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DEAL SUPPORT INSIGHTS

PART III: NEW TRENDS RESHAPING HEALTHCARE M&A - REPUTATION AND TRUST

"Given that the healthcare industry represents nearly one-fifth of the U.S. economy, it's hardly surprising that there is so much interest in healthcare M&A."

This is the final article in our three-part series exploring trends in M&A activity around healthcare companies. Healthcare M&A Trends Part I: Hospitals, Health Centers, and Other Properties focuses on healthcare companies where real estate is a major portion of the company's assets. Healthcare M&A Trends Part II: Intellectual Property examines IP influences in the broader healthcare M&A market.

Given that the healthcare industry represents nearly one-fifth of the U.S. economy, it's hardly surprising that there is so much interest in healthcare M&A. The market continues to surge upwards, driven in part by healthcare reform, a strong economy with low interest rates, and numerous high-profile acquisitions.

More fundamental changes are all but assured in the years ahead. Moving forward, exciting new technologies promise to transform the way healthcare is delivered, and major demographic changes will create a much larger pool of patients. Buyers in the healthcare space are reacting accordingly.

This article will review some of the more relevant M&A trends driving deals in five healthcare sectors, along with the critical importance of business license and reputational due diligence in these particular markets.

BEHAVIORAL HEALTH MARKET

The behavioral health market has long lagged behind the broader healthcare industry in terms of M&A activity. This is due, in part, to it being one of the smallest healthcare sectors. Yet signs are pointing up for behavioral health, as improved reimbursement policies and shifting attitudes have sparked the interest of buyers.

In the past, health issues such as eating disorders and addiction were viewed not as medical concerns but rather as lifestyle concerns. Today, most medical professionals and insurers have dramatically changed both their attitude and approach to behavioral health illnesses, viewing them largely through the prism of medical conditions and expanding coverage accordingly.

One hurdle buyers must clear when operating in this space is the fragmented nature of the market. Additionally, lenders and buyers are not always well informed about the behavioral health sector relative to other healthcare spaces. This has the effect of limiting the number of active buyers.

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Psychiatric hospitals, substance abuse centers and other behavioral health facilities sometimes draw controversy in the markets where they operate. Substance abuse clinics, and the physicians attached to them, must meet strict Drug Enforcement Agency mandates with regard to licensing, patient loads, etc.

HOME HEALTH AND HOSPICE CARE

The home health and hospice care sector has traditionally been known for small transactions and undisclosed prices. Many of the sellers are smaller, independent operations with little reach outside the county level. Given the looming demographic shift the U.S. population is poised to undergo, activity in this sector is projected to spike considerably.

Deal activity has already been trending up for the last three years, with each year seeing at least one $1 billion transaction. That's a significant shift from the period of 2000 to 2011, which saw not a single deal of that size completed.

Reimbursement is something of a thorny issue in home health care, while hospice care, a sector almost entirely funded via Medicare, has seen exponential growth over the last decade. While demographic changes might be the primary impetus of sector growth, new technologies have also piqued the interest of buyers and investors. Remote monitoring and other home health technologies are still in their infancy, yet they have the potential to transform the way home health services are delivered.

As mentioned, this is a sector deeply tied to federal funding. As such, ensuring the proper licensing and reputational due diligence procedures are followed is a critical part of any deal. Hospice, in particular, is a highly sensitive business, so it's important to know whether a care provider's reputation is in good standing.

MANAGED CARE

Although slowed by the effects of the 2008 recession, the managed care sector has recovered somewhat in the last few years, thanks in part to the Supreme Court's affirmation of the Affordable Care Act. The market in 2012 was particularly strong, with 28 publicly announced transactions worth nearly $19 billion. These deals were headlined by the $7.3 billion acquisition of Coventry Healthcare by Aetna.

Due in part to the troubled launch of state and federal health care exchanges, deal numbers and total dollars were down sharply in 2013. Once those kinks were ironed out, the new exchanges created roughly eight million new customers for insurance companies in 2014 alone. Mid-sized managed care companies with sizeable Medicare and Medicaid programs subsequently became attractive targets for acquisition.

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The managed care sector has historically been dominated by a group of major players at the top: companies such as Cigna, Aetna, UnitedHealth and Anthem. There are a large number of small regional managed care companies in the space as well, which often serve specific populations. These smaller companies fit the typical profile of a managed care acquisition target. Hospitals, physician groups and pharmacy benefit managers are also likely targets for large managed care companies in the years ahead, as they seek to reduce costs by putting providers and payers under one umbrella.

Such integrated payer/provider scenarios could lead to additional regulatory scrutiny. Business license and reputational due diligence will play a key role in ensuring the smooth completion of any similarly structured deals due to the impact activities like hospital acquisitions have on the local communities they serve.

MEDICAL GROUP PRACTICE

The M&A market for this sector hit a frenzied peak in the late 1990s, with more than 800 transactions between 1996 and 1998.

However, the bottom soon fell out. The market cap for publicly traded physician practice management companies was $11 billion in 1997. Three years later, it had dropped to less than $1 billion.

This boom and bust cycle was largely fueled by IPO activity and Wall Street's insatiable need for growth. Today, the medical group practice market is dominated by a much smaller number of specialty physician practices. Because prices are rarely announced, numbers in this sector are often hard to come by.

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It's likely that future growth will be driven by managed care companies and hospitals, both of which have a vested interest in dictating where patients receive care and the quality of that care. Reputational and business licensing questions should be addressed in any medical group practice deal, especially with regard to smaller practices whose success is largely determined by their interactions with the local community.

REHABILITATION

The rehabilitation sector is the minnow in the M&A healthcare pond. It typically features the fewest number of transactions and the lowest dollars spent in any given year. Yet that may be about to change, as the aging of the massive Baby Boom generation is poised to elevate demand for rehabilitation services. Hip and knee replacements were virtually unheard of five decades ago. Today such procedures are done in ever increasing number, which will facilitate growth in the sector.

The traditional rehabilitation market is comprised of inpatient rehab hospitals, physical therapy practices, occupational care providers, outpatient clinics, orthopedic companies etc. The rehabilitation sector's most recent high point in terms of M&A activity came in 2008, with 28 publicly announced transactions. By 2009, however, those numbers had been sliced in half. Since then, the market has slowly gained momentum, with 2014 representing the strongest year ever in terms of total combined deals and dollars.

This increased activity is likely to be sustained in the coming years, as investors with low capital costs seek deals to control growing health care expenses. Additionally, more service providers will seek to provide a full continuum of care, making rehabilitation targets an essential piece of the comprehensive services puzzle.

THE IMPORTANCE OF BUSINESS LICENSE AND REPUTATIONAL DUE DILIGENCE

Reputational due diligence is an absolute must when pursuing a deal in the healthcare M&A market. Buyers can uncover potentially damaging information that is publicly available in the media, but not tracked by a government agency, as part of their due diligence process. This includes the use of negative news searches, which comb through press outlets and alert buyers to any red flags or negative information that could affect a company's reputation and be financially impactful.

Additionally, business license due diligence must be rigorously pursued. This is essential for identifying jurisdictional requirements and identifying the required forms and data filings for business licenses. By doing so, buyers can ensure continual, uninterrupted operations of business assets after a sale and minimize the risk of fines or other financial infractions in these highly regulated industries.

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