

# *Remain Independent or Align?*

## A Guide To Manage Through This Critical Decision

**Sponsored By:**  
TRG Healthcare  
October 12, 2010

# Welcome

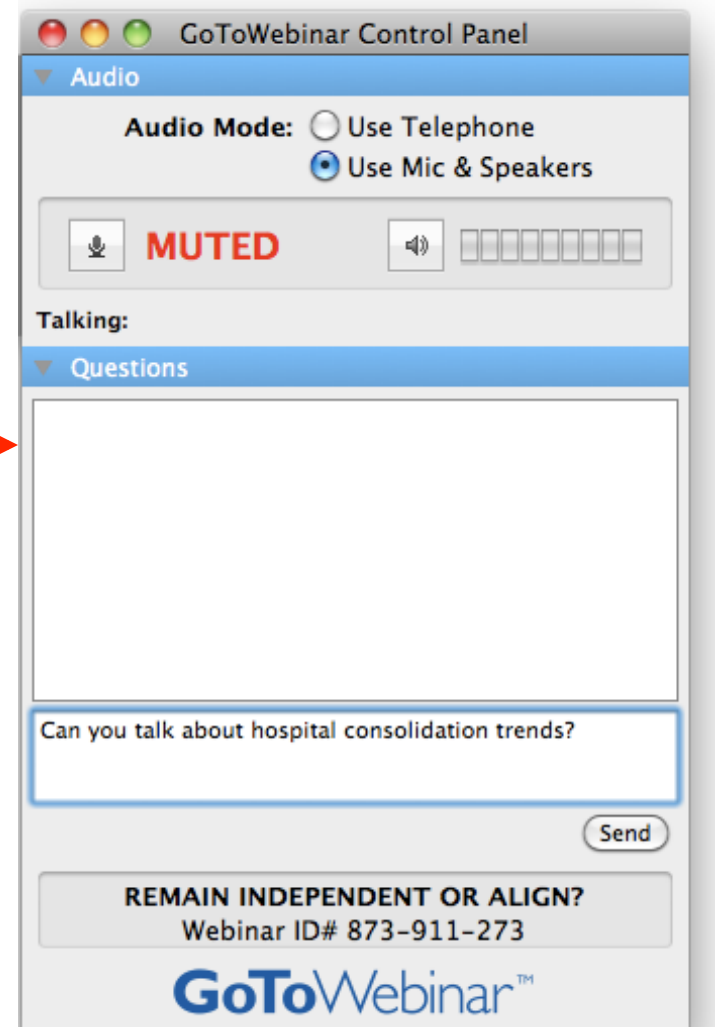
## ***Remain Independent or Align?*** **A Guide To Manage Through This Critical Decision**

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- We will begin shortly
- Audio Dial-In: **312-878-0218**
- Audio Participant Code: **590-184-068**
- If you are experiencing technical issues, please contact Patricia Lee at **215-599-2464**.
- Phone lines *will* be muted during the presentation.

# Housekeeping

- Send questions during presentation using the “Chat” feature on the right side of your screen →
- Questions will be fielded at the end of the presentation



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Mr. Peterson is the Founder and Managing Partner of TRG Healthcare, LLC. He has more than 30 years of healthcare experience developing progressive strategic, financial and operational solutions for a broad range of healthcare clients. His consulting expertise includes: strategic and financial positioning, operational and financial performance improvement, and strategic transactions. He has worked extensively with hospitals, health systems, academic medical centers, as well as physician and faculty group practices.

Prior to forming TRG Healthcare, Mr. Peterson served as President of Founders Healthcare, Inc., a for-profit physician organization. He also served for 15 years as a hospital executive, including seven years as CEO of Penn State University Hospital / Hershey Medical Center and eight years in various executive positions including COO of the University of Michigan Medical Center.

# Agenda

## **Howard Peterson**

Managing Partner,  
TRG Healthcare

- ➔ Hospital Consolidation Trends and Drivers
- ➔ Options for Independent Hospitals
- ➔ Getting to the Right Decision for Your Hospital

## **Joseph Kortum**

Chief Executive Officer  
Southwest Washington  
Medical Center

- ➔ *A Case Study: The Road to Partnership for Southwest Washington Health System*

## **Howard Peterson**

- ➔ Key Lessons from the Southwest Experience

## **Group**

- ➔ Questions and Answers

# TRG Healthcare Overview

- Founded in Philadelphia, TRG has been providing consulting services to healthcare clients since 1997.
- TRG serves clients nationwide with regional offices in: Philadelphia, PA; Southfield, MI; and Denver, CO.
- Our client base is comprised of not-for-profit hospitals and health systems, academic medical centers, and large physician groups.
- In the past six years, TRG has assisted more than 40 hospitals and health systems in processes involving mergers, acquisitions, or sales, including:
  - Suburban Hospital (MD) sale to Johns Hopkins Health System
  - Mount Clemens General Hospital (MI) merger with McLaren Health Care Corp.
  - El Camino Hospital (CA) acquisition of Community Hospital of Los Gatos.

# TRG Healthcare Services

## Strategic and Business Planning

- Organizational visioning
- Leadership facilitation
- Strategic planning
- Business plan development
- Market feasibility studies
- Implementation support

## Financial Advisory & Valuation

- Financial planning & forecasting
- Financial operations support
- Financial feasibility studies
- Business valuation services
- Fair market value opinions

## AMC Services

- Academic affiliation agreements
- Medical school and research planning
- GME accreditation and funding
- Faculty Practice Plan strategy & finance
- Funds flow arrangements

## Transactions and Affiliations

- Affiliation needs assessment
- Partner identification
- Merger/Acquisition/Sale assistance
- Specialty transactions and JVs
- Due diligence
- Integration planning

## Hospital-Physician Alignment

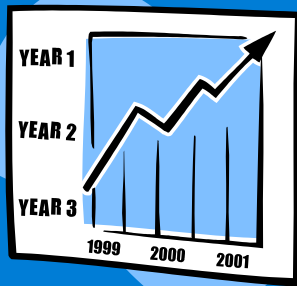
- Physician employment
- Bundled pricing
- Shared contracting
- Medical directorships
- Professional Service Agreements (PSAs)

## Clinical Service Line Services

- Specialized clinical programming
- Resource optimization
- Care Coordination
- Equipment & facility analysis
- Recruitment

TRG's website can be found at [www.trghealthcare.com](http://www.trghealthcare.com) with updates currently underway and expected to become effective no later than November 1, 2010.

# Consolidation Trends



- Hospital consolidation is active in the industry and gaining momentum due in large part to anticipated requirements of Health Reform; a larger geographic footprint, lower costs, mandated IT investments and development of coordinated care structures.
- In the first six months of this year, at least 50 hospitals were involved in merger-and-acquisition deals on pace to beat the 80 for all of 2009 (Irving Levin Associates).
- Proprietary hospital chains have recapitalized themselves and are pursuing growth but in a fundamentally different way than in the past:
  - Acquiring more hospitals in the markets where they already have a presence to expand their existing footprints; and
  - Acquiring much larger hospitals including those in urban markets (e.g., Vanguard plans to buy Detroit Medical Center in MI)
- There is growing interest by private equity firms in not-for-profit hospital acquisitions (e.g., Cerberus Capital Management bid to buy Caritas Christi Health Care in MA)

# Key Drivers of Growing Consolidation Trend

Primary Focus  
for Hospitals  
Today



## Need-Based Drivers

- To improve poor financial circumstances which threaten the viability of the organization
- To access more capital at reasonable rates
- To resolve fundamental competitive disadvantages

## Strategic Drivers

- To gain a competitive advantage
- To grow to achieve economies of scale with respect to:
  - Operating performance
  - Organization and distribution of clinical services
- To create an organization that is relevant under the precepts of Health Reform
- To bring down the cost per bed for investments required by emerging IT mandates
- To become more effective recruiters of the very best physicians

# Why Will Consolidation Likely Dominate Strategic Positioning Over the Next 3 to 5 Years?

Among the remaining 1,000 – 1,200 independent hospitals in the U.S. today, a growing number are asking the question:

“Can we preserve our independence?”

- For all of the reasons just discussed on the prior pages
- The world is about to change under Health Reform:
  - Rewards clinical integration
  - Places future constraints on Medicare reimbursement
  - Requires providers to operate more efficiently
  - Increases costs with increasing compliance burdens
- Information technology mandates are infeasible for a solo organization
  - Electronic Health Records
  - Sophisticated quality reporting systems

# The Fundamental Fiduciary Question



- Often not-for-profit hospital boards focus on preserving independence to retain control.
- Some view the loss of independence as a public admittance of failure, although it is not.
- However difficult, it is the responsibility of the Board to ask the fundamental fiduciary question:

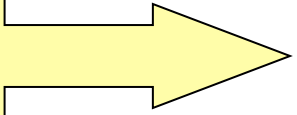
***“Which future course will assure that my hospital is BEST positioned to continue to fulfill its mission of service to the community?”***

- Independence is only one of the possible options.
- Most merger failures can be traced to focusing on finance and control rather than mission and community service.

# What Options Exist for Independent Hospitals?

- Pursue strategic initiatives to enhance the hospital's position as an independent entity such as:
  - FHA financing strategy
  - Leveraging balance sheet
  - Joint ventures or contractual agreements
  - Clinical service initiatives
- Merger with similar hospital or group of hospitals
- Merger with an established system
- Alignment with proprietary hospital company (e.g., sale, long-term lease, capitalized management agreement)
- Creation of a unique system structure

**What is the Best Option for My Hospital?**  
**How Do I Make the Right Decision?**



# Getting to the Right Decision



Adhering to the following **KEY PRINCIPLES FOR SUCCESS** while contemplating future options will better position your organization to make and effectively execute the right decisions.

- ❖ **Independent hospitals have significant value and can control the affiliation process on their terms.**
- ❖ **Focus the process on continuing your mission of service to the community.**
- ❖ **Plan early while you still have leverage and options in the market.**
- ❖ **Identify areas of particular importance to your hospital to serve as criteria for evaluating and comparing strategic alternatives up-front.**
- ❖ **Consider *all* reasonable options to avoid second guessing later on.**
- ❖ **Start with independence and keep it “on the table” throughout.**
- ❖ **Establish a competitive dynamic to enhance your negotiating leverage and the ability to close under your terms.**

A Case Study:  
The Road to Partnership for  
Southwest Washington Health System



Joseph Kortum  
Chief Executive Officer  
Southwest Washington Medical Center



Mr. Kortum assumed his present position as Chief Executive Officer with Southwest Washington Medical Center in May 2003. Mr. Kortum served eleven years at Northern Arizona Healthcare; eight years as President and Chief Executive Officer. Mr. Kortum served as President and Chief Executive Officer, Flagstaff Medical Center for three years. Mr. Kortum holds a Master of Health Administration, Hospital and Healthcare Administration from St. Louis University and a Bachelor of Arts, Psychology from St. Louis University. Mr. Kortum is a fellow of the American College of Healthcare Executives, past Chairman of the Arizona Hospital Association, and a member of the Arizona Chamber of Commerce Board, and Flagstaff Chamber of Commerce Board, as well as past-President United Way of Northern Arizona.

Mr. Kortum is a past Board member on the Boards of Identity Clark County, Columbia River Economic Development Council and Greater Vancouver Chamber of Commerce and the United Way of the Columbia-Willamette Board.

# Discussion Agenda

- Southwest Washington Health System overview
- Motivation for contemplating alignment
- Process and outcomes
- The road ahead
- What we gained from the process

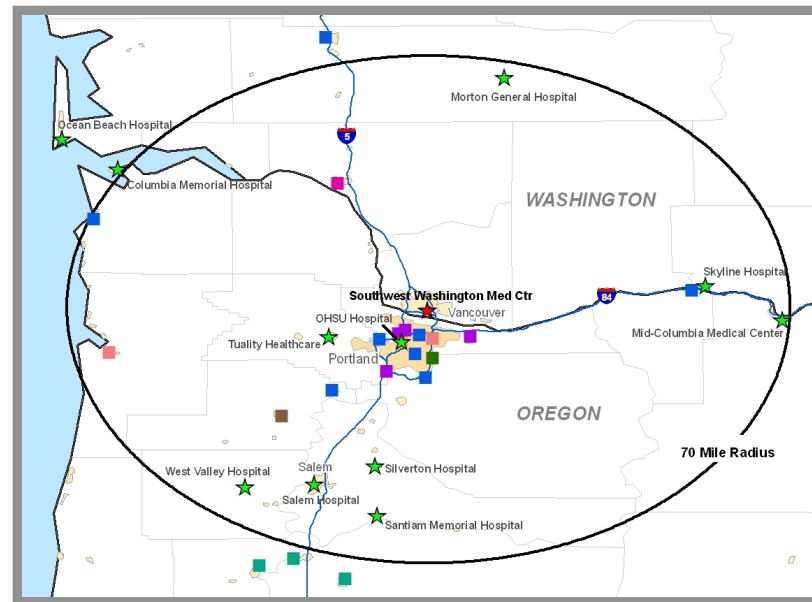
# Introduction to Southwest



- 150-year heritage as a not-for-profit provider in Southwest Washington.
- Provide services to more than 200,000 patients per year including residents from throughout Clark County and beyond.
- **Vision:** Exceptional medicine. Extraordinary care. Every person.
- **Mission:** As the leader in the provision of health services for our entire community, we emphasize clinical and service quality, promote accessible and affordable care and work with others to improve health status.
- Southwest Washington Medical Center is the flagship provider in the Southwest Washington Health System.
- Southwest was named as one of the Top 100 Hospitals® six times with many specialized capabilities including:
  - One of only three trauma centers in the Portland area.
  - One of the only CyberKnife® Centers on the West Coast.
  - Home to a Nationally Certified Stroke Center.
  - Advanced heart and vascular care, including open heart surgery

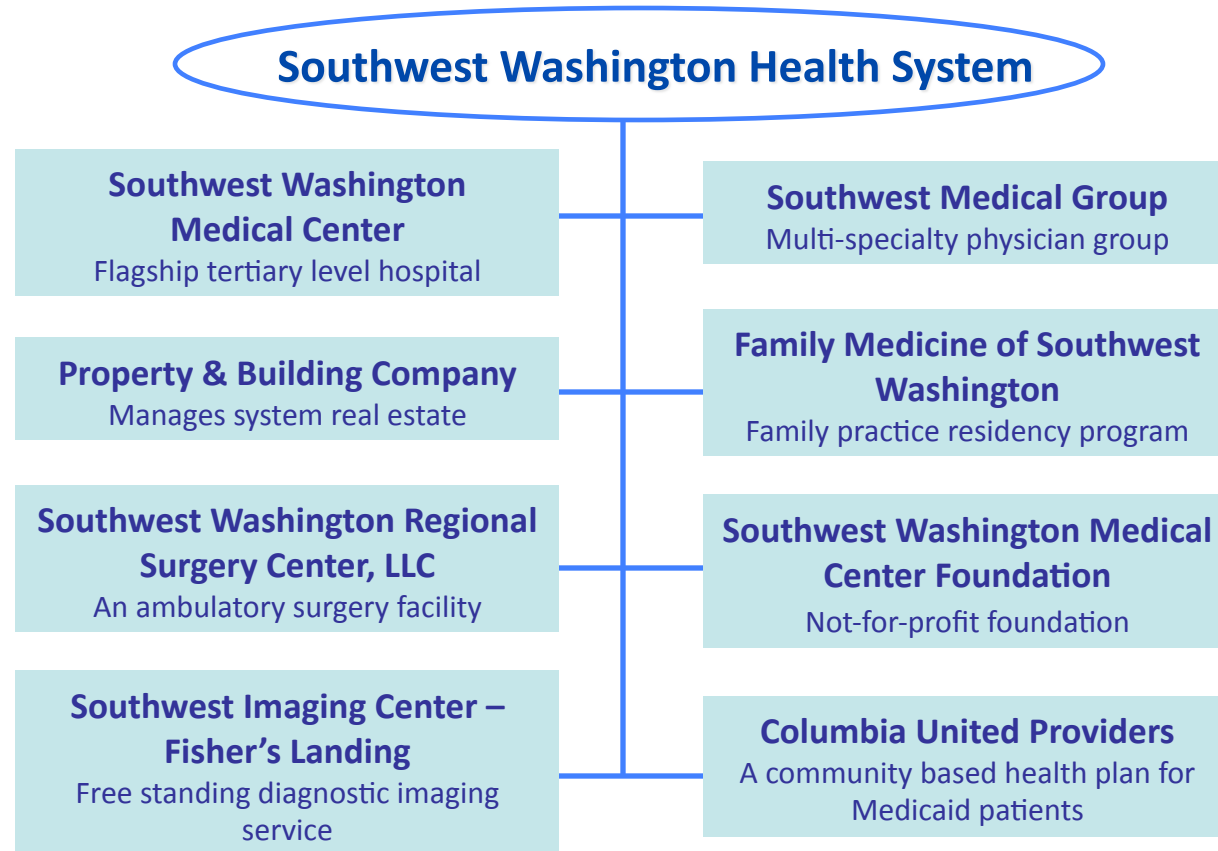
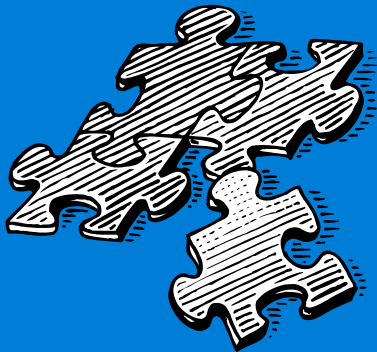
# Southwest's Market Area

- Southwest is located in an attractive, growing market.
- There are four large health systems including: Kaiser, Legacy, PeaceHealth, and Providence.
- Few independent hospitals remain and most that do are small or modest in size.
- The other larger, independent hospitals within the broader market are located in Oregon (Salem and Adventist).



- ★ SW Washington Medical Center
- ★ Independent Hospitals
- Adventist Health
- Department of Veterans Affairs
- Kaiser Foundation Hospitals
- Legacy Health System
- PeaceHealth
- Providence Health & Services
- Samaritan Health Services
- Triad Hospitals, Inc

# System Components



# System Facts and Statistics

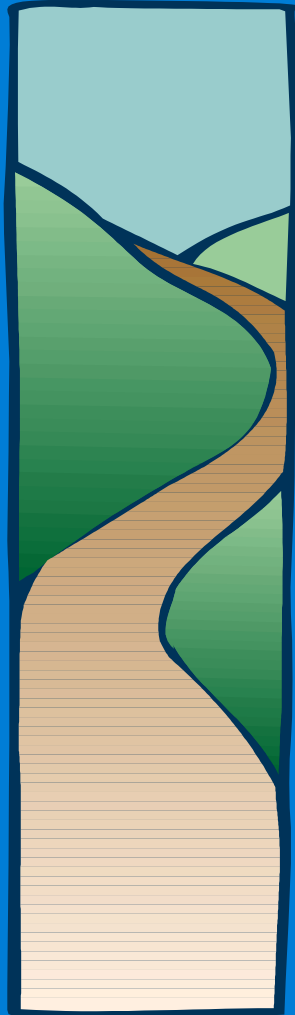


## Southwest Facts & Figures (2009)

Total Licensed Beds	442
Employees	3,350
Medical Staff	1,000+
Inpatient Admissions	24,461
ALOS	4.02 days
Average Daily Census	237.1
Centers of Excellence	Bone and Joint Center, Brain and Spine Center, Cancer Center, Heart and Vascular Center, Women's and Children's Services including birthing center
Trauma	Level II, Level II Nursery
Patient Volumes	Births (3,451), ER visits including urgent care (110,949)

Data Source: Fact Sheet available at: [www.swmedicalcenter.com](http://www.swmedicalcenter.com)

# Getting Started Down the Road to Partnership



- Southwest was initially targeted by another local hospital system (“System A”) to respond to *their* process for a potential partnership.
- Intrigued with this possibility and the potential to create something of greater significance for both organizations.
  - Opportunities for coordination and collaboration
  - Possible cost reduction with reduced redundancies
  - Likely to achieve large economies of scale
- Signed confidentiality agreement to enter into a two-party integration evaluation process with System A.
- Though involved in these two-party discussions, we made no decision to end our independent status at this time.

## Heading the Wrong Way



- Initial process and dialogue were controlled by System A, which seemed to be pushing a singular solution that would plug Southwest into *their* governance structure.
- Early communication seemed unbalanced and aimed at securing Southwest's agreement to follow *their* process.
- System A consultants were demanding proprietary information but unwilling to respond to questions of greatest importance to Southwest.
- There was an apparent urgency for an exclusivity agreement, driven perhaps by considerations specific to other hospitals targeted to become part of *their* system.

# Involving TRG Healthcare



- Engaged TRG to serve as our consultant and support us in the process already underway with System A.
- TRG's anticipated role included:
  - Designing framework for process going forward
  - Facilitating Board discussions throughout planning process and deliberations
  - Representing the interests of Southwest's leadership and Board
  - Negotiating voice with potential partner(s)

# Taking the Wheel

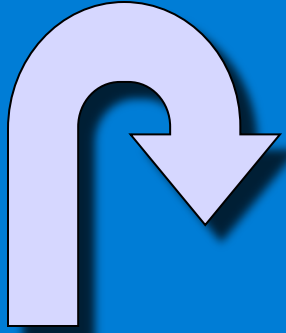


## Take Control.

The organization should control its options and evaluation process and the choices it makes regarding its future.

- As a result of our experience with System A, Southwest's leadership and Board quickly felt that the interests of the organization were not being served by the initial process.
- Took pause in our dialogue with System A.
- Recognized the decision at hand was of the *greatest importance*, one that could dramatically influence the course of the organization and its 150 year history - Had to get it right!
- Realized that comparing what we knew (independence) to something abstract (being aligned) was unfair. We had to understand the specific details of our alignment options to make a sound judgment in the end.
- Reached agreement at the Board level to reorder the logic and the structure of the process to comply with *Southwest's* timelines and *Southwest's* strategic objectives.

# Changing Direction



“If we don’t change direction, we are likely to end up where we are going.” (Chinese Proverb)

- Held a Board Retreat focused on Southwest’s strategic direction and decision making.
  - Large, diverse Board membership
  - Representation of medical community
  - Strong sentiment to continue as an independent entity
- Began to think critically about Southwest’s ability to continue as an independent organization.
  - Determined ongoing independence would require, at a minimum, enhanced strategies to mitigate organizational risk and remain relevant in the market.
- Obtained guidance from the Board as to their willingness to engage and consider potential partners other than System A.

# Identifying Our Alternate Routes



## Consider *All* Reasonable Options.

Evaluating all reasonable options will offer the very best opportunity for the organization to effectively reach its organizational objectives and eliminates the risk of second guessing decisions late in the process.

- Initiated a formal process to actively explore and evaluate the available alignment options.
- Identified all health systems present and competitive in Southwest's market area.
- Made judgment about which to include/exclude for further consideration, eliminating only one system with a fundamentally different model of operation.
- Did not have a compelling reason to include for-profit systems or not-for-profit systems outside of the market area in our partnership considerations.
- Three potential partners remained for further evaluation and consideration along with independence .

**System A**

**System B**

**System C**

**Independence**

# Establishing Criteria to Guide Us



## Establish “Decision Criteria” Early On.

Defining areas of particular importance up front will help ensure an objective process and strategic decisions or partnerships that address the organization’s critical issues.

- Developed our *own* set of terms and considerations for pursuing alignment based on the mission, vision and values of Southwest.
- SEVEN essential elements emerged which Southwest believed were of most importance when evaluating and choosing a particular partner (or independence) option.
- They became known as our “decision criteria”.

<b>COMMUNITY</b>
<b>SERVICE</b>
<b>CAPITAL</b>
<b>OPERATIONS/FINANCIAL</b>
<b>RISKS</b>
<b>CULTURE</b>
<b>STRATEGY</b>

## Decision Criteria – Seven Essential Elements

1. **COMMUNITY.** Produces a resilient orientation to understanding and acting on the health needs of Southwest Washington.
2. **SERVICE.** Establishes the ability to provide the broadest set of clinical services economically viable within southwest Washington.
3. **CAPITAL.** Results in substantially improved access to capital to make the investments necessary to more effectively serve the needs of the community.
4. **OPERATIONS/FINANCIAL.** Produces sustainable operating and financial benefits (e.g., access, quality, service, safety, etc.).
5. **RISKS.** Creates an organizational structure that mitigates exposure to any material risks and could perform well under Health Reform.
6. **CULTURE.** Ensures a cultural fit that is probable to advance the historical mission and values of Southwest.
7. **STRATEGY.** Accomplishes something strategic that Southwest could not accomplish without the partnership

# Taking a Closer Look at Independence



## Keep Independence "On the Table"

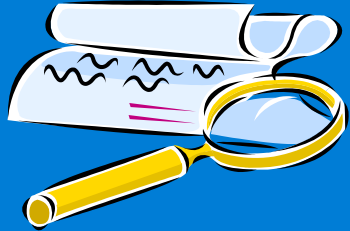
Contemplating alignment does not require your organization abandon its independence. Independence should be the starting point and remain an alternative throughout.

- More analytical work was done to fully understand the issues related to continued independence including the risks such as:
  - Limited access to capital
  - Inability to achieve certain economies
  - Mandates under Health Reform
  - Standing with commercial payers
- We identified a set of preferred strategies we could potentially pursue to enhance our position as an independent entity.

### Strategies for Enhanced Independence

- ➔ Aggressive alignment with primary care physicians.
- ➔ Engage in broad set of regional, resilient service line ventures.
- ➔ Become a niche provider of some service/set of services.
- ➔ Undertake strategies with other 3rd party organizations.
- ➔ Participate in new market growth and physician alignment strategies.
- ➔ Explore clinical partnership with a nationally recognized leader.

# Understanding Our Alignment Options



## Establish a Competitive Dynamic.

Without a competitive dynamic your hospital's negotiating leverage is diminished and the ability to close under your terms is jeopardized.

- Developed formal partnership Request for Proposal and distributed it to Systems A, B, and C
  - Fostered a competitive dynamic.
  - Provided leverage to drive time frames and results.
  - Established clear terms for partnership.
  - Helped in collecting consistent information from all respondents for an “apples to apples” comparison.
- Established an explicit schedule and followed it closely to avoid a protracted, ongoing effort.
- Had multiple discussions and data exchange with each potential partner organization.
- Received comprehensive, written proposals from Systems A, B, and C.

# Evaluating the Alternatives



- We evaluated partnership alternatives against the seven essential decision criteria.
- Board members provided a relative ranking related to each potential partner's ability to satisfy the decision criteria.
  - 3 = best satisfies the criteria
  - 2 = next best at satisfying the criteria
  - 1 = least satisfies the criteria

Results		
	<u>Alternative</u>	<u>Average Ranking</u>
Best	System B	2.6
↓	System C	2.0
Least	System A	1.4

System A, with whom we had EXCLUSIVE discussions early on, turned out to be the LEAST attractive when measured against the Decision Criteria.

# Getting a Better Sense of Direction



## Plan Early.

Many organizations wait to contemplate their future until they have lost a great deal of leverage and available options. Early planning will help control your own future and drive your options to the very best outcome possible

## Alternatives

**Independence**



Through education of process we decided long-term Southwest would not have what it takes to compete as others grew and built leverage.

Although no immediate need for a partner, we determined it was better to align earlier while still in a position of strength.

**Align - System A**



Review of proposals and evaluation against criteria made it obvious System A was not optimal partner.

**Align - System B**



Submitted a competitive proposal. Ranked as the best option for advancing the decision criteria.

**Align - System C**



Submitted a competitive proposal. Ranked a close second to System B when measured against the criteria.

## Pursue Further?



**NO**



**NO**

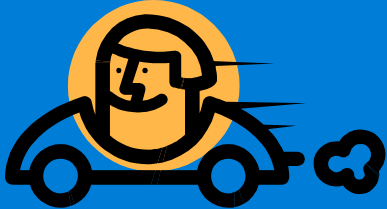


**YES**

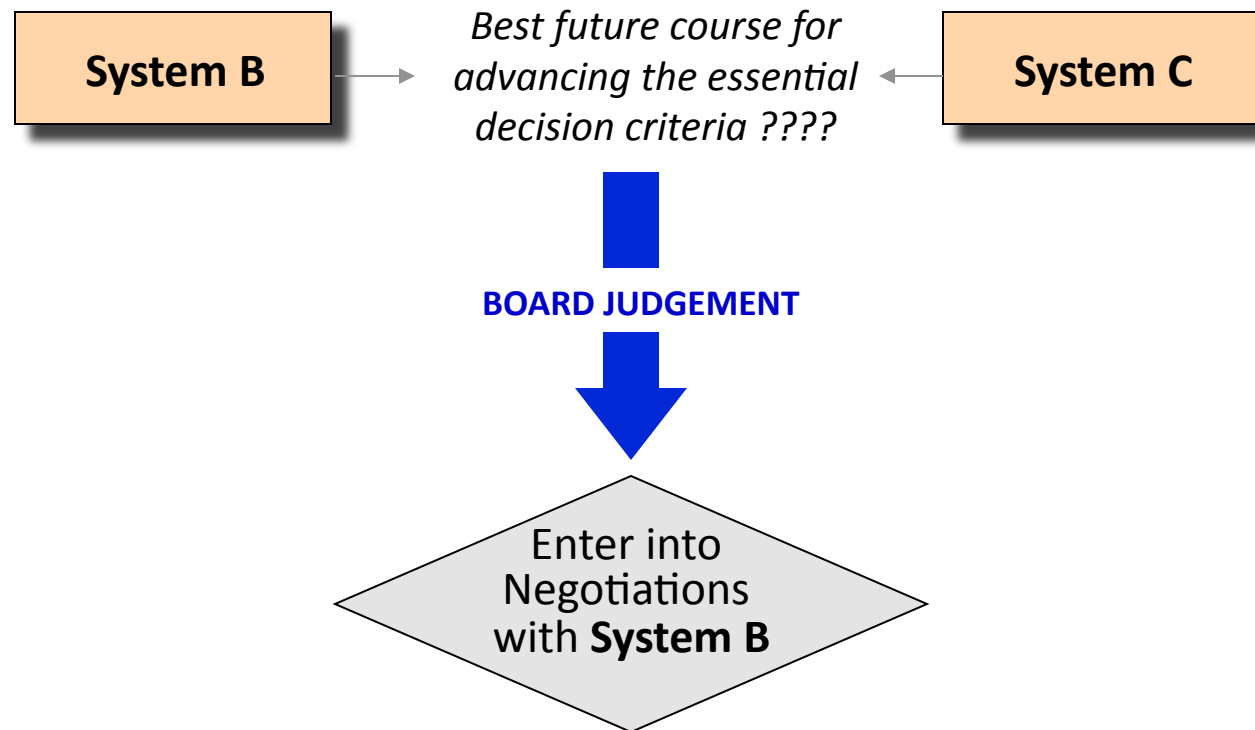


**YES**

# Moving Forward



- Gave formal consideration to the two systems emerging as the preferred alternatives from our process:



# The Road Ahead



- Moving into the end stages of our transaction.
  - Term sheet is done.
  - Due diligence is done.
  - Regulatory filings have been filed.
- Conducting final negotiations related to the definitive agreement between the two parties.
- Expect the transaction to be completed by the end of the year.

## What We Gained From The Process



- Established consensus around the vision for Southwest's future
- Focused on the issues most important to Southwest's long-term success
- Reached a common and full understanding of all of our available options
- Made a well-informed decision with confidence in our final choice
- Had a negotiating voice through TRG

# Lessons from the Southwest Experience



- Avoid wasting time in another party's process. Focus rather on creating your own process centered around your hospital's objectives and timelines.
- Getting caught up in a process initiated by another organization could take you down the wrong path.
- Consider all options to avoid overlooking the one that may turn out to be the very best among them.

# QUESTIONS?



**Howard Peterson**  
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# Thank You!

For any remaining questions or to request a copy of today's presentation please contact:

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