Healthcare's M&A Appetite Poised to Remain Steady in Light of Potential ACA Modification

Trump has repeatedly promised he'd "repeal and replace" Obamacare, but enough underlying drivers are expected to fuel healthcare companies' continued motivation to combine.

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While the dismantling of the Affordable Care Act in light of the Republican sweep raises more questions than answers for the whole spectrum of the healthcare industry, an aging population and a tremendous pressure to reduce costs should continue to propel a robust level of dealmaking.

How the healthcare landscape will change under the Republican Party, which not only won the presidency but both houses, remains massively uncertain. The complete "repeal and replacement" of the ACA, or Obamacare, is something Donald Trump promised time and time again during his campaign, yet we still don't know much about the President elect's views on the whole sector. That suggests any legislative change, and ultimately its impact on M&A, will stem from folks like House Speaker Paul Ryan and other delegates of health policy and reform.

"The administration obviously has a great deal of influence on what the Justice Department and Federal Trade Commission are going to think about mergers, but we don't have a clue what [Trump's] view of those things are," said Mark Rust, who as a managing partner of Barnes & Thornburg LLP and the immediate past chair of the firm's health care department, concentrates on transactional, regulatory and medical-legal issues affecting healthcare entities.

For instance, there has always been an incentive for providers of health services to merge, however once the ACA passed in March 2010 the markets saw a huge uptick in hospital in physician merger activity.

Still, "once you start getting a taste of consolidation and growth it has a force of its own", Rust noted. In other words, government regulations or rules are not likely to prevent healthcare M&A.

That's because underlying drivers of the healthcare sector remain intact, including an aging population, the need to reduce costs, as well as continued efforts from the CMS (Centers for Medicare & Medicaid Services) to migrate towards a system based upon value as opposed to the traditional fee-for-service model in a push to keep patients out of hospitals and fuel preventive care, explained Robert Annas, who as a partner at SOLIC Capital Advisors specializes in healthcare and other sectors, advising on turnaround situations, M&A and private equity.

"The beast that is the ACA is something you can't turn off over night," Annas said, explaining that regardless, greater scale will allow healthcare providers to absorb any theoretical changes to the reimbursement model or otherwise. "It's going to precipitate an increase in M&A. Uncertainty is going to make people want to have a bigger bulk of the market."

Nirad Jain of Bain & Co. agrees that what has been a tremendously strong corporate and private equity M&A healthcare environment will remain robust as competitive market dynamics remain untethered from the ACA or other legislation.

"Healthcare is a sector that most people with flock to when there's times of uncertainty," said Jain, who co-leads Bain's healthcare diligence advisory capabilities.

Much of that uncertainty on the healthcare front is tied to the extent to which Obamacare will be modified or repealed. The complete repeal of Obamacare would, among other things, mean that 22 million people would theoretically be left without health insurance. Over what period changes to the law are made and which aspects of the law are altered remain unknown.

"The opportunity and the motivation is there to repeal pieces—significant, high-profile pieces of the ACA—so it will happen," Rust said. "The question is which things? You can't really repeal the ACA as such, because there were lots and lots of pieces that have already been done. You can't undo them."

"The government is intentionally designed to generate a lot of gridlock and policy inertia," added Bain's Jain.

Acknowledging that it remains extremely pre-mature to assess what the full impact will be on the healthcare market, Jain noted that among sub-secotrs, the outlook for healthcare providers seemingly most negative should the ACA be repealed.

For example, the acute care sector including hospital operators would certainly see a decline in volumes with fewer fully insured patients, Jain said. At the same time, the pace toward accountable care mechanisms, or risk-based payment models, could slow, as providers may become less reluctant to transition away from the more profitable fee-for-service model, Jain explained. Pressure on acute care providers will flow back to suppliers, and so medtech and device companies exposed in that way will be indirectly impacted.

Besides the ACA, the conversion to a Medicaid structure based upon block grants is another policy proposal that House Republicans have pushed for. Block-granting Medicaid would cut federal funding and repeal health reform's Medicaid expansion. Other legislation that could be modified includes MACRA, or the Medicare Access and CHIP Reauthorization Act of 2015.

While the wave of M&A is likely to continue for providers of healthcare services, devices and technology regardless of the fate of the ACA, the dealmaking among pharmaceutical and biotech companies is seemingly more directly tied to the law.

For biotech and pharma players, the biggest potential driver of M&A as a result of the election is the likelihood that offshore profits are repatriated to the U.S. Repatriation of trapped cash essentially frees up cash that U.S.-based drugmakers can then spend on acquisitions of other U.S.-based companies, including biotechs.

Deal activity could start immediately even if repatriation isn't yet legislated, as U.S. pharma players may take on more debt simply knowing that they'll be able to repay it with repatriated cash later.

From a volume perspective, dealmaking could be massive as many Big Pharma companies already are sitting with a war chest ready to deploy. Jefferies LLC analysts estimate that its U.S. large-cap pharma coverage has $112 billion of gross cash at its disposal, $98 billion of which is estimated to be held overseas and the majority of which could be repatriated in 2017.

"We believe that M&A will likely be the primary use of this cash, as many company's require 'earnings bridges' through upcoming LOEs and we we expect that key disease areas of focus could include oncology, automimmune, CNS disorders, Orphan/ single gene disease, and fibrosis," Jefferies analysts wrote in a report.

Those sitting with the most available cash "for making potentially transformative acquisitions" include Johnson & Johnson (JNJ), Pfizer Inc. (PFE) and Merck & Co. (MRK), according to Jefferies.

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