

# The Daily Deal

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## A good prognosis

*While deal volume in healthcare services is falling, M&A in some subsectors remains strong*

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Healthcare is the largest and one of the most dynamic industries in the United States, and the healthcare services segment is particularly fragmented and complex because it is comprised of literally dozens of multibillion-dollar subindustries or subsectors. Each of these subsectors has separate regulatory and competitive pressures and, therefore, experiences different business cycles. Further, due to innovation and economic opportunity, new sectors such as urgent care clinics continue to emerge.

Although M&A deal volume in healthcare services has shown a general downward trend during the past twelve months, certain subsectors experienced increased activity—particularly those subsectors that were more directly affected by healthcare reform. This consolidation activity may continue as the effects of reform change the healthcare services landscape.

The acute care hospital sector was among the first sectors to experience the effects of reform via the “carrot and stick” of meaningful use, where billions of dollars of subsidies have been offered to technology adopters and significant penalties are facing those that do not invest. Initially a ripple, the impact of the hospital industry’s reaction to meaningful use is now growing into a wave of consolidation in the post-acute care sector.

In recent years, the home care sector also experienced significant consolidation. Just last year, the Medicare home care space gained considerable momentum as

smaller sellers pushed to close deals before the imposition of new taxes on Jan. 1, 2013. Consolidation in this segment may continue, driven by such long-term trends as the introduction of technology-enabled home care, consumer empowerment and increasing reimbursement pressures.

The dynamic regulatory environment and pending shift of 20 million Americans into some form of coverage, albeit mostly at low levels of reimbursement, are also significant factors driving demand for healthcare information technology. Information technology plays an important role in the operations of an expanding number of healthcare providers, thereby increasing efficiencies and enabling the organizations to meet rising demands. HCIT providers, especially software as a service companies, are trading near all-time highs, commanding the highest revenue and Ebitda valuation multiples relative to other subsectors. Demand continues to rise for technologies that help manage revenue cycles and clinical workflow.

In addition, HCIT is essential to integrated health networks and the patient care continuum. Under new regulations, healthcare providers are required to implement new IT systems, such as electronic health records. These IT systems initially proliferated in the hospital setting and are now spreading into the post-acute and home care environments. However, these IT mandates are often cost-prohibitive for the smaller providers, prompting their need to combine with the larger players.

Changes to reimbursement are also causing hospitals to discharge patients earlier into the post-acute setting. Managing the

continuum of care for these higher-acuity patients requires effective IT solutions. Accordingly, clinically focused post-acute care HCIT providers have emerged. M&A activity has increased as clinically focused and financially focused IT vendors combine to provide a complete and integrated IT solution for post-acute providers.

The wave of physician practice consolidation activity has continued across all specialties. For example, cardiology practices were acquired by hospitals and health systems in 2010 and 2011. Hospitals then shifted their focus to acquiring internal medicine, primary care groups and surgical specialists in gastroenterology and orthopedics. Hospitals have also been expanding into the radiation therapy market by hiring and acquiring oncology practices. In addition, consolidation activity has been robust in the physical rehabilitation, infusion therapy and diagnostic services sectors. Separate from hospitals, dental practices have also consolidated in recent years.

Due to the fragmented and complex nature of the healthcare services industry, there may never be a shortage of consolidation activity. The question becomes one of sector focus, since transaction activity appears to occur in cycles across the different sectors. Understanding reimbursement and other regulatory changes, along with imbalances in market supply and demand, may allow industry players to anticipate future consolidation activity. ■

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