Dialing Down the 'Deal Heat' During Due Diligence

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As the temperature topped 98 degrees on the East Coast last month, I was reminded of the "deal heat" we often witness in healthcare transactions. Sometimes the intensity of negotiating deal terms can cause participants to lose perspective on the big picture.

In our last post, we discussed the hot trends in hospital and insurer consolidation, noting the volume of mergers and acquisitions. Deals between hospitals and physician groups and practices also continue to percolate and simmer nationwide—and sometimes boil over as points of contention become too heated. Most providers are involved in at least one major transaction every year.

Deals are driven by the goals and objectives of the negotiating hospitals, physicians, or insurers. However, it also is important that deal terms make sense, are prudent, and—not just incidentally—comply with the various laws and regulations affecting healthcare providers.

Letters of intent (LOIs) and term sheets that precede the definitive agreements governing mergers and other transactions should give all parties time to check, double-check, and triple-check their goals and objectives and the deal parameters. After all, in most cases, a merger is the most important decision the board of an institution or corporation will ever make.

The due-diligence period is the perfect time to cool things down and bring some independence and objectivity to the table. Traditional due diligence, of course, involves the exhaustive search for serious problems or even deal stoppers. It typically includes:

- Review of all financial, operational, and legal documents and records
- Analysis of historical operating and financial trends and performance
- Evaluation of key performance drivers and quality of earnings
- Interviews with key management staff
- Identification of any compliance or regulatory issues

The calmer climate of the due-diligence period can be an excellent time to reevaluate the strategic and financial merits of the transaction. Often, the parties have been working at warp speed just to get to the LOI and term sheet stage. The due-diligence period thus should afford an opportunity to address questions related to three key areas of concern:

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- What constitutes each relevant scenario, what are the strategic and financial implications of each, and what will be the consequences if the organization walks away from the deal?
- What would the organization look like after the transaction? Specifically, if the deal goes through, what would the P&L statements and balance sheets look like over the next five to seven years for the organization and for the entity targeted for the merger or acquisition?
- What impact would these scenarios have on the local and regional market? How might other organizations respond?

The due-diligence period should be more than a search for deal barriers. The cooler emotional temperatures that prevail during this time present an opportunity to reaffirm why the deal is compelling and to establish clarity about the post-transaction future.

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