M&A Quarterly Activity Report: Q2 2020

Introduction

In our last quarterly activity report, we noted that M&A activity appeared to enter a state of flux in mid-March, as hospitals and health systems focused their attention and resources on preparing for impacts of the COVID-19 pandemic. Those impacts were dramatic in the early months of Q2. Data from Kaufman Hall’s National Flash Report indicated that hospital operating EBITDA margins fell 174% year over year in April and remained down 9% year-over-year in May, notwithstanding relief from the CARES Act and a slow return of scheduled procedures as markets began to reopen.

We anticipated that COVID-19’s impacts would affect M&A activity in Q2. But with two transformational deals announced in June, it seems that COVID-19 generated a much less dramatic decline in M&A activity, relative to underlying performance measures. If anything, the pandemic has demonstrated advantages of scale, coordination, and innovation that are likely to strengthen the strategic rationale for future partnerships. On the other end of the spectrum, we expect an increasing number of restructuring, distressed, and bankrupt hospitals. As a result, we do anticipate a significant uptick in M&A activity to be just ahead of us, as the industry recommences its transformation.

Overview of Q2 Activity

There were 14 transactions announced in Q2. While this represents a slowdown from the prior quarter, when 29 transactions were announced, it is not a significant change year-over-year from Q2 2019, when 19 transactions were announced. It also demonstrates that, notwithstanding the impacts of COVID-19, deals did move forward.

This quarter saw one of the highest figures for average size of seller by revenue we have ever recorded, at more than $800 million. This is well above the historic high of $409 million recorded for the year in 2018. Total transacted revenue for the quarter was also high, at just over $12 billion, which is especially noteworthy given the smaller number of transactions in Q2. Both figures were
affected by two transformational transactions announced in June (Steward Health Care’s acquisition by a group of affiliated physicians, and Advocate Aurora Health’s proposed merger with Beaumont Health, discussed below).

The quarter saw a high level of activity by for-profit hospitals and health systems. Nine of the 14 announced transactions were acquisitions of for-profit sellers, including six transactions involving major for-profit systems, as discussed below. Academic health systems and religiously affiliated organizations were not represented in any of this quarter’s transactions.
Moving Beyond the COVID-19 Crisis

In the conclusion of our report for Q1 2020, we noted that M&A activity would be a leading indicator that hospitals and health systems are moving beyond the immediate impacts of the COVID-19 crisis and are able to focus again on longer-term strategic initiatives. As we approached the end of Q2, we saw the following announcements:

- A group of physicians led by Steward Health Care's CEO acquired Cerberus Capital Management's 90% ownership stake in the health system, which has 35 hospitals across nine states and the country of Malta.
- Advocate Aurora Health, based in Illinois and Wisconsin, signed a non-binding letter of intent with Michigan-based Beaumont Health to explore a possible merger, which would result in a system with $17 billion in annual revenues.
- Lifespan and Care New England Health System, both based in Rhode Island, resumed talks about a possible partnership.

These announcements may well be the leading indicators we predicted. They also illustrate the impacts COVID-19 has had—and will continue to have—on M&A activity.

First, the need to address COVID-19's impacts paused activity but did not change the underlying strategic rationale for many transactions; if anything, the pandemic may have strengthened the rationale for partnerships. Advocate Aurora and Beaumont Health, for example, disclosed that they had begun conversations before the pandemic began.¹

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¹ Additional information or context about the source or nature of the data presented in the graph would be beneficial for a comprehensive understanding of the content.
Second, COVID-19 is causing healthcare leaders to assess current care delivery models and reimagine how health systems could be better configured to meet needs that the pandemic has exposed. Steward Health Care CEO Ralph de la Torre stated that “this is a transformational moment for the healthcare industry, with new realities in a COVID-19 world that must be addressed with an equally transformational, patient-first approach.”

Third, COVID-19 has forged partnerships that in many instances will continue and strengthen after the pandemic has passed. Talks of a possible merger between Lifespan and Care New England had been suspended in July 2019, but in a joint announcement, the CEOs of the two systems noted that, because of the COVID-19 crisis, the two systems “have been working together in unprecedented ways” and “have agreed to enter into an exploration process to understand the pros and cons of what a formal continuation of this collaboration could look like in the future.”

Finally, for-profit health systems have continued efforts to reshape their portfolios over the quarter, with six of the 14 announced transactions representing divestitures by major for-profit health systems, including Community Health Systems, Quorum, and HCA. Elsewhere, newly capitalized for-profit hospital owners and operators are forming and are beginning to actively evaluate initial or add-on targets. We anticipate further transactions focused on portfolio restructuring by both for-profit and not-for-profit systems as they look for opportunities to monetize or exit underperforming assets and strengthen their financial viability in the wake of COVID-19.

Looking Forward

We believe the COVID-19 crisis has only strengthened the healthcare industry’s imperative for transformation. We anticipate that we will see more discussions that began pre-pandemic moving to definitive agreements or closure in the remaining quarters of the year. And we look for a resumption, or even an acceleration, in the pace of new transactions as hospitals and health systems reposition themselves for the post-pandemic future.

References


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