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Health care M&A leads global deal surge

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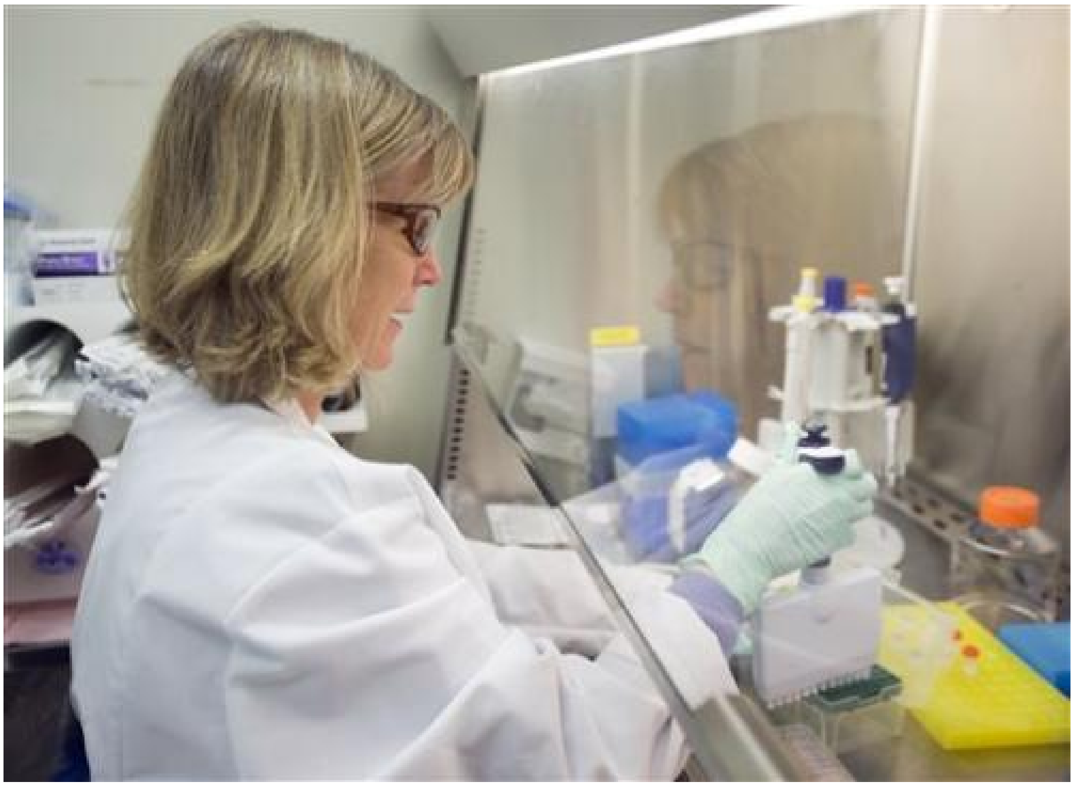

In this Thursday, Feb. 28, 2013 photo, Merck scientist Janet Lineberger conducts research to discover new HIV drugs in West Point, Pa. The health care industry has announced about $438 billion worth of mergers and acquisitions worldwide so far, about 14 percent of the $3.2 trillion total for all industries, according to data provider Dealogic. Merck & Co. agreed in June to pay nearly $4 billion for Idenix Pharmaceuticals Inc. to combine that company's hepatitis C medicines with its own. (AP Photo/Matt Rourke)

In a big year for deal making, the health care industry is a standout.

Large drugmakers are buying and selling businesses to control costs and deploy surplus cash. A rising stock market, tax strategies and low interest rates are also fueling the mergers and acquisitions.

It's all combining to make 2014 the most active year for health care deals in at least two decades. The industry has announced about $438 billion worth of mergers and acquisitions worldwide so far, about 14 percent of the $3.2 trillion total for all industries, according to data provider Dealogic. Overall, M&A is on track for its best year since 2007, the year before the financial crisis intensified.

"Health care has been a sleepy niche of M&A until recently, but the giant has been awakened," says Ken Menges, a senior partner handling M&A at law firm Akin Gump in New York.

To a large extent, the deals are being driven by "cost pressure on the entire health care system," as insurers and government health plans increasingly hold down or even reduce reimbursements to drug, device and service providers, says Ashtyn Evans, pharmaceutical and biotech analyst with investment firm Edward Jones in St. Louis, Missouri.

Companies also are looking to expand market share, and boost their portfolios in hot areas such as drugs for cancer and hepatitis C, she says.

Drugmaker Merck & Co., for example, agreed in June to pay nearly $4 billion for Idenix Pharmaceuticals Inc. to combine that company's hepatitis C medicines with its own.

Taxes are another reason behind the rush to the negotiating table.

Some big, U.S. pharmaceutical, biotech and medical device companies have been trying to acquire overseas rivals, allowing them to move their headquarters to a country with a lower tax rate. The deals also give the buyer access to billions in overseas profits to invest in research and development, without having to bring those profits back to the U.S. and pay taxes on them.

Medical device maker Medtronic's $43 billion acquisition in June of Covidien, a Dublin, Ireland-based rival, is an example.

For customers, this year's deal making has both benefits and drawbacks.

Patients could see a slight increase in new medicines and devices over time. That's because bigger companies typically have more money to spend on developing treatments, and have more experience navigating the difficult process of getting products approved by regulators. But patients could also have fewer doctor and hospital options as companies combine to lower costs.

For employees, the mergers could mean some job losses in areas such as administration and sales, but not in research at drugmakers. Losses at health care providers would be minimal, if any.

The frenzy of health care M&A has been good for stocks.

Mergers tend to boost share prices in general. That's because the acquiring company typically pays a premium over the market value of the target stock to ensure that the deal wins approval from shareholders.

The health care sector has surged 23 percent this year, making it the best-performing industry group in the Standard & Poor's 500 index and putting it on track to outperform the broader market for the fourth straight year.

Private equity firms are investing in small biotech and pharmaceutical companies needing billions for research and development. In return, private equity hopes to profit through initial public offerings of the companies they invest in, or by selling them to bigger rivals.

Big hospitals also have been doing their own deals, snapping up related businesses. That includes a surge in hospitals buying "mom-and-pop" doctors' practices and outpatient clinics to feed new patients into their system, says David Hillman, a partner at law firm Schulte Roth & Zabel LLP.

All health care companies—from nursing homes to drugmakers—are under pressure to keep costs down in today's market, says Bob Laszewski of Health Policy and Strategy Associates, an adviser to health companies.

"That in turn leads to ... combinations to make organizations more expense efficient, combinations for more economies of scale, people buying up smaller organizations that have developed an ability to deliver niche products."

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