2019 M&A in Review: In Pursuit of the New Bases of Competition
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Introduction

Transformative pressures on legacy hospitals and health systems intensified in 2019:

- **Disruption driven by new entrants to the healthcare marketplace took shape.** CVS Health launched the first of its HealthHUB locations early in 2019 and by June had announced plans to expand the HealthHUB concept to 1,500 more locations. In September, Walmart opened the first of its “Walmart Health” locations in suburban Atlanta, a 10,000-square-foot facility described as a “super center for basic healthcare services,” including primary care, dental care, and behavioral health.

- **Demands for friction-free, convenient, and transparent experiences influenced consumer preferences.** Kaufman Hall research on consumer preferences in 2019 found that only 36 percent of parents would choose their child’s primary care physician for a minor illness or injury, and 72 percent of these parents would opt for an alternative option if they had to wait more than one day for an appointment. Although only a small percentage of parents had tried a video visit with a care provider, 80 percent of those who had done so would do so again.

- **The government moved on several fronts to increase transparency and decrease disparities in payment.** The Centers for Medicare & Medicaid Services (CMS) built site-neutral payment policies into its 2019 Outpatient Prospective Payment System (OPPS) final rule. Although this rule was successfully challenged in court, site-neutral payments were again included in the 2020 OPPS final rule. A final rule on price transparency published in November 2019 will require hospitals and health systems to offer “consumer friendly” price information by 2021 on approximately 300 shoppable services.

“Competitors are moving in on a healthcare industry that remains largely local and small in scale.”

—Kenneth Kaufman
Insurers, risk managers, and employers sought to change the high and inconsistent costs of legacy providers. Health insurer Anthem has changed payment policies to reduce the costs of emergency care and hospital-based lab and imaging tests. In September, Amazon launched an Amazon Care pilot for its employees, combining virtual visits with in-home nurse follow-up visits to reduce utilization of emergency room and urgent care visits. Walmart, a leader in the use of center-of-excellence models for high-cost surgical procedures, introduced initiatives designed to steer associates to high-quality imaging centers and to preferred clinicians identified by data on the appropriateness, effectiveness, and cost efficiency of the care provided.

These pressures are influencing partnership, merger, and acquisition activity among healthcare organizations in multiple ways. The emphasis is shifting from aggregation to transformation as legacy hospitals and health systems focus on the changes required to succeed in healthcare’s new bases of competition (Figure 1).

Following a “Year in Numbers” summary of activity between hospitals and health systems in 2019, this report will describe key impacts of transformative change in the healthcare marketplace, including:

- Continued growth of “mega mergers”
- Increasing diversity of partnerships
- Transactions across the continuum of care
- Enterprise performance strategies

**Figure 1: From Aggregation to Transformation**

<table>
<thead>
<tr>
<th>AGGREGATION</th>
<th>TRANSFORMATION</th>
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<tbody>
<tr>
<td><strong>Strategic Focus</strong></td>
<td>Use of innovation to materially change industry dynamics</td>
</tr>
<tr>
<td><strong>Revenue Strategy</strong></td>
<td>Pursuit of high “quality of revenue” strategic pursuits</td>
</tr>
<tr>
<td><strong>Expense Strategy</strong></td>
<td>Total cost evaluation, attacking all sources of waste/excess</td>
</tr>
<tr>
<td><strong>Capital Strategy</strong></td>
<td>Frequently aimed at new channels, markets, or services</td>
</tr>
<tr>
<td><strong>Market Posture</strong></td>
<td>Market expansion, driven by alignment and collaboration</td>
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Source: Kaufman, Hall & Associates, LLC
The Year in Numbers

Several of the trends discussed in this report were evident in the data for transactions between hospitals and health systems in 2019.

- The average size of seller by annual revenue was below 2018’s historic high of $409 million but remained above historical averages at $278 million.
- Total announced deals for 2019 remained consistent with prior year at 92 transactions announced in 2019, compared with 90 in 2018.
- A trend toward partnerships between financially strong health systems continued. Three announced transactions were “mega mergers” (transactions in which the smaller partner by revenue had more than $1 billion in annual revenue), and in an additional 11 transactions, the smaller partner had annual revenue between $500 million and $1 billion. In five transactions, the smaller partner had an “A” credit rating or higher. The number of financially distressed sellers remained low at 20 percent (the same as in 2018).
- Enterprise performance strategy efforts by both for-profit and not-for-profit systems continued, with fewer independent hospitals involved in transactions. For-profit business line and unit rationalization efforts showed a high level of activity, with 19 announced divestiture transactions by for-profit operators.
- A state-specific focus on M&A activity became less relevant, as health systems increasingly look across state lines or leapfrog geographies for growth opportunities in new markets. Four transactions in 2019 involved cross-state transactions.¹

Figure 2: 2019 Hospital and Health System Transactions by the Numbers

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<table>
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<tr>
<td><strong>Total Announced Transactions</strong></td>
<td>92</td>
</tr>
<tr>
<td><strong>Breakdown by Seller Size in Revenue (as % of Total Transactions)</strong></td>
<td></td>
</tr>
<tr>
<td>Revenues &lt; $100M</td>
<td>45%</td>
</tr>
<tr>
<td>Revenues Between $100M and $500M</td>
<td>40%</td>
</tr>
<tr>
<td>Revenues Between $500M and $1B</td>
<td>12%</td>
</tr>
<tr>
<td>Revenues &gt; $1B</td>
<td>3%</td>
</tr>
<tr>
<td><strong>Average Transaction Seller Size by Revenue</strong></td>
<td>$278M</td>
</tr>
<tr>
<td><strong>Number of Cross-State Transactions</strong></td>
<td>4</td>
</tr>
<tr>
<td><strong>Not-for-Profit/For-Profit Deals</strong></td>
<td></td>
</tr>
<tr>
<td>Not-for-Profit Acquiring Not-for-Profit</td>
<td>66%</td>
</tr>
<tr>
<td>Not-for-Profit Acquiring For-Profit</td>
<td>14%</td>
</tr>
<tr>
<td>For-Profit Acquiring Not-for-Profit</td>
<td>11%</td>
</tr>
<tr>
<td>For-Profit Acquiring For-Profit</td>
<td>9%</td>
</tr>
<tr>
<td><strong>Transactions Involving:</strong></td>
<td></td>
</tr>
<tr>
<td>Religiously-Affiliated Seller</td>
<td>13%</td>
</tr>
<tr>
<td>Governmental Seller</td>
<td>11%</td>
</tr>
<tr>
<td>Rural or Urban/Rural Seller</td>
<td>36%</td>
</tr>
<tr>
<td>Financially-Distressed Seller</td>
<td>20%</td>
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¹ Source: Kaufman, Hall & Associates, LLC
Mega Mergers

The continued growth in mega mergers (transactions in which the smaller partner in the transaction has annual revenues exceeding $1 billion) is driven by the strategic focus, revenue focus, and market posture factors described in Figure 1.

- **Strategic focus.** In many instances, mergers between large systems are driven by complementary capabilities. The strength of one partner’s clinical capabilities, for example, may be complemented by the other partner’s health plan capabilities. This can change the dynamic in both partners’ markets.

- **Revenue driver.** As health systems face increasing competition from national companies with revenues that dwarf even the largest health systems, seeking partners with high-quality revenue streams helps build competitive strength.

- **Market posture.** As opportunities diminish in a health system’s home market, expansion to new markets can bring desired growth opportunities.

The merger between Michigan-based Beaumont Health and Ohio-based Summa Health, announced in July 2019, illustrates the influence of these drivers:\(^2\)

- **Complementary capabilities.** Beaumont has strong specialty clinical programs, while Summa owns health insurer SummaCare.

- **Financial strength.** Both systems are coming to the merger from a position of financial strength. Although Summa had experienced financial difficulties in prior years, it has executed a financial turnaround under its current CEO.\(^3\)

- **Competitive position.** SummaCare’s insurance capabilities will enhance Beaumont’s competitive position in Michigan, supporting risk-based and direct-to-employer contracting and putting Beaumont on an equal footing with other health systems in the state that own insurance plans. With Beaumont’s backing, Summa Health can also expand into additional geographies in Ohio beyond its home market of Akron, where population growth has been stagnant.\(^4\)
Mega Mergers (continued)

Although the number of mega mergers in 2019 was below the record high recorded in 2017, and average seller size by revenue was down from 2018’s record high (Figure 3), both indicators remain strong in comparison from an historical perspective. Kaufman Hall anticipates continued interest in combining large systems that bring complementary capabilities to the partnership, open opportunities for expansion into new markets, and strengthen revenues as health systems prepare to compete on a new basis of competition.

Figure 3: Average Seller Size by Revenue, 2009–2019

Source: Kaufman, Hall & Associates, LLC
Diversity of Partnerships

Our 2018 M&A in Review report predicted increasing competition to control healthcare’s “front door.” This prediction held true in 2019, with a diverse range of partnerships among payers, health systems, physician practices, and digital health companies intended to enhance consumers’ ease and convenience in accessing healthcare services.

Significant drivers of these partnerships include the following factors (as described in Figure 1):

- **Strategic focus.** New healthcare competitors are seeking to attract consumers early in their healthcare journey, when they can have the most influence over the consumer’s path forward. Without a strategy to compete in this space, legacy hospitals and health systems risk disintermediation.

- **Capital strategy.** As healthcare services increasingly move outside the hospital’s walls, capital strategy is focusing on building additional consumer access points and lower cost sites of care.

- **Market posture.** A strategy focused on enhanced consumer access and convenience provides the platform for expanding services and growing market share. Growth of a digital platform can enable expansion of services well beyond traditional geographic markets.

These partnerships often have unique attributes or structures tailored to the needs of the parties and their markets. Representative examples from the past year include:

- **Payer-provider partnerships.** In Kaufman Hall’s M&A Quarterly Activity Report for the third quarter of 2019, we highlighted the trend toward payer-provider partnerships designed to create efficiencies for the consumer by providing better care coordination, offering one-stop access to a range of healthcare services, or reducing administrative hassles between payer and provider. An example is a new joint venture between Blue Cross and Blue Shield of Minnesota and North Memorial Health in the Minneapolis-St. Paul market, announced in June 2019, which will assume ownership of North Memorial’s 20 primary and specialty care clinics. A goal of the joint venture is “removing confusion from the equation” as consumers try to understand and navigate the complexities of healthcare.5
Diversity of Partnerships (continued)

- **Partnerships with physician practices.** Health systems have been building physician networks for many years, but new partners are also seeking alliances with physician practices. New physician practice models are also appearing to address specific consumer demands. For example, house-call provider Heal, which employs 120 doctors and nurses, announced in December 2019 a partnership with a joint venture between Sutter Health and Aetna in northern California. The partnership is designed to offer more convenient care options for the joint venture’s health plan members.6

- **Partnerships with digital health companies.** Health systems are adding digital capabilities to facilitate online scheduling and virtual clinical visits through partnerships with digital health companies. In October 2019, for example, the Cleveland Clinic and digital health company American Well announced formation of a new joint venture, named The Clinic, “to provide broad access to comprehensive and high-acuity care services via telehealth.”7

Consumer demand for access and convenience will continue to act as a powerful driver of partnerships intended to transform industry dynamics and reduce or eliminate fragmentation and friction for the consumer.
Continuum of Care Transactions

Continuum of care transactions are a complement to partnerships focused on healthcare’s “front door,” expanding the services offered to consumers once they have entered the healthcare system.

Hospitals and health systems are finding that for certain services, partnership is a better option than ownership. Continuum of care transactions thus comprise a range of transactions, from health systems monetizing an asset that is not central to its business model to partnering with a specialty-service provider. Drivers for these transactions include the following factors (see Figure 1):

- **Strategic focus.** An expanded range of services across the continuum of care can increase consumer loyalty to a health system as the go-to destination for comprehensive healthcare needs.

- **Efficiency and quality of delivery.** A view across the continuum of care enables health systems to better manage total cost of care, identifying and eliminating areas of waste or inefficiency within the care continuum.

- **Capital strategy.** Partnership options ranging from monetization to collaboration to initiation of new relationships are being pursued to ensure access to capabilities as well as optimization of capital and other resources.

The range of continuum of care transactions in 2019 include the following examples in key service areas:

- **Home health.** Although the demand for home health and home care services is expected to increase as the population ages, ownership of a home health or home care agency can be challenging for health systems. Home health or home care services typically represent a smaller percentage of revenues and have different cost structures, lower pay scales, and higher employee turnover than other components of the healthcare system. Health systems may find it makes more sense to monetize existing services and contract with a home health or home care operator or form a joint venture. For example, in June 2019, Northwestern Memorial HealthCare sold its home health and hospice programs to JourneyCare, an Illinois-based hospice and palliative care provider. In April 2019, Geisinger finalized a joint venture with LHC Group, Inc., in which LHC Group purchased majority ownership of Geisinger’s home health and hospice services and assumed management responsibility.
Continuum of Care Transactions (continued)

- **Behavioral health.** In December 2019, Michigan-based Beaumont Health and United Health Services (UHS) broke ground on a new behavioral health hospital in southeastern Michigan that is being undertaken as a joint venture between Beaumont and UHS to meet growing demand for inpatient behavioral health services. UHS is operator of more than 200 behavioral health hospitals across the U.S.\(^1\) Beaumont plans to support the new hospital with graduate medical education programs in psychiatry, psychopharmacology, and other clinical programs.\(^1\)

- **Labs.** As noted in Kaufman Hall's *2019 M&A Snapshot* on laboratory services and trends, payment pressures on lab services has led several health systems to divest their outreach labs business to national providers or to outsource lab management to mitigate payment pressures and reduce costs. Examples from 2019 include management service agreements between national provider Quest and Catholic Health Services Partners of Long Island (July 2019) and Houston Healthcare (February 2019), and national provider LabCorp’s acquisition of South Bend Medical Foundation’s diagnostic laboratory testing services, announced in July 2019.\(^1\)

The ability to provide access to services and monitor patient experiences and outcomes across the continuum of care is not only a competitive differentiator, but also an essential capability for any health system pursuing a population health or other risk-based strategy. Kaufman Hall anticipates continued growth in transactions to form partnerships with providers that offer specialized management capabilities for services that build out the continuum of care.
Enterprise Performance Strategies

Several factors—including flat or declining inpatient volumes, stagnant markets, reductions in length of stay, and growth of outpatient and digital services—are causing health systems to evaluate their business lines and units thoroughly and divest assets that are not contributing sufficiently to the healthcare needs of the community or not meeting the strategic or financial needs of the organization.\(^{14}\)

With respect to the model described in Figure 1, this evaluation is a key component of a transformative expense strategy. It serves not only to eliminate underperforming assets within the organization, but also to access capital for deployment in new initiatives or in geographies more central to the organization’s strategic plan.

Examples of enterprise performance strategy transactions from 2019 include the following:

- **Ascension’s sale of two hospitals in central Wisconsin to the Marshfield Clinic Health System.** One of the hospitals included in this transaction is in Weston, Wisc., just 10 miles from a site in Wausau, Wisc., where the Marshfield Clinic was planning to build a new facility. The transaction will enable the Marshfield Clinic to expand into the Wausau market without the need for new construction.\(^{15}\)

- **Geisinger’s sale of Holy Spirit to Penn State Health.** Holy Spirit, based in the West Shore region of the Harrisburg, Pa., market, faced a significant competitive challenge from the opening of a new UPMC Pinnacle hospital on the West Shore. Penn State Health had begun construction of a new 108-bed facility in a nearby township but believed local demand for its services would soon exceed capacity. The sale of Holy Spirit to Penn State Health will help meet anticipated demand for Penn State services in the market.\(^{16}\)

- **University of Louisville’s acquisition of Kentucky One Health from CommonSpirit Health.** This transaction gives the University of Louisville an opportunity to strengthen the university’s academic medical center with more clinical opportunities for residents and students and additional venues to attract more research and clinical trial funding. The transaction was backed by $50 million in pledged support from the state of Kentucky, as well as investments from two local foundations.\(^{17}\)

As these transactions illustrate, enterprise performance strategy transactions also provide opportunities for health systems seeking to expand into a new market or enhance their offerings within an existing market.
Looking Forward

Kaufman Hall expects many of the trends from 2019 to carry forward into 2020, including:

- **Competition to control healthcare’s “front door.”** When we commented on this trend in our 2018 year-end report, the competitive threat from new market entrants was still largely speculative. The shape of the new bases of competition that these new entrants are pursuing came into clearer view this year, as national chains such as CVS Health and Walmart launched pilot efforts to attract consumers as they enter the healthcare system, and then quickly announced plans to expand these pilot efforts. With existing footprints in markets across the country, these new entrants could quickly reshape market dynamics.

- **New combinations across healthcare verticals.** Partnerships between healthcare organizations that historically have operated separately, or even in opposition to one another, will continue to grow as health plans, health systems, and physician practices seek new ways to provide better consumer experiences. Partnerships with organizations that bring strong digital and retail capabilities to legacy healthcare organizations will also continue to grow.

- **Continued growth of regional health systems.** Despite a few instances of planned large-system mergers that failed to close in 2019, we believe that interest in combining systems that have both financial strength and complementary capabilities and areas of expertise will continue. Increasing competition from national retailers and tech giants with revenues and capital resources that far exceed not-for-profit healthcare systems will continue to act as a powerful driver, as will the need to find growth with new services and in new markets.

- **An emphasis on increased reach within existing markets.** The continuum-of-care transactions and partnerships commented on earlier in the report are examples of health systems’ interest in expanding the depth of services they provide to consumers in their markets. Health systems will continue to seek partnerships that provide more consumer touchpoints and position the health system as a comprehensive source for consumers’ healthcare needs.
Kaufman Hall also anticipates increased use of alternative capital structures for partnerships and acquisitions, including the following:

- **Minority interest structures** are an option for independent hospitals and health systems that wish to seek additional capital or access to intellectual support or new clinical services without relinquishing organizational control. A minority investment from a larger system can provide capital or operational support while giving the larger system enhanced market access in partnership with the smaller system. A recent example is the agreement between Geisinger Health System and Evangelical Community Hospital, finalized in February 2019.\(^{18}\)

- **Sale/leaseback structures** can free up “trapped assets” in health system facilities and provide organizational flexibility as care continues to migrate outside of traditional inpatient settings. Steward Health System has been an industry leader in pursuing these structures, with investments from Medical Properties Trust (MPT) for $1.25 billion in 2016 and $1.4 billion in 2017. In 2019, MPT made additional acquisitions of health system real property interests, including a sale-leaseback transaction with St. Luke’s Health System for seven hospitals in the Kansas City area.\(^{19}\)

The new bases of competition are compelling legacy hospitals and health systems to pursue transformative change. New approaches to partnerships, mergers, and acquisitions will be integral to this effort.
References

1. Cross-state transactions are defined as transactions in which a system enters a new state through acquisition of one or more hospital facilities, or transactions that result in a system with broader geographic range across states than either of the partners had before the transaction.

2. Kaufman Hall represented Summa Care in this transaction.


17. University of Louisville website: *Acquisition Update* [www.uoflhospital.org/acquisitionupdate](http://www.uoflhospital.org/acquisitionupdate)


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