# HealthCare APPRAISERS

# FMVantage Point
## Quarterly Industry Insights

Quarter 1 ▪ 2019

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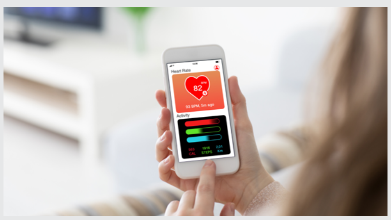







***Monitoring Industry Activity from Quarter 1 of 2019***

As part of our ongoing research into the healthcare industry, HealthCare Appraisers, Inc. follows commentary of publicly-traded health systems, physician services providers, ambulatory surgical center management companies, and other healthcare service providers. The following paragraphs are important valuation-related takeaways from recent earnings calls and conference presentations, as well as supporting quotes[1] from publicly-traded operators.

# Medicare For All

As the 2020 presidential campaign heats up, Medicare For All proposals from several Democratic candidates have been generating discussion amongst industry participants. In addition, according to the Kaiser Family Foundation, public support for some type of national health plan has been increasing.[2] While it is far too early to know what these proposals would look like if implemented, eliminating or significantly altering private insurance from the healthcare system would have a material impact on the financial performance of many healthcare providers. Our discussions with industry executives at the AHLA Transactions Conference suggest as many as 50 percent of hospitals would face bankruptcy if their payor mix shifted to 100 percent governmental payors without a large governmental support payment, while the largest publicly-traded ASC management company indicated its Medicare reimbursement rates are discounted approximately 45 percent compared to commercial insurance. Dialysis clinics would also face steep cuts to reimbursement that could leave many financially unviable given that their profit margins can swing significantly based on small changes in payor mix. The large dialysis providers recently spent more than $100 million fighting a ballot initiative in California that would have capped reimbursement from private insurance, which indicates the degree to which many rely upon private reimbursement rates. Anesthesiology practices, which are already dealing with payor mix headwinds from the increasing Medicare population, would also be negatively impacted. Public company valuations declined sharply (and have since recovered) following comments

"I know there's been public discussion about Medicare for all proposals…The wholesale disruption of American healthcare being discussed in some of these proposals would surely jeopardize the relationship people have with their doctors, destabilize the nation's health system and limit the ability of clinicians to practice medicine at their best. And the inherent cost burden would surely have a severe impact on the economy and jobs all without fundamentally increasing access to care."

David Wichmann – CEO of UnitedHealth Group on Medicare For All proposals

"I wanted to take a moment to discuss the ongoing public debate of how best to overhaul the U.S. healthcare system to continue to provide improved access to quality care while addressing the issue of affordability. This is a topic that continues to receive much focus and wide variation of opinions as how to best proceed legislatively. Our business model is uniquely built to address these challenges, which is why we support legislation that expands access to quality care at lower costs. We believe we are aligned with regulators, payers and patients, and our distinctive business model should prove to be resilient in the wide spectrum of outcomes that may evolve in the U.S. healthcare debate."

Wayne Scott DeVeydt – CEO of Surgery Partners, Inc. on Medicare For All proposals

"…generally speaking, we get a substantial discount on Medicare, almost 45 percent of what you see on commercial rates in general."

Wayne Scott DeVeydt – CEO of Surgery Partners, Inc. on Medicare versus commercial payment rates from UnitedHealth Group's CEO regarding the disruption that Medicare For All would cause. Some investment analysts covering the public companies believe that uncertainty surrounding the future of Medicare For All and related proposals could negatively weigh on valuation multiples for the foreseeable future.[3] This uncertainty could impact merger and acquisition activity as well, which would be reflected in valuation multiples throughout the healthcare sector.

"I think we called out four different areas of investment on the last quarterly call and [Medicare Advantage] was one of them. And so specifically, we're focused on regulatory compliance, which there is a whole set of things that you have to do in order to make sure you're compliant with Medicare regs."

Jason Gorevic – CEO of Teledoc Health, Inc. on Compliance with CMS telemedicine regulations

# Telemedicine

Telemedicine continues to be an area of strong growth within healthcare, with industry participants particularly interested in reimbursement dynamics. In particular, CMS is increasingly supportive of telemedicine arrangements, although reimbursement is mostly still determined at the state level through various parity laws, and through direct negotiation with private payors. Telemedicine M&A activity continues at a rapid pace, including at the international level.[4] Additionally, public companies, private physician medical groups, venture capital and private equity platforms are building out telemedicine service capabilities in radiology, family medicine, urgent care and pediatrics.[5] Given the potential for telemedicine to improve access, reduce cost, and lessen the impact of physician shortages throughout the healthcare industry, we expect telemedicine interest will continue to rise. Importantly, there are many CMS regulations that providers need to comply with when entering into telemedicine services arrangements. Those interested in learning more about how to structure telemedicine arrangements can find recent articles by HealthCare Appraisers here and here.

"I'd like to briefly cover the recently released CMS rule, since this has been a key topic as we head into the 2020 year for Medicare Advantage. CMS is very much behind the inclusion of telemedicine to increase accessibility to medical care and to lower costs. It's important to note that while the government has estimated savings from telemedicine in the ruling, it did not prescribe pricing for reimbursement. Pricing for services will be negotiated directly between virtual care providers, like us and the health plans. We are in active discussions with Medicare advantage plans spanning both existing and prospective clients, and we expect to have information on how we will be serving this important market in the back half of this year."

Jason Gorevic – CEO of Teledoc Health, Inc. on CMS support for telemedicine arrangements

# Hospitals Employing Physicians Providing Hospital-Based Services

Hospital operators are exploring potentially employing, as opposed to contracting with, more providers of hospital-based services. Specifically, the largest operator of hospitals in the United States indicated that it may start employing more of its emergency medicine, hospitalist and anesthesia providers. While the trend toward hospitals employing more providers has been well documented, certain hospital-based specialties have been less impacted to date. Going forward, an increased focus on reducing surprise billing practices may cause hospitals to want to employ more of their providers in order to reduce out of network charges and improve patient satisfaction. More broadly, the shift to value-based arrangements such as ACOs may be easier for some hospitals to implement if they employ their providers and are able to pay them based on the overall value they bring to the ACO. Finally, the move to employ hospital-based physicians may be driven by the substantial expenditures associated with subsidy or collections guarantee arrangements between hospitals and independent hospital-based practices. For insight into the financial and operational considerations driving new developments in hospital-based contracting, HealthCare Appraisers delivered a webinar that can be accessed here.

"As it relates to hospital-based physicians, specifically, we are exploring approaches to deal with some of the pressures that exist in the marketplace. Today we have hospital-based physician practices that are owned by HCA for critical care medicine. We may have the largest or the second largest critical care medicine practice in the country. We also have a very large pathology practice inside of HCA that's growing. We are exploring hospitalists, we're exploring emergency room physicians, we're exploring anesthesia in ways that may be different than what we've done in the past."

Samuel Hazen – CEO of HCA Healthcare on potentially employing hospital-based service providers

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[1] All quotes are taken directly from transcripts provided by S&P Capital IQ. Some quotes have been edited for clarity and relevance.
[2] https://www.kff.org/slideshow/public-opinion-on-single-payer-national-health-plans-and-expanding-access-to-medicare-coverage/
[3] https://www.nytimes.com/2019/04/19/business/medicare-for-all-health-care-stocks.html
[4] https://www.mobihealthnews.com/content/56-digital-health-mergers-and-acquisitions-2018
[5] https://healthcare.levinassociates.com/2019/05/06/amn-healthcare-services-acquires-staffing-firm/

# ASC Joint Ventures with Hospitals

The largest publicly-traded ASC management company indicated that it is increasingly interested in partnering with hospitals in three-party joint ventures in the second half of 2019. While three-party joint ventures between physician groups, management companies and hospitals are not new, it would represent a change in strategy for one of the largest operators in the surgery center space. Other large ASC management companies have recently implemented new three-party joint ventures as well.6 The shift in strategy is intended primarily to drive more hospital volume to the ASC, with a potential benefit to reimbursement rates as well. While ASC facility fees could increase in the near-term from these type arrangements, over the long-term we believe site neutral payment policies will limit the benefits from rate increases and result in most of the benefit coming from higher case volumes.

[6] https://www.beckersasc.com/new-asc-development/13-physicians-join-3-way-joint-venture-for-orthopedics-focused-asc-in-missouri-5-key-notes.html

"That being said, I would say that there has been an evolution to my thinking, while the majority of our business, roughly 96 percent is generally two-way JVs, I would tell you that I am really open-minded, in fact the team and I with Eric Evans joining us, are really looking at how we could really expand that 4 percent of three-way JVs at a much more accelerated pace in the back half of this year and going into next year. I think there's an opportunity for us to accelerate some value creation for our shareholders through those JVs. And I think some of these end market transactions, we've got good market share and good leverage, we might be able to accelerate some of our rate efforts over time through those initiatives. That being said, I want to be clear that we are only really looking to partner with those parties that are truly interested in taking costs out of the system. It's not our goal to play the rate game, it's our goal to be the preferred provider of choice for the best quality at the most affordable price. But we are finding more and more of the providers and larger systems are interested in having those discussions now, recognizing that our business model, if anything, cannibalizes their model over time, and so there's opportunities to partner together, we're exploring those. So I think, you'll start to see that hopefully evolve as this year progresses and it's part of why Eric has joined us."

Wayne Scott DeVeydt – CEO of Surgery Partners, Inc. on three-party JV's with hospitals and physicians

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