

# M&A: An upside to a down market

*Annual review of merger-and-acquisition activity shows a drop in deals in 2008, but the troubled economy may offer opportunities for strong systems*

Leo Brideau and William Petasnick have all too much company these days. Like bankers and mortgage holders and factory workers around the country, they've seen their best-laid plans laid to waste by perhaps the worst U.S. economic crisis since the Great Depression.

Until the recession shattered those plans, Brideau and Petasnick had been working for a long time to combine their Milwaukee-area hospitals in a new joint not-for-profit corporate partnership under the name Progressive Health. But the idea has been shelved for the time being.

"This thing hit like a tsunami," says Petasnick, president and chief executive officer of 451-bed Froedtert Memorial Lutheran Hospital, which is part of the regional system

Froedtert and Community Health. A management team can handle only so much at one time, Petasnick adds, and no one in his organization has navigated through such uncertain, dangerous waters.

Brideau is president and CEO of three-hospital Columbia St. Mary's, a regional subsidiary of St. Louis-based Ascension Health. He notes that Columbia St. Mary's, itself, is the product of a long-term joint operating agreement, so he knew that such partnerships tend to be very complex, requiring a high level of corporate introspection. "In the end, it's worth it. But to do that kind of work, out of necessity, it forces you to be internally focused," Brideau says. "It was the right idea, wrong time."

Last year was the wrong time for one thing in particular in the healthcare world—trying to issue tax-exempt debt. The shock waves that started with the auction-rate securities in the winter worked their way through the rest of the tax-exempt sector by fall. In October, Baptist Health Care Corp., Pensacola, Fla., tried to sell bonds to finance its \$245 million acquisition of HCA's 339-bed West Florida Hospital, Pensacola, and refinance some existing debt, but that month saw no major healthcare bond issues completed. Earlier this month, Nashville-based HCA canceled the deal because Baptist Health couldn't finance the transaction (Jan. 12, p. 12).

These are just two examples of how, frozen credit markets slowed dealmaking in 2008, analysts say, and *Modern Healthcare's* 15th annual mergers and acquisitions report bears that out. The report, which covers acquisitions, joint ventures, long-term leases and mergers, details 91 hospital deals that were announced or completed in 2008 (plus Jan. 1, 2009) and affected a total of 139 hospitals, compared with 103 deals and 214 affected hospitals in 2007. Unlike the previous two years, 2008 wasn't

anchored by a multibillion-dollar deal. The year before, 2007, included Community Health Systems' acquisition of 52-hospital Triad Hospitals and 2006 included the 172 hospitals involved in HCA's leveraged buyout.

The continuing tight credit markets exacerbate the problem that tips many struggling not-for-profits into a sale—lack of access to capital, says Carsten Beith, a managing director with Cain Bros. Other analysts agree that tight credit will have more hospitals and systems looking to sell. What divides the analysts, however, is who will be the buyers and will they be able—or willing—to bring any cash to the table.

## Resources available

On the one side are the analysts who believe that investor-owned hospital companies have the debt capacity to make acquisitions in a buyer's market. Moody's Investors Service posited in a report last month that for-profit chains, especially LifePoint Hospitals and Universal Health Services, would be well-placed to acquire not-for-profit hospitals because they still have debt capacity under their bank lending agreements (Jan. 5, p. 12).

Philip Pfrang, a partner with consulting firm Deloitte who works with several investor-owned hospital companies, agrees that these companies are going to be active acquirers in 2009. "Every company, whether it be healthcare or not, is probably more fiscally conservative today than they were three or four years ago, but the major systems that we are talking to believe that there are opportunities in this environment that typically are not present," Pfrang says. "And they intend to take advantage of those opportunities." Pfrang says that he expects healthy systems, ones with good size and position in their markets, to pursue a deal when before, their executives wouldn't have

See M&A on p. 31

## SPECIAL REPORT EXTRA PODCAST SERIES

In an exclusive interview, *Modern Healthcare* reporter Vince Galloro talks with Philip Pfrang, a partner with consulting firm



Pfrang

Deloitte, about trends in mergers and acquisitions. To listen to the interview podcast, visit the Special Report Extra section of *Modern Healthcare* Online at [modernhealthcare.com](http://modernhealthcare.com).

**2008 MERGERS AND ACQUISITIONS (Cont.)**

Buyer	Seller	Hospitals/Staffed beds	Cost (\$ in millions)	Transaction type	Status
<b>MULTISTATE</b>					
Capella Healthcare, Franklin, Tenn. (FP)	Community Health Systems, Franklin, Tenn. (FP)	70-bed Woodland Medical Center, Cullman, Ala.; 120-bed Parkway Medical Center, Decatur, Ala.; 120-bed Hartselle (Ala.) Medical Center; 56-bed Jacksonville (Ala.) Medical Center; 181-bed National Park Medical Center, Hot Springs, Ark.; 153-bed St. Mary's Regional Medical Center, Russellville, Ark.; 98-bed Mineral Area Regional Medical Center, Farmington, Mo.; 88-bed Willamette Valley Medical Center, McMinnville, Ore.; and 24-bed White County Community Hospital, Sparta, Tenn.	\$315.0	Acquisition	Closed
Olean (N.Y.) General Hospital (NFP)	Bradford (Pa.) Regional Medical Center	156-bed Olean General and 96-bed Bradford Regional have a letter of intent to merge under a new parent company	NA	Merger	Pending
Novant Health, Winston-Salem, N.C. (NFP)	Health Management Associates, Naples, Fla. (FP)	Sale of 27% interest in HMA's seven hospitals in the Carolinas: 64-bed Sandhills Regional Medical Center, Hamlet, 59-bed Franklin Regional Medical Center, Louisburg, 129-bed Lake Norman Regional Medical Center, Mooresville, and 149-bed Davis Regional Medical Center, Statesville, all in North Carolina; 156-bed Chester (S.C.) Regional Medical Center, 125-bed Upstate Carolina Medical Center, Gaffney, and 120-bed Carolina Pines Regional Medical Center, Hartsville, all in South Carolina.	\$300.0	Acquisition	Closed
Psychiatric Solutions, Franklin, Tenn. (FP)	United Medical Corp., Windermere, Fla. (FP)	99-bed Ten Broeck Hospital Jacksonville (Fla.); 94-bed Ten Broeck Hospital, Louisville, Ky.; 87-bed Ten Broeck Hospital Ocala (Fla.); 66-bed Ten Broeck Dupont, Louisville; and 60-bed Wekiva Springs Center for Women in Jacksonville, Fla.	\$120.0	Acquisition	Closed
<b>ALABAMA</b>					
Community Health Systems, Franklin, Tenn. (FP)	Baptist Health System, Birmingham (NFP)	375-bed Trinity Medical Center, Birmingham (Community acquired Baptist's 35% interest in Trinity, giving Community full ownership of the hospital.)	Undisclosed	Acquisition	Closed
<b>ARIZONA</b>					
Banner Health, Phoenix (NFP)	Sun Health Corp., Phoenix (NFP)	332-bed Sun Health Del E. Webb Memorial Hospital, Sun City West, and 365-bed Sun Health Boswell Hospital, Sun City	\$316.0	Acquisition	Closed
<b>ARKANSAS</b>					
Baptist Health, Little Rock (NFP)	Health Management Associates, Naples, Fla. (FP)	79-bed Southwest Regional Medical Center, Little Rock	Undisclosed	Acquisition	Closed
Community Health Systems, Franklin, Tenn. (FP)	City of Siloam Springs (P)	43-bed Siloam Springs (Ark.) Memorial Hospital	Undisclosed	Acquisition	Pending
<b>CALIFORNIA</b>					
Hoag Memorial Hospital Presbyterian, Newport Beach (NFP)	HCP, Long Beach (FP)	176-bed Irvine (Calif.) Regional Hospital and Medical Center (Tenet Healthcare Corp., Dallas, is allowing its lease on the hospital to expire in February. As part of the agreement, Tenet will close the hospital before relinquishing it to HCP.)	Undisclosed	Lease	Closed

(FP) For-profit; (NFP) Not-for-profit; (P) Public. Note: Deals organized by location of property acquired; states omitted had no deals. Seller category includes merger or swap partners.

09  
50

## 2008 MERGERS AND ACQUISITIONS (8 of 8)

Buyer	Seller	Hospitals	Cost (\$ in millions)	Transaction type	Status
<b>TEXAS (cont.)</b>					
Acuity Healthcare, Austin (FP)	Fundamental Healthcare, Sparks, Md. (FP)	30-bed Texas Specialty Hospital, San Antonio	Undisclosed	Acquisition	Closed
<b>VIRGINIA</b>					
Mountain States Health Alliance, Johnson City, Tenn. (NFP)	Community Health Systems, Franklin, Tenn. (FP)	78-bed Russell County Medical Center, Lebanon	Undisclosed	Acquisition	Closed
Mountain States Health Alliance, Johnson City, Tenn. (NFP)	Johnston Memorial Hospital, Abingdon (NFP)	135-bed Johnston Memorial (Mountain States agreed to acquire a 50.1% interest in the hospital.)	Undisclosed	Acquisition	Pending
University of Virginia Medical Center, Charlottesville (P)	Culpeper (Va.) Regional Hospital	60-bed Culpeper Regional (The university medical center agreed to acquire a 49% stake in the hospital.)	Undisclosed	Acquisition	Pending
Valley Health System, Winchester (NFP)	Page Memorial Hospital, Luray (NFP)	25-bed Page Memorial Hospital Carriage Hill Rehabilitation and Nursing Center	Undisclosed	Acquisition	Closed
<b>WASHINGTON</b>					
Community Health Systems, Franklin, Tenn. (FP)	Empire Health Services, Spokane (NFP)	265-bed Deaconess Medical Center, Spokane, and 93-bed Valley Hospital and Medical Center, Spokane	\$148.0	Acquisition	Closed
Catholic Health Initiatives, Denver (NFP)	Enumclaw (Wash.) Community Hospital (NFP)	25-bed Enumclaw Community Hospital (Enumclaw Community has approved a letter of intent to discuss joining CHI's Franciscan Health System, Tacoma, Wash.)	Undisclosed	Acquisition	Pending

(FP) For-profit; (NFP) Not-for-profit; (P) Public. Note: Deals organized by location of property acquired; states omitted had no deals. Seller category includes merger or swap partners.

### M&A >> from p. 22

even considered the idea. Those will be the once-in-a-generation opportunities that investor-owned companies will seek, he says.

Marc Cabrera, a managing director for investment bank Morgan Joseph, sees the same opportunities. "There are good companies that have debt that is maturing, or will be in technical default, and depending on how their lenders respond, they may be forced into a strategic decision" like a merger or a sale of assets, Cabrera says.

Beith, however, doesn't expect the same aggressiveness from investor-owned hospital companies, particularly from the companies owned by private-equity firms. "There are a number of investor-owned companies that, for lack of a better word, are stranded because they don't have the ability to access cost-effective capital, so they are not likely to be significant buyers in the market," Beith says. "Lack of capital is an acute and significant factor for the industry, on both the tax-exempt and

investor-owned sides."

Beith acknowledges that some of the stronger investor-owned companies could make some acquisitions, particularly when they can buy a competitor in one of their markets and strengthen their position. It's more likely that there will be consolidation among the smaller private-equity backed companies than that those organizations will be major acquirers of not-for-profit hospitals, he says.

Beith sees more activity in 2009 coming between not-for-profits, rather than involving conversions to for-profit status. Many of these deals can be done without a cash outlay, such as a system taking on a smaller hospital's debt as consideration for adding the hospital to its portfolio, Beith says. "A lot of traditional relationships will be formalized in acquisitions and mergers," Beith predicts. "Loose affiliations may become much stronger in the form of literal acquisitions and mergers. I think you'll also see loose affiliations where a merger doesn't make sense, and they will seek their freedom for other tie-ups."

If there are opportunistic acquirers, they may not be limited to investor-owned chains. Not-for-profit Advocate Health Care, Oak Brook, Ill., added its ninth hospital in December, with the acquisition of 283-bed Condell Medical Center in Libertyville, a suburb north of Chicago. Also last month, Advocate signed letters of intent to explore partnership with two other hospitals outside the Chicago area, 286-bed Rockford (Ill.) Memorial Hospital and 213-bed BroMenn Healthcare System, Normal, Ill.

There are benefits to being bigger that don't vanish in a recession, says Scott Powder, Advocate's senior vice president of strategic planning and growth. "There is a direct link between quality and scale," Powder says. "Having more partners and a larger system allows us to have more patients, to basically get better at quality." <<

### What do you think?

Write us with your comments. Via e-mail, it's mhletters@crain.com; by fax, 312-280-3183.