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INTELLIGENCE REPORT

71%
of healthcare executives say they anticipate that their healthcare organization's M&A activity will increase within the next three years.

JULY/AUGUST 2021

NO DROP-OFF FOR HEALTHCARE M&A POST-PANDEMIC

An Independent HealthLeaders Report Powered by:
healthleaders Council

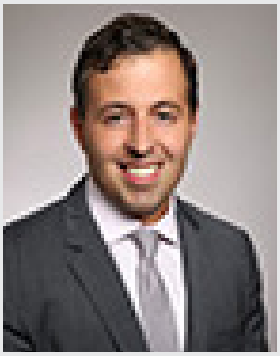
HEALTHLEADERSMEDIA.COM/INTELLIGENCE

DESPITE UNPRECEDENTED HEALTHCARE DELIVERY DISRUPTION, THE APPETITE FOR PROVIDER STRATEGIC GROWTH ENDURES

An exemplary provider response to COVID

The overall provider response to COVID disruption can quite simply be characterized as outstanding. While two of the three rating agencies most active in healthcare currently maintain "negative" outlooks on the not-for-profit healthcare sector, Fitch Ratings insightfully returned the sector to a "stable" outlook in December based on provider response.

In general, difficult staffing and supply decisions were made quickly and nimbly in direct response to declining utilization trends driven by government-mandated shutdowns, investment portfolios were expertly preserved, and capital structure risk was sufficiently and properly mitigated. Further, providers very quickly and efficiently moved to different healthcare delivery platforms including telehealth services and home health while ICU bed capacity and PP&E procurement in COVID hot spots were appropriately expanded.



Mike Quinn
Head of Healthcare
Strategic Advisory Services,
Managing Director
Bank of America

Despite continued questions from changing accounting guidance, supplemental government funding through the CARES Act and CMS advance payments proved largely sufficient and timely while the banking sector did a commendable job of providing much needed liquidity to its healthcare clients during the early stages of the pandemic. Management teams also deferred or scaled down large capital expenditures, deferred payroll taxes, and suspended retirement contributions to preserve cash and bolster balance sheets. Liquidity and Days Cash on Hand benefited from these external support measures.

While utilization trends likely altered permanently by pandemic, the fundamental rationale for strategic growth remains

While COVID response took precedent over consummating many strategic growth transactions, it's not surprising that interest in M&A transactions remains robust with more than two-thirds of respondents from the *2021 HealthLeaders Mergers, Acquisitions, & Partnerships Survey* expecting an increase in M&A activity within their respective organizations. It's also not surprising given the decline in inpatient admissions and ED visits that providers are most interested in physician practices and ambulatory surgery centers as we slowly exit the pandemic driven largely by two familiar financial objectives:

1. Increased market share and negotiating position with payors
2. Improved operational cost efficiencies

With respect to number one, whether fee-for-service or value-based reimbursement, a payor almost always asks one fundamental question: Is a contract with the provider in the market in question a must have? Not surprisingly, providers continue to seek strategic growth transactions that enhance their ability to become a "must have" provider through market share accumulation, which translates into a more favorable negotiating position with payors.

With utilization trends likely to remain altered for the foreseeable future, we will continue to see greater emphasis on the need to build ambulatory care capabilities and physician alignment as a strategy to enhance market essentiality and bolster commercial insurance reimbursement, especially given the fact that the state and federal anti-trust regulatory environment for hospital-to-hospital mergers remains an important consideration.

With the continued shift to governmental reimbursement in most markets and good, recent integration success in the area of realizing operational cost efficiency visible as validated by the survey, many providers will also continue to seek strategic growth as a strategy to improve operational cost efficiency, which will be needed to generate margins required for continued capital investment and balance sheet liquidity growth that became more valued during the pandemic.

Cost and access to capital: not a primary driver of near-term M&A activity

While financial markets seized in the beginning of the pandemic with more limited access to capital and widening healthcare credit spreads (the risk premium that healthcare investors demand for assuming healthcare risk), it's comforting to note that healthcare credit spreads have contracted sharply since last summer. The tax-exempt bond market has been the beneficiary of increased inflows, with year-to-date inflows in excess of $49 billion. With tighter credit spreads coupled with exceptionally low base rates such as tax exempt Aaa MMD or US Treasuries, deceased issuance and strong demand, good and historically attractive cost of capital is available to providers across the credit spectrum.

HEALTHCARE M&A ROCKETS OUT OF PANDEMIC

As the nation's healthcare sector emerges from the coronavirus pandemic, questions have been raised about how the care delivery landscape has shifted during the public health emergency and what effect that will have on providers' finances, operations, strategies, and growth.

John Commins
Senior Editor
HealthLeaders

Will telehealth—which flourished during the pandemic—continue to thrive as the nation returns to normalcy? If so, how will virtual care affect brick-and-mortar care venues? Did the pandemic expose the inherent weaknesses of the use of just-in-time supply chains in healthcare and render that strategy obsolete? Will the hospital-at-home movement, which also gained traction during the pandemic, diminish inpatient volumes?

One question, however, has been emphatically answered: The pandemic has fueled and accelerated the continued consolidation of the healthcare sector.

'Unprecedented' deal volumes

Moody's Investors Service predicted this spring that hospital partnerships, affiliations, and mergers and acquisitions "will continue at a robust pace in the healthcare sector in 2021," extending a decade-long consolidation trend in both the nonprofit and for-profit sectors.

"Larger health systems will pursue M&A to increase market share through geographic and service line diversification," Moody's said. "As COVID-19 takes a toll on financial performance, smaller providers will look to partner to gain access to clinical, strategic, and financial resources and reduce labor, supply, and information technology expenses."

In June, PwC reported that deal volumes in the health services sector this year are "unprecedented." After a slump in early 2020 with the onset of the pandemic, health services deals rebounded with 352 transactions in Q4 2020, a record for one quarter, only to be topped by 426 deals in Q1 2021. Additionally, PwC noted, healthcare has seen six "megadeals" valued at more than $5 billion.

And it's not just hospitals acquiring hospitals. A report commissioned by the Physicians Advocacy Institute found that health systems acquired 3,200 independent physician practices between 2019 and 2021, and that health insurers and other corporate entities acquired 17,700 independent physician practices during the same span.

ANALYSIS AND SURVEY RESULTS

Those reports jibe with the new 2021 *HealthLeaders Mergers, Acquisitions, & Partnerships Survey*, which finds that while almost half (49%) of survey respondents report that the pandemic delayed or stalled their M&A plans (Figure 1), more than two-thirds (71%) say they anticipate that their healthcare organization's M&A activity will increase within the next three years (Figure 12).

"The 71% who say it's going to increase, that's an overly optimistic view but kind of what we'd expect to see right after the pandemic," says Methodist Le Bonheur Healthcare President and CEO Michael Ugwueke.

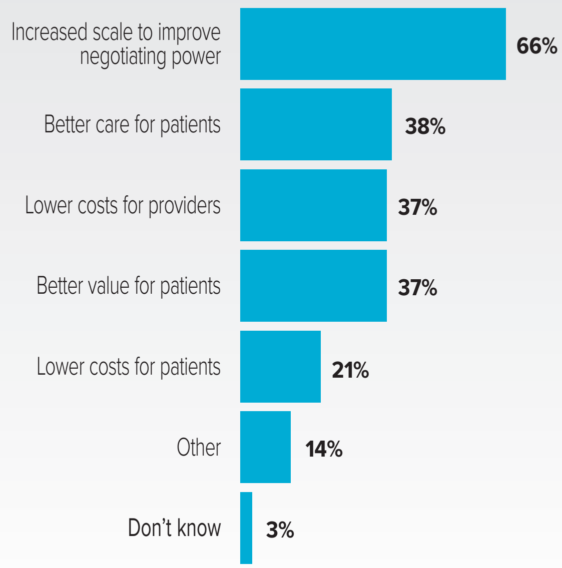
"When things calm down, there will be some additional activities in M&A. And there may be some organizations that are not in good shape because of the impact of COVID, and they may be financially weakened, which makes them vulnerable for M&A," he says.

At this point, it appears the only thing that will slow down hospital consolidation is a government intervention, and that appears to be happening.

President Joseph. R. Biden's July 9 executive order made it clear that the federal government would take a more aggressive stance on health system M&As.

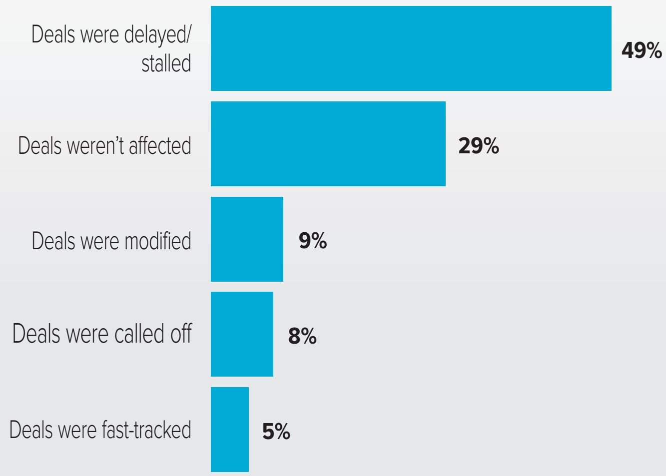
"Hospital consolidation has left many areas, especially rural communities, without good options for convenient and affordable healthcare service," the order said. "Thanks

Figure 2 | **Based on your experience and research, what result(s) do you think M&A activity among healthcare providers usually delivers?**



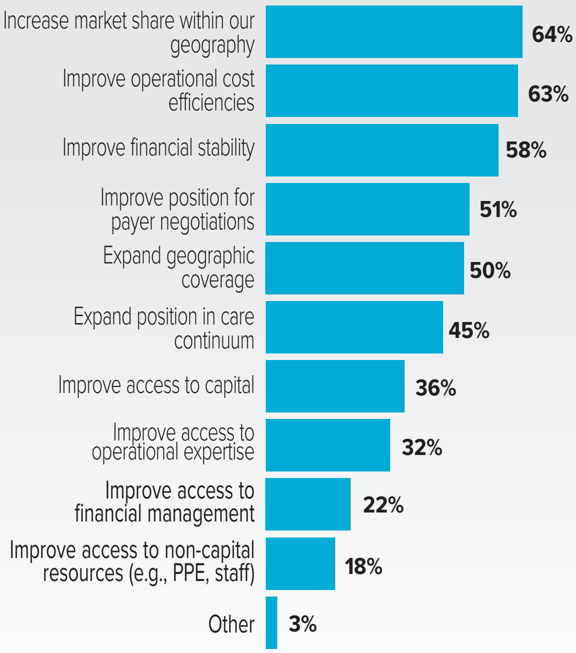
Base = 119, Multi-response

Figure 1 | **How were your organization's merger, acquisition, and/or partnership (M&A) deals affected by the COVID-19 pandemic?**



Base = 119

Figure 3 | **What are the financial objectives of your M&A planning or activity?**



Base = 119, Multi-response

to unchecked mergers, the 10 largest healthcare systems now control a quarter of the market. Since 2010, 139 rural hospitals have shuttered, including a high of 19 last year, in the middle of a healthcare crisis. Research shows that hospitals in consolidated markets charge far higher prices than hospitals in markets with several competitors."

M&A drivers remain

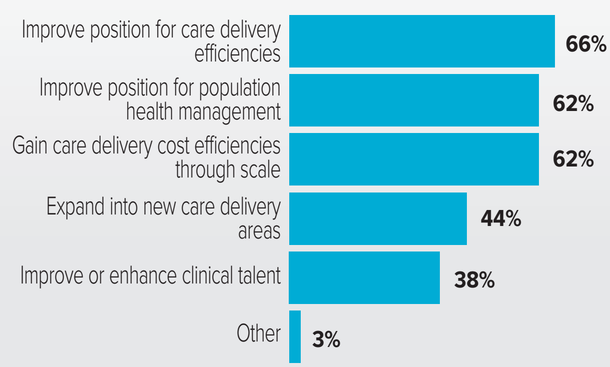
This post-COVID-19 bull market for M&A is not surprising because building scale to leverage bargaining power with payers—the key driver of healthcare consolidation—remains in place post-pandemic.

Two-thirds (66%) of respondents in HealthLeaders' survey say that increasing size to improve negotiations with payers is the top driver of consolidations. That is almost double the response of the next-biggest driver, improving patient care (38%) (Figure 2).

While negotiating power with payers is the key driver, Ugwueke says there are other good reasons to consolidate.

"Negotiating leverage could be one reason, but most organizations considering M&A are going to do it for various reasons depending on the market where they are and what they're trying to accomplish," Ugwueke says. "Oftentimes, it is due to looking for ways to serve patients, looking for ways to cut cost through synergies, and identifying opportunities where they can really bring value to the market."

Figure 4 | **What are the care delivery objectives of your M&A planning or activity?**



Base = 119, Multi-response

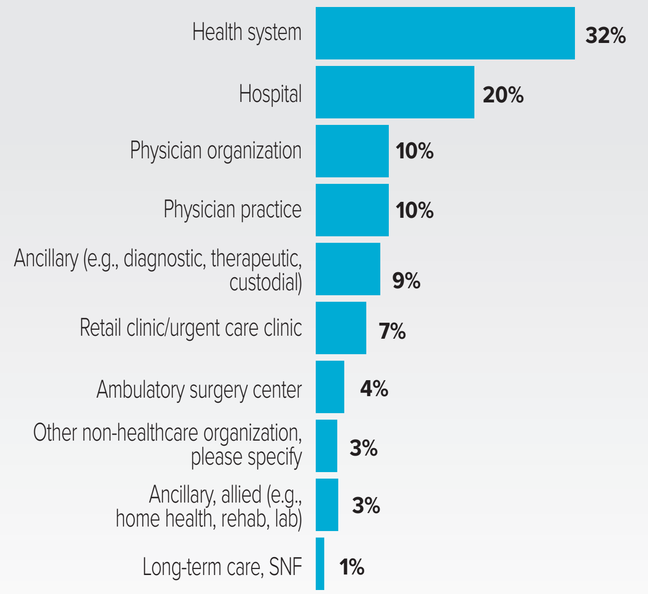
He notes that in markets with narrow networks, such as Memphis, Tennessee, size doesn't matter "because you can't have any negotiation power with the payers because the market is what the market is."

"Each organization will have a strategy based on what is best for them," Ugwueke says. "My experience has been that, at the end of the day, we are in this for right reasons and that is to take care of patients, and that should be the overriding reason. Mission and patient care should be the overriding reason for why you want to even consider it."

Care delivery enhanced

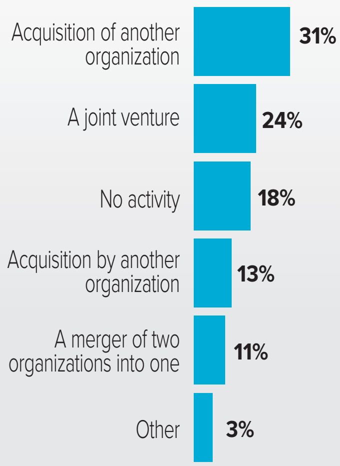
As for care delivery, about two-thirds of survey respondents say consolidation improves efficiency, enhances population health, and reduces care costs (Figure 4).

Figure 6 | **What kind of entity was involved in your most recent M&A activity?**



Base = 97, Of those involved in recent M&A activity

Figure 5 | **Please describe the nature of your most recent M&A activity.**



Base = 119

"Improving your position for population health makes a lot of sense if they're in a market where they need to do some kind of capitation or if they have a health plan," Ugwueke says. "That definitely fits and agrees with developing efficiencies in patient care."

More than half (55%) of survey respondents describe their most recent M&A activity as either acquiring another organization (31%) or a joint venture (24%) (Figure 5).

"Acquisition by another organization tends to be the most prominent M&A activity because that's an inorganic effort to meet the needs we've talked about," Ugwueke says.

Figure 7 | **Please describe the financial impacts your organization experienced after its most recent M&A activity.**

	Increased	Remained the same	Decreased	Don't know
Net patient revenue	48%	33%	7%	11%
Operating margin	34%	39%	12%	14%

Base = 97, Of those involved in M&A activity

Figure 8 | **How did costs change when providing care in each of the following settings after your organization's most recent M&A activity?**

	Cost of providing care increased	Cost of providing care decreased	Cost of providing care remained the same	Don't know
Inpatient	12%	25%	44%	19%
Outpatient/ambulatory	23%	31%	35%	11%
Virtual care	13%	32%	32%	23%

Base = 97, Of those involved in M&A activity

"Joint ventures are usually small entities, maybe with physician groups, but not necessarily."

More than half (52%) of the survey respondents identify a health system (32%) or a hospital (20%) as the entity involved in their most recent M&A activity (Figure 6). "That's not surprising at all because health systems are the ones that can afford to really engage at that level, more so than a single hospital," Ugwueke says.

For almost half of respondents, M&As increased net patient revenue (48%), and for 33%, revenues remained unchanged. With operating margins, 34% say they saw increases, 39% remained unchanged, and 12% saw margins decline (Figure 7).

"It goes back to what we said earlier, they were all doing it to get some bargaining strength. Obviously, some of them failed," Ugwueke says. "Some of these numbers, depending on who is answering, if it's a clinician, they may just presume that there is an increase in revenue and, because of that, on margins too. You could increase revenues, but it doesn't necessarily translate into margins as well."

More than two-thirds of respondents say the cost of providing care either decreased or remained unchanged in the inpatient (69%), outpatient (66%) or virtual care (64%) settings (Figure 8).

For 23% of respondents, cost of care increased in the outpatient/ambulatory setting, compared with 12% in the inpatient setting, and 13% in virtual care. Ugwueke says he's not sure why outpatient cost increases are the outlier. "Cost increases could be related to how inefficient they may or may not be," he says.

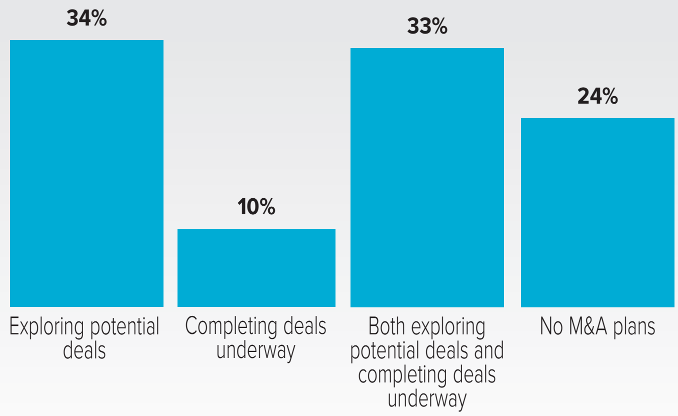
As for virtual care, Ugwueke says telehealth is still getting its legs, and that as the virtual setting matures, efficiencies and cost savings will become apparent.

"A year or two from now, if you do this survey again, you'd get a different view," he says. "But I don't think any organization goes into a merger because of the virtual care. That's just not what I will call a side attraction."

No buyer's remorse

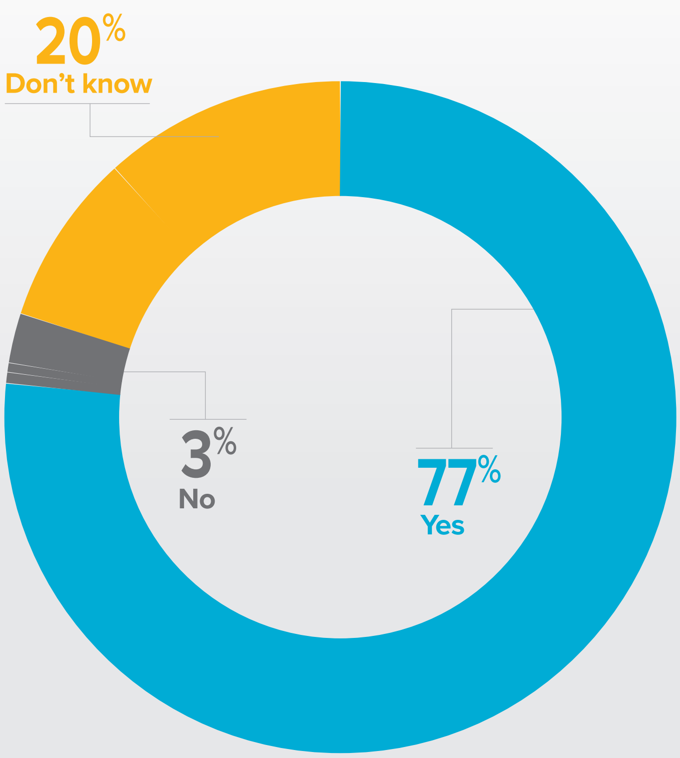
Buyer's remorse seems to be virtually nonexistent in healthcare consolidation. When survey respondents were asked to reflect on their most recent M&A and if they'd do it again, 77% say "yes," while only 3% say "no" (Figure 9).

Figure 10 | **Please describe your organization's M&A plans for the next 12–18 months.**



Base = 119

Figure 9 | **Looking back, would your organization choose to participate in its most recent M&A activity again?**



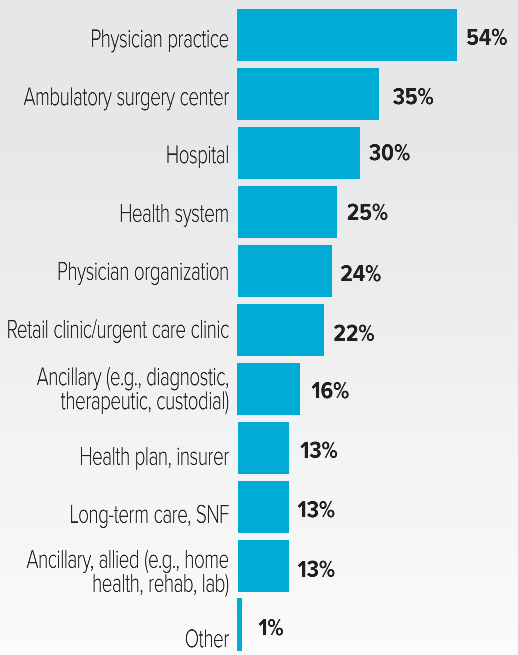
Base = 97, Of those involved in M&A activity

"Again, this is not surprising," Ugwueke says. "With 77% saying that they more than likely would do it again, that is a resounding 'yes' that most organizations get some benefit or meet their goals or whatever they're saying their objectives are. Only 3% say no, so that should tell you something right there."

"If there was a significant increase in cost, then more than likely, most of them wouldn't want to do it again. If they didn't get any savings or synergies, they probably wouldn't do it again," he says.

Ugwueke says another reason for the high enthusiasm for M&As could be buy-in. Executives can spend months and years in the painstaking effort to consolidate and they might be reluctant to express regret, even if it proves to be unsuccessful.

Figure 11 | What entities does your organization have a high interest in pursuing through M&A activity within the next year?



Base = 79, Multi-response, Of respondents exploring potential deals

Physician practices are the top target for M&As in the coming months, according to the survey, with 54% of respondents saying acquiring more physicians is their highest interest. Another 35% say ambulatory surgery centers are also a sought-after acquisition (Figure 11).

Ugwueke says it makes sense to target physician groups because they're a less-complex, less-regulated acquisition in a fragmented market. "Optum is a big entity in that space and then you have the venture capitalists also actively participating, so there is a lot of interest in physician practices," he says.

"It speaks to the fact that there's already been a lot of consolidation in the hospital space and that some of the fragmented physician companies or enterprises are seeing some significant growth opportunities."

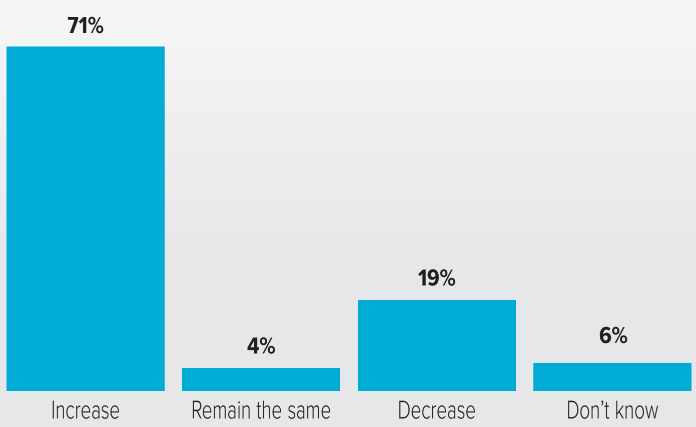
"You can't have buyer's remorse, but if your numbers go south, your board will," he says.

Exploring more deals

The enthusiasm for M&A doesn't appear to be cooling. Nearly 80% of respondents say that over the next 12–18 months they will either be exploring more M&As (34%), completing existing deals (10%), or both (33%) (Figure 10).

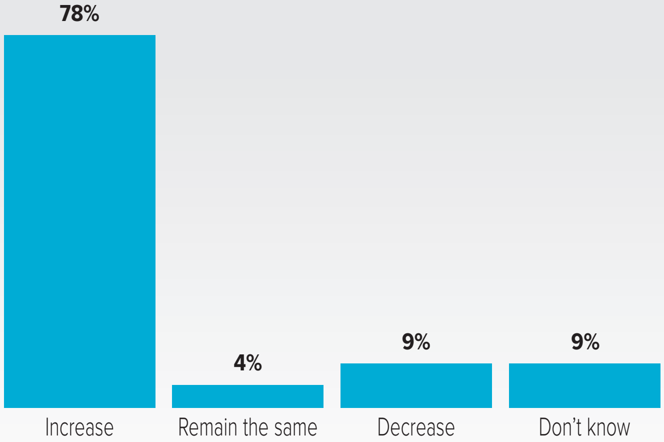
Ugwueke says some of the consolidation is being driven by private equity. "There's definitely a rebirth of activity going on in that area," he says, "even though the Department of Justice has been aggressive in squashing M&As."

Figure 12 | Within the next three years, do you expect your organization's M&A activity to:



Base = 79, Of respondents exploring potential deals

Figure 13 | **Within the next three years, do you expect the dollar value of your organization's M&A activity to:**



Base = 79, Of respondents exploring potential deals

And just as 71% of respondents say they anticipate more M&A activity over the next three years (Figure 12), 78% say they expect the dollar value of those acquisitions to increase as well (Figure 13).

"They're optimistic that the market and services are going to return and, that ultimately, there will be a significant interest in getting back into the market," Ugwueke says.

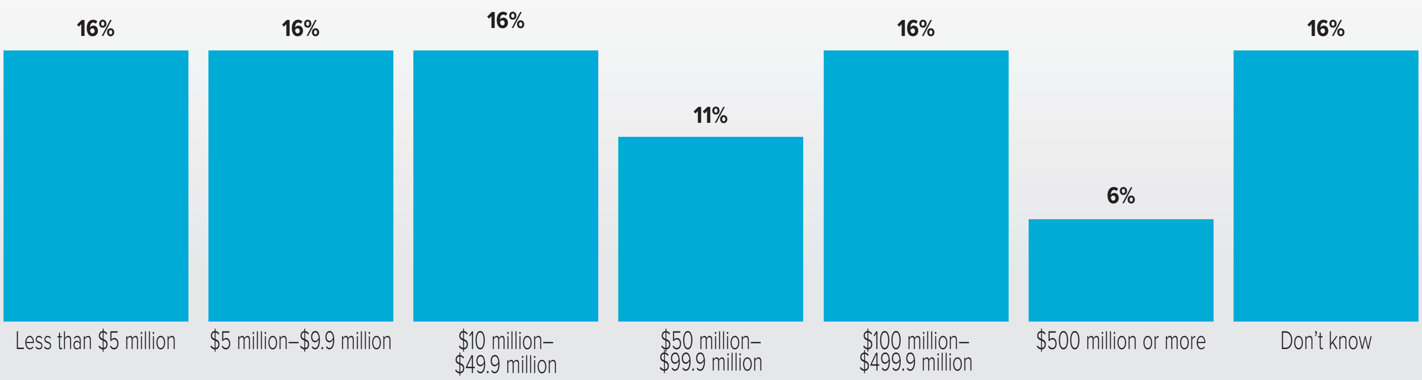
So, what does this all tell us about the status of healthcare M&A as we emerge from the pandemic?

"You can use this survey as a barometer for how you summarize the whole M&A market," Ugwueke says. "There is pent-up optimism in the market with entities thinking we'll get back to normal and that there's significant interest in trying to reduce costs and look for ways to create efficiencies, and M&A is one of those ways you can do that."

Rather than looking at M&A as the be-all, end-all solution, Ugwueke says it's better to view consolidation as "a tool in the toolbox."

John Commins is a senior editor for HealthLeaders. He can be contacted at jcommins@healthleadersmedia.com.

Figure 14 | **Please estimate the cumulative total dollar value of the M&A activity your organization will be exploring over the next three years.**



Base = 79, Of respondents exploring potential deals

METHODOLOGY

The HealthLeaders *2021 Mergers, Acquisitions, & Partnerships Survey* was conducted by the HealthLeaders Intelligence Unit, powered by the HealthLeaders Council. It is part of a series of thought leadership studies. In April 2021, an online survey was sent to the HealthLeaders Council and select members of the HealthLeaders audience at healthcare provider organizations. A total of 119 completed surveys are included in the analysis. The margin of error for a base of 119 is +/- 9.0 at the 95% confidence interval. Survey results do not always add to 100% due to rounding.

What Healthcare Leaders Are Saying

Here are selected comments from leaders who say how they expect M&A to be different after the pandemic subsides.

"There will be increased consolidation among hospitals and health systems and increased diversification by health systems."

—Chief Strategy Officer at a large health system

"Investors are guarded and want solid evidence of recovery via six months of consistent financial performance."

—CEO at a small physician organization

"We will look for more partnership/joint venture opportunities where risk can be shared."

—Chief Financial Officer at a small hospital

"M&A will go back to pre-COVID activity."

—Chief Technology Officer at a large hospital

"My impression is that, after some time, M&A activities will be similar to how they were before the pandemic, although perhaps with more attention to some aspects of negotiation (cultural fit, volumes, population health, etc.)"

—CEO at a small hospital

"There will be more opportunities, as many of the physician practices have suffered and may have to consider M&A."

—VP/Director Operations at a medium-sized physician organization

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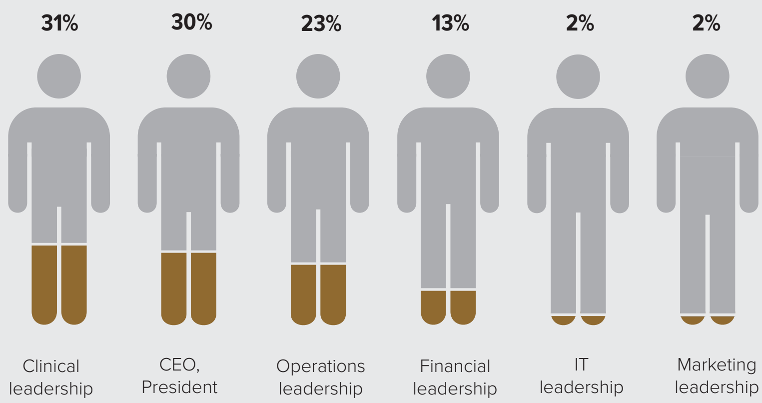
RESPONDENT PROFILE

TITLE

Base = 119



CEO, PRESIDENT
> CEO, President
> Chief Executive Administrator
> Chief Administrative Officer
> Board Member
> Executive Director
> Managing Director
> Partner

OPERATIONS LEADERSHIP
> Chief Operations Officer
> Chief Strategy Officer
> Chief Compliance Officer
> Chief Purchasing Officer
> VP/Director Operations Administration
> VP/Director of Compliance
> Chief Human Resources Officer
> VP/Director HR/People
> VP/Director Supply Chain/Purchasing

FINANCIAL LEADERSHIP
> Chief Financial Officer
> VP/Director Finance
> VP/Director Patient Financial Services
> VP/Director Revenue Cycle
> VP/Director Managed Care
> VP/Director Reimbursement
> VP/Director HIM

CLINICAL LEADERSHIP
> Chief Medical Officer
> Chief Nursing Officer
> Chief of Medical Specialty or Service Line
> VP/Director of Medical Specialty or Service Line
> VP/Director of Nursing
> Chief Population Health Officer
> Chief Quality Officer
> Medical Director
> VP/Director Ambulatory Services
> VP/Director Clinical Services
> VP/Director Quality
> VP/Director Patient Safety
> VP/Director Postacute Services
> VP/Director Behavioral Services
> VP/Director Medical Affairs/ Physician Management
> VP/Director Population Health
> VP/Director Case Management
> VP/Director Patient Engagement, Experience

MARKETING LEADERSHIP
> Chief Marketing Officer
> VP/Director Marketing
> VP/Director Business Development/Sales

IT LEADERSHIP
> Chief Information Technology Officer
> Chief Information Officer
> Chief Technology Officer
> Chief Medical Information Officer
> Chief Nursing Information Officer
> VP/Director IT/Technology
> VP/Director Informatics/Analytics
> VP/Director Data Security

TYPE OF ORGANIZATION

Base = 119

Health System (IDN/IDS)	**41%**
Hospital	**34%**
Physician organization (MSO/IPA/PHO/clinic)	**16%**
Ancillary services provider (diagnostic/therapeutic/custodial)	**4%**
Ambulatory Surgical Center	**2%**
Urgent Care Center	**1%**
Inpatient Rehabilitation Facility	**1%**
Payer/Health Plan/Insurer (HMO/PPO/MCO/PBM)	**1%**

NUMBER OF PHYSICIANS

Base = 119

1–9	**6%**
10–49	**15%**
50+	**78%**
N/A	**1%**

NUMBER OF BEDS

Base = 119

1–199	**28%**
200–499	**23%**
500+	**33%**
N/A	**17%**

PROFIT STATUS

Base = 119

For-profit	**33%**
Nonprofit	**67%**

NET PATIENT REVENUE

Base = 119

$1 billion or more (large)	**23%**
$250 million-$999.99 million (medium)	**22%**
$249.9 million or less (small)	**46%**
None of above	**9%**

RESPONDENT REGIONS