TRENDS IN HOSPITAL MERGERS & ACQUISITIONS
JUNIPER ADVISORY

- Specialized investment banking firm
- M&A advisory services for nonprofit hospitals
- 25 yrs, 200 assignments, 40 states, 58 AGs
- In PA, recently advised Conemaugh on a JV with DLP

Rex J. Burgdorfer -- Rex concentrates on M&A services for Juniper's nonprofit hospital clients. He has over a decade of investment banking experience and has advised all forms of hospital systems on business combination transactions. Rex was previously with Morgan Stanley and holds an MBA from the Kellogg School of Management at Northwestern University.
TREND 1 - - FRAGMENTATION OF U.S. HOSPITAL INDUSTRY UNDER SCRUTINITY

HEALTHCARE REFORM

- Healthcare services consume too much of the economy (~16% of GDP) - - central element of Federal debt crisis
- Increased need for economies of scale to cope with declining prices and higher costs

STRUCTURE

- Ten largest hospital systems only account for a little over 15% of industry revenue; 50 largest only 25%
- In comparable industries according to size, such as managed care, airline, food, beverage and tobacco, and banking, 50 largest have between 70% and 80%

Source: U.S. Office of Management and Budget

Source: Audited financial statements, First Research Industry reports.
TREND 2 - CAPITAL STRUCTURE LIMITATIONS

Correlation between size, credit rating, and cost of capital

- Systems more likely to hold high ratings than stand-alone hospitals
- In 2014, there were 37 downgrades and 28 upgrades in the healthcare sector by Moody’s, with consolidation among nonprofits driving upgrades
- Large systems are forecasted 3-4% growth in 2015, while small hospitals (<$500 million) will decline ≥ 2%
- 2015 credit rating downgrades forecasted to outnumber upgrades, as revenue sources are pressured


TREND 5 - PARTNERSHIPS FORMED WITH A NEW FOCUS ON OUTCOMES

Source: Modern Healthcare, Truven Health Analytics, “Hospital Performance Differences by Size and Ownership Status.”
TREND 6 - - WEATHERING FINANCIAL PRESSURES ↓ PRICES, ↑ COSTS REQUIRES NEW MANAGERIAL SKILLSET

Estimated $122 billion in Medicare will hit hospitals hardest

Share of Total Cuts, by Medicare Service Type

- Hospital Inpatient Care: 32%
- Skilled Nursing Facilities: 14%
- Physician Fee Schedule: 15%
- Hospital Outpatient Services: 8%
- Group Plans (includes MA): 4%
- Home Health Agencies: 12%
- Non-exempt Part D: 7%
- Other Services: 8%

Source: U.S. Government
TREND 7 - STRONGER, PROACTIVE M&A PARTICIPANTS

The effects of Healthcare Reform highlight the importance of scale, integration, operating efficiency, and access to capital. These factors are prompting a second wave of hospital transaction activity.
TREND 9 - OWNERSHIP FORMS LARGELY UNCHANGED

- 986 of the 2,079 community 501(c)(3) hospitals are standalone independent. That represents only 22.5% of the total number of hospitals in the U.S.
- While the number of hospital systems and proportion of hospitals in systems has grown meaningfully, the size of these systems, as measured by the number of hospitals per system, has actually decreased (7.5 hospitals per system in 2008 to 6.9 in 2013)

Sources: American Hospital Association, Juniper estimates.
Medicare and Medicaid payments account for 58% of all care provided by hospitals

Combined underpayments for 2014 were $51 billion: $37.9 billion for Medicare and $13.2 billion for Medicaid

In 2013, 65% of hospitals received Medicare payments less than cost, while 62% of hospitals received Medicaid payments less than cost

Source: American Hospital Association.
TREND II - DATA TRANSPARENCY AND CONSUMERISM IMPACTING BUSINESS COMBINATIONS

HIGH - 2 to 3 organizations control ~ 70% of market

San Antonio Health Systems Market Share

- Methodist (co-owned by HCA) 34%
- Baptist Health (Vanguard) 29%
- University Health System 14%
- CHRISTUS Santa Rose 9%
- Southwest General (IASIS) 5%
- Others 9%

Source: HealthLeaders Intrastudy, Inpatient Market Share, most recent available.

MODERATE - 4 to 5 organizations control ~ 70% of market

Dallas Health Systems Market Share

- Texas Health Resources 26%
- Baylor Health Care System 20%
- Methodist Health System 17%
- HCA North Texas 8%
- JPS Health Network 6%
- Parkland Health & Hosp Sys 4%
- Children's Med Ctr Dallas 3%
- Others 16%

Source: HealthLeaders Intrastudy, Inpatient Market Share, most recent available.

LOW - More than 5 organizations control ~ 70% of market

Chicago Health Systems Market Share

- Advocate Health Care 14%
- Presence Health 10%
- Trinity Health 5%
- Rush System for Health 5%
- Northwestern Memorial 4%
- Franciscan Alliance 4%
- NorthShore Univ HealthSystem 4%
- Others 54%

Source: HealthLeaders Intrastudy, Inpatient Market Share, most recent available.
**TREND 12 - CONSIDERING INDEPENDENCE THE NORM, INNOVATION IN TRANSACTION OPTIONS**

**ACA RESPONSES**

- Smaller systems < $500 million in revenue
  - 70% to 80% assessing independence
  - Only 10% to 15% doing this a few years ago
  - Stigma largely lifted
  - Processes very different — “market input”

- Large systems > $2 billion in revenue
  - Exhibiting increased acquisition appetite
    (e.g., regional 501(c)(3)s)
  - Much better responses
  - Well organized
  - Commercially reasonable

- For-profits losing edge
  - Intra-sector consolidation
  - Greater competition from regional np
  - Sellers objectives rarely include foundation

**INCREASING STRATEGIC ALTERNATIVES**

- **Buyer Joint Ventures**
  
  ![Diagram of Quality, Capital, Strategy](Diagram1)

  Typical characteristics — mutually exclusive

  - Academic & For-profit Joint Venture

- **Whole Hospital Joint Ventures**

  ![Diagram of Nonprofit, Investor Co., JV LLC](Diagram2)

  - Long-term lease
  - 50/50 Governance
  - Cash dist. from JV
  - Mgmt. Agreement

  - 20% NP
  - 80% FP
## SUMMARY OF CURRENT MARKET FOR CORPORATE CONTROL

### CURRENT INDUSTRY STRUCTURE

- Fragmented ownership
- Small companies
- Shift from fee for service
- Physician employment and recruitment
- Focus mired on inpatient services
- Payment economics
- IT systems
- Population health

### IMPACT ON M&A MARKET

- Issues are *systemic*
- ↓ Volumes, ↓ prices, ↑ costs
- Rating agencies pessimistic
- Consolidation leading to stronger, higher quality consolidators
- Healthy, proactive participants seeking business combinations
- Governance challenges remain
- Boards increasingly of the belief that duties include a need to assess full range of strategic alternatives
CERTIFICATE OF NEED

OBSERVATIONS

- Impact of CON, e.g., Lindenhurst, IL with Juniper’s former client Vista Health (now part of CHS)
- Dallas Fort Worth market example
  - No CON in Texas
  - Biggest building boom in U.S. - - 5 new hospitals in the past year, 5 under construction, 4 more planned
- In Colorado, construction “arms race” occurring in high growth Front Range of Denver