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Hospital & Health System Transactions – 15 Key Considerations, Trends and Issues

Presented By:
Scott Becker, Chairman McGuireWoods Healthcare Department, Publisher
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1. Mid size healthcare systems are looking to get larger for a variety of reasons. 800mm to 2bb in revenues seems to be the new mid size.
2. A decline in hospital transaction activity by number of deals in 2013 vs. 2012. Approximately 25% less deals than in 2012. The hospital sector saw a 35 percent year-over-year decline in transaction volume in the fourth quarter of 2013.
3. Small financially challenged hospitals having a more difficult time finding a partner. Healthy systems more selective regarding adding troubled hospitals. Many smaller community hospital unsure of how to survive in a changing reimbursement and physician environment. Carsten Beith, managing director of the healthcare investment banking firm Cain Brothers & Company, says strategically driven transactions are "substantially more appealing" to buyers, compared with “troubled sales” transactions. The jury is out on whether there will be more transactions involving troubled hospitals. From 25 to 30% of last quarter’s transactions involved troubled hospitals. The Board and leadership can have a very difficult time assessing the right time to examine a transaction.

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4. Mega mergers took center stage in 2013 -- CHS-HMA, Trinity- Catholic HealthCare East, and Tenet-Vanguard. Still, Joseph Cerreta of Juniper Advisory says the 10 largest hospital systems still only account for between 15 and 20 percent of total industry revenue.
5. Physician practice acquisitions have decreased significantly over the last few years. According to a Deloitte and a Jackson Healthcare report, medical group acquisitions declined after reaching a peak in 2011, which saw 108 deals; in 2012, there were only 70 reported medical group acquisition deals.
6. Healthcare mergers tend to increase the pricing leverage of healthcare systems. Mergers can reduce traditional local competition.
7. The antitrust enforcement as to hospital transactions has been relatively muted. Mr. Beith says the FTC is more open to consolidation where "there is a compelling case to increase efficiencies (reduce costs), improve quality and access and where payors are supportive." However, the FTC has increasingly challenged transactions which lead to more than 60+ percent market concentration. "See, e.g., Capella/Mercy Hot Springs (2013), Reading Hospital/Surgical Institute of Reading(2012), ProMedica/St Luke's Hospital (2011), OSF Healthcare System/Rockford Memorial Hospital (2011)

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8. More and more transactions require Anti-Kickback Statue or Stark Act self disclosure prior to completing the deal. There is less willingness of buyers to take risk post transaction, hospitals are seeking to limit post transaction exposure.
9. Due diligence is more extensive than ever. More effort to avoid/manage antitrust risk through cautious sharing of pricing terms. Extensive review of physician relationships, medical staff, billing and coding and revenue cycle issues.
10. Change of ownership and all licensure and contract assignment issues need to be reviewed closely. Need to review state attorney general and certificate of need and similar issues. "Although the basic principles are similar, many of these issues vary on a state-by-state basis," says Bart Walker of McGuireWoods. "Different states have taken different positions on the level and requirements for approval of these transactions." Valuations and extensive efforts to show market clearing can be needed for AG clearance.

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11. Increased review of special donation and other restrictions.
12. Religious challenges (ERDs) and restrictions tend to be overcome.
13. Many transactions can be straight mergers or member substitutions vs. actual cash sales. Increasingly, we see systems choose mergers with strategic partners versus the highest bid or offer.
14. The debt instruments of the buyer and seller need to be examined closely.
15. Union and labor issues need to be carefully reviewed.

Questions or Comments?

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