Speaker Introduction

Mr. Kevin M. Kennedy, Principal

- A consultant since 1990, Mr. Kennedy has helped dozens of healthcare organizations solve their strategic, financial, and operational problems.
- A frequent speaker before industry associations, he has received the Yerger/Seawell Article of the Year award for outstanding contribution to professional literature from HFMA.
- He leads the Northwest Healthcare practice and is a member of the ECG Management Consultants, Inc., Board of Directors.

Mr. Joshua D. Halverson, Principal

- Mr. Halverson has over 15 years of experience in healthcare strategic and business planning and financial management.
- He possesses extensive knowledge of strategic, operational, and financial best practices among large physician groups and in the context of their integration within health systems.
- Mr. Halverson specializes in economic alignment between physicians and hospitals involving acquisition, group development, compensation planning, and operations improvement.
- He leads the ECG Dallas, Texas, office.
Agenda

I. Setting the Stage
II. Common Mistakes and Solutions
III. Strategic Partnership Options
IV. Partnership Selection Process
V. Case Studies
VI. Questions and Discussion

I. Setting the Stage
I. Setting the Stage

Overview

There were major changes in the healthcare landscape in 2013.

TX

LA

TN

Trinity Health & Catholic Health East

Community Health Systems & Health Mgmt.

 LSU Health System

Mount Sinai Medical Center & Continuum

Tenet Healthcare & Vanguard Health Systems

Baylor Health Care System & Scott & White Health

Catholic Health Initiatives & St. Luke's

Highmark & West Penn Allegheny Health System

TX

NY

Highmark & WestPenn

Allegheny Health System

TX

PA

Tenet Healthcare & Vanguard Health Systems

$1.8 Billion Deal

Community Health Systems & Health Mgmt.

Associates

$7.6 Billion Deal

There were major changes in the healthcare landscape in 2013.

There were major changes in the healthcare landscape in 2013.

The megamergers make the headlines, but a vast majority of transactions involve a single acquired, often independent, hospital.

Frequency of Transactions by Number of Acquired Hospitals, 2007–2013


2 Annualized from first 6 months of data.
I. Setting the Stage
Hospital M&A Activity on the Rise

Hospital M&As have accelerated over the past decade.

Announced Hospital/Health System Transactions

```
Announced Hospital/Health System Transactions
0 20 40 60 80 100 120
82 56 37 59 55 61 69 52 77 86 103
```

“Hospital operators face a buyer’s market for acquisitions as weaker companies struggle with higher costs and a decades-long drop in admissions.”

“This business has gotten tougher and tougher as [companies deal with rising expenses and cuts to government payments]. We can do that across [a] vast portfolio. I can’t imagine if you’re trying to run a mid-sized, independent hospital how you figure this out.”

– Trevor Fetter, CEO Tenet Healthcare Corporation


I. Setting the Stage
Key Factors

Numerous factors are creating an environment ripe for hospital consolidation; however, the recent surge in M&A activity can largely be attributed to six key drivers.

“Five of the six first-quarter 2013 ratings downgrades were on hospitals with less than $500 million in revenues.”

– Moody’s Investors Service, Inc., 2013

“There are hospitals out there … saying, ‘We’re going to be independent for the next 100 years.’ That’s going to be a tall order. As other hospitals consolidate and grow around you, whatever niche you had will vaporize.”

– Lisa Goldstein, Moody’s 2013
I. Setting the Stage

Lower Utilization

Inpatient use rates are projected to fall across all populations.

National Inpatient Use Rates, 2011–2021

Sources: Milliman, Kaiser Family Foundation State Health Facts, and AHA.
I. Setting the Stage
Lower Utilization (continued)

It is anticipated that outpatient utilization will continue to fall over the next decade.

- MRI Usage
- Ambulatory Surgery
- CT Scans
- Office/Home/Urg. Care/Physical Exams Visits

Sources: Milliman, Kaiser State Health Facts, and AHA.

Past value-based reimbursement pilots have demonstrated that cost savings largely come from declines in inpatient service utilization, which negatively impact hospital margins.

Performance Summary From a PCMH Pilot Project

- Everyone likes costs savings until it comes out of your particular revenue stream.
- Early results indicate that the savings from alternative delivery models (such as PCMHs) will come from reductions in ED visits and hospital admissions.
- Primary care and pharmaceutical expenses have typically increased as part of this model.

Note: Percentage of change is based on respective baseline. Source: KI, 2010. AMGA National Summit on ACOs.

Hospitals have seen and will continue to experience reduced utilization with the implementation of PCMH and other population management initiatives.
I. Setting the Stage

**Investment Per Physician Increasing**

Health system-sponsored organizations in ECG’s national database have reported increased losses in the physician enterprise over the last 4 years.

Integrated Health System Investment/(Loss) Per Physician

<table>
<thead>
<tr>
<th>Year</th>
<th>Investment Per Physician</th>
<th>Percentage of Net Collections</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>$(138,724)</td>
<td>-29.7%</td>
</tr>
<tr>
<td>2010</td>
<td>$(148,791)</td>
<td>-33.2%</td>
</tr>
<tr>
<td>2011</td>
<td>$(148,025)</td>
<td>-28.3%</td>
</tr>
<tr>
<td>2012</td>
<td>$(181,407)</td>
<td>-33.6%</td>
</tr>
</tbody>
</table>

Source: ECG 2013 surveys.

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I. Setting the Stage

**Conclusions**

- Most observers believe that hospital utilization will fall over the next 5 to 10 years as clinical practice patterns evolve.
- Reimbursement is under strain from the following:
  - Planned ACA reductions.
  - Competitive pressures from exchanges.
  - Employer willingness to consider narrow networks.
- Expenses keep growing as pressures mount to improve quality and service.
- In addition, hospitals face unprecedented demand for investments in the following:
  - IT.
  - Physician alignment.
  - New capabilities in population management.
- Preparing a realistic 5-year pro forma with a variety of reimbursement and volume scenarios should be part of a hospital’s decision-making process.

Many independent hospitals have concluded that being part of a larger system will help ensure organizational survival.
II. Common Mistakes and Solutions

Reactive Versus Proactive

Most (but not all) hospital partnerships are borne out of mounting operational and financial distresses among the partner-seeking organization.

- Many hospitals choose to remain independent for too long, letting market and economic forces erode the organization’s long-term viability.
  - Independent hospitals do this to maintain autonomy as long as possible.
  - However, holding out too long lessens/eliminates partnership opportunities.
- Stand-alone hospitals that consider partnerships before financial/operational challenges arise, do so from a position of strength, which broadens their partnership options.
- Proactively seeking partnership opportunities from a position of strength can also improve negotiating leverage related to:
  - Clinical programs and services.
  - Community goals.
  - Capital and facilities.
  - Other key objectives.

Leaders must identify the “red flags” early on in order to improve performance or to position the organization for a partnership while it still has significant value.
II. Common Mistakes and Solutions

Stages of Distress

Rarely do hospitals seek partnerships as a result of a single event or performance against a handful of indicators. More commonly, it is a combination of forces and market factors that make a partnership necessary.

Sequential Stages of Distress (Example)

- Loss of Key Physician(s)
- Decline in Patient Volumes
- Increasing Expense/Payables
- Erosion in Payer Mix
- Cash/Cash Flow Deficiency
- Funding to Fund Capital Budget
- Bond Covenant Default
- Urgent Partnership Needed

At Risk | Financial Health | Insolvency

Myriad indicators exist to monitor hospital operational and financial performance; however, there are several “red flags” that, when triggered, warrant additional scrutiny.

Financial Red Flags
- Low Days Cash on Hand (<90 Days) and Downward Trend
- Depreciation Outpacing Capital Expenditures (2 Consecutive Years)
- Weak Operating Cash Flow Margin (<6%) and Downward Trend
- Increasing Bad Debt Expense (>10% to 15% Increase From Prior Period)

Operational Red Flags
- Year Over Year Decline in Inpatient/Outpatient Volumes
- Loss of Key Physician(s)
- Hospital Facing Compliance/Accreditation Problems
- FTEs Per Adjusted Patient Day Exceed Regional Averages
- Decrease in Market Share
III. Strategic Partnership Options

Overview

Hospitals considering a strategic partnership have a range of alternative transaction structures from which to choose.
III. Strategic Partnership Options

Clinical/Shared Services Affiliation

A clinical/shared services affiliation enables the partner-seeking organization to reduce costs and improve efficiency in targeted areas, but it generally offers a lower level of integration/stability relative to other models.

**Overview**

- The partner-seeking organization becomes an affiliate of the partner in exchange for certain services or expertise that partner provides.
- The affiliation may be very specific, such as a single service line, or for the entire entity.
- Generally speaking, this structure provides a low level of integration and stability for the partner-seeking organization.

### Shared Services

- Physician Coverage
- Clinical Protocols
- Marketing or Branding
- Business Office
- Group Purchasing
- IT Support
- Service Line Management

Management Services Agreement

Under a Management Services Agreement, the partner-seeking organization elects to outsource the day-to-day operation of the hospital to a third party.

- The partner-seeking organization enters into a fee-based Management Services Agreement with a partner, typically involving a for-profit hospital management company, to manage the operations of the partner-seeking facility.
- A Management Services Agreement does not result in realignment of ownership or governance/control.
- Management fees are often structured as a percentage of the partner-seeking organization’s net revenues (3% to 6%).
III. Strategic Partnership Options

**Joint Operating Agreement**

Joint operating agreements typically bring together two or more health systems/hospitals to create a jointly governed entity to operate the affiliating organizations.

- A joint operating company is formed to serve as the operator of both the partner and partner-seeking organization’s hospitals.
- Its role is to coordinate strategic decisions regarding operations of affiliates and has the power to approve budgets, loans, strategic plans, managed care participation, asset transfers, and other initiatives.
- The individual boards of affiliates retain power to make medical staff appointments, develop budgets, monitor quality of care, and make other day-to-day decisions.
- Balance sheets are **not** consolidated, and the net income/future capital expenditures are **shared** between the organizations according to **predetermined formulas**.

**Joint Operating Agreement Diagram**

- Partner-Seeking Organization
- Joint Operating Company
- Partner Organization
- Partner-Seeking Organization’s Hospital(s)
- Partner Organization’s Hospital(s)
- Shared Governance and Operational Responsibility

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IIII. Strategic Partnership Options

**Joint Venture**

The joint venture model involves engaging a strategic partner (typically for-profit chain) in the development of a new corporate entity that provides services.

- The for-profit chain contributes cash to the joint venture; the partner-seeking organization contributes its physical hospital assets and operations in exchange for ownership interest/cash.
- Not-for-profits typically only keep JV ownership interest of 20% to 30% but with proportionately higher representation on the JV’s governing board (50%/50% is common).
- The not-for-profit party generally uses extracted cash to repay tax-exempt debt and liabilities that are not assumed by the joint venture.
- The for-profit partner manages the JV, subject to the JV board’s oversight, and receives a management fee in return (3% to 6% of net revenue).
III. Strategic Partnership Options

Member Substitution

- The partner-seeking organization amends its articles of incorporation and bylaws so that the partner becomes the sole corporate member – this is generally a cashless transaction structure.
- The partner-seeking organization continues to operate itself subject to certain reserve powers held by the acquirer.

Hospital/Health System Consolidation

- The partner and partner-seeking organizations both contribute their operating assets (and liabilities) to a new entity – this is also a cashless transaction.
- Membership on the governing board of the combined entity either features equal representation among both parties or is based on the value of the assets contributed to the new entity.
- New entity has successor liability related to the historical actions of both organizations.
- This structure requires numerous licensure, payor, and other approvals that are more complex than with most other structures.
III. Strategic Partnership Options

**Long-Term Asset Lease**

A long-term lease arrangement preserves many benefits from other alternatives, while allowing the partner-seeking organization to retain ownership of assets.

- The parties enter into a long-term lease (e.g., 25-plus years) in which the partner organization receives access to and use of the partner-seeking organization’s assets.
- The partner is responsible for the hospital’s revenue, all expenses, physical plant maintenance, capital expenditures; medical staff relations; etc.
- Unless the lease is renewed or the hospital is leased to another party, the operational responsibility of the hospital will revert to the partner-seeking organization.
- The board of the partner organization is often expanded, or a separate oversight/steering committee is established to enable the partner-seeking organization’s board members to maintain a role in the direction of the organization.

**Partner-Seeking Organization (Lessor)**

- Lease Agreement
- Lease Payments
- Leased Hospital
- Retains Ownership
- Operational Responsibility
- Revenues and Expenses

**Partner Organization (Lessee)**

- Operational Responsibility
- Leasing Agreement
- Lease Payments
- Revenues and Expenses

- The partner-seeking organization transfers its assets (and operations) and certain liabilities to the partner in return for a cash payment.
- The cash payment is used to repay any outstanding liabilities that are not assumed by the partner, which typically include long-term debt and current liabilities.
- If there are net proceeds remaining after repayment of non-assumed liabilities, the remaining funds are placed in a charitable foundation and can be used to further benefit the community.
- The partner-seeking organization may be invited to participate in governance on the partner’s board and/or local community board.

**Partner Organization (Buyer)**

- Purchased Assets (And Assumed Liabilities)
- Cash
- Repayments
- Net Proceeds
- Net for Profit Community Foundation

**Partner-Seeking Organization (Seller)**

- Repayments
- Net for Profit Community Foundation
IV. Partnership Selection Process

Getting From “Here” to “There”

While each arrangement has unique characteristics, most hospitals experience the following phases as part of a strategic partnership:

<table>
<thead>
<tr>
<th>Phase I</th>
<th>Phase II</th>
<th>Phase III</th>
<th>Phase IV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partnership Planning</td>
<td>Partner Exploration and Transaction Development</td>
<td>Due Diligence/Partnership Execution</td>
<td>Integration</td>
</tr>
<tr>
<td>- Develop partnership goals and objectives.</td>
<td>- Identify and evaluate partner universe.</td>
<td>- Conduct transactional due diligence.</td>
<td>- Confirm expectations related to degree of integration for “Day 1.”</td>
</tr>
<tr>
<td>- Select appropriate partnership process (e.g., exclusive negotiated process versus competitive process).</td>
<td>- Prepare descriptive memorandum and/or RFP.</td>
<td>- Negotiate and finalize definitive agreements.</td>
<td>- Assemble resources and structure to execute integration.</td>
</tr>
<tr>
<td>- Assemble transaction team.</td>
<td>- Evaluate RFP responses (as necessary).</td>
<td>- Secure regulatory approvals.</td>
<td>- Develop integration roadmaps.</td>
</tr>
<tr>
<td>2 to 3 Months</td>
<td>6 to 12 Months</td>
<td>6 to 12 Months</td>
<td></td>
</tr>
</tbody>
</table>

In reality, the transaction process is not as linear, and the lines between phases are often blurred.
**IV. Partnership Selection Process**

**Developing Goals and Objectives**

*Setting partnership goals is likely the most important component of the partnership planning process.*

**Sample Questions**

<table>
<thead>
<tr>
<th>Mission, Vision, and Values</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>What are the missions of the respective organizations and how do they align with other potential organizations?</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Governance Considerations</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>What are the governance expectations of the partners (e.g., decisions relating to strategy or operations)?</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Strategic Plans</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>What are the critical elements of the existing strategic plans? How do the organizations’ assets contribute?</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Clinical Program and Services</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>What are the goals for existing clinical programs and services?</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital and Facilities Commitments</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>What capital commitments are expected, including consideration for facilities, clinical equipment, and information systems?</td>
<td></td>
</tr>
</tbody>
</table>

**IV. Partnership Selection Process**

**Determining Partnership Pathway**

*There are generally two options available to partner-seeking organizations.*

<table>
<thead>
<tr>
<th>Exclusive Process</th>
<th>Competitive Process</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Involves engaging one potential partner.</td>
<td>• Involves engaging several potential partners.</td>
</tr>
<tr>
<td>• The selected partner is believed to have a strong:</td>
<td>• Creates a competitive environment to identify the best partner.</td>
</tr>
<tr>
<td>– Chance of fulfilling the goal/objectives of the partnership.</td>
<td>• Enables the board to weigh the merits of alternative proposals.</td>
</tr>
<tr>
<td>– Level of interest in forging a partnership with your organization.</td>
<td>• Generally carried out through a Request for Proposal (RFP) process.</td>
</tr>
<tr>
<td>• Precludes comparative evaluation of multiple proposals.</td>
<td></td>
</tr>
<tr>
<td>• Enables partner-seeking organization to maintain confidentiality.</td>
<td></td>
</tr>
</tbody>
</table>
### IV. Partnership Selection Process

**Key RFP Factors to Consider**

The matrix depicted below is an example of a tool that can be used to evaluate potential partners/options.

<table>
<thead>
<tr>
<th>Category</th>
<th>Weight</th>
<th>Hospital A</th>
<th>Hospital B</th>
<th>Hospital C</th>
<th>Hospital D</th>
<th>Hospital E</th>
<th>Hospital F</th>
<th>Total Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial</td>
<td>5</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>122</td>
</tr>
<tr>
<td>Access to capital</td>
<td></td>
<td>3</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Willingness to fund infrastructure, IT, and physician investments</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operational</td>
<td>4</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>104</td>
</tr>
<tr>
<td>Experience in managing hospital-owned physician networks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ability to recruit/retain top physician services</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment in strategic services and programs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strategic</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>102</td>
</tr>
<tr>
<td>Commitment to maintain inpatient services in the community</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Acceptance of role in governance</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commitment to the local community [e.g., community foundation]</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cultural Fit</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>84</td>
</tr>
<tr>
<td>Consensus of partner vision with our mission, vision, and principles</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Priority of partner's operations and other services</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Demonstrated ability to partner with other organizations</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transaction Considerations</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>72</td>
</tr>
<tr>
<td>Willingness to consider a variety of transaction options</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Perceived ease of decision-making process</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Score</strong></td>
<td></td>
<td>122</td>
<td>104</td>
<td>102</td>
<td>84</td>
<td>72</td>
<td>60</td>
<td></td>
</tr>
</tbody>
</table>

#### IV. Developing and Executing Integration Plan

A project management office and work group structure is often established to lead the integration of both organizations.

<table>
<thead>
<tr>
<th>Steering Committee</th>
<th>Documents and Due Diligence</th>
<th>Employment and Benefits Coordination</th>
<th>Operational and Organizational Planning</th>
<th>Physician Employment Terms</th>
<th>Financial Terms</th>
<th>Other Work Groups (As Appropriate)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEOs, CFOs, COOs</td>
<td>Leadership Legal/Compliance</td>
<td>Leadership COOs</td>
<td>Leadership COOs</td>
<td>Leadership COOs</td>
<td>Leadership CFOs</td>
<td>Leadership COOs</td>
</tr>
<tr>
<td>Legal counsel</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advisers</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Responsibilities**
- Preparation of definitive agreements
- Due diligence
- Regulatory issues/necessary approvals/notifications
- Governance
- Benefits
- Compliance

**Other Work Groups (As Appropriate)**
- PMO (Internal/External Resources)
- PMO (Internal/External Resources)
- PMO (Internal/External Resources)

**In many cases, key work groups (e.g., financial terms) are established during earlier phases to support the overall timeline.**
IV. Partnership Selection Process
8 Rules for Strategic Partnerships

When one or more of these rules are broken, partnership discussions are far more likely to collapse.

1. Establish and adhere to a firm timetable for discussions.
2. Any stipulations (deal breakers and must-haves) should be voiced before negotiations commence.
3. All agreements or assurances made must be maintained.
4. Information used to inform discussions must be deemed accurate by designated representatives of each organization in advance of scheduled steering committee meetings.
5. Determine who will be privy to merger discussions – strict confidentiality is essential to maintain trust and integrity of the process.
6. Avoid changing or adding steering committee members midway through the process. Each member must be both committed to and available for active participation through closing.
7. Parties should agree up front to any messages that will be communicated to internal and external stakeholders, as well as to the media. The steering committee may consider developing a communication subcommittee for joint updates.
8. Be willing to change the way things have been done in the past.

V. Case Studies
V. Case Studies

Mountain Healthcare

Mountain Healthcare (MH), a 349-bed nonaffiliated hospital, felt confident in its performance and so missed out on ideal alignment opportunities.

The Situation
- MH is a financially stable, well-performing independent hospital with strong community support and an excellent payor mix.
- Health Systems A and B are the two major systems in the region, with MH between their respective catchment areas.
- The market was consolidating rapidly into fewer and fewer systems.
- Believing there was no urgency, the MH board rebuffed affiliation offers from both systems.

The Result
- Within 12 months, Systems A and B announced a merger.
- Antitrust concerns precluded MH’s continued discussions with this new system.
- The remaining potential partners all present major compromises in terms of financial strength and strategic fit.

If you have attractive options, time is not your friend.

1 Pseudonym.

1/22/2014

V. Case Studies

St. Mary’s Hospital

St. Mary’s Hospital (SMH), an independent, 400-bed regional referral center, has been experiencing financial distress primarily due to increased competition.

The Situation
- Increased competition and volume losses in profitable service areas such as cardiovascular, neuroscience, and general surgery created financial pressures.
- The competing hospital was aggressively recruiting specialty physicians in these key areas to steal market share.
- The hospital had several resident training programs with a university health system in a nearby town.

The Decision
- After a long decision-making process, SMH is pursuing an affiliation with its academic partner.
- The academic partner is enthusiastic about the prospect of building its clinical enterprise and creating a more robust faculty practice.

The Result
- Initial discussions are positive.
- Discussions have focused on strategic and operational aspects.

1 Pseudonym.
V. Case Studies
Riverside Medical Center

The Situation
- Intensely loyal primary care physicians.
- Weak specialty presence, mostly splitters; difficulty recruiting and obtaining coverage for key specialties.
- Relatively rapid population growth, but newcomers often seeking care in nearby major metropolis.
- Strong competition from a competitor facility in nearby community, especially for profitable services like cardiology and surgery.
- Recent decision by major group (orthopedic surgeons) to open ASC; multimillion dollar negative financial impact expected.
- Recent large investments in new MOB, ED, and birthing center with significant interest and depreciation expense. Additional capital needed for electronic health records (EHRs).
- Recent purchase by regional system of plot of land in nearby community.

A proud past, but clouds on the horizon.

Riverside Medical Center, a 143-bed community hospital, aligned with Regional Health System.

V. Case Studies
Riverside Medical Center (continued)

The Decision
- A multiyear dialogue was conducted at the board level and with medical staff leadership regarding independence and market evolution.
- With the impending loss of surgeries and emergence of strong competition, the board worried that Riverside's attractiveness to potential partners would decline over time.
- Riverside issued an RFP to three health systems; serious dialogue was conducted with two.
- A decision to align with a regional health system was based on experience with EHRs and commitment to deploy, an agreement to maintain certain services locally, the ability to secure specialty coverage, and a strong health plan.

The Result
- Margins have been stable despite loss of orthopedic cases.
- Riverside has secured an EHR and access to less costly shared services.
- Specialty coverage has improved through the Regional Health System.

With very strong local competitors and significant looming external strategic threats, Riverside elected to seek a partner.
The Situation

- Four consecutive years of multimillion dollar operating losses driven by declining volumes, low revenue growth, and high cost structure.
- Primary care market dominated by competing system’s employed group, weak specialty presence, and difficulty recruiting and obtaining coverage for key specialties.
- Capture of only 25% of volumes in primary service area; significant out-migration of commercially insured patients to competing hospitals.
- Rapid increase in bad debt expense.
- Weak balance sheet leading to postponement of capital improvements for several years.
- LH public support waning as demonstrated by polls indicating weak support for a proposed increase in tax levy.
- Financial projections that suggested organization was less than 9 months away from insolvency.

Immediate Needs

- Access to capital.
- Operational bench strength.
- Clinical program development.
- Brand enhancement.

The Decision

- Board elected to move ahead with partnership as well as financial improvement plan; aim was to “buy time” and improve attractiveness to potential partners.
- LH issued an RFP to seven health systems; Major Hospital (MH) was selected as preferred partner for transaction planning.
- MH ultimately terminated discussions when its parent organization merged with another large system.
- Financial improvement plan generated measurable gains but was still insufficient to ensure LH’s independence over the long term.
- LH was approached by several for-profit chains; entered into partnership discussions with For-Profit Healthcare.
- Parties agreed to joint venture structure and had developed definitive agreements when For-Profit terminated discussions amid growing concerns over LH’s financial performance.

The Result

- LH is continuing to evaluate partnership options with local providers.
- Ability to forge partnership prior to insolvency is in question.
Questions & Discussion

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