Hospital Focus

December 2017

A Year of Change for Community Hospitals

By Rex Burgdorfer, Juniper Advisory

As 2017 comes to an end, we thought it would be helpful to The Governance Institute membership to provide some observations regarding the state of health system merger and acquisition (M&A) activity, and specifically its impact on independent non-profit hospitals.

First, the industry remains among the most fragmented in the U.S. economy. It comprises over 6 percent of GDP, is capital intensive, regulated, and complicated. Despite this, there are more than 2,000 "companies" nationally that own and operate the roughly 4,300 acute-care hospitals. As described in our previous article in *Hospital Focus*,[1] hospitals also operate with significant capital market limitations. These constraints combined with intense industry pressure has proven difficult.

Most health systems are now of the belief that the cost and quality equation could be improved by hospitals organizing into more effective regional networks. This holds the potential to coordinate care, share best practices, raise capital, implement IT systems, recruit physicians, and the like. Our team of investment banking professionals has yet to come across a hospital (whether a large system, prestigious academic medical center, or a small rural sole community provider) that believes they are adequately positioned to contend with the radical economic changes afoot. As one CEO we worked with recently put it, "We're moving from the horse and buggy to Tesla era overnight."

Consequently, the vast majority of health systems appear to be actively exploring "strategic alternatives." We define this to mean they are considering a partnership with another health entity that would change some portion of both ownership and control. And as the pace of change accelerates, development strategies (whether by growth or divestiture) at non-profit systems have become more blunt. This frontal tone manifests itself in the language used by the parties during the M&A process as well as a heightened attention to the terms, conditions, and value. Historically, there was a large divide in the approach taken by for-profit companies, non-profit systems, and independent hospitals. Those differences have narrowed substantially.

Our hope is that this information can aid the nimbleness with which non-profits wield various transaction techniques. In the process, we will describe the modern, albeit more corporate, transaction approaches and tactical decisions available to independent non-profit hospitals. Significantly, non-profits of all types are beginning to utilize these more advanced M&A tools.

In 2018, we will publish a series in *Hospital Focus* related to common issues that emerge in business combinations. Topics to be addressed include:

1. Acquisition currencies in non-profit hospital M&A
2. Valuing the troubled hospital
3. Fairness opinions and their role in non-profit M&A
4. Regulatory considerations for hospital combinations

In the next issue, which comes out in March, we will begin by covering "acquisition currencies in non-profit hospital M&A." Our team will: 1) define and dissect the issue, 2)

[1] Rex Burgdorfer, "Is Healthcare a Charity, Social Service, or Business? Community Hospital Board Members Contemplate Their Role," *Hospital Focus*, The Governance Institute, September 2017.

reference the conventional handling of that topic in comparable transactions and comparable industries, and 3) provide commentary to fit the topic into today's business climate, market cycle, and how it has evolved over time. For example, citing the macro-credit environment as a cause for the for-profit industry's challenges, and highlighting the new opportunities this presents to the non-profit hospital readership. The article will also describe the techniques and evolution of how health systems "pay for" their newfound acquisition appetite.

Looking toward 2018, most health system boards and managements we work with expect hospital mergers and acquisitions to remain a priority corporate strategy. We hope this series will be informative and aid those considering partnership alternatives do so with a renewed set of tactics and approaches.

The Governance Institute thanks Rex Burgdorfer, Vice President at Juniper Advisory, for contributing this article. He can be reached at rburgdorfer@juniperadvisory.com.

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