BNA's Health Law Reporter™

Health-Care Transactions Update: Will 2018 Surpass 2017?






By Gary W. Herschman, Kevin J. Ryan, Victoria Poindexter, Robert Aprill, Michael J. Tierney, and Michael Mahoney

Gary W. Herschman is a member of Epstein Becker & Green in its Newark, N.J., office. He can be reached at gherschman@ebglaw.com. Kevin J. Ryan is a member of Epstein Becker & Green PC in its Chicago office. He can be reached at kryan@ebglaw.com. Victoria Poindexter is a principal with Hammond Hanlon Camp LLC, an independent investment banking and strategic advisory firm, in Chicago. She can be reached at vpoindexter@h2c.com. Michael Tierney is a vice president in the Chicago office of Hammond Hanlon Camp LLC. He can be reached at mtierney@h2c.com. Robert Aprill is an analyst with Provident Healthcare Partners LLC, a leading middle market investment bank, in Boston. He can be reached at raprill@providenthp.com. Michael Mahoney is an analyst with Provident Healthcare Partners in Los Angeles. He can be reached at mmahoney@providenthp.com.

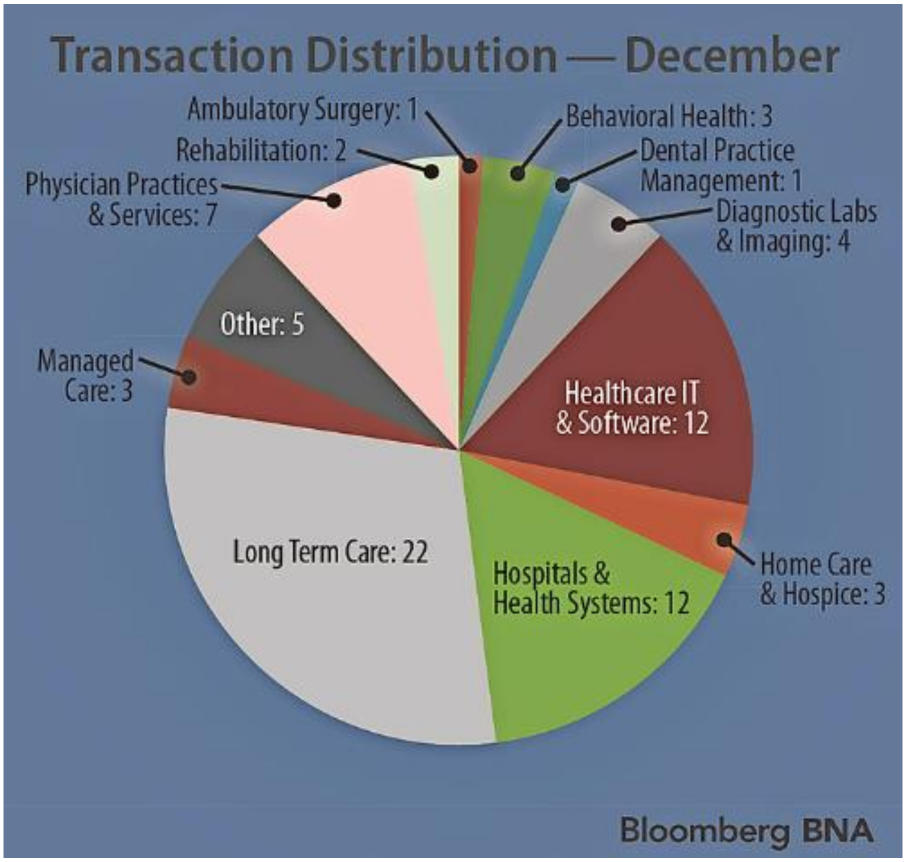
Health-care industry deal activity has been going strong ever since the Affordable Care Act took effect in 2010. There was some trepidation it might slow down when the Trump administration took over, but the 2017 transactions year-to-date list shows the failed push to repeal the health-care law seems to have calmed any concerns.

Rumors that Congress might take up the repeal issue again in 2018 haven't revived those concerns, as witnessed by the boom in big deals announced at the end of 2017 that will close in the coming year. If anything, the deals have gotten bigger—creating huge health-care entities that incorporate a variety of different services.

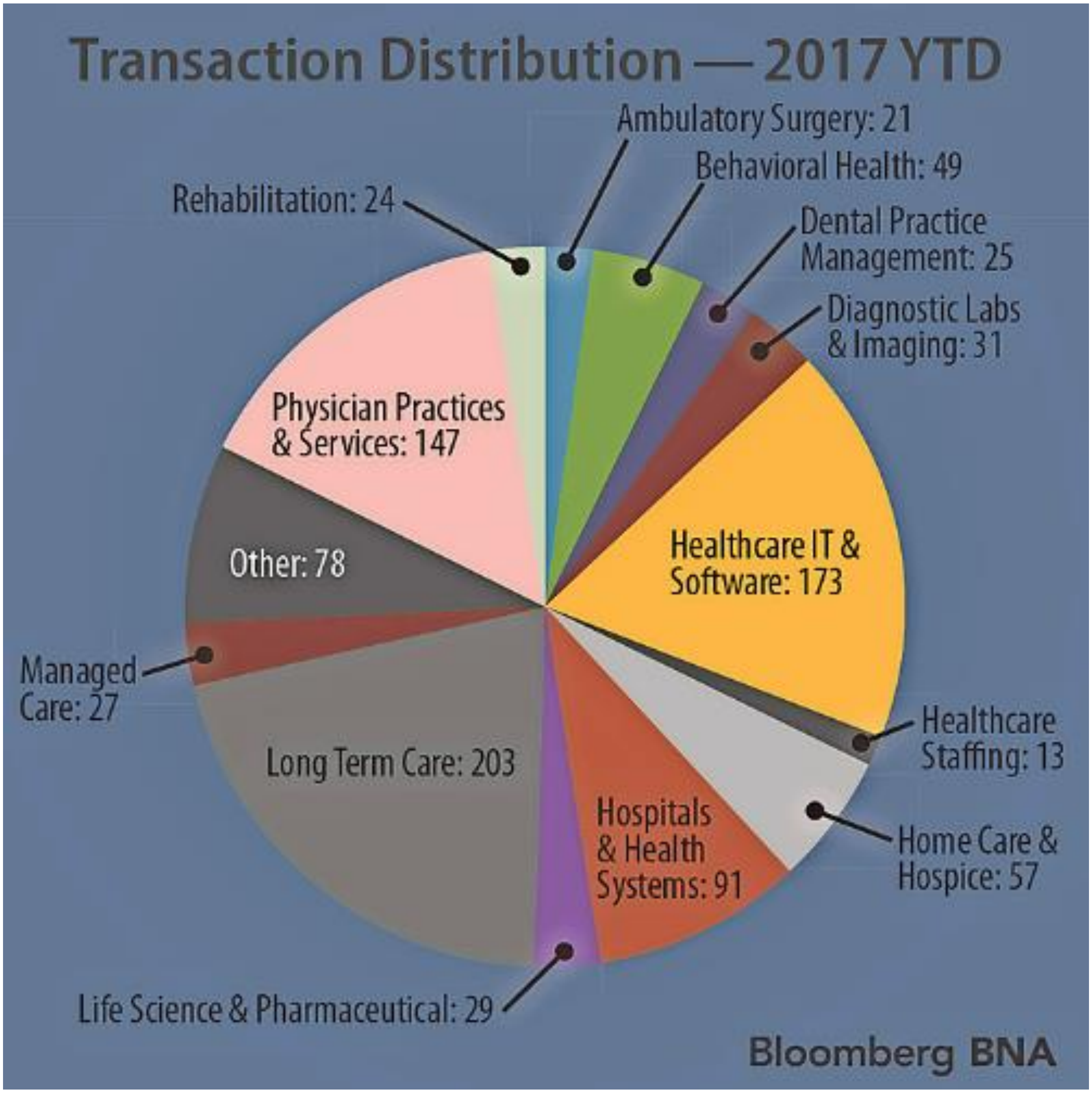
Bloomberg Law's transactions editorial advisory board takes a look at the activity that ended the year and projects there will be a vigorous deal climate in 2018.

Year-End Deals Grab Spotlight

The year 2017 ended with several mega-deals. These mega-deals, as shown by the December transaction list, included several hospital system transactions, including, Catholic Health Initiatives/Dignity Health, Advocate Health Care/Aurora Health Care and the reported Ascension Health/Providence St. Joseph Health. In addition, CVS announced that it was going to acquire Aetna in a deal valued at approximately $70 billion.

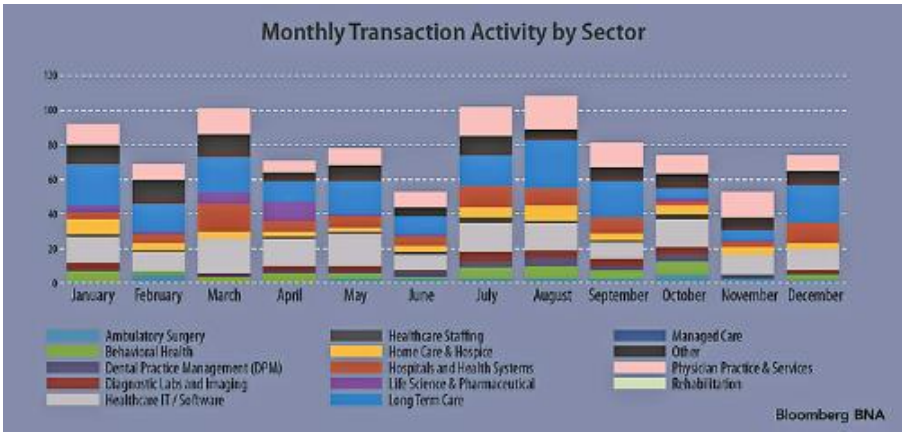


The announced partnership between Advocate Health Care and Aurora Health Care was especially intriguing. Advocate bounced back from its failed merger with North Shore with a new approach, reaching into Wisconsin to find a partner. Advocate had focused its operations in Illinois, but when the regulators prohibited additional market consolidation, it began to seek opportunities across state borders. What is really interesting about this transaction, which creates the 10th largest not-for-profit system in the country, is that both organizations felt greater scale was necessary. Aurora is the largest system in Wisconsin and maintains a strong presence in virtually all of its markets, and Advocate is Illinois' largest system. From the outside, it appeared that each were formidable enough on their own, but that was obviously not the systems' perception.



So how big is big enough? The CHI-Dignity merger will create the largest national not-for-profit health system with over $28 billion in revenues. Soon after this deal was signed, the Ascension Health deal with Providence St. Joseph Health was announced in the Wall Street Journal. If completed, this combination would create the nation's largest hospital chain with 191 hospitals and just under $45 billion in revenue according to sources. These mega-deals demonstrate that even the largest systems believe that they can benefit from the efficiencies relating to size and from increased negotiating strength with third party payers, and suggest that large, regional and national systems are likely to continue to pursue mergers.

The $69 billion acquisition of Aetna by CVS may well have received the most attention among all transactions announced in late 2017. Not only did it surprise the industry, but it wasn't immediately apparent what the strategy or benefits of the merger might be. The parties to the deal stated that the combination will allow the companies to provide consumers with a better experience with reducing cost and improving access to health-care experts in home and communities across the country. CVS Health, which operates more than 9,700 pharmacy locations and 1,100 Minute Clinics, as well as specialty pharmacy and nursing services will connect with Aetna's extensive network of providers.



The combination is anticipated to enhance Aetna's ability to steer patients away from costly inpatient settings and into CVS retail locations, to better control the cost of treating chronic diseases, and to protect against new entrants (Amazon) into the pharmacy space. This merger is an example of the trend in disruptive transactions that we expect to see more of in 2018.

Health-Care M&A Activity Outlook for 2018

The 2018 Outlook for Healthcare M&A activity is very favorable, and we expect the same or increased level of transactions as were reported in 2017. This is based on several factors. From a "macro" perspective, regardless of if or how "TrumpCare" will replace (or simply gut) "ObamaCare" – the aging population, the greater demand for health care and attendant pressure on government funding, will keep the pressure on providers, payers and all related health-care organizations to provide quality health care at the lowest cost. As such, health-care providers will continue to need access to significant capital to invest in state-of-the-art electronic health record systems, cutting-edge data analytics, and advanced care coordination capabilities (staff, protocols, etc.) – all of which are geared towards making them more successful in growing value-based payment and population health initiatives. Thus, the urge to consolidate into mega-health systems and investor supported platforms will continue in order to satisfy these enormous capital needs and to benefit from economies of scale. Leveraging these capital investments to help professionalize the back office and create more integrated enterprises, health-care providers will lean on size and scale to combat falling margins and help win in the ever increasing competitive landscape of recruiting new providers. The shift away from the hospital setting will continue to shape the future of healthcare as groups like Optum, Envision/Amsurg, and major payers like Anthem and Aetna push a new model of care forward. Five top sectors are expected to drive increase health-care industry consolidation in 2018.

More Hospital Consolidation, Including Mega-System Mergers

Over the past few years, hospitals' financial results have been helped in part by the surge in government funds from the Affordable Care Act. While that provided a temporary boost to cash flow, the benefit will be short-lived. Now that federal dollars are beginning to evaporate, providers that didn't already implement the necessary tactical and operational improvements are likely to struggle. Hospitals' cost per unit of service has been increasing for a long time, and the Affordable Care Act didn't slow that down. When the struggle accelerates, it is likely that many hospitals, which have not already joined a large system, will look for a partner in order to survive. Moreover, even large regional and state-wide health systems in different geographies are looking to further consolidate into "mega-systems," as the capital resources and scale opportunities of multi-state systems are even greater. The foregoing is demonstrated by the late 2017 announcements of both the Advocate-Aurora merger and CHI-Dignity merger.

As a side note, as hospitals and hospital systems become more hyper-focused on their "core services" – including outpatient services and other care access initiatives – they will continue to divest non-core and non-performing assets (e.g., behavioral, labs, home health, ambulance, long-term care, dialysis, imaging, real estate). This will drive significant transaction activity, as these service-lines and assets are sold to third parties, either entirely, or into joint ventures in which the hospitals continue as minority owners with certain control rights.

Continued Momentum in Physician Group Consolidation

An uncertain reimbursement environment fueled a healthy consolidation marketplace within physician services throughout the last year. With the previously mentioned changes coming to the broader health-care industry, these uncertainties will likely only amplify in 2018. Single-specialty medical practices are feeling pressure to move towards size and scale to combat these industry headwinds. Physician groups around the country are facing the decision as to either continue operations autonomously and face the uncertain future alone or seek out partnerships in the form of mega-groups, hospital systems, private equity companies, or national consolidators. This trend will also gain momentum in light of the parallel mega-consolidation trend throughout hospitals and hospital systems around the country. Thus, more and more physician groups will be exploring: (i) lucrative sales to Private Equity partners or PE-backed national consolidators, (ii) joining a "mega-physician group" through a cashless merger, or (iii) pursuing a transaction with a local hospital system in their region (typically the least appealing of all the options).

The coming year will be the "Year of the Platform" in many new physician service sub-sectors such as Orthopedics, Gastroenterology, Urology, and Women's Health & OB/GYN (all of which saw their first private equity transaction in the last 18 months). These sectors have only experienced the tip of the iceberg in terms of Private Equity dollars and we expect to see several platform investments made into each sector in 2018. In addition, hospital-based physician specialties such as radiology began to see an uptick in transaction activity in 2017, and this is an area we expect to garner significant private equity interest in the new year. While to date there have been only three private equity platform investments into on-site professional radiology services, we expect that figure to increase in 2018, following a trend that has been prevalent in similar hospital-based physician specialties anesthesia and emergency medicine for a number of years. More heavily consolidated alternative site specialties such as dermatology, ophthalmology and pain management will continue to see a heightened level of add-on acquisition activity. With 22, 14 and 7 PE-backed consolidators in those spaces respectively, small providers facing downward reimbursement pressures have never had more opportunities to join a platform. With more dollars flowing to physician services and fewer investable opportunities available, it is expected that the near all-time high valuation levels experienced for much of 2017 will continue into the New Year.

Complimentary IT Solutions and Services

It is also likely that investments will continue at fast pace in companies that provide services and IT solutions to enable health-care providers to treat patients in a more efficient and quality manner. As a result, provider organizations will continue to buy (and contract for) IT technology, apps and related systems, as well as care management platforms, all of which drive efficiency and quality. In turn, the health-care investor community will continue to invest in and acquire companies that are developing and offering these technologies and services, including telemedicine solutions.

Long-Term Care Services

In light of the growing elderly population (as baby boomers continue to age), combined with the need to care for them in a more efficient manner, the long-term care sector will continue to face many challenges, which makes it ripe for transaction activity. Home health companies, adult day care providers, and others on the low-cost end of the long-term care spectrum, will become more and more popular in light of mounting pricing pressure. Residential facilities will need to better adopt to the industry's changing approach to quality, cost-effective care – which likely could result in ongoing consolidation among major players in this space, and possibly bankruptcies which also generate opportunities and transaction activity.

Disruptive Transactions

It is also likely that disruptive transactions in the industry – such as the announced CVS-Aetna merger, and continued acquisitions by Optum/United – will generate yet additional strategic transactions and joint ventures, as players in all sectors of the industry will be assessing how best to competitively position themselves in a marketplace that is undergoing substantial transformation, and for which the landscape will be contorted and look quite different in the near future. On first blush, it appears that the thrust of these changes will result in a competitive battle over patient access and outpatient care, which will experience further sea-change as telemedicine becomes more accepted and widespread.

For More Information

The lists of select transactions involving health-care providers, managed care and services companies for December 2017 and for 2017 year-to-date were compiled by health-care investment bankers using publicly available information, including articles, websites, and press releases.

The December list is at http://src.bna.com/vUE.

The year-to-date list is at http://src.bna.com/vUH.

Bloomberg BNA would like to thank its Health Care Transactions Editorial Committee for their guidance: Gary W. Herschman, of Epstein, Becker & Green PC, Newark (gherschman@ebglaw.com); Kevin J. Ryan, of Epstein, Becker & Green PC, Chicago (kyan@ebglaw.com); Victoria Poindexter, of Hammond Hanlon Camp LLC, Chicago (vpoindexter@h2c.com); Mike Tierney, of Hammond Hanlon Camp LLC, Chicago (mtierney@h2c.com); Robert Aprill, of Provident Healthcare Partners LLC, Boston (raprill@providenthp.com); and Michael Mahoney, of Provident Healthcare Partners, Los Angeles (mmahoney@providenthp.com).

Epstein, Becker & Green PC did not comment on any particular transaction or party discussed or listed in this article.