

# Up in the Air with Obamacare and Health Care Distress

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# AFFORDABLE CARE ACT

## DISCUSSION PANEL

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## Affordable Care Act

### Goals of the ACA

- The House and Senate versions that make up what is commonly referred to as the Affordable Care Act ("ACA") passed in 2010. The goals for the ACA were to:
  - Provide access to healthcare for all
  - Improve quality of care
  - Reform healthcare delivery system
  - Appropriately price service and modernize financing systems
  - Fight waste, fraud and abuse
  - Institutionalize continuous process improvements to the system

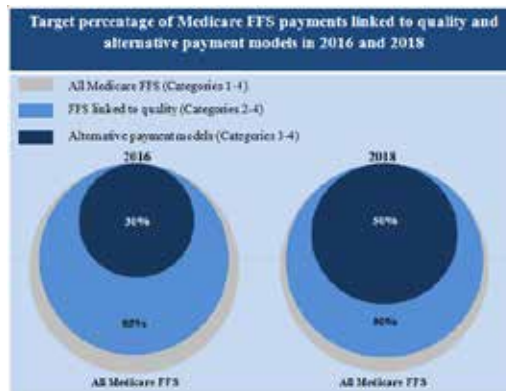


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## Affordable Care Act

### How ACA proposes to control costs

- Controlling healthcare costs is easier said than done, especially when the ACA increases the number of insureds. The way of doing business has to change over time
  - Incentivizing consolidation of hospital systems to control costs and quality
  - Using increased disclosure requirement and big data to squeeze costs out of providers
  - Increasing impact of Centers for Medicare and Medicaid Services (CMS) on all payors to control reimbursement and utilization
  - Leadership in fighting waste, fraud and abuse
  - Institutionalize continuous process improvements to the system – Independent Payment Advisory Board ("IPAB")



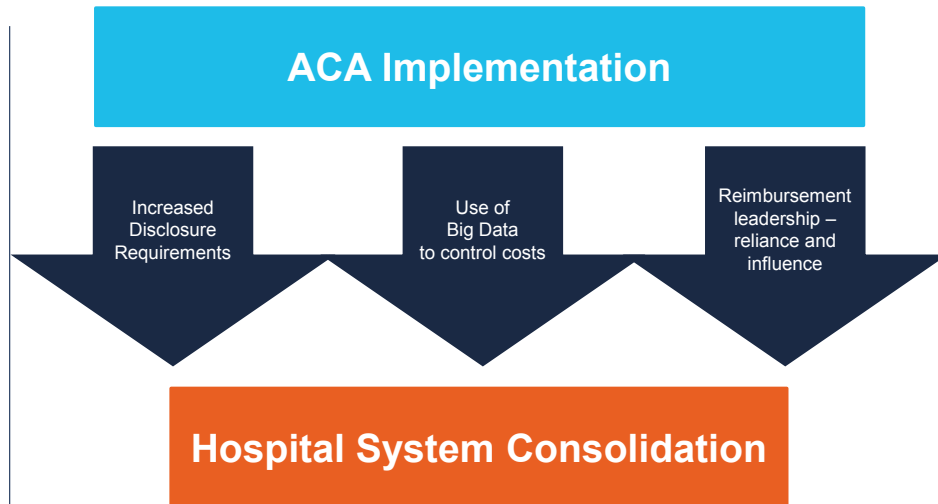
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## HEALTHCARE INDUSTRY TRENDS

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## Healthcare Industry Trends – Macro Trend

Macro trend in the healthcare industry – Bigger is better



- Large hospital systems both for profit and non-profit are beginning to consolidate to control costs and quality which will be essential for maximizing reimbursement for government and non-government payors

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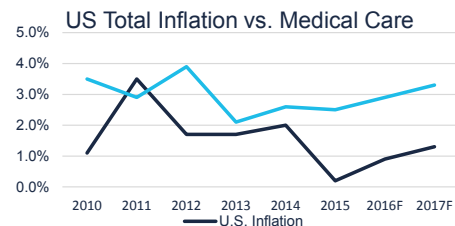
## Healthcare Industry Trends - Overview

Aspects of the challenge of healthcare industry

- The healthcare industry needs to change to provide products and services to all Americans
  - Factors attributed to constant change:
    - Chronic illness/diseases
    - Focus on care and quality
    - Social and financial regulations (Affordable Care Act “Obamacare”)
    - Innovation in technology and care initiatives
- Utilization of big data to better understand the appropriate levels of costs of healthcare providers leads to decreasing reimbursement and scrutiny over utilization of services
  - Lower reimbursement expectations and increasing costs drive innovation



Source: Deloitte 2016 Global Health Care Outlook



Source: BLS

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## Healthcare Industry Trends – Demographic Challenges

### Population trends

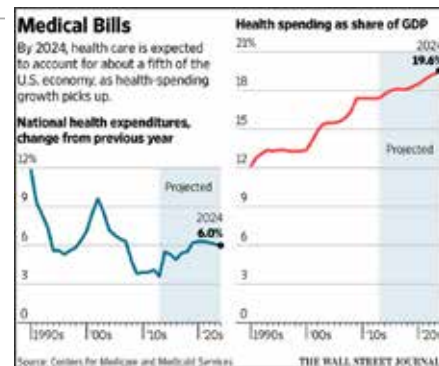
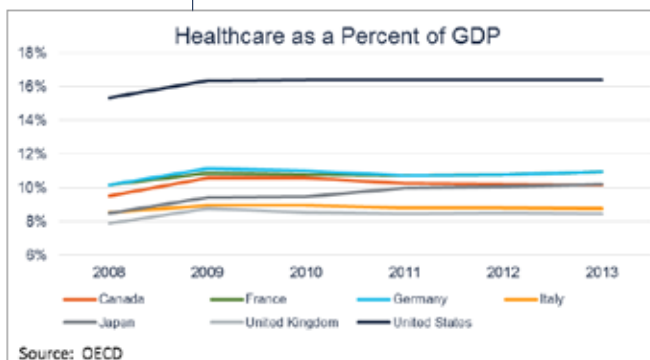
- The aging of our population creates risks and opportunities in the healthcare industry
  - Paying for an aging population's healthcare costs requires cooperation between government and healthcare providers
  - In 2050, the population aged 65 and over is projected to balloon to 83.7 million (21% of the total), almost double its estimated population of 43.1 million in 2012. *Source: US Census*
  - Aging population can present opportunity for certain healthcare companies
  - Others fear a more challenging reimbursement environment

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## Healthcare Industry Trends – Increasing Costs a National Challenge

### Healthcare industry costs are increasing

- Health quality is not keeping pace with demands of longevity, nor is the development of age-appropriate health policies and services. The proliferation of chronic diseases due to longevity creates serious repercussions
  - US Healthcare spending grew 5.3% in 2014, reaching \$3 trillion or \$9,500 per person. Healthcare spending accounted for 17.5% of US GDP in 2014
  - Providing increased quality at flat or decreasing reimbursement, challenges the entire healthcare industry – providers and payors

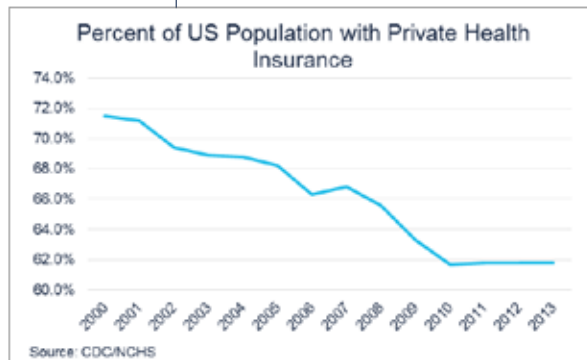


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## Healthcare Industry Trends – Providers

### Changing approach to providers

- Providers who treat patients covered by government payors (Medicare, Medicaid, etc.) are subject to increasing scrutiny due to government interest in controlling costs
  - There were approximately 56 million participants in Medicare and Medicare Advantage plans in 2014 and payments were approximately \$346 million. *Source: CMS Facts Sheet 2014*
- CMS requires providers to submit detailed disclosure schedules. Smaller providers such as home health companies, labs and DME find increasing disclosure obligations costly and anti-competitive
- In addition to the 312,000 institutional providers, there are approximately 1.17 million non-institutional practitioners and providers who rely on Medicare reimbursement



Medicare Institutional Providers Calendar Year 2014

Type of Provider	Count
Total Hospitals	6,142
Home Health Agencies	12,268
Skilled Nursing Facilities	15,179
Labs	250,247
Outpatient PT/Speech Pathology	2,102
Rural Health Clinics	4,062
Federally Qualified Health Centers	6,451
Ambulatory Surgical Centers	5,444
Comprehensive Outpatient Rehab Facilities	216
Community Mental Health Centers	251
Hospices	4,140
Physical Therapy	n/a
Total providers	312,644

SOURCE: CMS/Office of Enterprise Data & Analytics

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## Healthcare Industry Trends – Consolidation

### Provider consolidations

- Engagement with the changes in the healthcare industry requires new technological and treatment strategies to adapt to the changing governmental emphasis on controlling costs
  - Industry consolidation** - The health care sector is moving from its traditional, fragmented approach to clinical and financial operations to operations focused on consolidation, convergence, and connectivity
    - Health care industry saw \$723.7 billion of M&A deals in 2015
    - A substantial increase in M&A activity is forecast for 2016
- Hospital systems are reacting to ACA initiatives hastening the transition by changing incentives and payment models
  - Smaller providers are vulnerable under the new regulatory regime**



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## Healthcare Industry Trends – Providers

### Changing approach by providers

- **Changing treatment strategies** – To avoid increasing costs, CMS and providers must work together to address the cost curve with innovative approaches to managing the health of the US population. There must be financial incentives to shift from the “break-fix” model of care to prevention, predictive maintenance, and outcome optimization
- **Value based care** – Development and institutionalization of performance and quality indicators must convert care strategies from fee for service to outcome - or value-based care payment models, which align physician and hospital bonuses and penalties with cost, quality, and outcomes measures



Source: Infectious Diseases Society of America (IDSA)

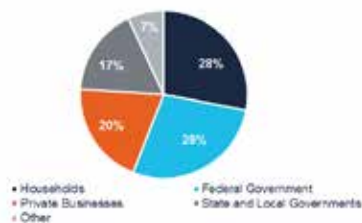
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## Healthcare Industry Trends – Payors

### Changing approach by payors

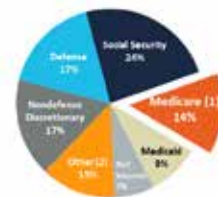
- U.S. healthcare payors have come under tremendous pressure to strike a difficult balance: control rapidly rising medical expenses to make healthcare more accessible, while also constraining operating expenses to maintain margins
- As costs for healthcare treatment increase, payors (government and private insurers) are scrambling to control costs by incentivizing streamlined treatment strategies and reducing fraud and abuse
  - Medicare costs increased 5.5% in 2014 due to increases in prescription drug costs, increasing use and intensity of services
  - Medicaid spending increased 11% in 2014 due to increased federal payments from the increasing number of eligible enrollees from the ACA
  - Private insurance and self-pay increased approximately 4% in 2014

Health Spending by Sponsor



Source: CMS

2014 Medicare as % of the Federal Budget



Total Federal Outlays, 2014 – \$3.5 Trillion  
Net Federal Medicare Outlays, 2014 – \$505 Billion

Note: All amounts are for federal fiscal year 2014.  
[1] Consists of Medicare spending minus income from premiums and other offsetting receipts.  
[2] Includes spending on other mandatory outlays minus income from offsetting receipts.  
SOURCE: Congressional Budget Office, Updated Budget Projections: 2015 to 2025 (March 2015)

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## Healthcare Industry Trends – Specific Risks

### Outpatient treatment providers targets of CMS

- Outpatient treatment providers who are in the cross hairs of the CMS include
  - Residential care – increasing disclosure requirements
  - Dialysis treatment – changes in facilities and reduced reimbursement
  - Imaging – reduce frequency of usage based on efficacy
- Others targeted by CMS include
  - Labs – increasing disclosure requirements and decreasing reimbursement
  - DME – competitive bidding process that seeks to lower reimbursement and manage utilization
- CMS increased the budget for fighting fraud and abuse
  - Federal Anti-Kickback Statute
  - Stark law – prohibiting certain affiliated referrals
  - The False Claims Act
  - Civil Monetary Penalty Law

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## AT RISK INDUSTRIES

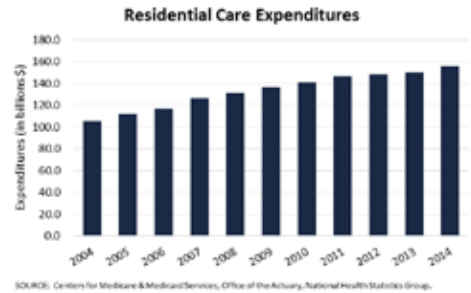
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## At Risk Industries: Residential Care

Residential treatment centers are aging and overleveraged

- Demographic changes, which includes seniors living longer and willing to move to different geographic locations, in order to find more affordable senior housing
  - CCRCs – Independent and Assisted Living
  - Assisted Living
- Challenging trends we are seeing today:
  - People are moving to facilities later in life
  - With more health issues
  - Resulting in shortened stays
  - Older facilities cannot compete with newer facilities that attract stronger patient mix**
- The aging population is a long-term strength of the sector. **In the short-term, however, the weakened economy and slowly-recovering real estate market will continue to present challenges for senior living facilities**
  - Senior living facilities in general and non-profit facilities most particularly can achieve improved financial performance by focusing on operations, debt profile, marketing, contract types, and service lines



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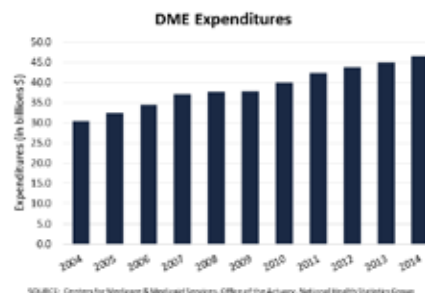
Company Name	Exchange: Ticker	Total Revenue (LTM)	EBITDA (LTM)	Total Assets (LTM)	Total Debt (LTM)	Total Debt / EBITDA	Cash from Operations (LTM)	Interest Expense (LTM)	Capital Expenditures (LTM)	Quick Ratio
Capital Senior Living Corp.	NYSE:CSU	404.1	71.4	897.7	672.6	10.5	43.7	(36.5)	(29.0)	0.6
Brookdale Senior Living Inc.	NYSE:BKD	4,239.8	809.3	10,521.4	6,266.0	8.0	288.0	(390.2)	(587.6)	0.3
Kindred Healthcare Inc.	NYSE:KND	6,538.6	504.0	5,653.0	2,880.8	6.3	174.2	(216.0)	(119.0)	1.3
SunLink Health Systems Inc.	AMEX:SSY	89.3	2.1	57.1	12.0	5.7	3.1	(0.8)	(1.4)	0.8
AdCare Health Systems, Inc.	AMEX:ADK	203.3	22.5	210.0	140.2	5.5	(13.4)	(9.6)	(1.4)	0.2
Five Star Quality Care Inc.	NYSE:FVE	1,117.8	19.5	535.0	86.2	4.1	26.7	(4.9)	(51.6)	0.4
Diversicare Healthcare Services Inc.	NasdaqCM:DVCR	383.4	22.6	129.1	49.1	2.5	4.7	(3.9)	(4.9)	0.9
The Ensign Group, Inc.	NasdaqGS:ENSG	1,245.5	104.8	493.9	68.4	0.7	31.5	(2.5)	(69.7)	1.5
National HealthCare Corporation	AMEX:NHC	899.1	106.2	1,074.1	46.6	0.4	81.1	(2.4)	(55.5)	1.5

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## At Risk Industries: Durable Medical Equipment

**Competitive bidding and increasing CMS scrutiny**

- Of the healthcare industry segments under cost cutting scrutiny by the Independent Payment Advisory Board ("IPAB") none are more stressed than the Durable Medical Equipment ("DME") market
  - Increased reporting of operations, demand for products, costs
  - Increased utilization of "Competitive Bidding" stratagems for reducing reimbursement and unnecessary provisions of DME products
  - Decrease in products available and imposition of rent vs. buy reimbursement of certain products



Company Name	Ticker	Total Revenue (LTM)	EBITDA (LTM)	Total Assets (LTM)	Total Debt (LTM)	Total Debt / EBITDA	Cash from Operations (LTM)	Interest Expense (LTM)	Capital Expenditures (LTM)	Quick Ratio
Nxstage Medical, Inc.	NasdaqGS:NXTM	326.2	0.3	309.7	15.1	46.90x	(1.5)	(1.0)	(13.9)	1.85
Hill-Rom Holdings, Inc.	NYSE:HRC	1,988.2	294.9	4,457.6	2,233.2	7.57x	213.8	(18.4)	(121.3)	1.19
Becton, Dickinson and Co.	NYSE:BDX	10,282.0	2,631.0	26,820.0	12,822.0	4.87x	1,730.0	(371.0)	(596.0)	0.72
Alphatec Holdings, Inc.	NasdaqGS:ATEC	191.9	22.8	344.9	82.7	3.50x	5.6	(13.8)	(12.3)	0.47
IDEXX Laboratories, Inc.	NasdaqGS:IDXX	1,554.2	337.7	1,384.2	900.1	3.38x	169.8	(26.7)	(85.5)	0.67
Stryker Corporation	NYSE:SYK	9,849.0	2,644.0	17,713.0	3,973.0	1.32x	907.0	(113.0)	(252.0)	1.37
BioScrip Inc.	BIOS	1,039.6	(30.2)	562.7	563.0	NM	(67.1)	(37.3)	(11.9)	1.00

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## At Risk Industries: Testing Labs/Imaging Facilities

**Declining reimbursement and utilization and increased CMS scrutiny**

- Continuing rate cuts by CMS and other payors
- Consolidating to improve pricing power with commercial insurers
- Increasing reporting demands to CMS for Medicare providers
- Distressed labs and bankruptcies are increasing in this segment of the healthcare industry

Company Name	Ticker	Total Revenue (LTM)	EBITDA (LTM)	Total Assets (LTM)	Total Debt (LTM)	Total Debt / EBITDA	Cash from Operations (LTM)	Interest Expense (LTM)	Capital Expenditures (LTM)	Quick Ratio
RadNet, Inc.	NasdaqGM:RDNT	779.5	102.3	740.7	597.6	6.32x	67.0	(41.2)	(46.6)	1.45
Alliance Healthcare Services, Inc.	NasdaqGM:AIQ	458.4	115.5	500.9	507.3	4.78x	96.3	(25.8)	(67.4)	1.22
Quest Diagnostics Inc.	NYSE:DGX	7,527.0	1,489.0	9,877.0	3,790.0	2.51x	842.0	(161.0)	(258.0)	0.94

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