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M&A Activity Slowed in 2020, But is Poised to Accelerate in 2021

The COVID-19 pandemic undoubtedly had a strong influence on the healthcare *merger and acquisition* (M&A) market in 2020, as clearly seen from differences in activity between the first quarter and subsequent quarters of 2020, after the pandemic fully infiltrated the U.S. in March 2020. The COVID-19 pandemic represents a unique shock to the healthcare system, as it has directly affected acute care delivery. Revenues declined precipitously as: many lucrative, elective procedures were cancelled; occupancy rates in many hospitals decreased; and, new demands of staff related to the virus and infection prevention created greater burdens on hospital costs and clinical workers.[1] In fact, estimates indicate that extra costs and lower revenues led to more than $200 billion in lost funds for hospitals and health systems between March and June of 2020.[2] This article focuses on the data from several reports that outline the M&A activity in 2020, compares the transactional market volume to past years, and explores possible future trends.

Prior to the pandemic, the healthcare M&A market had seen steady increases throughout the previous decade. The number of M&A transactions peaked at 117 in 2017, then dropped to 90 in 2018 before rising slightly to 92 in 2019.[3] It may have realistically been expected that 2020 would follow this same trend, and first quarter 2020 M&A activity indicated a strong start to the year. During this quarter, 29 transactions were announced, the second highest amount in the first quarters of the previous five years.[4] It quickly became apparent, however, that this trend would likely not continue for the rest of 2020. Both greater financial burden on providers and an increased focus on short-term operations hampered healthcare executives' ability to implement strategic initiatives, including M&A deals.[5] Being unable to conduct business face-to-face led to differences in negotiations. Especially for organizations that are not well-acquainted with each other, conducting intensive meetings with boards, committees, physicians, leadership staff, and stakeholders – such as those required for M&A discussions – can be challenging.[6] Hospital executives have cited difficulties in understanding an organization's culture when meetings are conducted remotely, which can hinder effective relationship building.[7] In fact, one proposed merger between Advocate Aurora Health and Beaumont Health, which was one of the largest deals announced during the pandemic and would have created a $17 billion health system, was called off in October 2020, in part because of the difficulties of working remotely.[8]

Despite the unprecedented circumstances of 2020, the year closed at 79 announced transactions, still higher than the 74 transactions announced in 2010.[9] In fact, even in the midst of the worst declines in hospital operating earnings before interest, taxes, depreciation, and amortization (EBITDA) margins in April and May 2020, M&A activity did not experience declines to nearly the same degree.[10] Experts hypothesize that, while transactions decreased for the reasons listed above, the pandemic also brought about a need for change in building business strengths, including resiliency to market changes; in creating partnerships; and, in strengthening intellectual capital resources.[11] In other words, 2020 numbers may have otherwise been lower, but the public health emergency accelerated the need for strategic initiatives, including transactions and partnerships, in order to drive change, create more efficient operations, improve quality, and fill in gaps and weakness in existing organizations.[12]

Some previous transactional trends continued into 2020. Overall, the size of the smaller partner in M&A deals (as measured by that partner's annual revenue) has been increasing over the years, at a compound annual growth rate (CAGR) of 6.2%.[13] In 2020, nearly 9% of transactions included a smaller partner having revenues exceeding $1 billion, the highest proportion since 9.4% in 2017 and a significant increase from 3.3% in 2019.[14] Consistent with 2019, the majority of acquisitions in 2020 (59%) occurred between two not-for-profit organizations. Approximately one-quarter of transactions involved a rural or urban/rural seller in 2020, compared to a little over one-third in 2019.[15] Curiously, more transactions in 2019 included a financially distressed seller (20%), than in 2020 (16%).[16] Even the number of M&A transactions among hospitals remained generally in line with historical numbers, although there was a decline in 2019.[17] After declines in the first two quarters of 2020, post-acute care M&As, including those for home health, hospice, and personal care services, experienced increases from 2019 by the third quarter of 2020, likely due to government financial aid.[18] Physician offices saw similar patterns, with expected returns to normal levels at the end of 2020 and beginning of 2021, with *private equity* (PE) buyers leading this activity.[19] Further,

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managed care, pharmacy, and *ambulatory surgery centers* (ASCs) all saw their fair share of M&A activity in 2020.[20]

Notwithstanding the large market fluctuations, in the form of declines in the first half of 2020 and increases by the end of the year, the 2020 M&A market looked different than previous years. One area where M&A saw strong growth was in behavioral health, which experienced a significant increase in demand throughout the pandemic.[21] Many of these transactions were made by PE buyers and were connected to technological benefits.[22] Investments in healthcare information technology, digital assets, and virtual healthcare tools similarly increased as healthcare providers began to implement these technologies at greater rates in order to improve services, outcomes, and compliance with social distancing guidelines.[23] In fact, one of the largest M&A deals of 2020 occurred in this sector of the healthcare industry – closing on October 30, 2020, the telehealth company Teladoc acquired Livongo, a company that provides tools for chronic disease management, for $18.5 billion.[24]

Telemedicine and healthcare technology will undoubtedly be a strong focus for M&A activity in 2021. A 2021 survey of healthcare *chief financial officers* (CFOs) indicated that 44% predict that the pandemic will drive an increase in partnerships and 42% believe it will drive increased consolidation across the healthcare industry.[25] Half of CFOs are also focused on digital transformation, with 47% and 41% focused on product or service expansion and geographic expansion, respectively.[26] Further, 31% indicated that they plan to acquire physician practices, 28% plan to merge with another organization, 24% plan to enter a joint venture, 20% plan to sell to another organization, and 17% plan to acquire another organization.[27] Similarly, a Bain & Company report found that half of hospital administrators were very likely to make one or more acquisitions within the next two years.[28] This research also found that nearly 70% of independent physician practices were open to merging with or being acquired by another organization.[29] Chad Beste, a Principal at accounting firm BDO, summarized the situation as follows: "*2021 will be all about making the most of newly-formed partnerships…From seeking to address financial distress, to building up scale, to capitalizing on innovation and research, strategic and financial deals will help the industry on its path to better care for patients and continued financial recovery.*"[30]

While uncertainty, financial pressures, virtual communication, and rapid changes resulting from the pandemic led to decreases in M&A activity early in 2020, these elements may also be what led to an upswing at the end of the year and what will lead to increases in 2021. In fact, the number of announced transactions in the fourth quarter of 2020 is the highest since that same quarter in 2017.[31] As healthcare providers look to diversify; expand; increase quality of care and outcomes; focus more on primary care and eliminating social disparities; and, invest in new technologies, the number of M&As is likely to increase.[32] Further, evidence from executives indicates that private offices and hospitals alike are open to, and even planning on, participating in M&As in the coming years.[33] While the pandemic may have temporarily delayed this activity, it has likely had the ultimate effect of accelerating it, and the effects will likely be felt throughout the U.S. healthcare system for years to come.

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