Deal Scan

The Reconsolidation of Imaging Centers

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Significant market trends, over the past few years, have affected the competitive environment between hospitals and physician-owned freestanding imaging centers. The primary drivers of these trends are the relative weaknesses of a large number of freestanding imaging centers (caused by changes in reimbursement and regulation) and the sensitivity of these businesses to the economic crisis. These changes in the landscape have created the ideal environment for a reconsolidation of imaging centers that can bring them back into hospital operations through acquisitions, perhaps at depressed market values.

Todd Sorensen, AVA

Hospitals are using their newfound relative strength in certain key strategic areas opportunistically to acquire freestanding imaging centers in their markets. Some hospital advantages include reimbursement, access to capital, vendor relationships, and physician employment. Our company, VMG Health, has experienced a significant increase in the demand for valuation services, in the past year, in support of hospital acquisitions of freestanding imaging centers.

A Challenging Past

The loss of imaging services, over the years, has caused myriad unpleasant dynamics for hospitals. There has been a consistent and continuing migration of imaging services out of the hospital setting, mostly to physician-owned or entrepreneurial businesses. Often, the imaging services that remain in the hospital have low margins, combined with a high remaining cost structure.

The result has been a deterioration of capacity in imaging services due to the inability to reinvest in imaging equipment and infrastructure; this, in turn, has caused a loss of market share and a loss of business to more efficient competitors in the marketplace. Two years ago, experts were predicting continued brisk outmigration of imaging volume to the freestanding setting. Recent changes in the strategic landscape, however, might slow this outmigration.

Given the trends favoring of outmigration, it defies common wisdom to consider the strategic positioning of hospital outpatient imaging departments as strong. The current phase of the market cycle has given hospital management a chance to take the initiative.

The acquisition of freestanding imaging centers allows hospitals to win back market share; to deploy capital intelligently, in an optimal fashion, throughout the imaging delivery model; and to reintegrate key radiologists. The ability to tap the market and industry expertise of prominent radiologists is vital to the expansion of imaging's service-line continuum for hospitals. The strategic dynamics favoring hospitals today (and initiating the recent wave of acquisitions) are reimbursement, access to capital, vendor relationships, and physician employment.

Reimbursement: Changes in the payment landscape are adding to the pressure on profits for freestanding imaging businesses. Imaging centers experienced significant reimbursement hits in 2007 as a result of the DRA. Health reform alters the utilization rate for high-end imaging equipment and results in phased-in Medicare cuts over the next few years for freestanding outpatient imaging.

Compounding the impact of Medicare changes, commercial payors are consolidating in some markets, gaining leverage that allows them to push down rates. Thinning margins, combined with volume losses, can have a significant impact on the profitability of a physician-owned business. Conversely, hospitals can influence negotiations with commercial payors for outpatient imaging using the negotiating leverage that they inherently have for inpatient services, resulting in higher periodic rate adjustments.

Access to capital: Since the beginning of the financial crisis, the difference in access to capital between hospitals and small freestanding providers has been stark. The gap has widened recently, since hospitals' capital access has improved as the financial crisis has ebbed. Aggressive hospitals have replaced aging equipment in markets where their freestanding competitors have been unable to do so, creating a technological strategic advantage. The unwillingness of freestanding imaging centers' owners to provide a personal debt guarantee can create a situation in which updating or replacing aging equipment is impossible.

Vendor relationships: Due to closings and consolidations, the marketplace currently has a flood of used equipment for sale. More than ever, manufacturers are willing to negotiate prices to win an imaging center's business; software and hardware enhancements can sufficiently upgrade many advanced imaging systems. The ability to take advantage of this buyer's market is crucial to an imaging center's competitive longevity—and it depends entirely on the creditworthiness of the imaging center.

Hospitals are using their relationships with equipment vendors to garner favorable pricing on new and used equipment, leveraging purchasing power with these companies throughout their systems. Volume discounts and preferred-provider relationships are available to large systems (and unavailable to small freestanding imaging providers).

Physician employment: A dramatic increase in physician employment by hospitals has been seen. Employment of the physicians by hospitals creates a captive and reliable source of referrals to hospital-owned imaging centers. Imaging referrals from employed physicians are especially effective when hospital-owned centers are clustered in medical office buildings or in areas with a significant number of employed physicians. The hospital also can take advantage of integrated information systems, reducing turnaround times for reports.

Hospitals are taking the initiative in stemming the outmigration trend for imaging volume by aggressively pursuing in-market acquisitions of freestanding imaging centers. Trends in reimbursement, access to capital, vendor relationships, and physician employment have coalesced to create an optimal environment for acquisition and consolidation in the imaging service line. This trend will probably slow (or alter the growth of) imaging-volume outmigration for the foreseeable future.

Elliott Jeter is a partner with VMG Health, a national company (with offices in Dallas, Texas, and Nashville, Tennessee) that specializes in health-care valuations and transaction advisory services. Todd Sorenson is a partner with the company.

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Does your description of freestanding include the in-campus imaging that very large groups often perform; using Government loopholes on referring-physician ownership? These hurt hospitals both in terms of volume and "patient dumping" where non-covered or low-payer covered patients were sent to the hospital for imaging; the practices kept the better-paying patients to themselves. I applaud your work in assisting hospitals in reducing the number of facilities. High-volume centers can perform the cases at better price-points.

Posted By: James A Kieffer May 20, 2010

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