MERRITT HEALTHCARE ADVISORS

WHITE PAPER

The road ahead

Navigating the post-COVID-19 landscape

Merritt Healthcare Advisors
INVESTMENT BANKING

"Spanish influenza moved across the United States in the same way as the pioneers had, for it followed their trails which had become railroads...the pandemic started along the axis from Massachusetts to Virginia...leaped the Appalachians...positioned along the inland waterways...it jumped clear across the plains and the Rockies to Los Angeles, San Francisco and Seattle. Then, with secure bases on both coasts...took its time to seep into every niche and corner of America."[1]

Not unlike the spread of the ongoing coronavirus pandemic, this was one researcher's account of how the Spanish flu, also known as the 1918 flu pandemic, swept across the United States in three waves during 1918-19. As with the current public health crisis, the human cost of the 1918 flu pandemic was devastating: Infecting one-third of the world's population, the virus ultimately killed 50 million globally, including more than 650,000 in the United States alone.[2]

While macroeconomic data sets from the time are unavailable, there's little doubt about how the 1918 flu pandemic negatively impacted the U.S. economy. A Federal Reserve Board of St. Louis analysis suggests that the virus ground local industry and commerce to a halt in communities across the United States, with merchants anecdotally reporting that business plummeted by as much as 70% during the pandemic and output in some coal mines dropped by half.[3]

"Many businesses, especially those in the service and entertainment industries, suffered double-digit losses in revenue," the central bank's research shows.[4]

In the end, the 1918 flu pandemic corresponded with a seven-month recession in the United States that ended in March 1919. Similarly, the 1957-58 flu pandemic also hurled the nation into crisis, leading to more than 100,000 deaths in the United States and corresponding with an eight-month economic contraction that ended in April 1958.

A more recent regional public health crisis shows just how much more suspectable we are today to the potential effects of a global pandemic: In 2002-03, SARS — caused by another coronavirus strain — infected thousands of individuals in Asia, primarily in China and Hong Kong, and cost the global economy an estimated $40 billion in lost output, according to a National Academies Press study. The study also shows that SARS decreased demand for services in China and Hong Kong by an estimated 15% during the mostly regional contagion.

It's likely to be some time before we know the full extent of the devastation caused by the current coronavirus pandemic. But without question, it will be historic. Even more, the post-COVID-19 recovery is expected to alter the landscape further for U.S. healthcare providers, who were already navigating shifting trends heading into 2020 and are now straining under the financial and clinical pressures of caring for the more than 2,400,000 — and counting — coronavirus patients to date.

[1] https://www.stlouisfed.org/~/media/files/pdfs/community-development/research-reports/pandemic_flu_report.pdf
[2] https://www.cdc.gov/flu/pandemic-resources/1918-pandemic-h1n1.html
[3] Ibid.
[4] Ibid.
[5] https://www.nber.org/cycles.html
[6] https://www.ncbi.nlm.nih.gov/books/NBK92473/

Great Recession lessons?

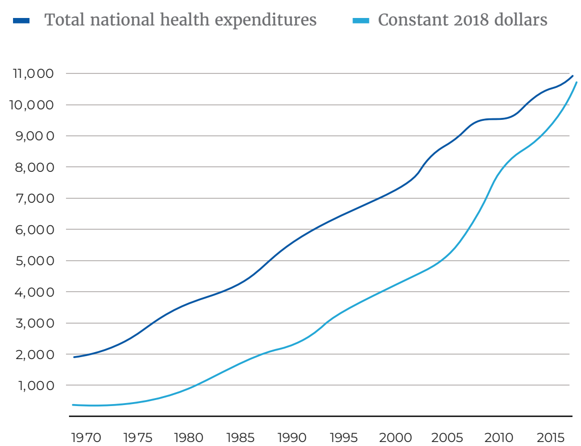
While in hindsight there were many warning signs, the financial crisis of 2007-08 seemed to happen all at once. In a 30-day period ending Oct. 1st, 2008, the federal government took over mortgage lending giants Fannie Mae and Freddie Mac; Lehman Brothers, then the fourth largest investment bank in the United States, and Washington Mutual went bankrupt; Bank of America bought struggling Merrill Lynch; the Federal Reserve took over American International Group; and President George W. Bush signed the $700 billion Troubled Asset Relief Program in a dramatic attempt to shore up the nation's financial sector.[7]

Officially, the economic recession spurred by the financial crisis lasted for 18 months, from December 2007 until June 2009. According to the U.S. Bureau of Labor Statistics, the unemployment rate peaked at 10% in October 2009, a few months after the contraction ended.[8] As a result, the rising unemployment rate edged the healthcare industry closer to a crisis that had been many decades in the making: Rounds of corporate layoffs grew the ranks of the nation's uninsured, which peaked at nearly 46.5 million people — nearly 18% of the population — in 2010.[9] After growing from $4,145 to $7,624 in the decade leading up to Great Recession, per capita healthcare spending held steady around $8,000 annually between 2007-09, according to a Kaiser Family Foundation study.[10]

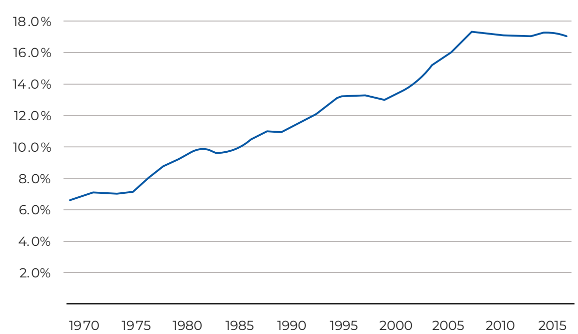
THE LONG VIEW

While flattening out during economic downturns, the U.S. healthcare system's overall price tag continues to grow

TOTAL NATIONAL HEALTH EXPENDITURES, US $ PER CAPITA, 1970 - 2018

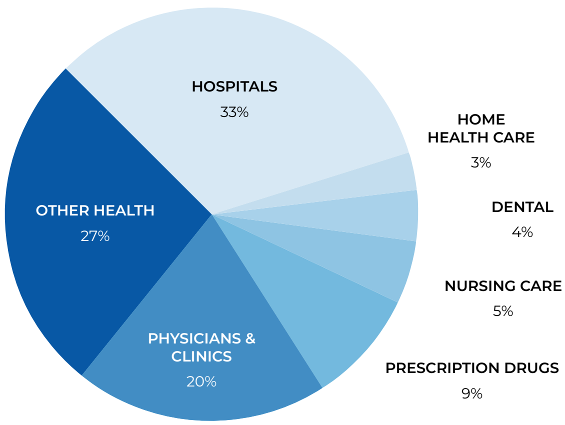


TOTAL NATIONAL HEALTH EXPENDITURES AS PERCENT OF GROSS DOMESTIC PRODUCT, 1970 - 2018



[7] Various.
[8] https://www.bls.gov/charts/employment-situation/civilian-unemployment-rate.htm
[9] https://www.kff.org/uninsured/issue-brief/key-facts-about-the-uninsured-population/
[10] https://www.healthsystemtracker.org/chart-collection/u-s-spending-health-care-changed-time/#item-nhe-trends_total-national-health-expenditures-us-billions-1970-2018

RELATIVE CONTRIBUTIONS TO NATIONAL HEALTH EXPENDITURES, 2019



Centers for Medicare and Medicaid Services statisticians published research at the time challenging the then-conventional wisdom that "healthcare spending is often thought to be somewhat insulated from the immediate impact of a downturn in the overall economy."[11] Centers for Medicare and Medicaid Services statisticians published research at the time challenging the then-conventional wisdom that "healthcare spending is often thought to be somewhat insulated from the immediate impact of a downturn in the overall economy."[12]

Trends to watch

With an industry-wide emphasis on expanding coverage and lowering costs, the coronavirus pandemic, and the economic contraction that's expected to follow, likely will accelerate cost-cutting trends that were already underway before the pandemic, including:

CONSOLIDATION — ACCELERATING PRESSURE ON INDEPENDENT PROVIDERS: Consolidation of healthcare providers by hospitals, strategics and private equity firms has increased dramatically over the past decade. For example, Optum, owned by United Healthcare, now employees 55,000 physicians nationwide. Physician hospital employment increased by 11% between 2012-18, from 155,000 to 169,000 physicians, according to the Physician Advocacy Institute.[13] Already large private physician groups continue to expand, and private equity platform companies have proliferated in recent years. Following the public health crisis, we expect consolidators to acquire more practices — and at a faster rate — as independent physicians struggle to recover from the financial impact of shelter-in-place orders. On average, physician practices are experiencing a 55% drop in revenue and a 60% dip in patient volume during the pandemic, a Medical Group Management Association survey shows.[14]

TELEHEALTH: A 2020 American Medical Association study found that physician telehealth adoption doubled between 2016-19, from 14% to 28%.[15] Expect this rate to jump considerably once the dust settles post-COVID-19: An official from the University of Rochester Medical Center told The Lancet in April 2020 that there's been a ten-fold increase in telehealth visits in recent weeks, calling it "as big a transformation as any ever before in the history of U.S. health care."[16]

[11] https://www.healthaffairs.org/doi/full/10.1377/hlthaff.2009.0839
[12] https://www.healthaffairs.org/doi/full/10.1377/hlthaff.2009.0839
[13] http://www.physiciansadvocacyinstitute.org/Portals/0/assets/docs/021919-Avalere-PAI-Physician-Employment-Trends-Study-2018-Update.pdf?ver=2019-02-19-162735-117
[14] https://mgma.com/getattachment/9b8be0c2-0744-41bf-864f-04007d6adbd2/2004-G09621D-COVID-Financial-Impact-One-Pager-8-5x11-MW-2.pdf.aspx?lang=en-US&ext=.pdf
[15] https://www.ama-assn.org/system/files/2020-02/ama-digital-health-study.pdf
[16] https://www.thelancet.com/journals/lancet/article/PIIS0140-6736(20)30818-7/fulltext
[17] https://www.advisory.com/daily-briefing/2019/03/05/asc-shift

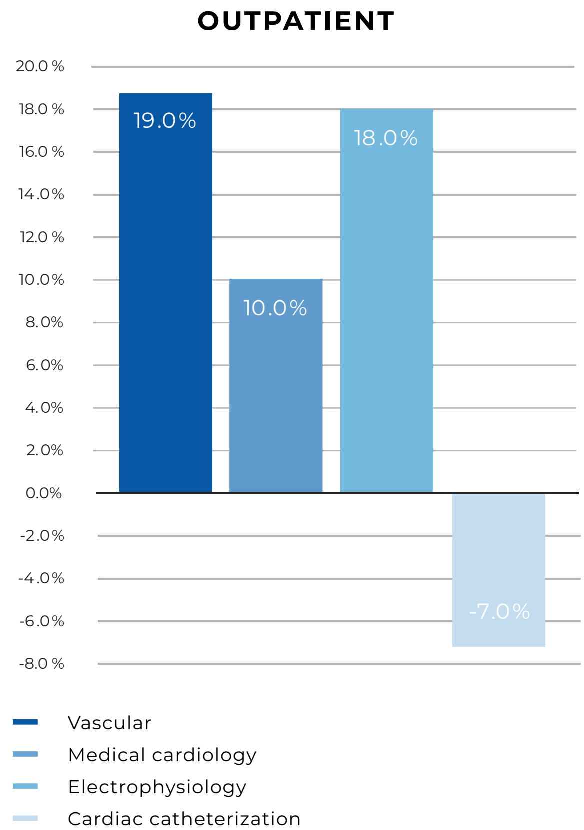
OUTPATIENT CARE: Procedures performed in ambulatory surgery centers (ASCs) have increased 50% since 2005, according to an Advisory Board study.[17] There are many reasons for that jump, but a primary reason is cost. Medicare pays about half for a procedure performed in an ASC rather than a hospital outpatient department, saving the federal program more than $2 billion annually.[18] With COVID-19-related healthcare costs expected to exceed $550 billion in the next two years, policymakers likely will look to proven lower-cost settings like ASCs to balance the books.[19]

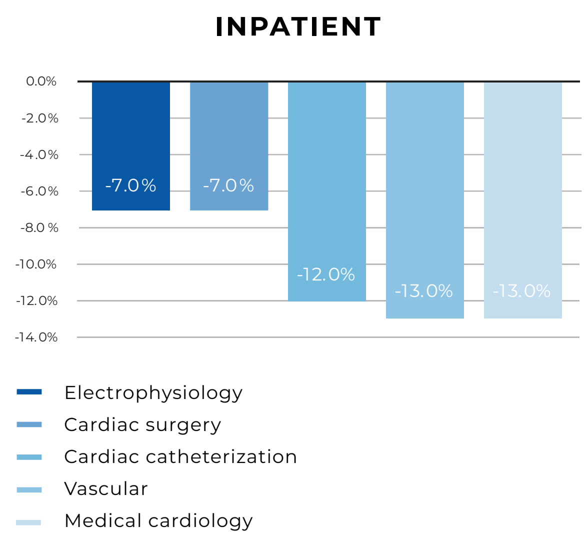
HEALTHCARE ACCESS: About 28 million individuals in the United States do not have health insurance, according to the U.S. Census Bureau. The Kaiser Family Foundation estimates that as much as 7% of the uninsured population, or 2 million individuals, will require hospitalization due to coronavirus symptoms during the pandemic. With the federal government's price tag to cover these costs of treating the uninsured at $42 billion, expect lawmakers from both parties to explore expanding healthcare access after the 2020 presidential election.

SPOTLIGHT ON CARDIOLOGY

Lower-cost outpatient procedures expected to drive growth opportunities

The Advisory Board expects total inpatient cardiovascular cases to dip 12% by 2023, as baby boomers age and payers and policymakers look to cut costs during lean times. Low-acuity cases are particularly ripe for disruption, five-year service line growth projections suggest:





[18] https://www.ascassociation.org/advancingsurgicalcare/reducinghealthcarecosts/paymentdisparitiesbetweenascsandhopds

[19] https://www.ahip.org/new-study-covid-19-health-care-costs-could-reach-556-billion-over-two-years/

Interested in learning more about the shifting healthcare landscape? Let's talk.

Merritt Healthcare Advisors is the industry's leading advisory firm focused exclusively on representing owners of healthcare businesses, surgical facilities and practices that are considering a strategic transaction, whether it is partnering with another group, selling an interest in their business or growing their business through acquisitions. We offer:

- **M&A EXPERTISE:** We leverage our investment banking background, and as registered securities brokers, we have both the experience and qualifications required to manage this extremely complex process.
- **PRACTICE AND OUTPATIENT MEDICAL FACILITY FOCUS:** As the only investment bank with experience owning, developing and managing medical facilities, we add value to your business in ways others cannot. This insight enables us to effectively present your business to the market.
- **UNMATCHED EXPERIENCE:** Our leadership team has more than a century of combined experience working in healthcare and has successfully completed over $2b in transactions on behalf of our clients.
- **PROVEN PROCESS:** Positive outcomes are the result of a deep understanding of your business, transactional expertise, knowledge of the Seller and Buyer communities and the ability to most effectively package, market and manage the sales process.
- **EXCEPTIONAL RESULTS:** By eliminating risk for the owners, effectively positioning your organization, creating the most effective marketing piece, validating our projections and the integrity of the offering, creating the most competitive environment for your business and then understanding how to push potential buyers to agree to the terms of the deal we want, we make a significant impact on the financial and non-financial outcomes of your sale.

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