

From Surviving to Thriving:

The Leader's Obligation to Consider All Affiliation Options

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Outline

Introduction

Headwinds and Trends

Board's Role and Obligations

Thoughtful Process

Key Takeaways



Our Perspective

Todd Linden

Partner in Linden Consulting, dedicated to leading ways to improve the wellbeing of individuals and advance the quadruple aim for healthcare. Leader, speaker, innovator, he received his master's and bachelor's degrees from the University of Iowa, is a fellow in the American College of Healthcare Executives and retired after 24 years as president of Grinnell Regional Medical Center where he was named CEO Emeritus.

Chris Benson

Executive Director at Juniper Advisory, a specialized investment banking firm focused solely on hospital merger and acquisitions advisory services. Nearly 25 years in leadership at the Mayo Clinic in operations, strategy and provider collaborations both domestically and internationally. Background and experience provides an unparalleled understanding of how organizations in the hospital industry can create value together short of change of control transactions.



Who's in the room?



The “Vow of Independence”

It is not uncommon for Boards and leaders of independent hospitals to have a deeply held position favoring independence above all.

Proven as a solid strategy time and time again

Where to set the bar – Survive vs Thrive?

Is independence an end goal or shorthand for important interests?



Interests

Local Governance	retain local decision-making authority and input on issues that matter
Community Investments	ensure assets built and donated over the years remain focused on the community
Retain and Grow Services	maintain access to high-quality care locally and avoid becoming a referral center or “band-aid station”
Local Employment	protect local jobs and preserve the hospital’s role as a significant employer in the community, contributing to economic stability and growth



Interests

Community Support	maintain strong relationships with the community
Brand & Reputation	protect the hospital's brand and maintain trust and credibility
Agility	retain the ability to respond swiftly to local health care needs and opportunities without bureaucratic hurdles
Collaborations	retain ability to enter strategic partnerships, alliances or joint ventures to meet community needs



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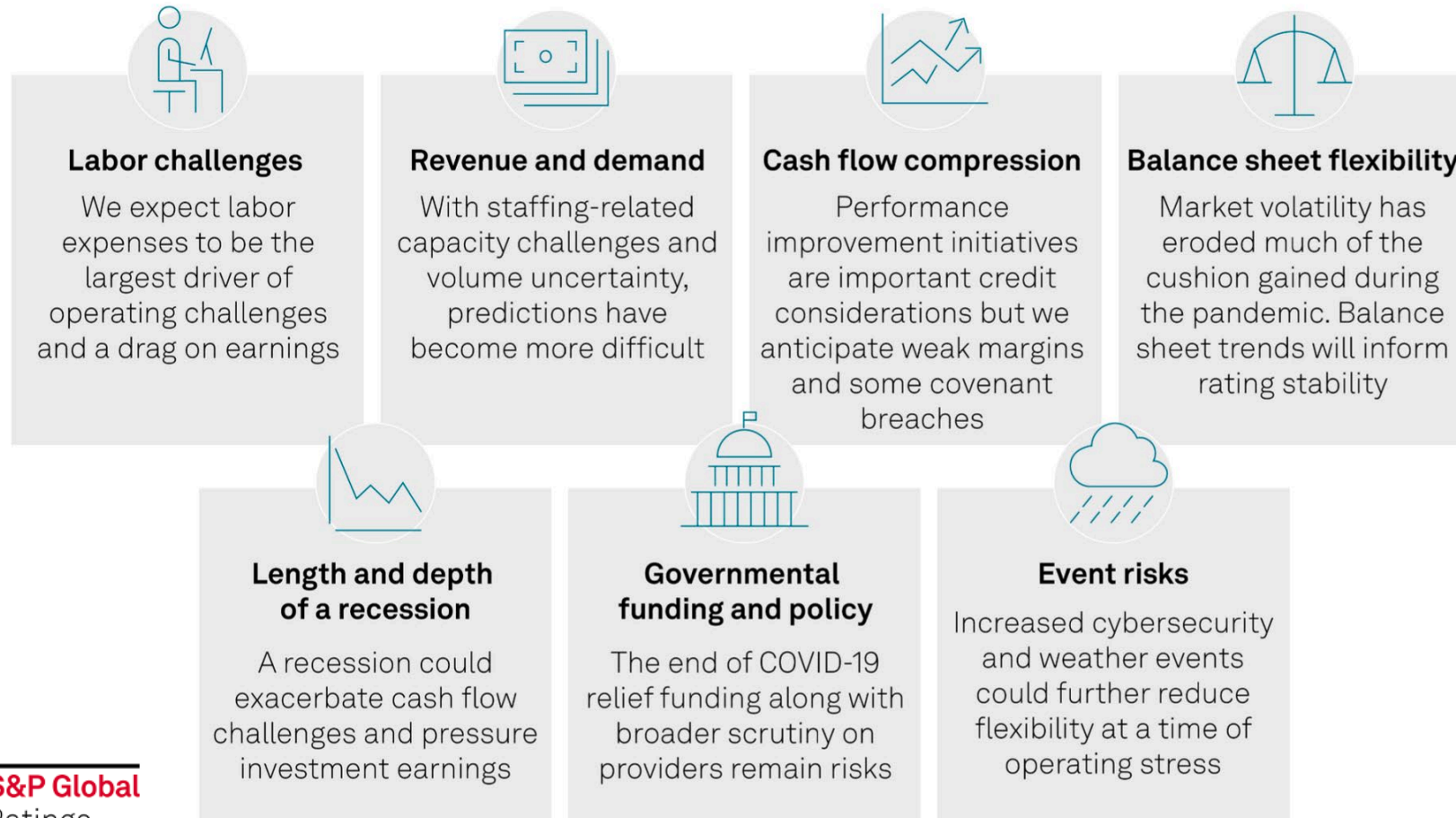
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Industry Headwinds



S&P Global
Ratings



Texas

For 2022, nearly half of all Texas hospitals had negative operating margins. Almost one out of every 10 Texas hospitals is at risk of closure.

Texas Hospitals Now Face:

- Soaring supply costs
- Unprecedented labor shortages
- Negative margins
- Lower patient volumes
- Risk of closure



Today, nearly twice as many Texas hospitals are at risk of closure since before the pandemic. **Almost one out of every 10 hospitals in Texas is at risk of closure**, which would leave patients and communities struggling to find care.



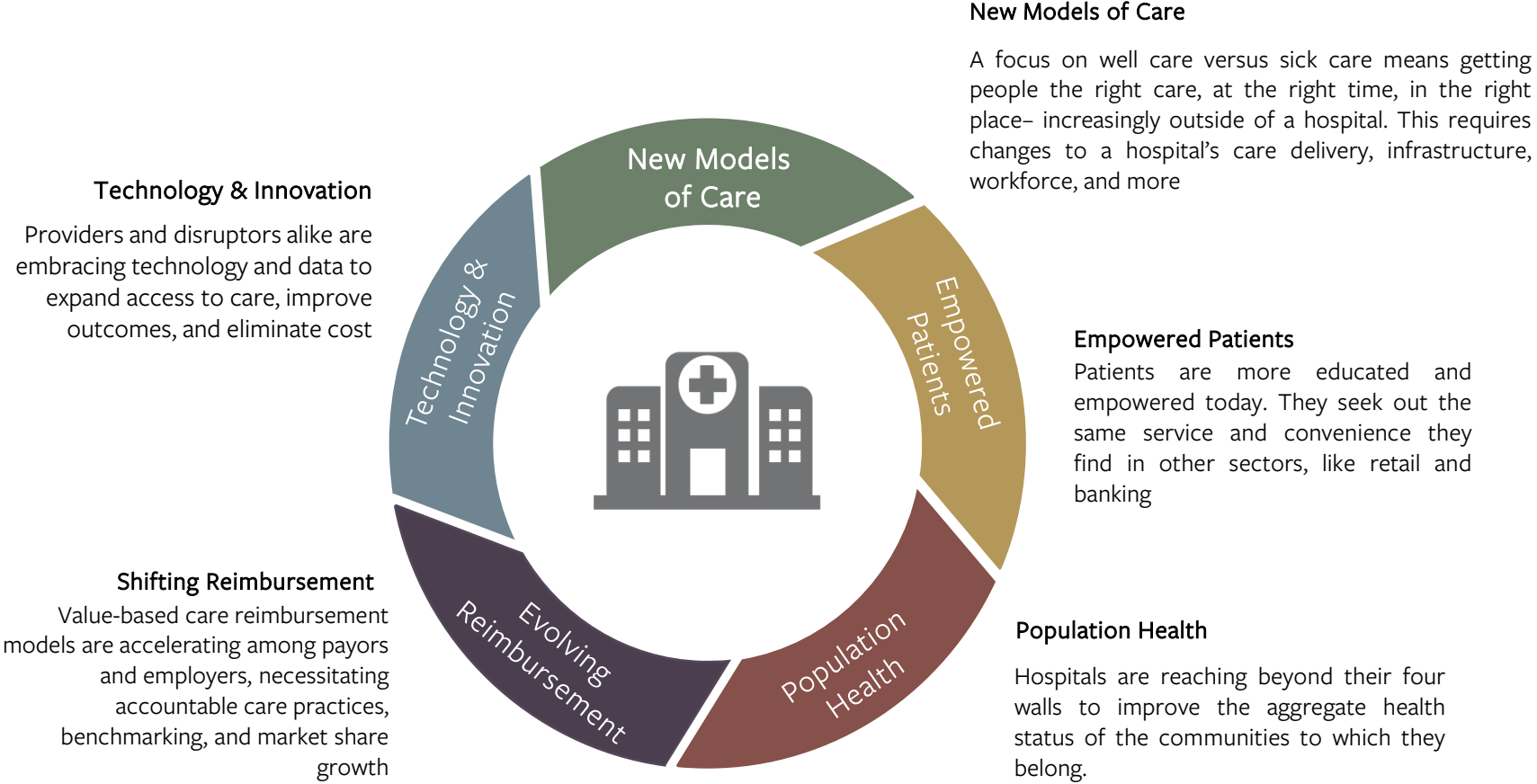
Source:  Texas Hospital Association

COVID-19 IMPACT REPORT

Health Recovery: COVID-19's Critical Impact on Texas Hospitals

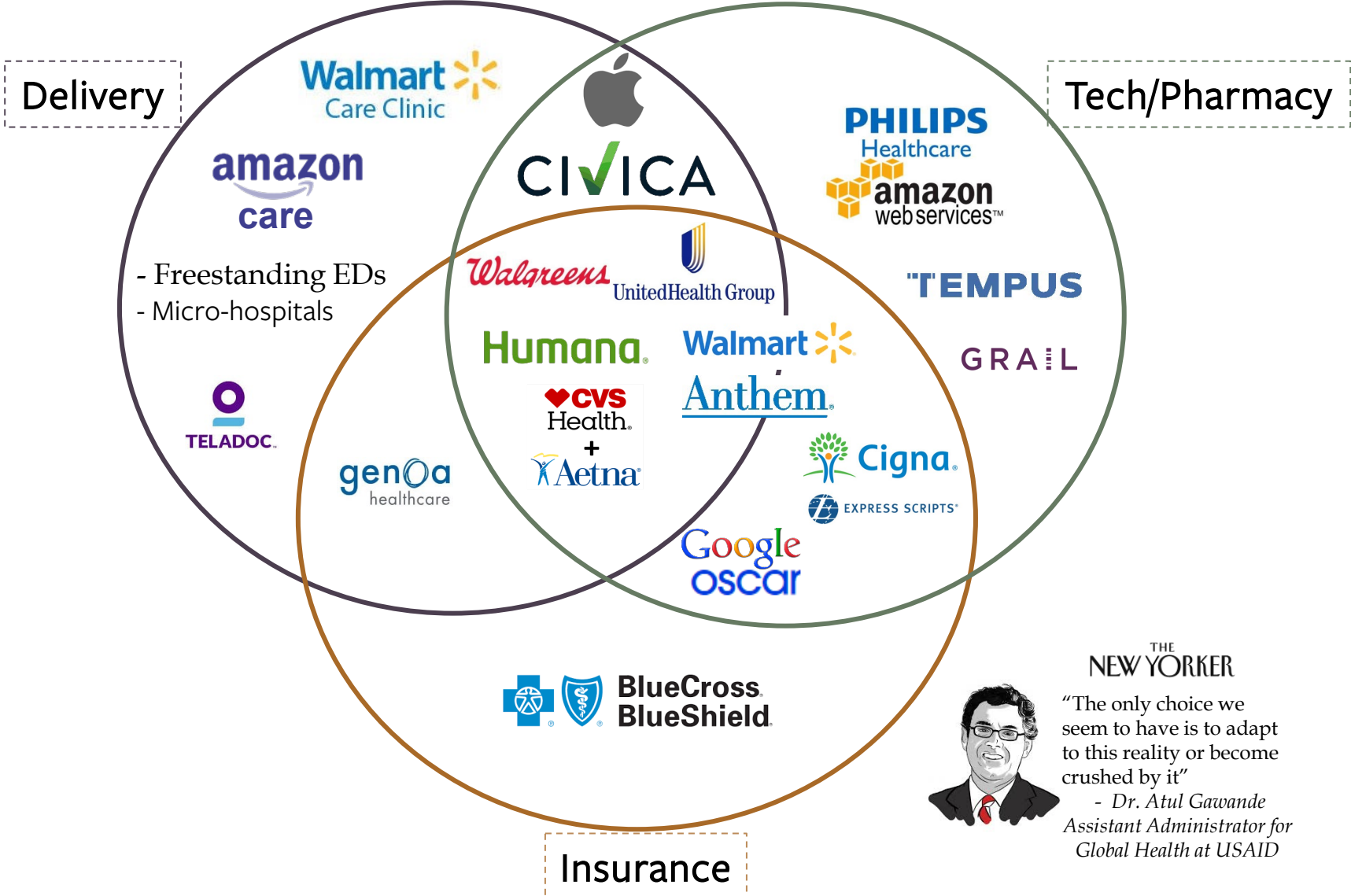


Necessary Investments in Future of Care



How can a health system built on an expensive, acute care chassis best transform to meet the health needs of its communities and thrive in the future?

Disruption











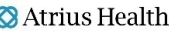





- Freestanding EDs
- Micro-hospitals



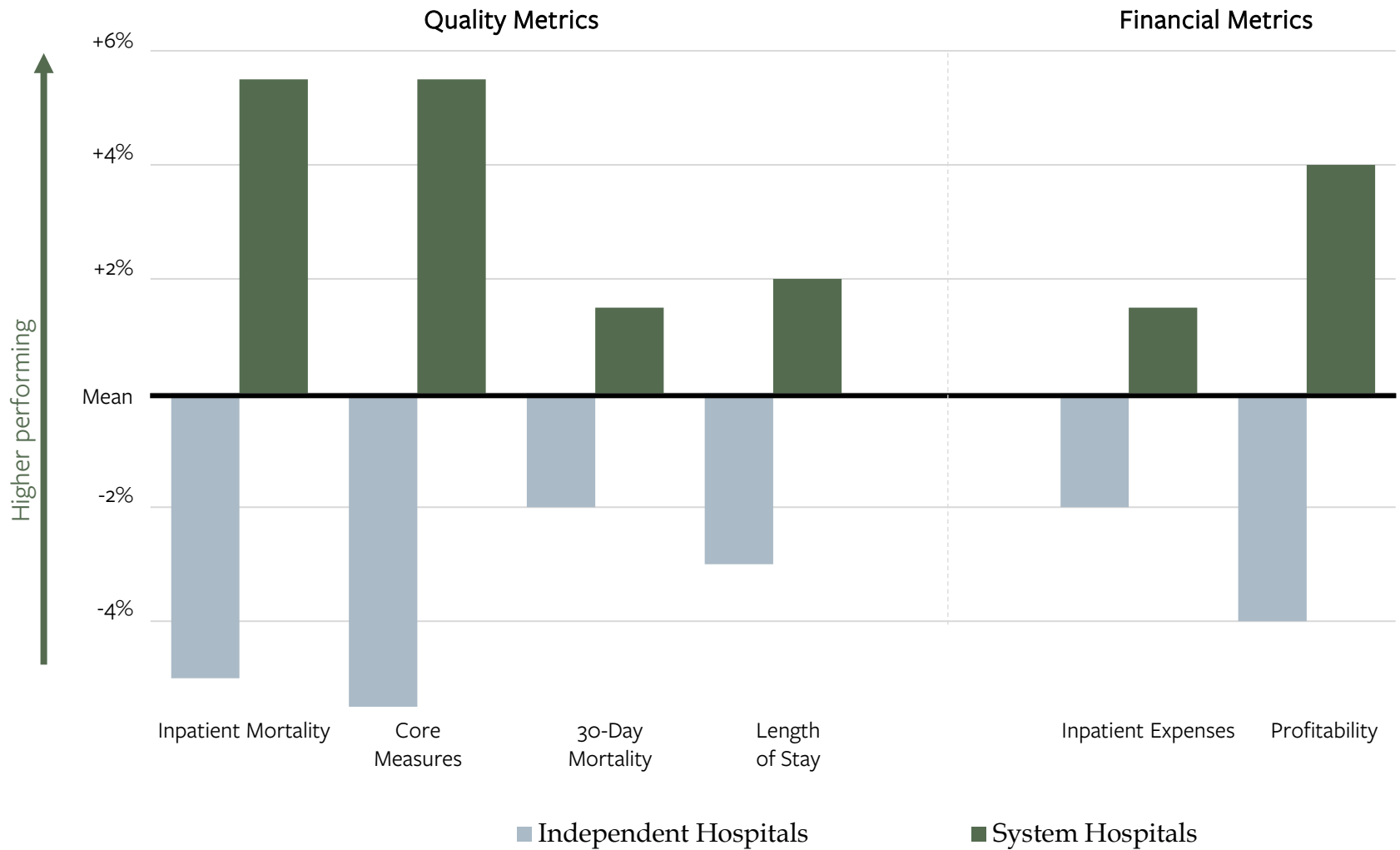
THE NEW YORKER
 "The only choice we seem to have is to adapt to this reality or become crushed by it"
 - Dr. Atul Gawande
 Assistant Administrator for Global Health at USAID

Private Equity

Target	Acquiror	Date	Transaction Value (TV)	TV / No. Physicians	Details
 Healthcare Associates of Texas	 OPTUM™	Jun-22	\$300m	-	<ul style="list-style-type: none"> • Optum purchasing HCAT from Webster Equity Partners paying an EBITDA multiple in the “high teens” • 22 facilities
 Kelsey-Seybold Clinic Changing the way health cares.	 OPTUM™	Apr-22	~\$1.3b	\$2.6m	<ul style="list-style-type: none"> • Over 30 practice locations, 500+ physicians • Multiple specialty centers, one cancer center, 2 ASCs, sleep center, and women’s health center • Offers its own Medicare Advantage plan • KSC was valued at \$1.3b in 2020 when TPG Capital purchased a minority stake in the company
 EIPHANY DERMATOLOGY	 LGP LEONARD GREEN & PARTNERS	Feb-22	~\$350m - \$400m	\$3.8m - \$4.4m	<ul style="list-style-type: none"> • 67 clinics, 90+ physicians, 12 states • “EBITDA of \$25 - \$30 million who could catch a multiple in the mid-teens”
 CVM Cardiovascular Medicine, P.C.	 Webster Equity Partners	Dec-21	-	-	<ul style="list-style-type: none"> • 23 cardiologists, 175 total providers • 11 locations across Iowa and Illinois • Practice located in the Genesis Heart Institute
 GASTRO HEALTH	 OMERS Private Equity	May-21	\$950m	\$3.8m	<ul style="list-style-type: none"> • \$950m purchase price • 150 locations, 250 physicians • Spans Alabama, Florida, Maryland, Ohio, Virginia, Washington, Massachusetts
 Atrius Health	 OPTUM™	Mar-21	\$436m	\$676k	<ul style="list-style-type: none"> • \$236m and \$200m capital commitment over 5 yrs • 30 practice locations, 645 physicians • Optum is paying 233% more than its initial offer of \$73m • Atrius Health was going through a period of sub-par financial performance for years leading up to acquisition
 DuPage Medical Group	 ARES	Aug-17	\$1.45b	\$1.8m	<ul style="list-style-type: none"> • 800+ physicians, 80+ locations (2017) • 100% physician owned & directed with significant retained ownership by DMG physicians • Ares acquired Summit Partner’s \$250m stake in DMG, and Summit exited as an investment partner

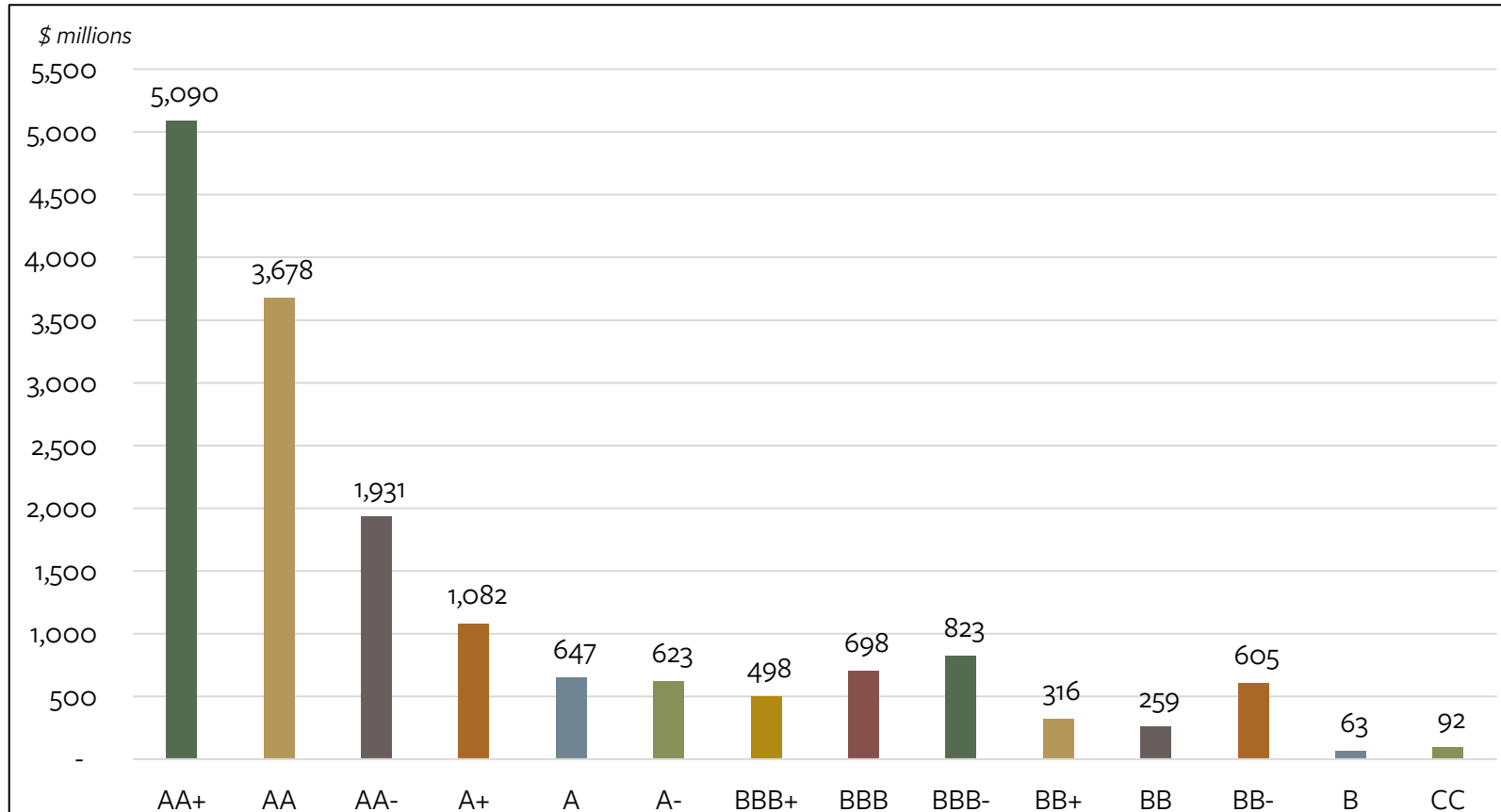
$\bar{x} \approx \$2.62m / \text{physician}$

Performance



Source: IBM Watson Health, Truven Health Analytics; data set includes 882 independent hospitals and 1,858 hospitals in systems

Access to Capital Debt Markets

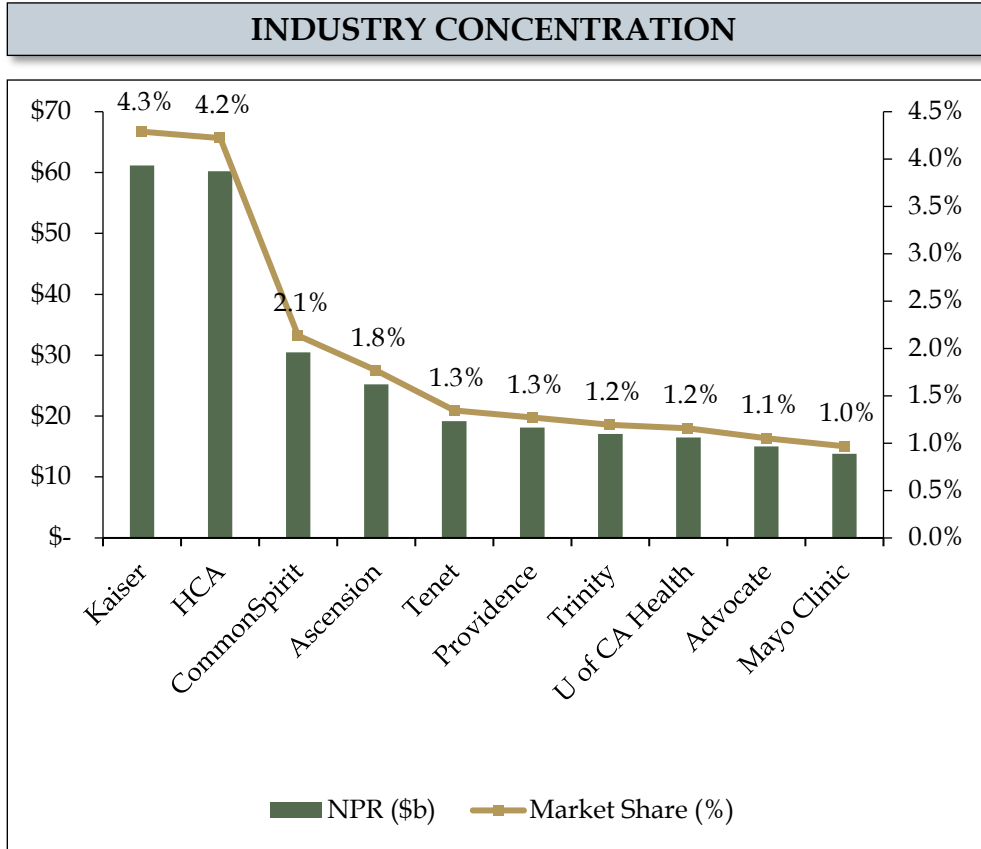


Size is highly correlated with bond ratings

Higher bond ratings allow organizations to access more, and cheaper, capital

Source: Fitch Medians Report, 2020

Trends in Consolidation



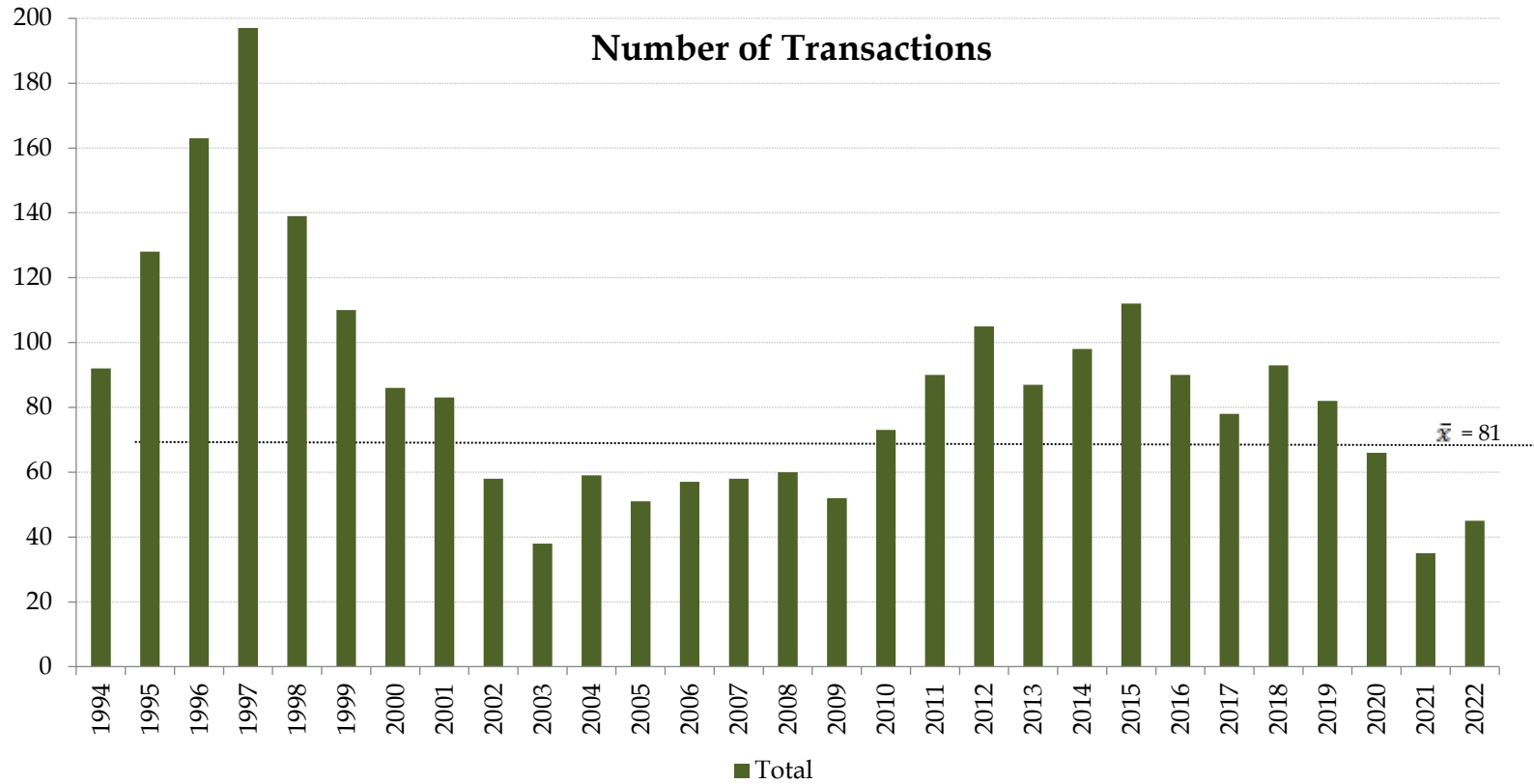
Source: Bond filings, SEC Edgar, IBISWorld *Hospitals in the US (January 2023)*

- Ten largest hospital systems account for approximately 20% of industry revenue
- In comparable industries according to size, such as managed care, airline, food, beverage and tobacco, and banking, 5 largest have between 70% and 80%

And yet:

- Two largest payers, United and Anthem, account for 35% of total direct premiums written
- Payers are increasingly leveraging market strength to push into traditionally provider terrain - - United's Optum division now has more physicians than any other organization, including Kaiser

Trends in Consolidation



Late 90s:
External stimulus:
Managed care

Aughts:
Internal stimulus:
Financial leverage

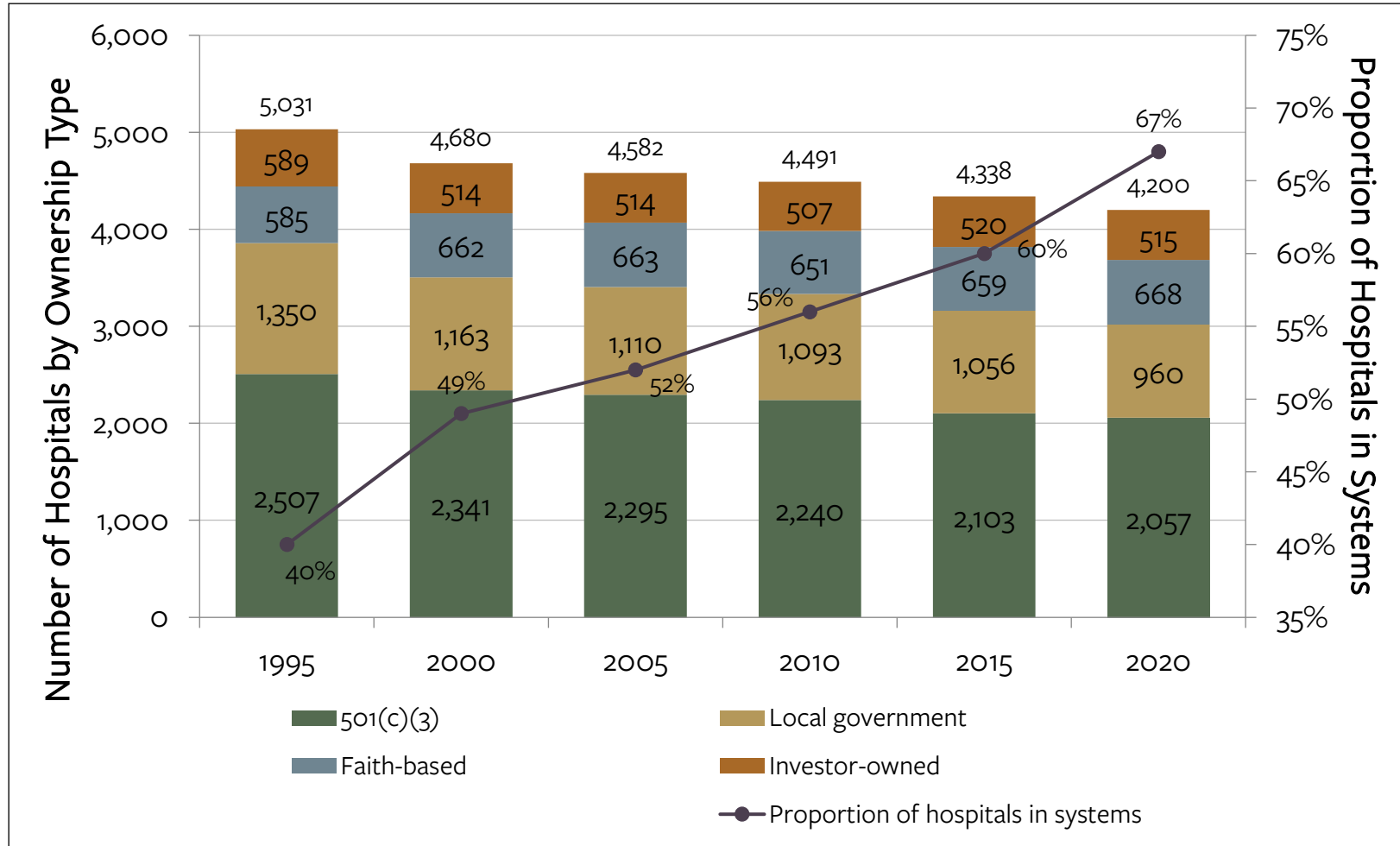
Pre-Covid:
Population health, core measures, reimbursement

Post-Covid:
Financial and Strategic

Evolving reimbursement models and financial stressors underscore the importance of scale, integration, and access to capital. These factors are prompting a second wave of hospital transaction activity

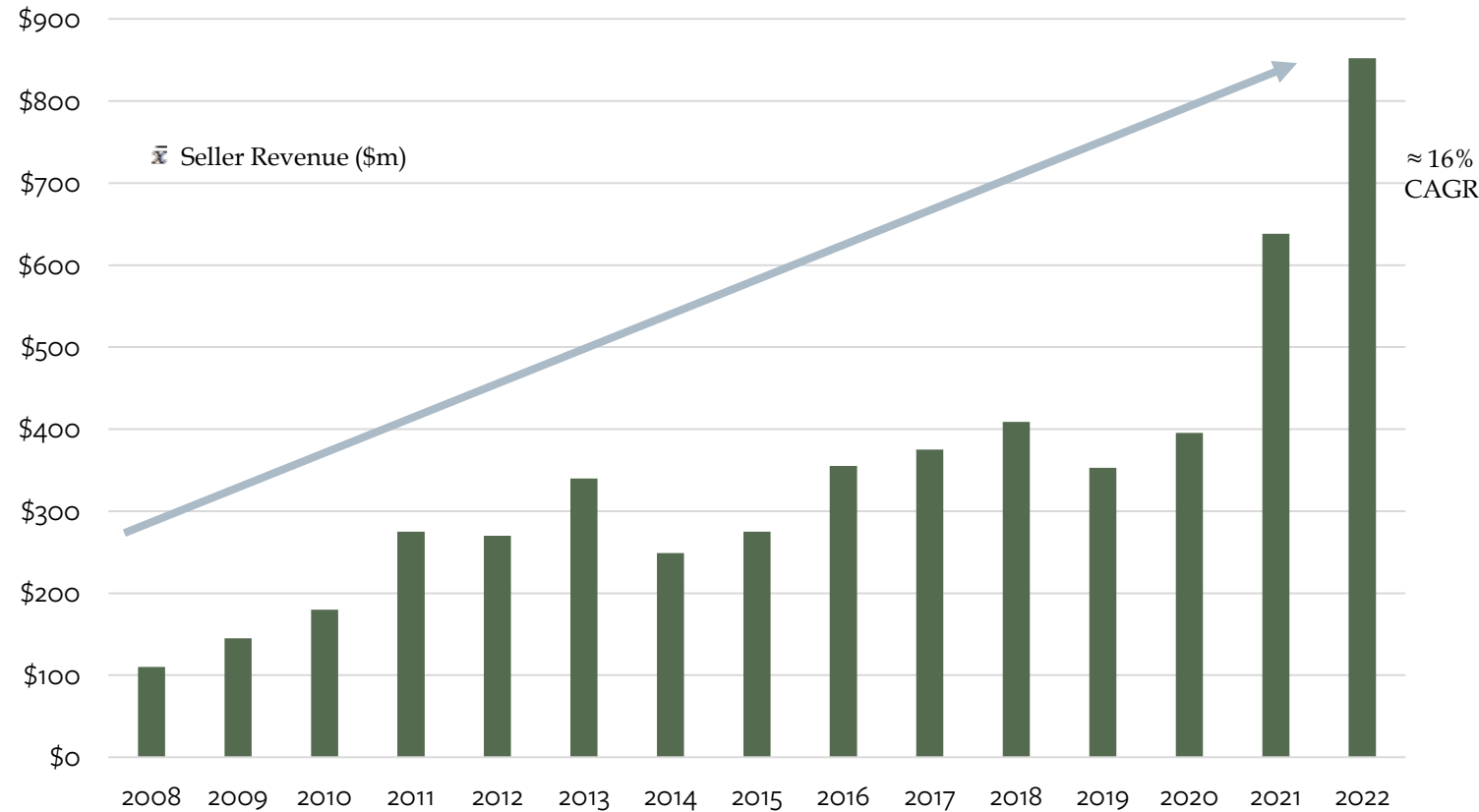
Source: Irving Levin, industry reports

Trends in Consolidation



Source: American Hospital Association, Juniper estimates

Trends in Consolidation



Source: Irving Levin

Changing Profile of Hospitals Seeking a Partner

Size and drivers have evolved

Financial and operating benefits

Strategic growth and proactive

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Overall Board Responsibilities

*Oversight
*Foresight
*Insight

Set and Maintain the Mission

Hire the CEO (Guide, Support & Evaluate)

Plan for the Future (Strategic Plan / Vision)

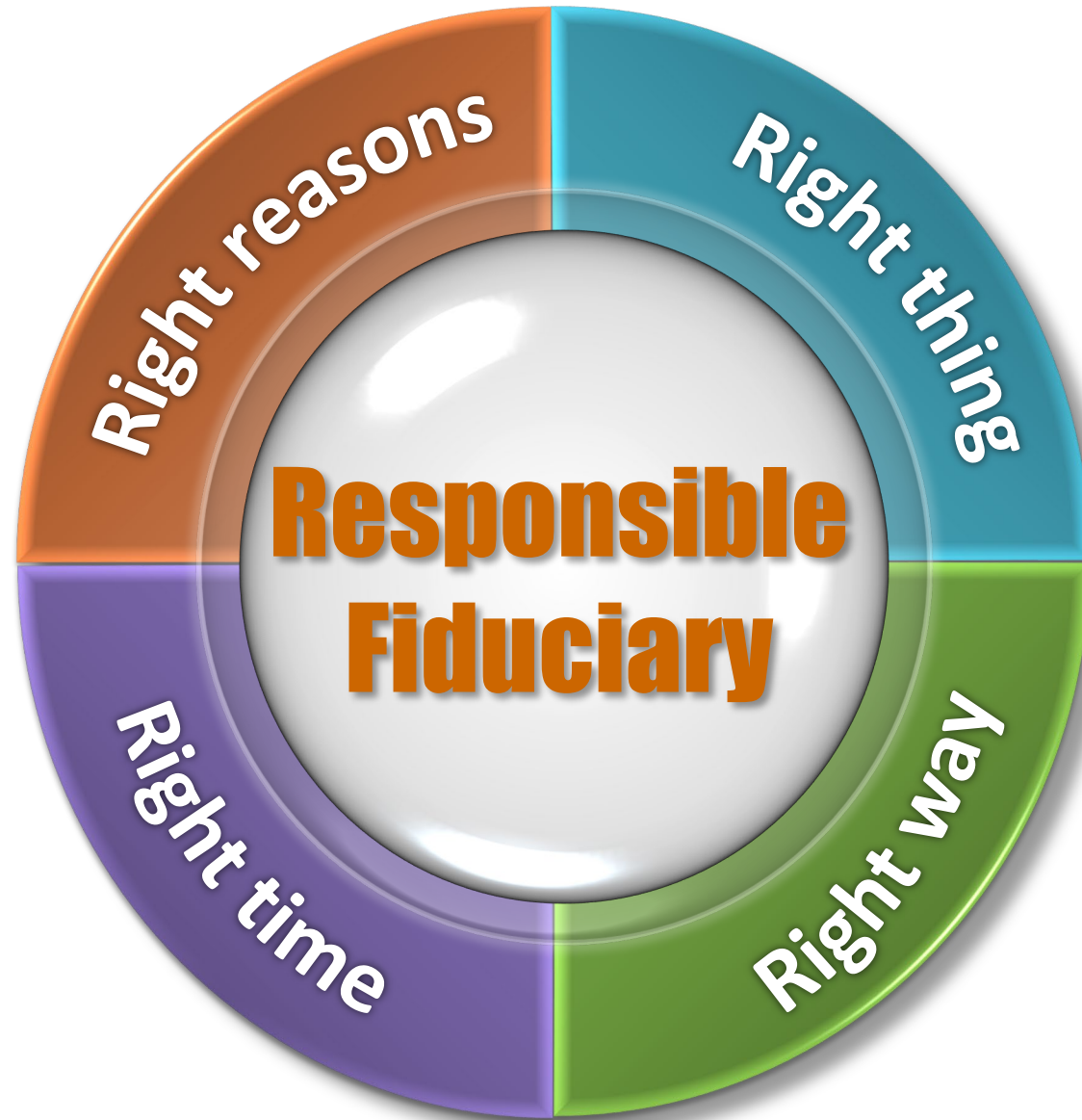
Quality and Patient Safety Oversight

Approve Budget / Financial Oversight

Focus on Good Governance:

- Duty of Care (Judgement / Good Faith)
- Duty of Loyalty (Conflict of Interest / Put Institution First)
- Duty of Obedience (Follow Rules / Laws)

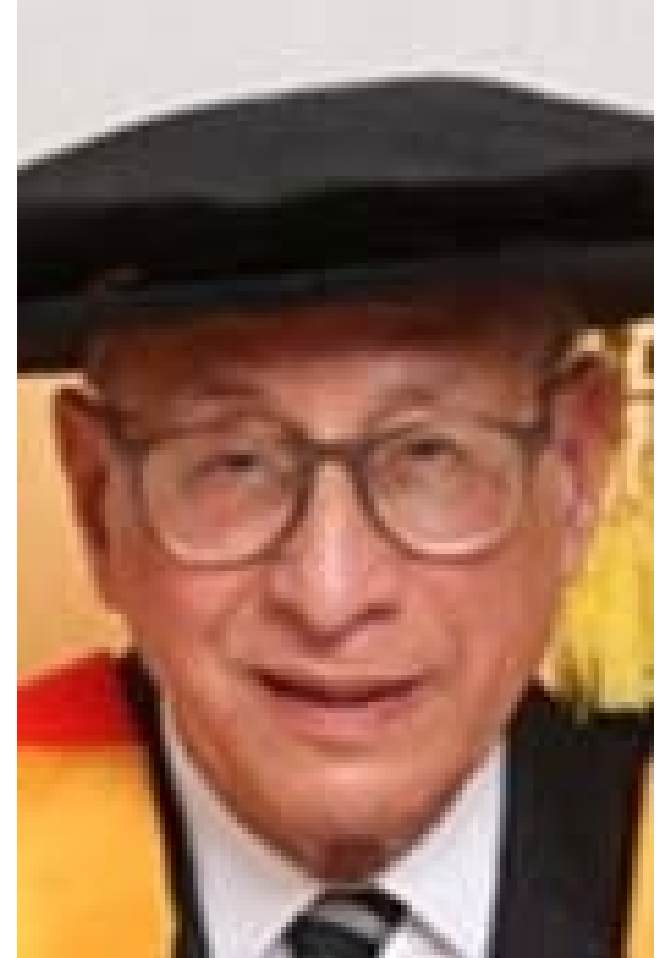




Fiduciary

“A fiduciary is someone who has undertaken to act for and on behalf of another, in a particular matter, in circumstances which give rise to a relationship of trust and confidence.”

• Lord Millett



A Legal Framework for Governance

Duty of Care

Obtain all pertinent information before making decisions

Act in good faith

Make decisions in organization's best interests



The Duty of Care is Carried Out By...



Consistent attendance







Judicious preparation for
meetings



Seek all relevant information
before voting



The Duty of Care is Carried Out By...

-  Strong and independent judgment
-  Periodic examination of governing leadership performance
-  Meaningful, regular review of quality, patient safety and financial performance
-  Act in good faith, with the care of an ordinarily prudent person in similar circumstances



A Legal Framework for Governance



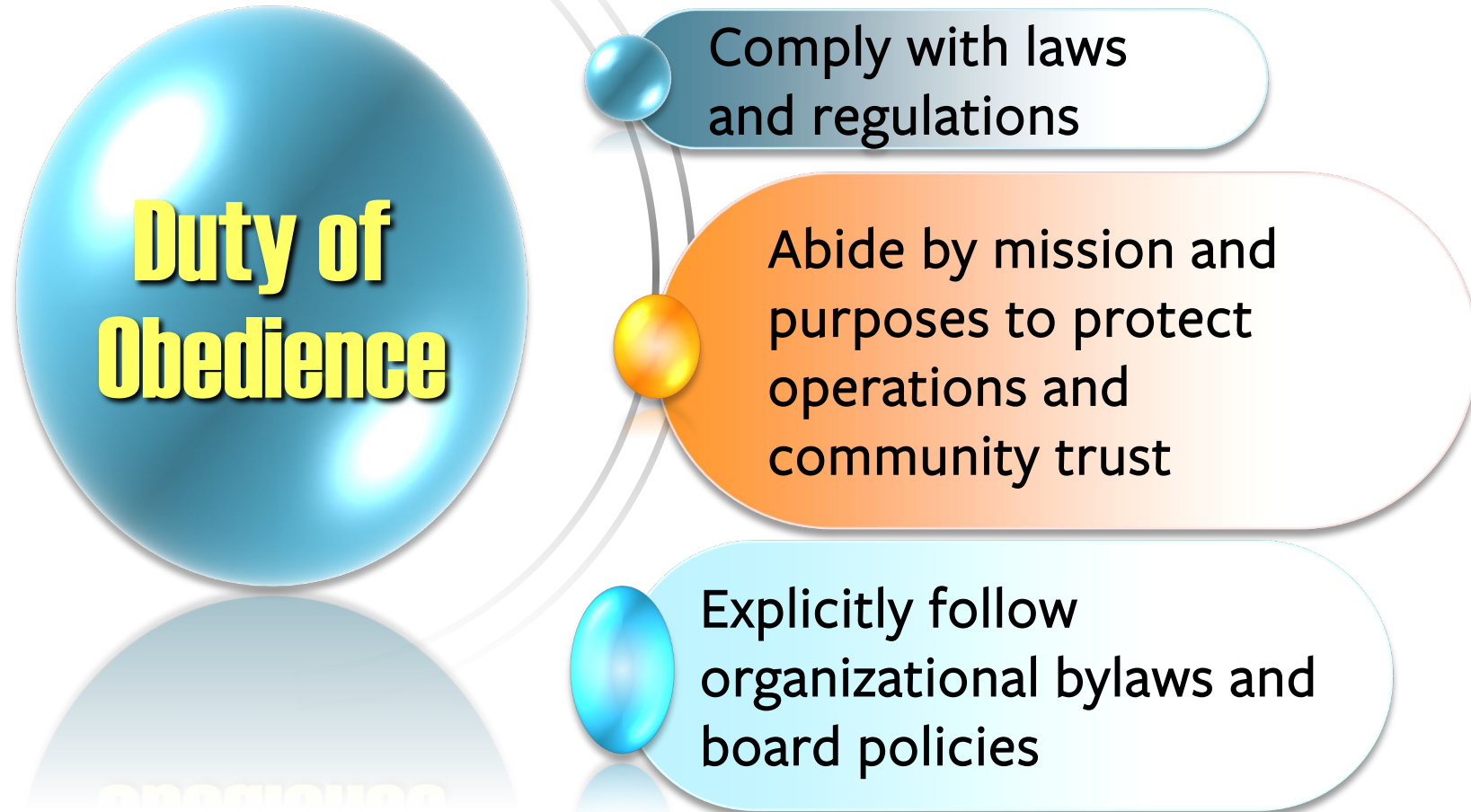
The Duty of Loyalty

Avoiding Conflicts of Interest

- **Evaluate policy:**
 - ✓ Solely in the interests of the hospital
 - ✓ Written procedures
 - ✓ Action when a conflict occurs



A Legal Framework for Governance





Power and Duty of Individual Board Members

Each director exercises power only as a member of the board. The board, acting officially and by recorded vote, has all the power and authority. Individual directors have no power or authority acting individually outside their votes as board members. All power of the board is a joint and collective power which only exists when the board is acting together as one body.



Who Does What?

Keep Focused on the Big Picture



“Great CEOs want to work for boards that focus on great governance!”



Who Does What?

Ask For
Advice
When
Needed

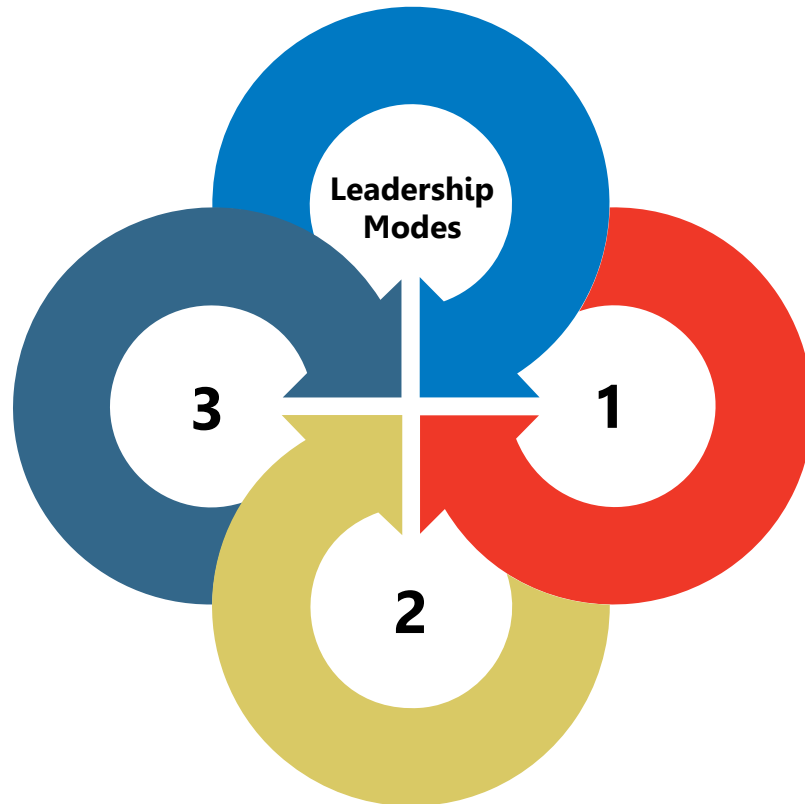


This is the one time
it's okay to weigh-in
on management
issues...when asked!



High-Performing Boards

Governance as Leadership



#1: Fiduciary

"Oversight"

#2: Strategic

"Foresight"

#3: Generative

"Insight"

Source: Governance as Leadership: Reframing the Work of Nonprofit Boards.
Richard Chiat, William Ryan and Barbara Taylor



Governing Modes

	Fiduciary	Strategic	Generative
Board's central purpose	Protect assets	Set the course	Make sense
Board's core work	Oversight	Foresight	Insight
Key question	What's wrong?	What's the plan?	What's the question?
Problems are to be...	Spotted	Solved	Framed



What Do Hospitals Seek from Scale?

Structural economies	local market coverage, risk sharing and advocacy.
Operational economies	lower operating and capital costs, shared services and information technology.
Skills economies	standardization of operations management, improved quality protocols and standards, access to resources, talent and management and — significantly — physicians



What Do Hospitals Fear from Scale?

Diseconomies of Scale	<ul style="list-style-type: none">cost of coordination and standardizationincreased complexitylocal span of control diminishedagency issues (ambiguity over accountability & risk)unanticipated cultural changes



Asking the Right Questions



Sources: governWell™ BoardBRIEF, Becoming a Remarkable Board.

Do we have the financial resources to thrive well into the future?

Do we have the scale necessary to take on risk?

What if one of our competitors joins a system?

What are all our options regarding affiliation?

What trustee education is needed as our board navigates the emerging health care environment?



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What Might a Move to Scale Look Like?

Joining a larger system is just one option – objectives drive form

Clinical and administrative focused affiliations, cancer, cardiac, full spectrum

Regional combinations with similar or smaller - joint ventures up to consolidation transactions

Hospitals seeking broad objectives, including capital commitments, clinical resources and information technology, may join a system with demonstrated competency in these areas



STRUCTURES

	Affiliation	Joint Operating Agreement	Seller Joint Venture	Consolidation	Buyer Joint Venture	Business Combination
Features	<ul style="list-style-type: none"> Contractual arrangement •2+ nonprofits work on projects •Clinical •Scale •Marketing 	<ul style="list-style-type: none"> •2+ NPs cede control to new company •NPs retain ownership of real assets •JOA provides <ul style="list-style-type: none"> - Executive management - Financial reporting - Capital raising - Contracting 	<ul style="list-style-type: none"> •Sale of majority ownership to newly created JV •Retention of control •Foundation 	<ul style="list-style-type: none"> •Combination of two entities into a <i>new company</i> •Self-perpetuating board created 	<ul style="list-style-type: none"> •Combination with joint venture hospital company •BJV between NP and FP partners •Newly created or existing BJV 	<ul style="list-style-type: none"> •Combination of two entities, one survives •Merger or sale structure •Majority of transactions
Impact	<ul style="list-style-type: none"> •No change in control •No change in ownership 	<ul style="list-style-type: none"> •Change in control •No change in ownership 	<ul style="list-style-type: none"> •Partial change in control •Partial change in ownership 	<ul style="list-style-type: none"> •Partial change in control •Partial change in ownership 	<ul style="list-style-type: none"> •Change in control •Change in ownership 	<ul style="list-style-type: none"> •Change in control •Change in ownership
Pros	<ul style="list-style-type: none"> •Maintain control and ownership •Less controversial •Easier decision 	<ul style="list-style-type: none"> •Scale •Retain ownership of real assets 	<ul style="list-style-type: none"> •Shared control •Access to capital •Management, scale 	<ul style="list-style-type: none"> •Scale •Few but impactful •Unique circumstance 	<ul style="list-style-type: none"> •Scale •NP and FP strengths •Economic consideration 	<ul style="list-style-type: none"> •Scale •Straightforward •Access to capital, management •Foundation
Cons	<ul style="list-style-type: none"> •Limited impact •Transitory •Provisional 	<ul style="list-style-type: none"> •Failure rate •Easy to undo 	<ul style="list-style-type: none"> •Minority shareholder •Investment risk •Limited applicability 	<ul style="list-style-type: none"> •Symbiosis required •Difficult transaction 	<ul style="list-style-type: none"> •Impermanence of BJVs •Loss of control •Finality 	<ul style="list-style-type: none"> •Loss of control •Finality
	Anniston, AL - UAB	UC Health - Cincinnati	Watertown Regional - WI	Advocate - Chicago	Marquette, MI - Duke Lifepoint	Mid Columbia - Adventist

A Thoughtful Process is Necessary

Begins with *internal* process to understand position and options

Review recent performance, consider how environmental factors may impact the future

Consider economic and non-economic objectives to thrive

Involve key stakeholders, they are key to a successful journey, regardless of path chosen

Don't start with a solution in mind, rather start with a thorough and candid review of organizational needs and environmental factor

Ranked list of objectives is critical to measuring potential options against real-world organizational priorities.



A Thoughtful Process is Necessary

*Continues with **external** process if Board desires more information*

Board should remain in control of timing and process

The hallmark of good decision-making is having a basis of comparison.

Process should simultaneously identify several interested potential partners and elicit a vision of how they are prepared to work collaboratively.




It is nearly impossible to envision all potential partners and options in a closed room

Considering a broad range of partners and options helps ensure that any eventual decision meets internal and external challenges.

Remaining independent is remains a choice throughout the process at key toll gates



Process

SITUATION	OPTIONS	MARKET INPUT	TRANSACTION
<p><i>Thorough Assessment</i></p> <ul style="list-style-type: none"> • Market-centric <ul style="list-style-type: none"> - Financial markets - Business value - Debt capacity • Health system-centric <ul style="list-style-type: none"> - Financial condition - Competitors - Physicians, payors - Strategic needs • Hospital industry <ul style="list-style-type: none"> - Structure - Regional market - Consolidation trends 	<p><i>Structural alternatives</i></p> <ul style="list-style-type: none"> • Business and financial implications • Pros, cons, practical realities <p><i>Potential partners</i></p> <ul style="list-style-type: none"> • Business and finance • Approach to affiliation • Culture and personalities <p><i>Marketing design</i></p> <ul style="list-style-type: none"> • Process for evaluating indications of interest • Both ownership change and no ownership change 	<p><i>Phase One Market Input</i></p> <ul style="list-style-type: none"> • Optional • Approach to market • Comparison of proposals and partners <ul style="list-style-type: none"> - Ideas from market • Basis of comparison <p><i>Decision to stop or continue</i> </p> <ul style="list-style-type: none"> • Board decision • Remain independent -- stop • Continue to consider partner <ul style="list-style-type: none"> - Phase two market clear - Select finalists 	<p><i>Phase Two Market Clear</i></p> <ul style="list-style-type: none"> • Interaction with finalists <ul style="list-style-type: none"> - Management meetings - Reverse due diligence visits • Refined proposals • Select partner or stop • Letter of Intent -- agreement on major business, social, legal and financial terms <p><i>Decision to stop or continue</i> </p> <ul style="list-style-type: none"> • Partner's due diligence • Confirm and finalize terms in definitive agreement • Governmental approvals • Close
<p><i>Board understands position</i> <i>Well defined objectives</i></p>	<p>Status quo or approach  market?</p>		



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Consider your Horizon

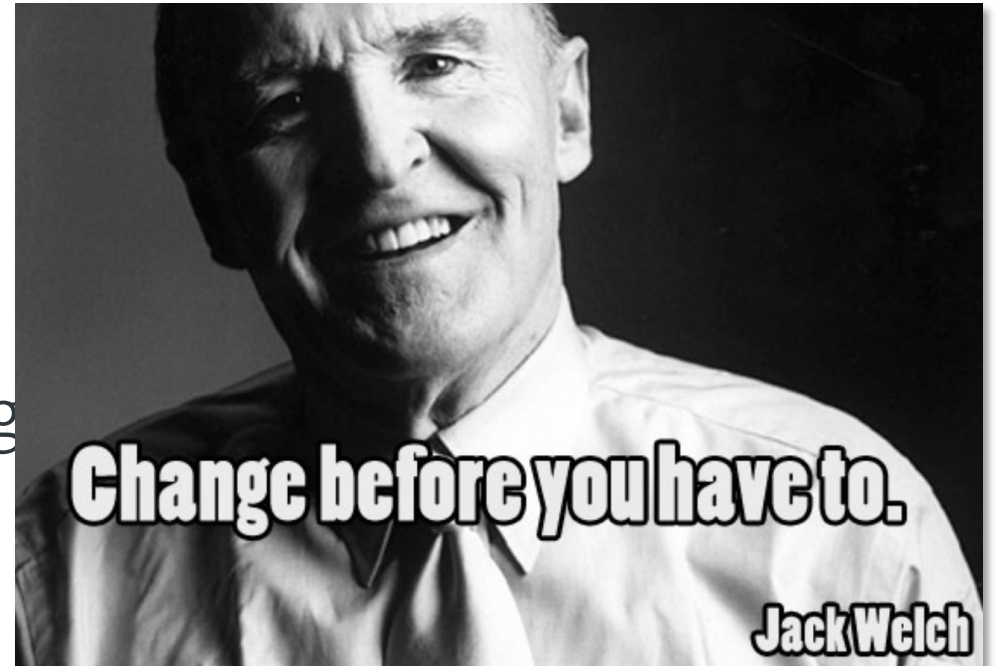
Waiting until situational challenges become structural issues is a risky proposition

- ❖ For patients
- ❖ For your operations
- ❖ For your future

Beware of distant sunny forecasts predicting stable conditions

A burning platform is a difficult time to explore your options.

Regularly assessing your competitive position is good governance



Caution is Warranted

Every transaction is different, and every community has a different need

This is a process that should be done right vs. quick

Dip your toe? May unwittingly give away leverage when these partnerships involve essential offerings such as electronic medical records and clinical staffing.

Given the unique nature of this undertaking, many boards choose to engage experienced advisory firms for real-time guidance on the process's financial, legal and communications aspects.



Monitoring for the Future

Status Quo

- Appropriate service & physician mix
- Stable market share
- Strong financials
- Improving quality
- Strong care resources
- Community support

Early warning

- Loss of market share, outmigration
- Increased difficulty to recruit physicians
- Competitor opens in your locality
- Quality metrics decline
- Deferred capital spending

Just in time

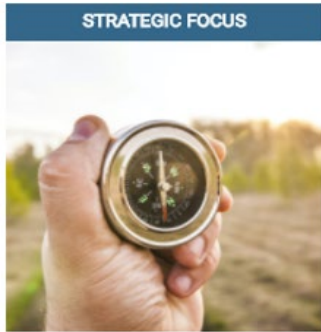
- Ratings downgrade
- 2nd year NOI decline
- Loss of share in a “big four” service: neuro, ortho, cardio & cancer
- Volume decline in key revenue drivers
- Reliance on investment or reserve funds to break even

Limited Options

- Breach of bond covenant
- 3rd year of NOI decline
- Loss of key physicians or group
- Competitor consolidation
- Inability to access capital



Asking the Right Questions



Sources: governWell™ BoardBRIEF, Becoming a Remarkable Board.

Have we considered all options regarding independence or affiliation?

How often should we go through the process of considering the options?

Have we prepared our stakeholders for possible changes?

If we decide affiliation may be our best option, what process will we use to optimize the outcome?

Have we fulfilled our fiduciary obligation – Duty of Care?

