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Inside the Health Care M&A Market

Buying, Selling and Valuing Hospitals: Our Expert Panel Talked About the Current M&A Market

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Hospital mergers and acquisitions have undergone some changes in recent years. Affiliations, joint ventures and partnerships are now a few of the ways systems are coming together, without actually changing control. One example: the "joint operating company" formed by Alexian Brothers Health System and Adventist Health System that created an integrated health system in Chicago's northwestern suburbs. Both parties said the deal was "neither a merger nor an acquisition" when it was announced last June, and each retained its own board.

Our recent webinar, "Buying, Selling and Valuing Hospitals," looked at the market today, who's buying, and who's selling. Brian Nichols, a partner in Robinson & Cole's health law group, moderated the panel that included **Matt Caine, managing director at SOLIC Capital Advisors**, Bob Cimasi, CEO of Health Capital Consultants, Trey Crabb, managing director of Ziegler's health care practice, and Scott Li, vice president of Hammond Hanlon Camp LLC.

Caine reviewed the factors affecting the market today. Inpatient volumes are declining as consumers shift to outpatient or urgent care centers for treatment. CMS' announcement that it will increase its value-based reimbursements to 50% by 2018 is making providers look for ways to boost efficiency. Then there's the growing competition. "Larger systems are expanding their reach into secondary markets," he said. "That's creating pressure on the community-based providers. They need capital to be able to compete, to provide differentiated services and absorb some of the earnings volatility."

Bond market activity among tax-exempt bond issuers in the acute-care space slowed considerably in recent years, Caine said. In 2012, 177 issuances were made, but fell to 110 in 2013 and 105 in 2014. "The trends are pretty depressing, even in a low interest rate environment."

Another trend is the for-profit and not-for-profits coming together. "When we go to market to sell or partner a hospital, we're definitely reaching out to both not-for-profits and for-profits," Crabb said. "In many cases, they can compete on a valuation basis when you include things like capital commitments. Low rates are definitely driving the market, and 2015, in our opinion, is shaping up to be a very busy year."

"We're seeing some of the for-profits start to reposition or recalibrate their portfolios as they identify markets they want to develop more resouces in," Li commented. "For example, we were working with IASIS a couple years ago, selling a few hospitals in Florida. These were strong performers, but they just decided that Florida wasn't where they would be devoting more resources. So they sold those hospitals and refocused the proceeds to other parts of their portfolio. We might see a little bit more of that in the future."

How the Valuation Process Is Changing

Although the traditional indicators haven't changed— benchmark profitability, cash flow, liquidity, activity ratios and the like are still necessary—Cimasi noted that risk has always been a big concern in valuing hospitals, but it's heightened even more now by the move to value-based reimbursement.

"It changes the revenue stream. You're moving towards reimbursement for population health and outcome-based methods, and patient-satisfaction metrics, but you have a constant threat of Medicare spending cuts," he noted. "All this uncertainty breeds the perception of risk, and that perception of risk drives a demand for a higher, risk-adjusted required rate of return. And that drops your value."

Different valuation multiples, such as revenues or EBITDA, for different situations, Cimasi said. "If you've got a horizontal consolidator in a given market, they may be more concerned about the revenue aspect. If somebody is trying to integrate vertically by adding certain hospital assets or properties, they may be more concerned with the EBITDA." Also, check the capital expenditures to collected revenues, what they have been historically. "If you have a hospital that's in financial distress, regrettably, the first thing they cut is capital expenditures."

Can Branding Drive Volume?

There's a consumer component driving the activity, as well. "A portion of the overall value of certain hospitals, especially large tertiary care regional, maybe academically affiliated hospitals, is a branding they bring to the table," Cimasi said. "For the community hospitals, that can be an important factor, and the for-profits may be looking at that, too. We have more and more consumers who have high co-pays or high deductibles."

The larger systems are ahead of the game with branding, Li agreed. "It's not necessarily a strong point for hospitals but it's going to become more important in the future. In many instances, I think it will drive volume. So for those that don't have a brand name, it'll be interesting to see how they develop it, or if they can develop it. But the big systems like Kaiser, Intermountain, Cleveland Clinic, they have it in spades."

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