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Health-Care Transactions Update: 2017 Year-to-Date

By Gary W. Herschman, Kevin J. Ryan, Victoria Poindexter, and Robert Aprill

Gary W. Herschman is a member of Epstein Becker & Green in its Newark, N.J., office. He can be reached at gherschman@ebglaw.com .

Kevin J. Ryan is a member of Epstein Becker & Green PC in its Chicago office. He can be reached at kryan@ebglaw.com .

Victoria Poindexter is a principal with Hammond Hanlon Camp LLC, an independent investment banking and strategic advisory firm, in Chicago. She can be reached at vpoindexter@h2c.com .

Robert Aprill is an analyst with Provident Healthcare Partners LLC, a leading middle market investment bank, in Boston. He can be reached at raprill@providenthp.com .

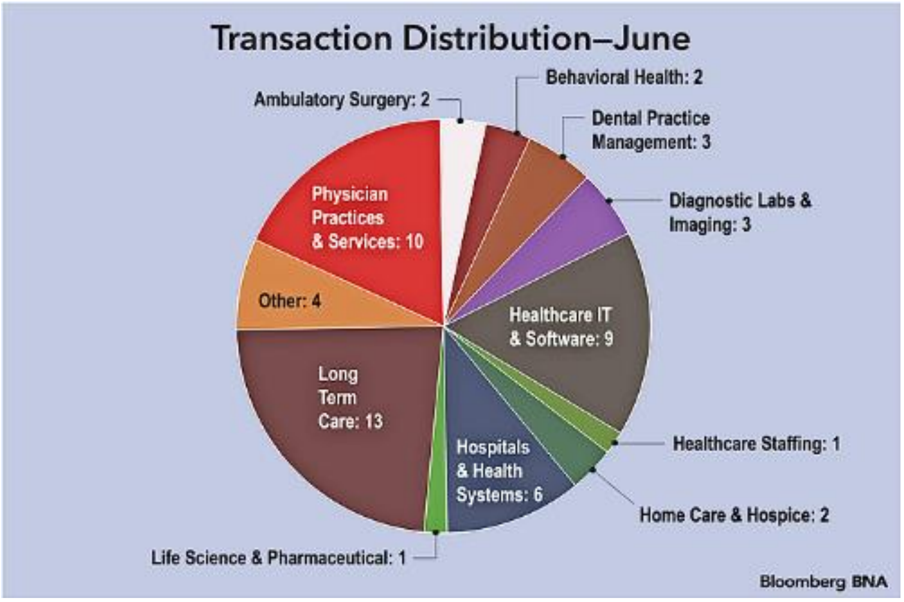
Introduction

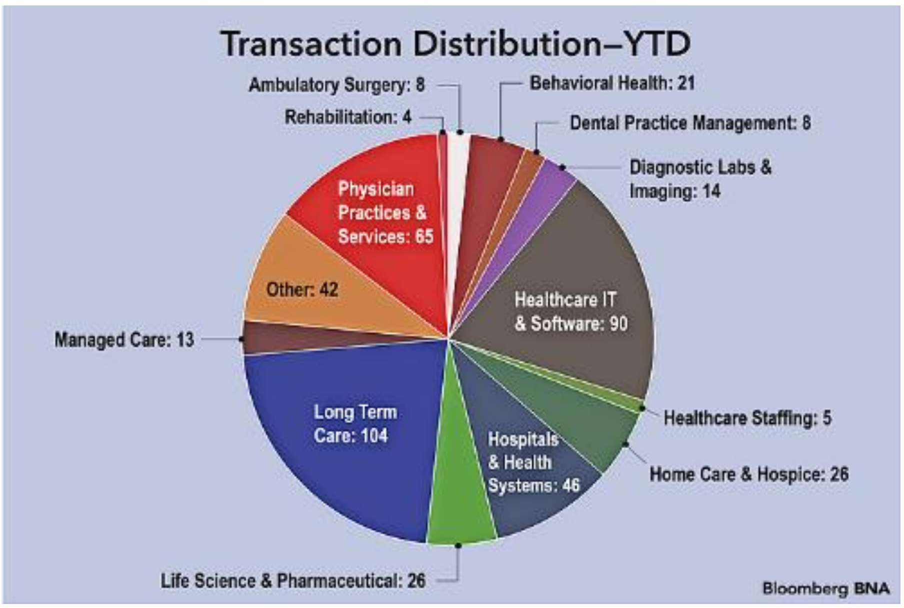
The health-care industry continued to experience uncertainty and volatility in the second quarter of 2017. In May, the House of Representatives passed legislation to repeal and replace the Affordable Care Act. While the legislation represented a success for Republicans after failing to repeal and replace Obamacare earlier in the year, the bill faced scrutiny as headed to the Senate. A Senate bill that looked to put an end to months of health-care debate has now floundered leaving considerable uncertainty about what will come next.

Despite this rough terrain, the June transaction list shows that dealmakers were not encumbered by political noise. A year-to-date list shows that merger activity remained high in the second quarter of 2017 after a robust first quarter. Many players in the health-care market likely sought consolidation as a way to hedge risk as the future of Medicare and Medicaid spending remain unclear.

Legislative Uncertainty Fuels Consolidation

Uncertainty over the future of the Affordable Care Act has increased as the Republican rift on health-care policy has widened. After returning from the weeklong July 4th recess, Senate Republicans scrambled to get a new health-care bill on President Donald Trump's desk before their next break in mid-August. Those efforts were derailed when it became clear that there was insufficient support among GOP senators to move the Better Care Reconciliation Act forward. Subsequent discussions concerning a hard Obamacare repeal, with no replacement, also appear doomed. What remains is the same degree of uncertainty the health-care industry faced in January.





The uncertainty on Capitol Hill has placed increasing pressure on providers and pushed many to turn to merger and acquisition strategies to add stability. Physicians who receive a large proportion of collections from Medicare and Medicaid, which would likely endure cuts under Republican legislation, will be most inclined to consolidate and diversify their collection sources. Merging with strategic or financial partners is a proven method for physicians to mitigate risk when the future of health-care is unclear.

Blocked Mergers Leave More Buyers on the Table

The beginning of 2017 saw the Department of Justice's attempts to block two mega-mergers between four of the big five health insurers finally succeed. Antitrust law precluded a merger between insurance giants Aetna and Humana because it was anticompetitive, forcing the rivals to terminate the merger. Similarly, a federal judge found that Cigna had to end merger talks with Anthem after the deal was likewise found to be anticompetitive. It was announced both deals had finally died mere hours apart in February. Since then, Anthem has made it clear the company is looking for its next deal following the unsuccessful attempt to merge with Cigna. The Company has announced on multiple occasions they are dedicated to growth through M&A strategies. The continued attempts by the big five health insurers to form mega-companies is something the entire health-care industry will have its eye on through the remainder of 2017.

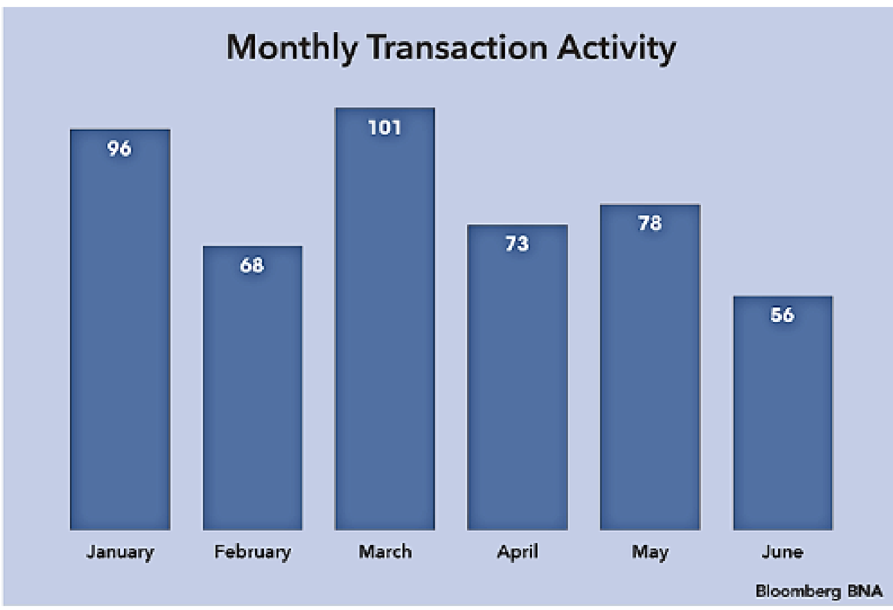
Quickly Changing Contract Research and Outsourced Pharmaceutical Space

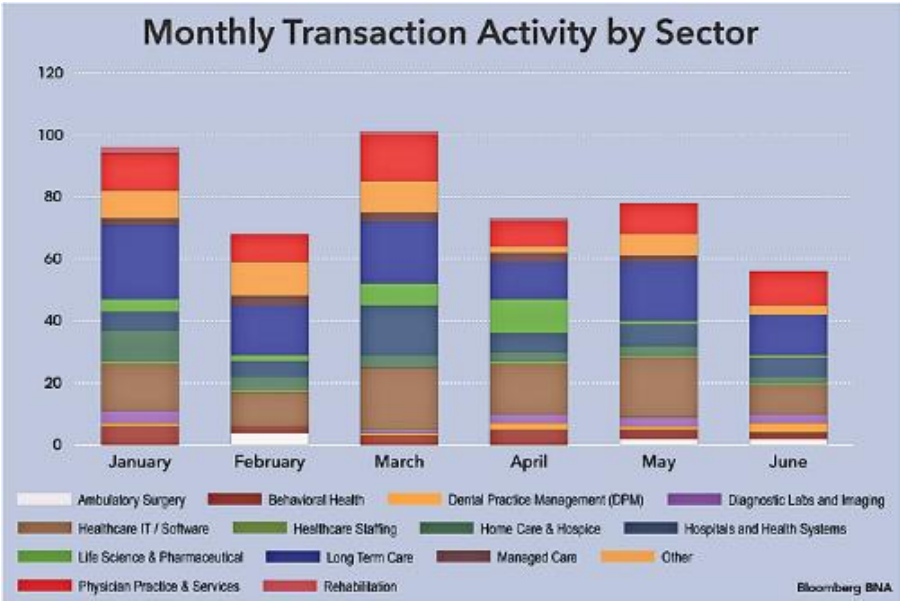
The contract research and outsourced pharmaceutical (CRO) space continues to undergo significant alteration in 2017. Although a greater number of overall dollars are flowing to the space, fewer total contracts have increased competition and lowered margins across the industry. To combat a dynamic industry climate, many of the world's largest CROs are taking drastic steps to posture the company for future success. In 2016, the CRO space saw a mega-merger between Quintiles and IMS Health. In May of this year, the industry experienced its next mega-merger as INC Research and InVentiv Health agreed to merge into what will be one of the three largest CROs in the world. June saw the publicly traded Parexel be taken private by Pamplona Capital Management and reports suggest Laboratory Corporation of America (the world's largest clinical lab) is planning an $8 billion buyout of leading CRO, Pharmaceutical Product Development (PPD). Consolidation in the industry will only increase competition as industry behemoths compete over fewer contracts with pharmaceutical companies.

Physician Services Continue to See Consolidation

Orthopedics

The orthopedic sector became the most recent example of private equity groups looking to replicate their successes in other physician specialties as Boston-based Candescent Partners made a majority acquisition into the Southeastern Spine Institute. Located in Mount Pleasant, South Carolina, the Southeastern Spine Institute is the first example of a private equity group making a platform investment into the orthopedic space with the intent to pursue an aggressive roll-up strategy.





Led by an increasing number of orthopedic procedures being done in outpatient/ASC settings, private orthopedic practices have been able to support more robust ancillary service lines. The model of ‘one-stop shop’ has created a drastic shift in the industry. Ancillaries such as imaging, physical and occupational therapy, DME, walk-in clinics, among others, create a more patient centric experience and provide a practice with additional revenue streams resulting in more favorable margins. These additional revenue sources have made orthopedics a prime target for private equity investment. With an increased amount of private equity capital flowing to physician services, the orthopedic sector is sure to see significant interest from the private equity community throughout the remainder of 2017 and beyond.

Eye Care

The eye care sector saw a significant uptick in investment and consolidation activity in the first half of 2017. Private equity capital has flowed into the sector to the tune of seven new platform investments in the first 180 days of 2017. The investment thesis in the sector is predicated on procedure volume tailwinds because of an aging population, cash-based premium eye care service offerings, and a highly fragmented landscape ripe for consolidation. There are now several private equity-backed ophthalmology practices as investment activity has accelerated in 2017. The first six months of this year saw seven private equity groups make platform investments in practices headquartered in Arizona, California, Colorado, Georgia, Michigan, Minnesota, and Tennessee. The most notable transaction so far in 2017 came at the beginning of June, as Varsity Healthcare Partners announced their exit from EyeCare Service Partners (ESP) in a transaction with Harvest Partners. This marked the first successful exit for a private equity firm in the industry and this will undoubtedly attract more investors looking to replicate Varsity's success in the space.

Conclusion

Uncertainty continued to be the dominant theme in health-care markets this quarter. Doubt surrounding the future of the ACA incentivized providers of outpatient physician services, specifically orthopedics and eye care, to consolidate while ambiguity in the insurance space after two failed mega-mergers left more buyers on the table for the time being. The same uncertainty that drove merger activity in the second quarter of 2017 is expected to carry into a busy third quarter.

For More Information

The lists of select transactions involving health-care providers, managed care and services companies for May 2017 and for 2017 year-to-date were compiled by health-care investment bankers using publicly available information, including articles, websites and press releases.
The June list is at http://src.bna.com/qUX .
The year-to-date list is at http://src.bna.com/qUY .
Bloomberg BNA would like to thank its Health Care Transactions Editorial Committee for their guidance: Gary W. Herschman, of Epstein, Becker &

Green PC, Newark (gherschman@ebglaw.com); Kevin J. Ryan, of Epstein, Becker & Green PC, Chicago (kyan@ebglaw.com); Victoria Poindexter, of Hammond Hanlon Camp LLC, Chicago (vpoindexter@h2c.com); Mike Tierney, of Hammond Hanlon Camp LLC, Chicago (mtierney@h2c.com) and Robert Aprill, of Provident Healthcare Partners LLC, Boston (raprill@providenthp.com).

Epstein, Becker & Green PC did not comment on any particular transaction or party discussed or listed in this article.