Health Care Attracts Corporates and PE

MIDMARKET TRENDS // Robust Deal Flow Shows No Sign of Slowing

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M&A in midmarket health care services has benefited from steady growth. Enterprise values and EBITDA multiples remain strong, as sponsors and corporate buyers seem willing to spend on quality assets with sizeable growth expectations. Although corporate strategic buyers continue to dominate the health care services industry, financial sponsors have materially increased their activity over the last few years, benefiting from rich stores of dry powder and fragmentation within certain health care subsectors.

Key drivers for this robust deal activity include consolidations, low cost of capital and accessible debt markets, large balance sheets, availability of dry powder, cost pressures, and desires to offset low organic growth. Even generalist private equity firms are becoming more interested in health care, with a buy-and-build strategy (as add-ons and strategic tuck-ins make up a significant portion of PE buyout activity). Processes remain competitive, even among sponsor-to-sponsor transactions, where there is a strong track record and opportunity for significant scale.

Particularly active subsectors include long-term care, specifically assisted living and home health; physician practice management, including women's health, dermatology, behavioral health and dental; and hospital combinations, affiliations and strategic transactions. Other subsectors, like ophthalmology, remain ripe for roll-up and consolidation, given their growth, high fragmentation and new technologies.

There also has been significant activity in health care mega-mergers. CVS announced a proposed acquisition of Aetna for $69 billion, and UnitedHealth's Optum announced a proposed acquisition of DaVita Medical Group for $4.9 billion, both vertical mergers. Amazon, Berkshire Hathaway and JPMorgan announced a new health care initiative to improve employee satisfaction and reduce costs. Amazon already is challenging CVS and Walgreens with its proposed pharmacy offering.

These moves show how the industry is distancing itself from traditional health care delivery and insurance models. There could be a real opportunity to drive down costs and improve patient care with vertical mergers. It remains to be seen if the moves are meant to embrace this opportunity, or are more defensive and seek to control the entire continuum of patient care. Regardless of motive, these moves could influence the activity in the midmarket space—causing more health care providers and organizations and their financial sponsors to look beyond their core capabilities for acquisitions and avenues to improve their bottom lines.

Tail winds remain strong as the health care services sector is mostly a highly fragmented, founder-owned industry. Meanwhile, people are healthier and living longer. Value-based medicine is having a positive impact on M&A for companies that lack the infrastructure and human and capital resources to compete and need to merge.

Regulatory risk and labor shortages remain the strongest head winds. Although it is unclear how the tax cuts will impact government reimbursement, there is more certainty and clarity on the potential for reform as "repeal and replace" of the Affordable Care Act has so far failed. Accordingly, we should expect continued activity in midmarket health care M&A and investment by financial sponsors in fragmented subsectors with significant growth opportunities that face minimal negative impact from policy changes. //

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