



DJI Consulting

How Dealmaking in US Healthcare Is Evolving



Why M&A has been on the upswing in US healthcare

M&A within US healthcare services enjoyed a steady rise in activity from the depths of the financial crisis in 2009 to peak by volume in 2015. Although aggregate activity has declined since, historically robust deal value suggest that overall, the M&A cycle is still going strong and entering its later stages. Multiple factors underlie such significant strength, both macroeconomic and microcyclic.

Macroeconomic factors

Demographics have played a significant role in encouraging consolidation within healthcare services. As US baby boomers age, the eventual population of patients has increased, while political policy shifts have also ensured the pools of those insured have only steadily grown. Moreover, healthcare costs have by and large only grown, particularly in light of growing obesity rates and life expectancies. Last but not least, increased digitization of multiple

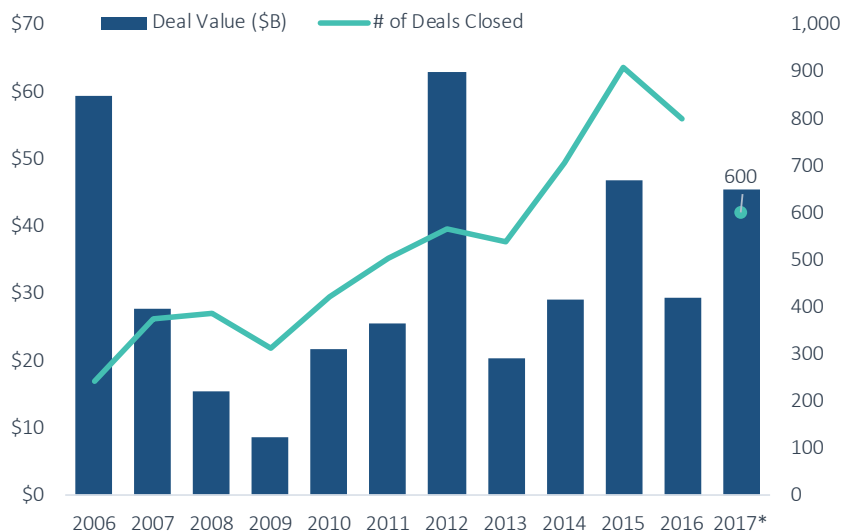
facets of care will only prompt additional investment in technology, which some entities cannot scale to the same degree others can, producing better-adapted providers in certain niches.

Microcyclic factors

In regional markets, there isn't an infinite supply of healthcare service providers of quality, particularly as

the CMS continues to implement star-rating regulations. Accordingly, after the recent period of highly active consolidation, a diminishing in volume is to be expected. Larger systems will also take some time to fully integrate regional acquisitions, taking a hiatus from buying additional divisions and companies.

The M&A cycle in healthcare services has entered its later innings
US M&A activity in healthcare services



Source: PitchBook
*As of 12/15/2017



About DJI Consulting

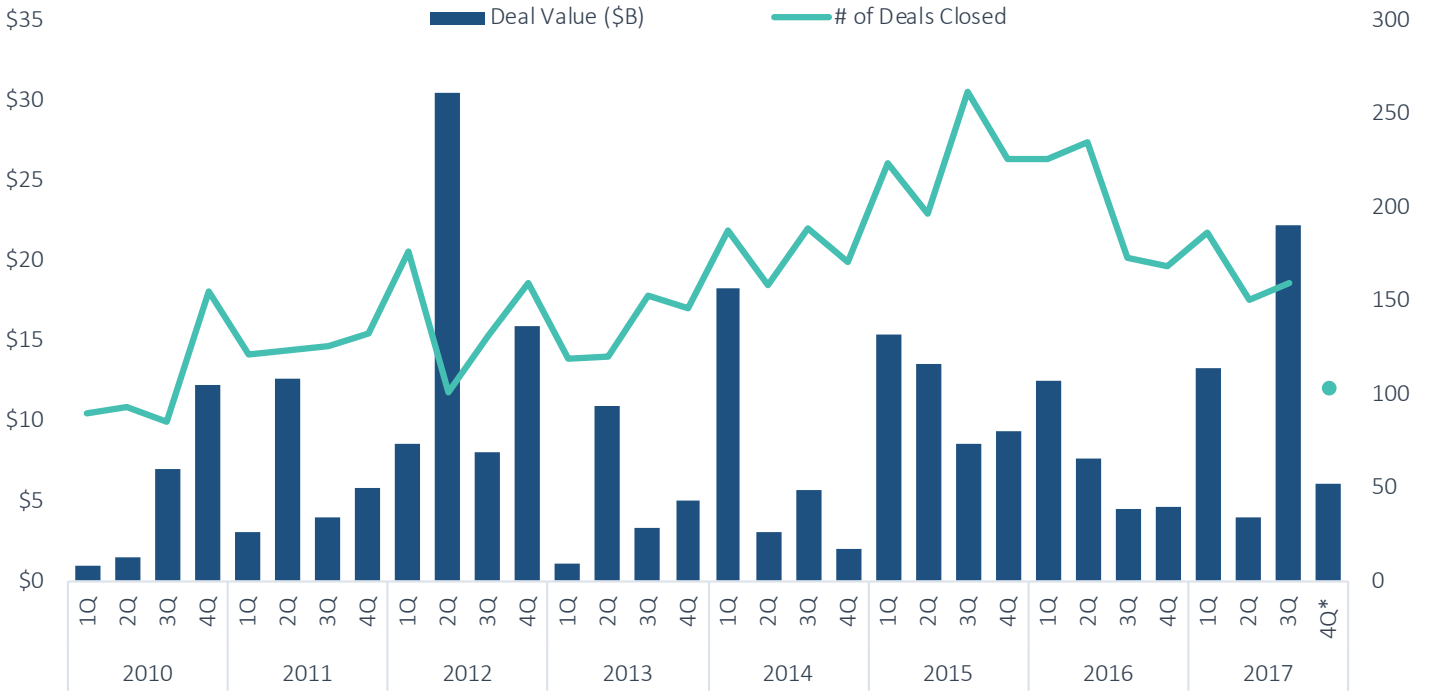
DJI Consulting is at the intersection of strategy, implementation and creativity. We help medical practices, hospitals and health systems re-imagine their business models so they can maximize profits and reshape how work is done

using current technological advances. As a healthcare consulting firm with 15 years of experience in the industry, we've acquired deep insight into departments as diverse as sales, operations and management.

We work with C-Suite executives and senior leadership to drive business performance and outcomes based healthcare and shareholder value.

Quarterly figures reveal impact of mega-deals as well as slowing momentum

US M&A activity in healthcare services



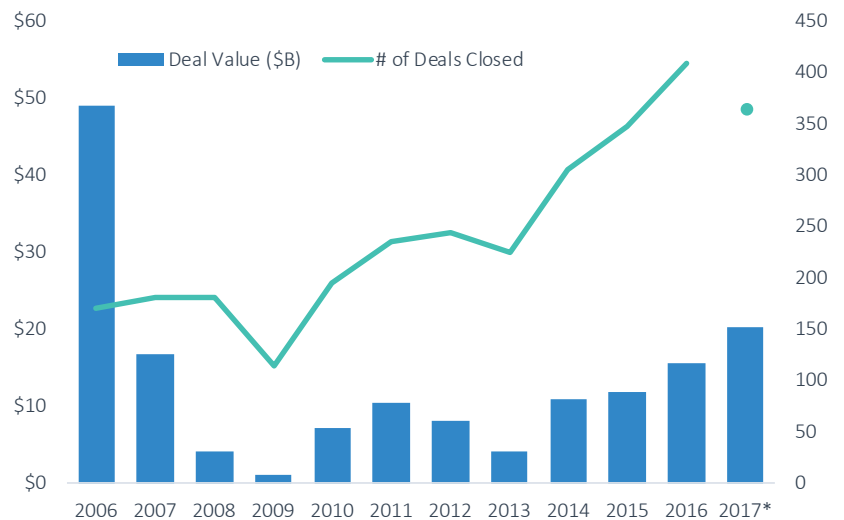
Source: PitchBook
*As of 12/15/2017

The role of PE firms has only become more important in underpinning sector consolidation

An under-appreciated driver of sustained M&A activity has been the skyrocketing rate at which PE firms have been engaging in consolidating platforms across healthcare services. Depending on the rate of fragmentation, certain segments such as dental practices are ripe for assimilation into a broader PE platform. Plus, PE centralization and cost-cutting strategies can often align well with smaller entities that don't have the resources to invest in

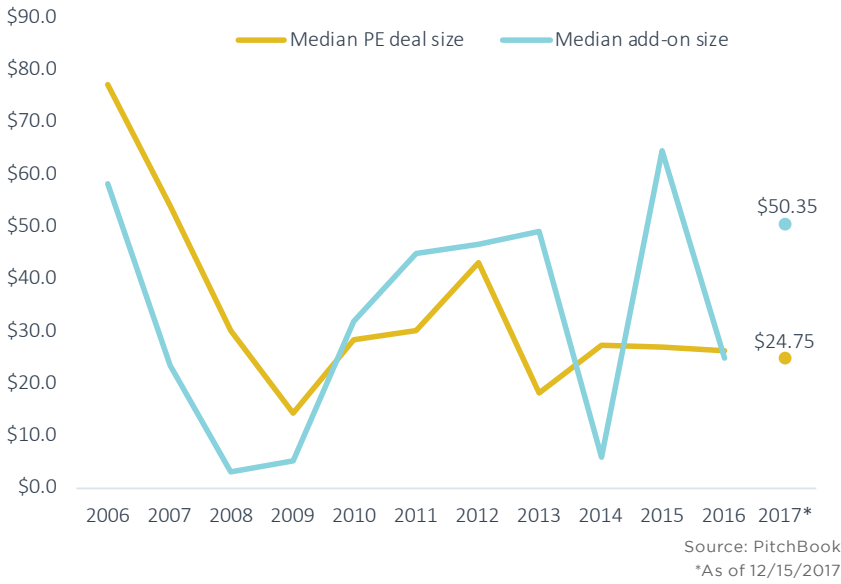
PE firms have been able to find a sweet spot in consolidating smaller providers

US PE activity in healthcare services



Source: PitchBook
*As of 12/15/2017

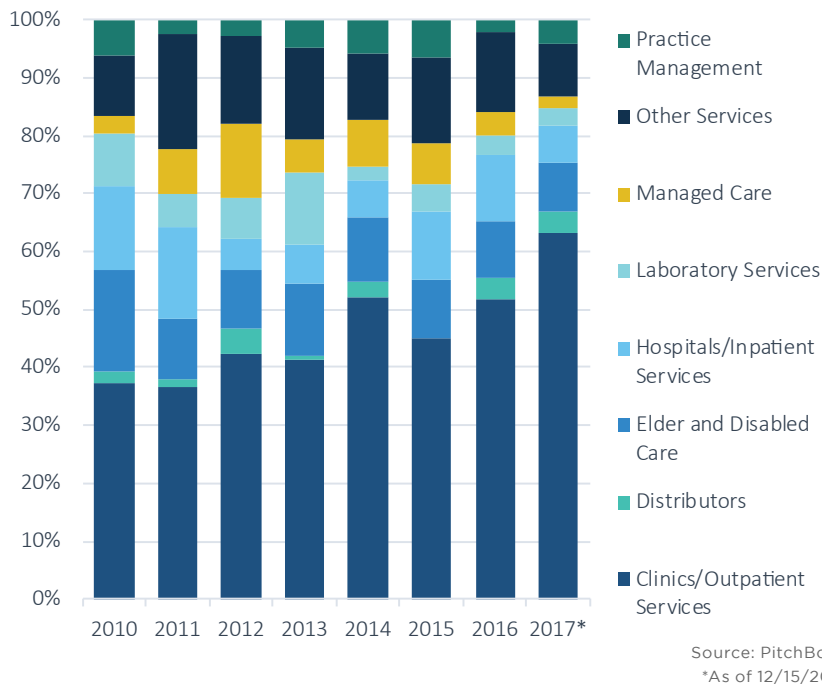
Given sample sizes, median deal sizes are quite volatile, reflecting the variation in the size of target companies as well as strategies
 Median PE deal sizes in US healthcare services



technical updates and compliance that the current environment requires. Competition for the best deals has produced steadily rising deal value totals—the past four years have seen the most consistent rise in PE activity within the entire sector, resulting in 2017 surpassing 2007 for the second-highest tally of the decade. At this point, it would not be unreasonable to see slightly lower tallies going forward, given the impact of pricey valuations potentially protracting deal sourcing and time taken to close. Although given aforementioned macroeconomic pressures there could arise potential targets in publicly traded firms shedding divisions or underperforming centers, by and large, high asking prices and the necessity of significant resources could entail that only a select coterie of PE firms will be able to pull off such transactions.

Add-ons have primarily been concentrated in clinics & outpatient services

US PE add-ons (#) in healthcare services by sector



Tight focus on building out services platforms

It's clear that in a competitive marketplace PE firms have hunkered down on focusing their acquisitional efforts in the clinics/outpatient services realm, at the expense of hospitals and laboratories, as those latter entities already are concentrated. Biotech remains a difficult area for buyout firms to access in a fashion that aligns with typical PE strategies. PE operational strategies as well as return-maximizing incentives align best with continuing to build out platforms, and that does not look set to change anytime soon.



Dana Jacoby of DJI Discusses How to Adapt to the Evolving Healthcare Environment

In the course of your advisory, what tend to be the most common challenges investors and clinics/care providers face when they seek to roll up multiple small entities into a larger platform?

The three most common challenges I see for investors are the following:

1. Failing to take into consideration the cultural and political nuances attached to merging small entities who have had a fair amount of autonomy and a lack of governance/oversight
2. The pace of the roll-up sometimes is too rapid for effective change management to take place. If the pace were more driven by milestones against a timing set by appropriate stakeholders versus a templated roll-up, things would move at a more consistent and profitable pace in the long run.
3. Not employing a conduit or 'merger ambassador' across the parties. Many times investors take for granted that healthcare specialties have unique qualities, characteristics, and verbiage. Many of the presentations I sit in I attend are "templated" and use financial or and

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accounting terminology that providers have never heard before. All parties involved usually have a high intelligence level, but are naïve to each other's processes, industries, and terminology. As a result a mediator or translator can assist in creating a smoother process if employed effectively.

The four most common challenges I see for clinics/care providers are the following:

1. The lack of understanding of the time, terminology, and intricacies of the overall process
2. How to best set up a successful merger or acquisition from a financial, operational, cultural, and negotiation standpoint. There is a recipe for success to M&A that can be followed and can alleviate many of the challenges we see downstream. Many clinics/care providers get too far down the path prior to realizing that a process, effective communication, and appropriate outside guidance could have saved them a significant amount lot of grief.
3. A lack of understanding of the importance of "dating prior to getting married". A successful merger or acquisition takes time, asks tough questions, and provides transparency and honest communication. I find many clinics/care providers underestimate the value of a 'dating' process when getting to know the merger or parent entity.
4. The effect on secondary providers, leadership, and staff. There is always a downstream effect around culture, the fear of change, and the desire to "keep things the way they have always been" versus getting married or merging. Clinics and care providers should have

a process around their communication, communication timelines, staff involvement and (if appropriate) press releases, fireside chats, roadshows, and introductions at appropriate levels. We have found great success in including front-line staff, as well as leadership in the M&A process at appropriate milestones and I wish more clinic leaders/care providers understood the importance of this step in the success of the overall process.

What is your take on the rate of technology investment and adoption as an encouraging factor in M&A? Are smaller providers finding it difficult to keep up with the adoption of and increasing regulations around EHR, for example?

In my experience, if you have seen one M&A technology adoption, you have seen one M&A technology adoption.

Currently there are varying levels of adoption, investment and implementation in each of the merger and acquisition engagements across the country. Hospitals and integrated medical systems tend to move more rapidly than smaller providers or small PE engagements in forcing this change, mainly because it has a large cause and effect to provider work output and satisfaction. In a successful M&A process the adoption, investment, and implementation should be communicated up front. 'Super champions and trainers' of the technology within the system or provider group should be trained and selected and there should be an appropriate pace selected for the technology to be rolled out. I anticipate that this rate of technology adoption will not only increase, but continue to scale and consolidate as mergers take place and entities grow in size. In its current state it is a stress for small providers, but one that in certain markets is not being forced until other critical factors of the M&A engagement have been completed and

Adoption, investment, and implementation should be communicated up front

have been deemed successful. Technology implementation is definitely one of the largest fears and stresses behind M&A as providers try to maintain their business operations and overall profitability amid mergers, acquisition, and new payment model methodologies.

Where do the most opportunities reside for larger organizations when it comes to technology investment, or where do you see the greatest opportunities for increasing focus?

Large organizations tend to invest in new technology solutions and then scale them while working out the bugs and workflows 'real-time'. The greatest opportunities for large (and small) organizations in healthcare related to technology investment is around communication, clinical decision tree/pathway development, and cross-communication templates and tools for the end user staff. I am always fascinated by technology investments and implementation where the workflows, current communication, and current clinical decisionmaking have not been mapped out or adequately taken into consideration. This is a 'miss', and many times staff and clinicians create workarounds versus adopting the technology due to the lack of focus on the above.

In my experience I have found that IT and healthcare have two separate ways of communicating and two styles of workflow. What works in an IT engineers' workshop, does not always work in real time when a clinician is in front of a patient or working in the patient-centric world of medicine. Recent studies [have shown](#) that clinicians spend 20%-30% of their time with EMR, and dealing with technology while attempting to create quality and satisfying patient visits. If large (and small) organizations would pilot their technologies and garner adequate 'front-line' clinician feedback through technology, it would alleviate many of the investment 'misses' that large organizations face.

Lastly, more cross-communication and collaboration tools and resources should be available in large organizations. I always lament that my cousins can go on social media and have a 'team' approach to picking

a restaurant in a new city. Our clinicians on the other hand, many times, have siloed technology solutions and have to make life-and-death clinical decisions in a vacuum due to the lack of collaboration, communication, and benchmarking in present-day healthcare technology solutions.

Clinicians spend 20%-30% of their time with EMR and dealing with technology

What are some of the best practices for independent practitioners looking to merge into a larger organization, and how do they vary by area of focus?

This question could be a book of case studies based on the current market research DJI has conducted. There is quite a variance across different specialties, regions, geographies, and entities and this question requires a lot of guidance and careful thought.

In short, the main best practices are the following:

1. Know the goals, mission, and vision as to why you are looking to merge and what you hope to achieve from the outcome
2. Shop your potential merger partners and make a spreadsheet assessment/ list of what you bring to the table and what their strengths and weaknesses are prior to having in-person meetings
3. Make sure all partners/stakeholders/ shareholders understand the merger process, are on the same page, and are ready for discussions, decisions, and due diligence (the three D's!)
4. Get your house in order before considering a merger or acquisition
5. Date, as long as it takes, prior to getting married
6. Create a committee or a subset of leaders to decide on things like operating agreements, governance, board discussions, culture, politics,

staffing, etc. DJI has a governance framework that can be utilized around these types of items which we can make available to PitchBook readers post-publication

7. Hire an expert or experts around valuation, M&A, tax implications, malpractice, and overall integration decisions
8. Take copious notes, create milestones, develop a process for M&A and look for case studies from similar specialties who have already gone through the process
9. Track your progress, create a communication plan along with the financial, operational, cultural, political, and clinical plans
10. Celebrate the merger success

The easiest way to capture best practices is to treat the M&A process like a dating/ marital discussion:

- Know what you are looking for
- Look for that partner in the appropriate place/geographies
- Communicate and put your best effort forward out of the gate
- Discuss finances, leadership, operations, personnel, etc.
- Communicate, communicate, communicate to make sure there is no confusion going into the marriage
- Decide on pre-nups, legal and tax ramifications
- Prepare for the changes of being engaged/married
- Let the family (personnel) know of your decision
- Get married, sign the appropriate documents, integrate the entities
- Celebrate the marriage, create a new brand/name and entity if appropriate
- Realize things will be different, but that the synergy of entities makes you a stronger or better organization long-term