

Have U.S. Hospitals Reached their M&A Apex?

An April 2019 hospital merger & acquisition (M&A) report has found that the number of hospital transactions in the 1st quarter of 2019 is the fewest in almost ten years.¹ Those 14 deals is the lowest number in a single quarter since the 4th quarter of 2009.² In addition to the low number of deals occurring, the median of the target company's revenue was over 40% smaller than in 2018; in fact, no 1st quarter target hospital had more than \$150 million in revenue.³

There could be a number of reasons for this slump. First, the transaction numbers throughout 2017 and 2018 were buoyed by the number of for-profit divestitures that occurred. During this time frame, Community Health Systems (CHS) announced 24 separate divestiture actions; CHS's spinoff system, Quorum Health Corporation (QHC) also announced several divestiture transactions; and, Tenet and LifePoint had 12 combined divestitures.⁴ The fact that these divestitures have largely trailed off may have painted a picture of a seemingly more-depressed 1st quarter; however, this reason alone does not appear to tell the full story, as this was the fourth straight quarter in which the number of hospital deals was fewer than the rolling quarterly average.⁵ Other possible explanations for this dip include, but are not limited to:

- (1) The healthcare delivery system's ongoing shift to outpatient care may be keeping buyers from investing in additional hospitals;
- (2) Fewer "*low-performing targets*" remain to be acquired, and there are also fewer potential buyers as a result of the flurry of consolidations over the past few years;
- (3) Both acquirers and targets have more alignment options available to them than simple M&A, e.g., joint ventures and management services agreements (MSAs); and,
- (4) The vertical integrations that occurred in 2018, e.g., CVS-Aetna, may give pause for providers who wish to examine the significance of these transactions, and impact of these deals on their own operations, before making any strategic decisions.⁶

As to whether this low transactional volume trend is a harbinger, the M&A report's author, Ponder & Co., does not believe this trend will continue, because:

- (1) There has been no correlating change in consolidation drivers (e.g., reimbursement challenges, value-based payment changes, capital requirements of healthcare technology), which drivers tend to incentivize larger-scale operations;
- (2) Ponder found in its discussions with healthcare providers that a similar number of marketplace participants are still exploring M&A opportunities through strategic discussions;
- (3) There are still likely to be divestiture actions in the near future by the aforementioned parties, which may serve to increase the number of transactions, at least temporarily;
- (4) While the pace of transactions has been slow, the value of the transactions has been increasing – target company revenue has increased by a compound annual growth rate (CAGR) of 13.8% annually since 2008, and peaked in 2018 at \$409 million;⁷ and,
- (5) A number of larger transactions have already been announced in the 2nd quarter of 2019, e.g.:
 - (a) NY-based Health Quest and Western Connecticut Health Network have announced their intent to form Nuvance Health, a \$2.4 billion not-for-profit health system;⁸ and,
 - (b) Elizabeth, NJ-based Trinitas Regional Medical Center is in discussions to be acquired by RWJBarnabas Health (one of NJ's largest systems).⁹ Accordingly, some potential acquirers may wait to see how these deals transpire before making any moves.

Of note, another recent M&A report, by Kaufman Hall, found no slowdown in hospital M&A transactions; in fact, the report found a strong 1st quarter 2019 transactional environment. However, this contrast can be explained by the types of transactions included in each report – Ponder & Co. utilized a "narrower definition of deals...[o]nly change-of-control transactions," in contrast to Kaufman Hall's inclusion of management agreements and other types of non-ownership structures.¹⁰

Ponder & Co. asserts that this 1st quarter dip indicates “a shift to more thoughtful, slow, and highly-disciplined processes,”¹¹ an approach that aligns with the current healthcare delivery environment, wherein patient care is shifting to the outpatient setting, the movement of healthcare reimbursement to a value-based system, and the uncertain future of the *Patient Protection and*

Affordable Care Act (ACA). In the midst of the current sea-change in the U.S. healthcare market, providers will likely continue consolidating as needed (and required) to amass the requisite economies of scope and scale to provide efficient, high-quality patient care in order to not just survive, but thrive.

- 1 “Announced Quarterly Hospital M&A Volume is the Lowest in Nearly 10 Years” By Eb LeMaster and Karl Henkel, Ponder & Co., April 15, 2019, https://emma-assets.s3.amazonaws.com/pxibb/149b94e58c5d88b1dc605ada0460b1bb/Lowest_Hospital_M_A_Quarter_in_10_Years_v1.4.pdf?utm_source=newsletter&utm_medium=email&utm_content=Dowload%20white%20paper&utm_campaign=Lowest%20M%206A (Accessed 4/19/19).
- 2 *Ibid.*
- 3 *Ibid.*
- 4 *Ibid.*
- 5 *Ibid.*
- 6 *Ibid.*
- 7 *Ibid.*; “2018 M&A in Review: A New Healthcare Landscape Takes Shape” KaufmanHall, 2019, https://www.kaufmanhall.com/sites/default/files/documents/2019-01/2018-merger-acquisition-year-in-review_kaufman-hall.pdf (Accessed 4/19/19), p. 4.

- 8 “New York, Connecticut health systems merge to form \$2.4B provider” By Rebecca Pifer, Healthcare Dive, April 4, 2019, <https://www.healthcaredive.com/news/new-york-connecticut-health-systems-merge-to-form-24b-provider/552039/> (Accessed 4/19/19).
- 9 “One of N.J.’s largest hospital chains looking to expand its turf with another big merger” By Susan K. Livio, NJ.com, March 21, 2019, <https://www.nj.com/news/2019/03/one-of-njs-largest-hospital-chains-looking-to-expand-its-turf-with-another-big-merger.html> (Accessed 4/19/19).
- 10 “Report: Hospital M&A was strong in first quarter” By Tara Bannow, Modern Healthcare, April 23, 2019, <https://www.modernhealthcare.com/providers/report-hospital-ma-was-strong-first-quarter> (Accessed 4/24/19).
- 11 LeMaster and Henkel, April 15, 2019.




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