – managed care IPA and MSO in Southern California
  - Acquisition of multiple smaller primary care group practices to create scalable employed physician platform
  - Multi-payor model, operating under prior names
Monarch Healthcare

- Closed November 2011
- Monarch is largest Managed Care IPA in Orange County, CA, with over 2,300 Physicians
- Limited HMO (Knox-Keene) license allows Monarch to take global capitated risk
- Participated in commercial ACO and Brookings ACO project
Monarch Transaction

- Establishes Optum as largest Physician Network in Orange County, CA
- Access to large number of Primary Care Physicians
- Significant number of both Commercial and MA members
- Managed Care Exclusivity required of Physicians in transaction
- Multi-payor model
NAMM Transaction

- NAMM
  - 15 IPAs in California
  - Illinois management company
  - Multiple new states launched
- One of the 3 largest National Population Health Management Provider Entities
- Strong IT backbone
- Transaction closed in December 2012
Other Optum Activities

- **WellMed**
  - 90,000 MA members in Texas (San Antonio, El Paso) and Florida
  - 30+ clinics
  - Purchase included small MA plan entity
  - Multi-payor model
    - Summer 2011: HealthSpring Texas subsidiary plan contracted with WellMed and will utilize WellMed clinics
Optum: Arizona

- Multiple models underway in Arizona
- Lifeprint operation
  - Hub and spoke: IPA wrapped around a high risk multidisciplinary clinic model
  - Utilizing significant amounts of technology recently purchased or developed by Optum
NEXT STEPS FOR THE MARKET
Building Population Health Skills

- Growing National awareness of need for expertise/experience in Population Health Management (payors, health systems) and in Physician Aggregation and Alignment
  - Where is this skill set? --- Clearly in California, Texas, Florida
  - Build or Buy decision
  - How many groups truly have this skill set?
  - Is there an opportunity to scale nationally, either with financial backing or in partnership with a national player (payor or hospital system)?
Continuing Consolidation

- Where are the Remaining Targets of Scale?
  - Managed Care
  - Fee for Service

- The Next Wave – Building Physician Networks and Employed Physician Groups
  - Aggregating the Large Number of Small Physician Practices
  - Barriers to Aggregation

- Hospital Consolidation trend convergence
Case Study: Orange County, CA

- 2010
  - Large staff model group Talbert purchased by HealthCare Partners
  - Bristol Park aligns with hospital system MemorialCare
  - Strategic managed care physician entity Regal Medical Group buys ADOC IPA in northern Orange County
Case Study: Orange County, CA

- 2011
  - OptumHealth buys Monarch Healthcare, largest IPA physician network in Orange Cty
  - Blue Shield structures exclusive narrow network with St. Joseph integrated delivery system; excludes other local physician groups
  - Blue Shield in a dispute with Monarch Healthcare
  - Hoag Hospital – largest managed care groups are Monarch and Greater Newport Physicians
Case Study: Orange County, CA

- 2012 - Greater Newport Physicians (2nd largest IPA in OC) aligns with MemorialCare
  - Follows the 2012 purchase of Bristol Park
  - Merger of Nautilus Healthcare Management IPA, practice management and group model
  - Medicare and Commercial lines of business

- Realignment of Market – Hoag and St. Joseph hospital systems affiliate, new medical groups forming, other medical groups selling

- 2013 – Individual Physicians choosing to align with Hospital Systems
Regulators Are Watching….

- FTC and DoJ is active in investigating Healthcare deals
- Renown Health – merger of 2 Cardiology groups in Nevada
- California Attorney General issues subpoenas to Dignity, Sutter, Sharp, Scripps and Cottage systems re: Pricing and Physician Consolidation/Alignment
WORKING TOWARD NEW MODELS
The California Coordinated Care Model

- California: Delegate, Capitate and Coordinate
  - Accepting risk – “managed care”
  - Increasing sophistication in medical management
  - Risk stratification
  - IT investment
  - Drive profitability from MA program: HCC-RAF $$
  - Working with both group/staff models and with IPAs
  - DaVita HealthCare Partners; Aveta/NAMM; Heritage; others
But...

- In other Markets, who can take Delegation and Capitation?
  - Need sufficient patient pool size to accept risk (economic resources, mitigation of adverse selection, large enough physician network to be attractive to patients)
  - Need knowledge base and infrastructure (IT, medical management, physician leadership)
  - Not enough IPAs or groups nationally that can do this
Risk Stratification: The Next Step

- Coordinated Care Model used by National leaders: DaVita HealthCare Partners and North American Medical Management (NAMM)

- In Seniors, over 40% of Healthcare Costs may be attributable to less than 5% of Patients
  - Controlling costs in just that patient population results in significant cost reduction and profitability
Risk Stratification

- **Coordinated Care:**
  - Wraps programs around sickest patients – high risk clinics, post-discharge programs, 24/7 hospitalists, home visits, monitoring
  - IT Focused: Data collection, intervention tools, predictive modeling, connectivity between care providers
  - Reduces hospital and post-acute admissions and length of stay, significantly resulting in significant savings
  - Global risk-based – hospital and MD $’s
HealthCare Partners Example

- ~700,000 Patients and 8,000+ Physicians in CA, FL and NV; accepts full risk
- Tightly Managed Care, but large Coordinated Care Physician Network, so Members have “room” to choose
- Same-day Access programs; mix of groups and IPAs
- Tight focus on Risk Stratification and Care
  - Multi-disciplinary high risk/disease state management programs
  - Home visits by physicians to high risk patients
  - Hospitalists and SNFist programs
- High Patient satisfaction, strong results in Star Ratings and HCC-RAF
Final Points

- Continuing Consolidation for Physicians
  - Accelerated by demographics, reimbursement pressures and Medicaid expansion
- Pricing will remain at current levels, absent industry shifts
  - Increasing competition between hospitals, plans, strategics and private equity
- ACOs: not moving the needle economically, but moving the Patients and Physicians?
Final Points

- Long-term success of industry leaders depends on both “first-wave” Physician Group alignment and “second wave” smaller Practice aggregation
  - Building or buying platforms
  - Clinical or other integration of community physicians
  - Equation: Direct control of physicians, alignment of economic incentives and applied data can change economics and behavior
Final Points: Care Redesign

- Trends to Watch:
  - Care delivery teams
  - Rise of the mid-levels
  - E-visits
  - Group visits
  - Managed Post-Acute Care
  - Unified Care Management

- Employee Health
  - Employee Clinics
  - Direct to Employer Opportunities
Final Points: Small Practices

- Small Physician practices will:
  - Continue to see reimbursement pressures and shift to value-based reimbursement models
  - See opportunities to stabilize or increase revenue with value-based reimbursement
    - But not for every specialist!
  - Have more partnering opportunities in next 5 years

- Need to figure out how to prove value
  - To patients, HMOs, hospitals, employers

- Practices that self-align with other MDs can create significant value
This is the Time for Leadership…

- The Healthcare industry will continue to change
- Many Opportunities exist today for Physicians – but Leadership and Support is required
- Without Physician Leadership, the industry will limit the role of Physicians
- Physicians need to actively choose their own destiny – or they will find themselves living someone else’s dream
Key Takeaways

- More big hospital and payor deals coming….
- The physician environment is rapidly changing and will continue to change
- Technology creates opportunities – and burdens
- Many physicians are choosing to affiliate
- Physicians can stay independent if they provide “value” and are willing to adapt their practices to meet market needs
- Physicians that aggregate will have more control and create more financial value
Questions?

Contact:
Eric Klein
310.228.3728
eklein@sheppardmullin.com
www.sheppardmullin.com