



M&A Source -- Healthcare Webinar

April 14, 2010



Meeting Agenda

- Introduction (Chet Walden)
- Healthcare Industry Overview (Ryan Kelley)
- Healthcare Sourcing & Diligence (Matt Hicks)
- Healthcare Segments & Valuation (Ryan Kelley)
- General Question & Answers Session



Introduction

Webinar Presenters

- **Chet Walden**
 - Founder and President of Walden Businesses, a nationally recognized M&A intermediary based in Atlanta
 - Since 1990, Chet has guided business owners through the buying and selling process, completing over three hundred successful transactions
 - In 2008, Chet earned one of the highest designations in the M&A industry, the coveted Mergers & Acquisitions Master Intermediary (M&AMI)
- **Matt Hicks**
 - Currently a Partner with Excellere Partners a Denver-based middle-market private equity firm
 - More than 17 years of experience in private equity investing and financing middle market companies
 - Began career with Bank of America's Leveraged Finance group and an internal Private Equity group
- **Ryan Kelley**
 - Currently a Partner at Shore Capital Partners a Chicago-based lower middle-market private equity firm
 - Previous private equity investment experience at Water Street Healthcare Partners in Chicago
 - Began career with Bank of America's Healthcare Investment Banking group in New York



Introduction

Goals & Webinar Format

Goals

- Provide M&A Intermediaries as well as other M&A Professionals and business owners background information on opportunities in the healthcare industry
- Educate M&A professionals on what they should be looking for as they attempt to represent healthcare companies
- Webinar serves as an introduction to the upcoming 4-hour healthcare educational discussion that will be held in Orlando, FL in June 2010

Webinar Format

- 1 hour time allocation for presentations and Q&A
- Presentation material from Chet Walden and private equity professionals will be delivered according to the meeting agenda
- Last 15-20 minutes for Q&A; Webinar participants can ask questions of the webinar panelists



Introduction

Common Healthcare Terms

Common Healthcare Terms	Definition / Use
Payor / Payer / Managed Care Organization	3 rd party that pays for health services provided to a patient. Examples include state Blue Cross Blue Shield organizations, UnitedHealth Group, WellPoint, Aetna, CIGNA and Humana.
Acute Care	Branch of healthcare where necessary treatment is only a short period of time. A patient is treated for a brief but severe episode of illness. Many hospitals are referred to as acute care facilities. The goal is to treat and discharge the patient as soon as the patient is deemed healthy and stable, with appropriate discharge instructions.
Non-Acute Care	Care delivered in setting outside of the hospital / acute setting. Examples include home healthcare, nursing homes, assisted living facilities, hospice and some surgery centers.
Chronic Care	Refers to medical care which addresses preexisting or long term illness, as opposed to acute care which is concerned with short term or severe illness of brief duration. Chronic medical conditions include, but are not limited to, asthma, emphysema, chronic bronchitis, congestive heart disease, cirrhosis of the liver and hypertension.
Home Healthcare / Home Care	Healthcare services delivered by a healthcare professional in the patients home. Common services include general nursing services, home infusion therapy (delivery of drugs intravenously), and the delivery of durable medical equipment (DME) which includes respiratory equipment, beds, wheelchairs, walkers, etc.
Centers for Medicare and Medicaid Services (CMS)	The Centers for Medicare and Medicaid Services (CMS), previously known as the Health Care Financing Administration (HCFA), is a federal agency within the United States Department of Health and Human Services (DHHS) that administers the Medicare program and works in partnership with state governments to administer Medicaid, the State Children's Health Insurance Program (SCHIP), and health insurance portability standards.
Medicare (and associated Parts A – D)	Government sponsored health insurance program generally for U.S. citizens age 65 and older. Original Medicare program has two parts: Part A (Hospital Insurance), and Part B (Medical Insurance). As of January 2006, Medicare Part D provides comprehensive drug coverage. Medicare Advantage plans, also known as Medicare Part C, are another way for beneficiaries to receive their Part A, B and D benefits.
Medicaid	Government program for individuals and families with low incomes and resources. It is a means tested program that is jointly funded by each state and the federal government while being managed by the state.
Physician Self Referral (Stark Laws)	Physician self-referral is the practice of a physician referring a patient to a medical facility in which he/she has a financial interest (i.e. ownership, investment, or a structured compensation arrangement). Critics of the practice allege an inherent conflict of interest, given the physician's position to benefit from the referral. They suggest that such arrangements may encourage over-utilization of services, in turn driving up health care costs. US Congressman Pete Stark sponsored a bill known as the Stark Law to ban certain physician self referral arrangements.



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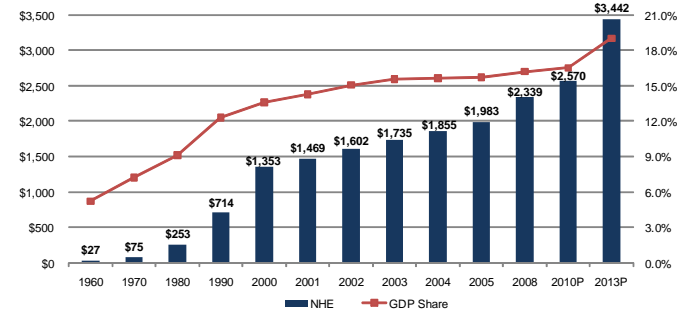
Healthcare Industry Overview

Large & Growing

- Healthcare is one of the largest and fastest growing segments of the global economy.
- Total healthcare expenditures in the U.S. were estimated to be \$2.3 trillion in 2008, representing approximately 16% of GDP.
- By 2013, national healthcare expenditures are forecast to be approximately \$3.4 trillion, representing approximately 18-19% of GDP.

(\$ in billions)

National Healthcare Expenditures (\$ and % of U.S. GDP)



Note: GDP adjusted for inflation as of 2005.

Source: Centers for Medicare & Medicaid Services (CMS).



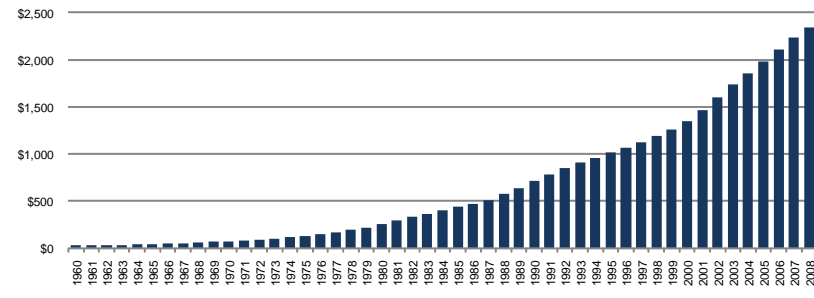
Healthcare Industry Overview

Non Cyclical

- Healthcare expenditures have grown at an average annual rate of 7.8% between 1985 and 2005, have not experienced a single year of growth less than 4.4% since 1960 and are expected to continue to grow at rates of 6% to 8% per annum for the next decade and beyond.
- The Centers for Medicare and Medicaid Services ("CMS") projects healthcare expenditures will continue to grow at rates 200 – 250 basis points per year faster than GDP.

(\$ in billions)

Non-Cyclical Growth in Healthcare Expenditures



Source: Centers for Medicare and Medicaid Services, Office of the Actuary (2005).



Healthcare Industry Overview

Highly Fragmented & Complex

Fragmentation (a)

- It is estimated that there are more than 390,000 healthcare companies operating in the U.S.
- Only 4,500 of these companies have more than 20 employees which highlights the fragmented nature of the industry

Complexity

- The U.S. healthcare industry is regulated by numerous federal and state governmental bodies, including the Food and Drug Administration, the Centers for Medicare and Medicaid Services and the Department of Health and Human Services.
- Reimbursement for products and services can also be complicated, driven by numerous insurance and payment structures (e.g. self pay, HMO, PPO, Medicare, Medicaid, etc).
- Perhaps most importantly, the delivery of care is often complex, involving various clinicians and organizations that must work together to deliver quality care to the patient.
- This complexity creates opportunities for investors and M&A agents that understand the unique needs and opportunities associated with healthcare companies.

(a) Fragmentation and company information as per Hoovers estimates.



Healthcare Industry Overview

Healthcare Reform – General Pros & Cons for Investors

- In March, The House approved the 2,409 page Senate Bill that was passed in December, with 153 pages of amendments
- Later that month, the amendments were approved by Senate and the Bill was signed into law by President Obama on March 23rd

Pros

- Anticipate 30 – 50 million un-insured to obtain coverage which will provide a volume boost to providers and reduce bad debt exposure
- Bill offers little structure around reining in rapidly rising healthcare costs
- Provides some clarity around the priorities and goals of reform (i.e. Healthcare IT and Home Care Services)

Cons

- Increase in personal and corporate taxes to help fund expansion of healthcare
- Ultimate timing and magnitude of changes remains somewhat uncertain
- Health insurance companies may be forced operate with higher cost structures – backlash of this on healthcare providers is “unknowable”

Take Away Points

- Companies that help “take cost out of the system” will prosper
- Service companies should expect volume to expand and margins to compress
- Massive changes to the system won't take place until 2013 / 2014



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Sourcing – Understanding the Buyers

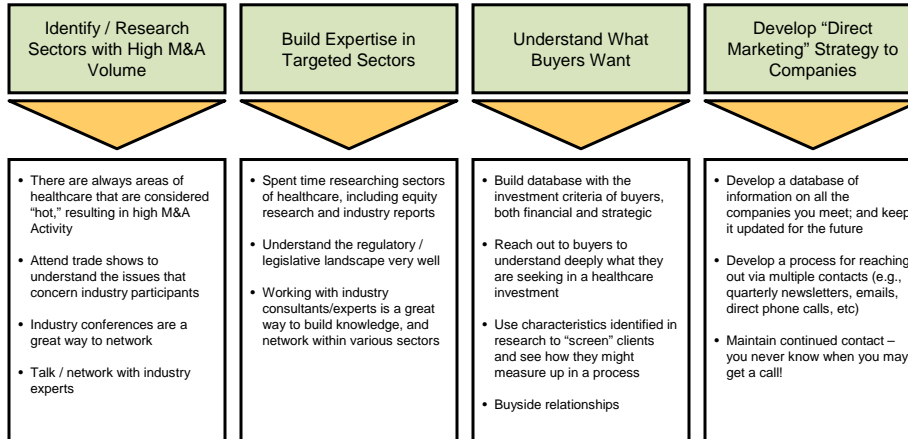
- There are two primary types of buyers: Financial and Strategic Buyers
 - Both have different transaction drivers, which the Advisor must understand to most effectively source quality opportunities for buyers

	Financial	Strategic
Investment Strategy	Seek returns through Ebitda growth (organic and acquisition), exit multiple expansion, and debt reduction	Stock accretion, driven by purchase price and synergies between the companies
Investment Criteria	May have size parameters (e.g. Ebitda), and likely not to invest outside of this range, unless target is an add-on	Size of target not as important as it may be for a financial buyer
Company Characteristics	Dependent upon buyer, but generally high growth and strong free cash flow potential	Highly strategic additions to current business (e.g., geographic expansion, new products/services, etc.)
Industry Focus	Financials buyers may be generalists or industry specific	Industry specific, though buyer may be willing expand into adjacent, related markets
Bidding Strategy	Some financial buyers “bid on everything” while closing few transactions, while other bid less but can be more aggressive	Generally higher selectivity in bidding on companies, due to need for strategic value

Sourcing – Develop a Process for Sourcing Opportunities



- A successful strategy for generating quality deal flow with a high probability for close is both targeted and multi faceted:

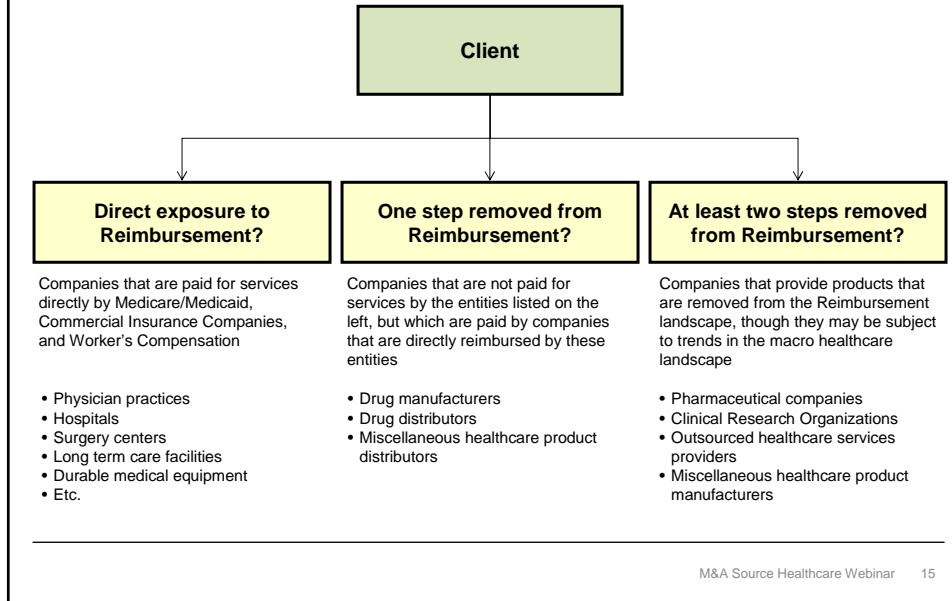


Due Diligence – Overview of Healthcare Diligence



- Healthcare is a highly complex sector of the economy, with many "moving parts" that buyers need to understand during a sale process – e.g., federal/commercial reimbursement trends, demographic trends, legislative reform
- Advisors must understand their clients' businesses, and prepare in advance for difficult questions that buyers may ask
- Many small, entrepreneurial businesses do not possess the IT systems and dashboard reports necessary to answer detailed questions that sophisticated buyers may ask – if they don't, Advisors should consult with them as to how they might track this information
- The best way Advisors can prepare their clients for a sale process is by producing a detailed package of information that addresses any major questions that buyers would ask; while spending time highlighting the company's value proposition and competitive positioning

Due Diligence – Where Does Your Client Fit?



Due Diligence – Key Themes, based upon Client Type



Direct exposure to Reimbursement?	One step removed from Reimbursement?	At least two steps removed from Reimbursement?
<ul style="list-style-type: none"> • Financial diligence (Strong focus) <ul style="list-style-type: none"> ✓ Cash vs Accrual ✓ "Reviewed" financials, but preferably audited ✓ Build up of projections, including management discussion • Business Profile (Strong focus) <ul style="list-style-type: none"> ✓ % of Revenue In/Out of Network ✓ Revenue concentration by state, payor, procedure, provider/physician, referral source, etc. ✓ Historical reimbursement trends • Regulatory / Legislative Environment (Strong focus) <ul style="list-style-type: none"> ✓ Impact of healthcare reform ✓ Legislative changes in the foreseeable future • Compliance (Strong focus) <ul style="list-style-type: none"> ✓ Accurate coding (e.g., procedure CPT codes) ✓ Results of recent government audits ✓ Internal/external coding audits ✓ Utilization by product/procedure 	<ul style="list-style-type: none"> • Financial diligence (Strong focus) <ul style="list-style-type: none"> ✓ Cash vs Accrual ✓ "Reviewed" financials, but preferably audited ✓ Build up of projections, including management discussion • Business Profile (Strong focus) <ul style="list-style-type: none"> ✓ Revenue concentration by state, customer, product, service, etc ✓ Potential reimbursement exposures of client base (i.e., the "trickle down" of clients being hit by reimbursement) • General Healthcare Landscape (Strong focus) <ul style="list-style-type: none"> ✓ Demographic trends ✓ Healthcare expenditures ✓ Drug/product utilization • Regulatory / Legislative Environment (Moderate focus) <ul style="list-style-type: none"> ✓ Impact of healthcare reform ✓ Legislative changes in the foreseeable future 	<ul style="list-style-type: none"> • Financial diligence (Strong focus) <ul style="list-style-type: none"> ✓ Cash vs Accrual ✓ "Reviewed" financials, but preferably audited ✓ Build up of projections, including management discussion • Business Profile (Strong focus) <ul style="list-style-type: none"> ✓ Revenue concentration by state, customer, product, service, etc ✓ Potential reimbursement exposures of client base (i.e., the "trickle down" of clients being hit by reimbursement) • General Healthcare Landscape (Strong focus) <ul style="list-style-type: none"> ✓ Demographic trends ✓ Healthcare expenditures ✓ Drug/product utilization

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Due Diligence – Case Studies

- There are many pitfalls that can occur during the sale of a healthcare company, but the better informed the buyers are of the issues the more likely the chance of a success close

Anesthesiology Practice	Specialty Pharmacy	Durable Medical Equipment Company	Ambulatory Surgery Center Business
<ul style="list-style-type: none">• Outsourced anesthesiology services• Advisor reported Ebitda of nearly \$20 million on a TTM basis• 80-90% of business was out of network, indicating highly unsustainable profit margins• Led to a broken process	<ul style="list-style-type: none">• Value added, mail order pharmacy for specialty pharmaceuticals• Advisor did not fully understand the various concentrations of the business• Nearly 80% of all gross profit came from one disease state• Contributing element to a broken process	<ul style="list-style-type: none">• Distributor of multiple DME products• Diverse base of products, and strong growth trajectory• Strong management team, vision for the future, and value proposition• "Competitive Bidding" program launched by federal government• Led to a broken process	<ul style="list-style-type: none">• Growing multi- specialty surgery center business, with diverse business profile• Excellent management team• Multiple buyers in the 8.0x plus range from the initial round• Potential over utilization of anesthesia led to extreme multiple compression from acquiring party



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Healthcare Segments & Valuation

Recommended Healthcare Focus Areas for M&A Brokers

	Segment	# of Companies	Size of Buyer Universe	General Comment(s)
Devices & Products	Medical Devices	302	Large	High tech / high R&D devices are controlled by large, well capitalized players. Smaller companies will be low / mid-tech devices. Look for proprietary technology in a niche but growing market.
	Medical Equipment & Supplies	7,897	Large	Highly fragmented segment of healthcare. Large opportunity for brokers to work with mom & pop companies. Mixed interest from private equity and strategic buyers.
	Medical products distribution	17,496	Large	Highly fragmented. Look for "value added" specialty distribution. Low margin "box moving" won't attract much interest from private equity or strategic buyers.
Services	Healthcare plans	2,962	Small	Most private equity firms won't be interested in buying a health insurance company / payer. Regional players likely to have a hard time competing with national players. Healthcare reform creates too much uncertainty in this segment of healthcare.
	Home healthcare	23,926	Large	Significant area of interest. Viewed as a "win-win" due to lowest cost site of care with highest patient preference. Focus on home nursing, home medical equipment (HME) and home infusion services.
	Hospitals	23,123	Medium	Figures likely include hospitals, surgery centers and other related sites of care. High reimbursement risk. Providers are expected to benefit from recent healthcare reform (more volume, less bad debt).
	Long-term care facilities	42,987	Medium	Growth driven by aging population of the U.S. Few large national providers but still a highly fragmented industry. Very reimbursement sensitive business.
	Medical laboratories & research	25,229	Large	Medical testing drives 60%+ of all healthcare decisions and is viewed as a way to identify conditions early, reducing healthcare costs. Significant amount of strategic and private equity interest.
	Prescription benefits management	14	Small	Several large players such as Medco and Express Scripts. Brokers should only focus on niche players with a different value proposition. Has become a "high volume / low margin" business over time.
	Specialized healthcare services	34,097	Medium	very broad category. Generally speaking, private equity firms will be interested in seeing any specialized / niche healthcare services firms.

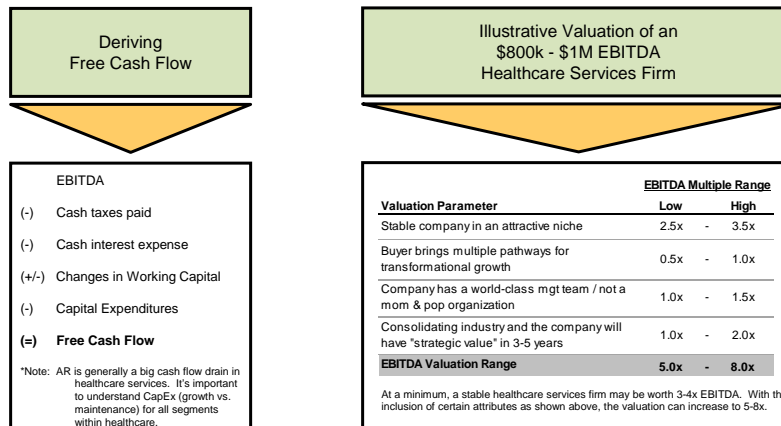
Note: Excludes physician practices, pharmaceutical companies and biotech companies. Segment groupings and # of companies estimate as per Hoovers.



Healthcare Segments & Valuation

Illustrative Healthcare Valuation Considerations

- Similar to other industries, healthcare buyers will focus on EBITDA as a proxy for free cash flow
- Cash flow is king; Ensure EBITDA translates to a consistent positive free cash flow stream



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