AFFILIATION STRATEGIES TO ENHANCE RURAL HOSPITALS:

THE BENEFITS OF HEALTH SYSTEM COLLABORATION

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Providence Health & Services
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PRIOR TO CONSIDERING AN AFFILIATION OR COLLABORATION

1. Have you updated your organizational goals?

2. Do you know your strengths, weaknesses, opportunities and threats?

3. Can you accomplish your goals independently?

4. When are your goals best achieved through an outside relationship?

5. How should we position our organization to approach external parties?

6. What is the process to follow to negotiate and execute the optimal relationship for your organization?
WHAT IS THE DIFFERENCE BETWEEN:

COLLABORATION

DEFINITION:
The act of working with someone or a group to produce or create something, especially in a joint intellectual effort.

AFFILIATION

DEFINITION:
1. To adopt or accept as a member, subordinate associate, or branch.
2. To associate (oneself) as a subordinate, subsidiary, employee, or member.
WHAT IS THE DIFFERENCE BETWEEN:

**COLLABORATION STRATEGY**

A pathway designed to align stakeholders, and business objectives, which requires both parties share in the development and management of the joint venture.

**AFFILIATION STRATEGY**

A joint venture which involves a degree of subordination and release of certain managerial and administrative responsibilities to one party.
LEARNING OBJECTIVES FOR TODAY’S PRESENTATION

1. Learn what is happening nationally and regionally
2. Understand the rationale for hospital transactions
3. How to determine what you are looking for and whether it is realistic
4. Assess the pros and cons of each option
5. How to maximize your franchise's value and delivery of healthcare
19% Decline in the Number of Independent Community Hospitals From 1999 to 2011

RURAL HOSPITALS ARE LESS “AFFILIATED”

PERCENTAGE OF HOSPITALS IN HEALTH SYSTEMS (2012)

Source: American Hospital Directory, Inc.
PRIMARY FACTORS ACCELERATING NUMBER OF HOSPITAL COLLABORATIONS & AFFILIATIONS

- Lasting affects of recession (altered employment status, modified healthcare spending)
- Uncertainty over Healthcare Reform (impact timing, scope and applications)
- Certainty of Healthcare Reform (emphasis on efficiencies, quality and continuum of care)
- Strained federal, state & local budgets (pressure to reduce healthcare spending)
- Credit sensitive capital markets (lenders and investors favor quality in rising interest rates)
- New forms of collaboration and affiliation arrangements
QUESTIONS FOR BOARD AND MANAGEMENT CONSIDERATION

1. Does my hospital have the ability to remain independent?

2. Should we collaborate?

3. What is the difference between a collaboration and an affiliation?

4. Can we affiliate without ceding governance?

5. Should we or must we consider a merger or sale?

6. How do we value our hospital and franchise’s worth to the community?

7. How do we make a decision?
• Review your operations and poll your board and stakeholders regarding independence versus affiliation
• A review of pros and cons, plus costs of independence v. affiliation should be discussed
• Your hospital must be aware of different forms of affiliation and their level of retained control
• An RFP process and evaluation of respondents based on prioritized goals should direct your choice
• The future of hospitals and healthcare in the U.S. is rapidly trending toward affiliations to achieve performance efficiencies and quality levels required for financial success
INDEPENDENCE VIABILITY MEANS TESTING

THE CORPORATE DECISION MAKING PROCESS

Evaluate your hospital's current health

Identify your: (1) projected challenges; (2) estimated capital and cash flow needs; and (3) available resources to realize your potential

Determine if your hospital is well-positioned to achieve its stated goals and objectives

YES - Independence or Collaboration are Viable Options

YES AND NO - Collaboration or Affiliation May Be the Answer

NO - Affiliation or Merger Must Be Pursued
THOROUGH ANALYSIS SHOULD GUIDE THE DECISION MAKING PROCESS

1. Operational assessment
2. Market study
3. Financial forecasting and debt capacity calculations
4. Evaluation of quality and patient satisfaction
5. Facility needs review
6. Strategic planning
7. Governance and legal review
8. Economic impact and demographic study
### Hospital Franchise Evaluation

<table>
<thead>
<tr>
<th>Market Position: Market Share, Utilization Trends and Medical Staff Profile</th>
<th>Quality and Patient Satisfaction Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Strong</strong></td>
<td><strong>Quality and Patient Satisfaction Indicators</strong></td>
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<tr>
<td><strong>Below Peers</strong></td>
<td><strong>Above Peers</strong></td>
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<table>
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<tr>
<th>Condition of Plant, Property and Equipment, plus Facility Community Compatibility</th>
<th>Financial Performance, Operating Efficiency and Debt Capacity</th>
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<tr>
<td><strong>Positive</strong></td>
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</tr>
<tr>
<td><strong>Negative</strong></td>
<td><strong>Poor</strong></td>
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<tr>
<td><strong>Good</strong></td>
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# Hospital Franchise Evaluation

## Market Position, Utilization Trends and Medical Staff Profile

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<tr>
<th>Target Analysis</th>
<th>Purpose</th>
<th>Partner Dependency Testing</th>
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<tr>
<td>Market/Demand Review</td>
<td>Identify service area, market share, outmigration and specialty demand to project future performance potential.</td>
<td>Can market share in sub-performing, high value service lines be improved?</td>
</tr>
<tr>
<td>Competitor Profile</td>
<td>Profile hospital competitors, their current position, trends and opportunities for growth.</td>
<td>Do other hospitals possess seemingly insurmountable competitive advantages?</td>
</tr>
<tr>
<td>Detailed Utilization Trending Report</td>
<td>Assess changes in hospital utilization patterns by service line.</td>
<td>What are the causes of utilization trends and can they be addressed independently or in a network?</td>
</tr>
<tr>
<td>Physician Needs Assessment</td>
<td>Review hospital physicians and specialties v. market need.</td>
<td>Is physician recruitment achievable without partnership?</td>
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## HOSPITAL FRANCHISE EVALUATION

### Quality and Patient Satisfaction Indicators

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<tr>
<td>Quality Review</td>
<td>Benchmarking hospital versus peer group and regional competitors for patient safety and other quality measures. Quantifying the costs of any indicated &quot;off quality.&quot;</td>
<td>Can your hospital optimize its quality levels at or above its peers and competitors?</td>
</tr>
<tr>
<td>Patient Satisfaction Assessment</td>
<td>Review and score patient satisfaction indicators versus peer group and regional competitors along with a trends analysis.</td>
<td>Can your hospital optimize its patient satisfaction levels at or above those of its peers and competitors?</td>
</tr>
<tr>
<td>Physician Profile</td>
<td>Compare the quality/cost attributes of hospital medical staff.</td>
<td>Identify any quality/cost variances of hospital physicians and evaluate your ability to implement improvements?</td>
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### HOSPITAL FRANCHISE EVALUATION

#### Condition of Plant, Property and Equipment

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<td>Limited Master Facility &amp; Equipment Planning</td>
<td>Assess physical condition of current hospital and equipment. Evaluate adequacy of current location vs. population and demand centers. Identify future improvements required to be competitive.</td>
<td>Can your hospital undertake, manage and execute a capital improvement project required to recruit and retain physicians and boost patient demand and compete?</td>
</tr>
<tr>
<td>Capital Improvement Budgeting</td>
<td>Prioritize and quantify hospital capital budget to optimize prospective capital projects.</td>
<td>Does your hospital require a significant capital investment or loan to remain competitive?</td>
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## HOSPITAL FRANCHISE EVALUATION

Financial Performance, Operational Efficiency and Debt Capacity

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<tr>
<td>Financial Analysis and Forecasting Modeling</td>
<td>Analyze trends in financial performance v. industry, region and peers. Produce financial forecast and sensitivity analysis w/ conservative operational and financial assumptions</td>
<td>Can your hospital achieve satisfactory performance relative to industry, region and peer group? What does your financial forecast project? Are there revenue or funding gaps?</td>
</tr>
<tr>
<td>Functional Cost Comparison</td>
<td>Assess operational efficiency and productivity by functional department in comparison to its peer group.</td>
<td>Is your hospital operating efficiently? If not, can productivity levels be increased with your current resources?</td>
</tr>
<tr>
<td>Debt Capacity Analysis</td>
<td>Based on financial forecasts assess current and projected debt capacity.</td>
<td>Can debt capacity support facility improvements, recruitment or working capital needs?</td>
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</table>
GOALS AND OBJECTIVES THROUGH AFFILIATION

- A commitment to employees, medical staff and community
- Preserve and increase availability of community healthcare
- An immediate and ongoing capital commitment
- Assistance with quality and patient satisfaction
- Access to information systems and EMR
- Leverage partner’s support services
- Maintain local control and governance

SAMPLE AFFILIATION GOALS AND OBJECTIVES
ENHANCED ASSETS THROUGH AFFILIATION AND COLLABORATIONS

• Branding
• Purchasing discounts and insurance access
• Service line expansion and efficiency enhancements
• Operational and administrative management
• Improved capital access through guarantees and financial investments
• Advanced technology
• Physician alignment and expansion
• Clinical integration
Retaining Control and Governance

1. Self-sufficient independence

2. Collaborations and financial/operational enhancement from third parties
   - Remain independent but work with outside organizations

3. Contractual support through management contracts and departmental or clinical contracts
   - Time-based fee for service contracts for a defined payment
   - No change in ownership or governance

4. ACOs
Joint Ventures With and Without Equal Interest

1. Affiliation
   - Rural hospital affiliates with a larger entity to access services, capital or expertise
   - May range in scope from a single service-line, to the entire hospital

2. Joint Operating Agreement
   - A Joint Operating Company, which could be the partner or a new entity, acquires and operates a hospital or alternative healthcare organization
   - No financial statements are consolidated, and the net income of the JOC is distributed to each organization as predetermined

3. Joint Venture Merger
   - Rural hospital merges entirely with its acquirer into a new combined entity
   - The consolidation of assets provide for control and respective interests based on a valuation of contributed assets and negotiated agreement
Transfer or Sale of Financial Control of Hospital

1. Sole Member Replacement
   • The rural hospital amends its articles and bylaws to designate the acquirer as its sole corporate member
   • A preferred method for acquiring nonprofit hospitals, as the rural hospital continues to operate as a distinct entity subject to the powers of the acquirer

2. Lease
   • No ownership change, as rural hospital leases facility to operator for agreed upon term
   • Financial consequences of hospital flow to lessor, who may also be able to purchase the operating assets
   • A forward option for a future purchase of PP&E may be a possibility

3. Sale
   • As permitted by law
   • The acquirer/partner retains certain liabilities of the seller
ROAD MAP FOR COLLABORATIONS AND AFFILIATIONS

STEP ONE: PLANNING

STEP TWO: DEVELOPMENT

STEP THREE: EXECUTION
STEP ONE: PLANNING

- Determine goals and objectives of a partnership arrangement
- Identify universe of potential partner candidates
- Develop an objective proposal scorecard/matrix to rank candidate responses
- Create and distribute Request for Proposals (RFP) to candidate partners
- **Highlighted Planning Document - The RFP**
ROAD MAP FOR COLLABORATIONS AND AFFILIATIONS

STEP TWO: DEVELOPMENT

• Follow up with partner candidates and answer questions to assist in their formulation of responses

• Review and rank all responses

• Conduct on-site interviews with selected candidates

• Select affiliation partner and negotiate and execute a non-binding, exclusive letter of intent - The Memorandum of Understanding (MOU)

• Highlighted Development Document - The MOU
ROAD MAP FOR COLLABORATIONS AND AFFILIATIONS

STEP THREE: EXECUTION

- Complete necessary due diligence procedures based on the proposed structure
- Negotiate and execute the Definitive Agreement
- Obtain any necessary regulatory approvals
- Close the transaction
- **Highlighted Execution Document - The Definitive Agreement**
# Potential Partners for Rural Community Hospitals

<table>
<thead>
<tr>
<th>Academic Medical Centers</th>
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<tbody>
<tr>
<td>Many are expanding hospital networks to create ACOs</td>
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<tr>
<td>Hybrid (non-acquisition type) models are becoming more common</td>
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<th>Non-Profit Health Systems</th>
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<td>Traditionally target local community hospitals</td>
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<td>Expanding into other markets</td>
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<th>For-Profit Health Systems</th>
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<tr>
<td>Aggressive acquisition strategies</td>
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<tr>
<td>Have significant cash resources and can offer access to low cost capital</td>
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### POTENTIAL PARTNERS FOR RURAL COMMUNITY HOSPITALS

**Equity Investors**

- Evaluate hospital sector and potential hospital investments relative to alternative industry investment opportunities on a risk/return basis
- Working to build hospital and healthcare delivery networks and corporate value through hospital acquisition strategies, which may put corporate mission in conflict with local hospital care

**Consortium of Regional Providers (ACOs)**

- Consortium of community hospitals forming contractual and/or ownership relationship
- Establishing an organization with the size and reach necessary to achieve the cost and quality efficiencies expected by ACO members
BENEFITS OF A HEALTH SYSTEM COLLABORATION

From the Perspective of the Rural Hospital
- Clinical integration and quality enhancement
- Infrastructure and technology improvement
- Branding and service line expansion
- Scale for risk-based contracting
- Scale for operating efficiency gains
- Management resources

From the Perspective of the Health System
- Scale for risk-based contracting
- Clinical integration and quality enhancement
- Expanding market presence
- Strengthening service lines
- Scale for operating efficiency gains
RURAL HOSPITAL – AN AFFILIATION CASE STUDY

<table>
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<tr>
<th>Co-Manager/Lessor</th>
<th>Co-Manager/Lessee</th>
<th>Affiliation Advisor</th>
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**TRANSACTION SUMMARY**

- Results of Independence Viability Testing
- Identified partner candidates (local, regional & national)
- Distributed Request for Proposals and received responses
- Selected affiliation candidate and preliminary structure/terms
- Structured affiliation arrangement
- Completed due diligence
- Negotiated the execution of Memorandum of Understanding
- Negotiated the execution of Definitive Agreement
- Closed transaction
GROUP DISCUSSION AND CONTACT INFORMATION

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