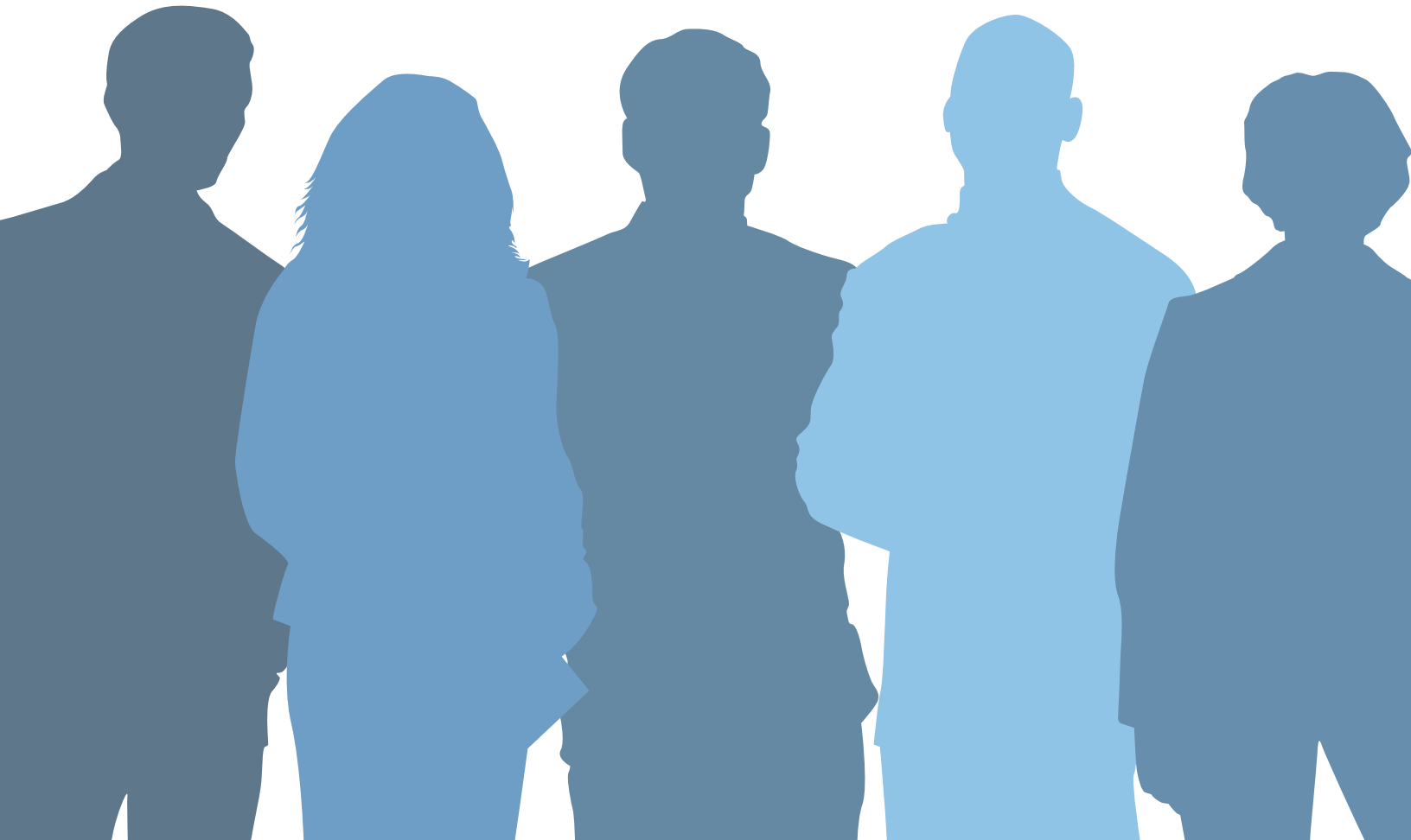


January 2012

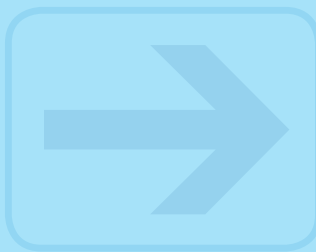
M&A: Hospitals Take Control

By Margaret Dick Tocknell



WWW.HEALTHLEADERSMEDIA.COM/INTELLIGENCE

Access. Insight. Analysis.



Be a voice
Gain insight from your peers
Shape the direction of the industry



HEALTHLEADERS MEDIA
Council

The nation's most exclusive
healthcare intelligence community

Join today at www.healthleadersmediacouncil.com



Foreword

INTERESTING TIMES, UNPRECEDENTED OPPORTUNITIES

There is a familiar ancient expression often attributed to the Chinese that says, "May you live in interesting times." Like it or not, in today's healthcare environment, we live in interesting times.

This timely survey of almost 200 healthcare leaders from across the country provides useful insight into the industry's approach to the interesting times in which we operate. It reflects the sharpening of our collective strategic focus and illustrates the efforts of hospitals and health systems across the country to fortify their positions through consideration of mergers and acquisitions of services that add breadth and depth to their offerings.

As we work to transform ourselves from an industry focused on acute care and healing the sick to one focused on wellness and managing the health of populations in our care, organizations are rethinking their integration strategies. Collaboration across the entire continuum of care—physicians, acute care, postacute care, and even health plans—is reflected in the survey results. While once thought to be a thing of the past by many, the acquisition of physician practices has returned with zeal. But surprisingly, postacute care acquisitions appear to remain low on the priority list. And all respondents still wrestle with how to balance cost, quality, culture, and return on investment.

A climate defined by an uncertain economy, healthcare reform, reimbursement pressures, physician shortages, and questions about the future of our entire provider system do indeed make our current times "interesting" to say the least. But it also invites and inspires our collective creative energy. I believe that as an industry, we have the unprecedented opportunity to truly redefine and shape the way healthcare is delivered. This survey offers insight into how your colleagues across the country have begun to respond to some of those opportunities.



Stephen L. Mansfield, PhD, FACHE

President and CEO

Methodist Health System

Dallas

Lead Advisor for this Intelligence Report



Table of Contents

Foreword	3
Methodology	5
Respondent Profile	6
Analysis	7
Survey Results	12
M&A Activity Impact on <u>Quality</u> of Care.....	12
M&A Activity Impact on <u>Cost</u> of Care.....	12
Elements of Strategic M&A Goals.....	13
Organization's M&A Plans for the Next 12–18 Months.....	14
Sectors of Interest in M&A Activity.....	14
Most Relevant Physician Specialties in M&A Strategy.....	15
Likelihood of M&A Type.....	16
Issues Resulting in M&A Termination of Proposed Transaction in the Past 12 to 18 Months.....	16
Challenge of M&A Strategy Issues.....	17
Team Members Involved in M&A Functions.....	17
Strategic Leader for M&A Activity.....	18
Operational Leader for M&A Activity.....	18
Specific Team Dedicated to Hospital-Physician Practice Acquisition.....	19
Estimated Dollar Value of the M&A Deals in the Next 12–18 Months.....	19



Methodology

The 2012 Healthcare Mergers, Acquisitions, and Consolidation Survey was conducted by the HealthLeaders Media Intelligence Unit, powered by the HealthLeaders Media Council. It is part of a monthly series of Thought Leadership studies. In October 2011, an online survey was sent to the HealthLeaders Media Council and select members of the HealthLeaders Media audience. Respondents work in hospital and health system settings. A total of 189 completed surveys are included in the analysis. The margin of error for a sample size of 189 is +/- 7.1% at the 95% confidence interval.

ADVISORS FOR THIS INTELLIGENCE REPORT

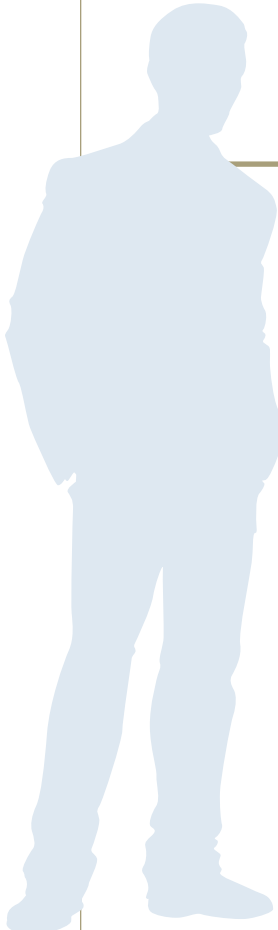
The following healthcare leaders graciously provided guidance and insight in the creation of this report.

Lisa M. Carlson
Corporate CFO
Sanford Health
Fargo, ND

Kevin Gross
President, Oklahoma
division
Ardent Health Services
Nashville

Stephen L. Mansfield,
PhD, FACHE
President and CEO
Methodist Health System
Dallas

Robert S. Shapiro
CFO
North Shore-Long Island
Jewish Health System
Great Neck, NY



About The HealthLeaders Media Intelligence Unit

The HealthLeaders Media Intelligence Unit, a division of HealthLeaders Media, is the premier source for executive healthcare business research. It provides analysis and forecasts through digital platforms, printed publications, custom reports, white papers, conferences, roundtables, peer networking opportunities, and presentations for senior management.



Upcoming Intelligence Report Topics

- 2012 Industry Survey
- Service Line Strategies
- Accountable Care Organizations



Intelligence Report Editor
MARGARET DICK TOCKNELL
mtocknell@healthleadersmedia.com

Publisher
MATTHEW CANN
mcann@healthleadersmedia.com

Editorial Director
EDWARD PREWITT
eprewitt@healthleadersmedia.com

Managing Editor
BOB WERTZ
bwertz@healthleadersmedia.com

Intelligence Unit Director
ANN MACKAY
amackay@healthleadersmedia.com

*Senior Director of Sales
Northeast/Western Regional Sales Manager*
PAUL MATTIOLI
pmattioli@healthleadersmedia.com

Media Sales Operations Manager
ALEX MULLEN
amullen@healthleadersmedia.com

Copyright ©2012 HealthLeaders Media, 5115 Maryland Way, Brentwood, TN 37027 • Opinions expressed are not necessarily those of HealthLeaders Media. Mention of products and services does not constitute endorsement. Advice given is general, and readers should consult professional counsel for specific legal, ethical, or clinical questions.

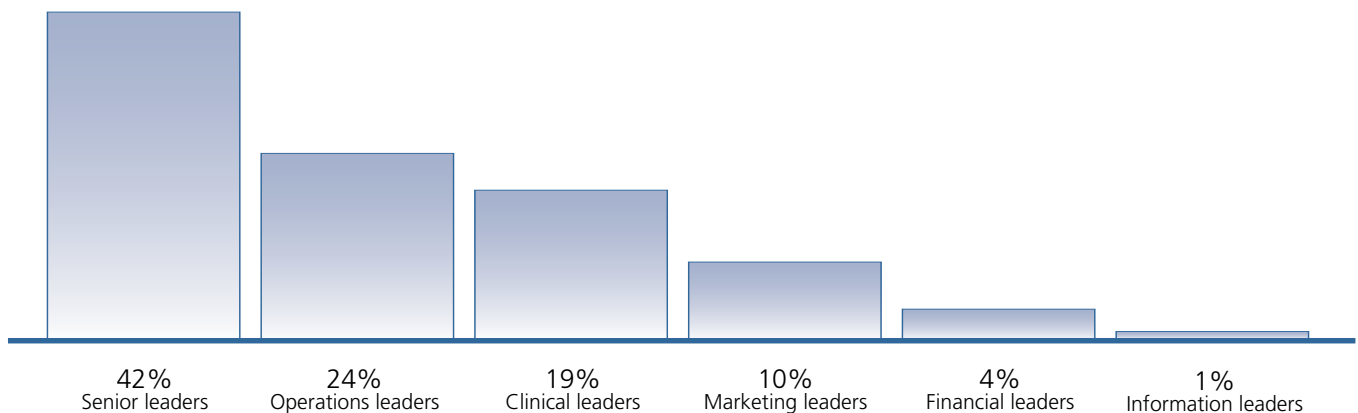


Respondent Profile

Respondents represent titles from across the various functional areas including senior leaders, operations leaders, clinical leaders, financial leaders, marketing leaders, and information leaders. Over 40% of the respondents have senior leader titles. They are from hospitals and health systems.

Title

Base = 189



Senior Leaders | CEO, Administrator, Chief Operations Officer, Chief Medical Officer, Chief Financial Officer, Executive Dir., Partner, Board Member, Principal Owner, President, Chief of Staff, Chief Information Officer

Surgical/Perioperative Services, Medical Director, VP Clinical Informatics, VP Clinical Quality, VP Clinical Services, VP Medical Affairs (Physician Mgmt/MD)

Operations Leaders | Chief Compliance Officer, Chief Purchasing Officer, Asst. Administrator, Dir. of Patient Safety, Dir. of Quality, Dir. of Safety, VP/Dir. Compliance, VP/Dir. Human Resources, VP/Dir. Operations/Administration, Other VP

Marketing Leaders | VP/Dir. Marketing/Sales, VP/Dir. Media Relations

Financial Leaders | VP/Dir. Finance, HIM Director, Director of Case Management, Director of Revenue Cycle

Clinical Leaders | Chief of Orthopedics, Chief of Radiology, Chief Nursing Officer, Dir. of Ambulatory Services, Dir. of Clinical Services, Dir. of Emergency Services, Dir. of Nursing, Dir. of Rehabilitation Services, Service Line Director, Dir. of

Information Leaders | Chief Medical Information Officer, Chief Technology Officer, VP/Dir. Technology/MIS/IT

Type of Organization

Base = 189

Hospital	56%
Health system	44%

Number of Beds

Base = 105 (Hospitals)

1-50	17%
51-199	29%
200-499	34%
500-999	18%
1,000+	2%

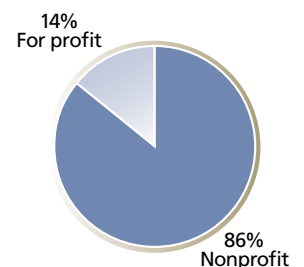
Number of Sites

Base = 84 (Health systems)

1-5	29%
6-20	23%
21-49	20%
50+	29%

Status of Organization

Base = 189





ANALYSIS

Physician Practices Top Target, But Health Plans of High Interest, Too

By Margaret Dick Tocknell

After a record-breaking year for mergers and acquisitions in 2011, hospital and health system leaders say they are still on the hunt for deals in 2012. The usual targets—physician practices—are most desired, but health plans emerged as a significant entry in the M&A quest. Meanwhile, it looks as if balancing financial limitations with M&A strategy remains a considerable challenge. These are among the key findings of the HealthLeaders Media 2012 *Healthcare Mergers, Acquisitions, and Consolidation Survey*.

What Healthcare Leaders Are Saying

49% say the quality of care will get better as a result of the current M&A activity

16% say the quality of care will get worse as a result of the current M&A activity

51% say the cost of care will get better as a result of the current M&A activity

24% say the cost of care will get worse as a result of the current M&A activity

6% say their organization has no M&A strategy

13% say their organization's strategy is to maintain independence and enter into no M&A activity

21% expect no M&A activity in the next 12–18 months

18% of hospital and health system organizations have a high interest in the insurance, player plan sector

50% or more cite hospitalist, cardiology, orthopedics, and primary care physician specialties as most relevant to their M&A strategy

48% say their organization is likely to pursue an acquisition in the next 12–18 months

29% cite access to capital as a major challenge to their organization's M&A strategy

50% say their organization relies on a standing internal team to handle M&A functions

68% say the CEO is the strategic leader for their organization's M&A activity

29% say the CEO is the operational leader for their organization's M&A activity

14% are exploring M&A deals worth \$100 million or more in the next 12–18 months

Nearly 80% of healthcare leaders say they will have M&A deals under way or will be exploring deals over the next 12–18 months. The dominant element of leaders' M&A strategy is to shore up existing geographic markets (65%) rather than to expand into new ones (43%). “The priority is to close the service gaps and get ready to assume risk for the total cost of care,” says Lisa M. Carlson, corporate CFO of Sanford Health in Fargo, ND.

That response may also reflect the respondent pool—86% are affiliated with a nonprofit facility. “I can tell you that investor-owned systems are definitely interested in expanding into other geographies,” says Kevin Gross, president of the Tulsa-based Oklahoma division of



ANALYSIS (continued)

“The priority is to close the service gaps and get ready to assume risk for the total cost of care.”

—Lisa M. Carlson, corporate CFO, Sanford Health, Fargo, ND

for-profit Ardent Health Services, which is headquartered in Nashville and also operates healthcare facilities in Albuquerque, NM.

Healthcare reform and government reimbursement levels continue to influence the selection of M&A targets. The acquisition of physician practices, which are central to the care coordination efforts espoused in the Patient Protection and Affordable Care Act, is of high interest to 59% of the respondents. Another indication of the critical role physician groups are poised to play in the healthcare

delivery system: 56% of healthcare leaders have a specific team dedicated to hospital-physician practice acquisition.

“Docs are special people. You can’t send just anyone out to speak to them,” explains Robert S. Shapiro, CFO at North Shore-Long Island Jewish Health System in Great Neck, NY. The health system has a group dedicated to making deals with physician practices and finds that it’s a competitive edge. “It’s better to have someone who understands the physician world. That way everyone is comfortable. Deals happen when everyone is comfortable.”

The M&A strategy for physician practices is focused on what already exists rather than building on something new. Some 52% of healthcare leaders say they will acquire physician practices to strengthen existing service lines rather than to expand into new service lines (37%).

Primary care tops the M&A wish list of 64% of healthcare leaders. “Primary care practices are so important. It’s the piece that makes accountable care organizations and medical homes work,” says Stephen L. Mansfield, PhD, FACHE, president and CEO of Methodist Health System in Dallas. “Our interest is a lot higher than this survey indicates.”

Primary care networks control the flow of patients to hospital-based specialists as well as to the ancillary services offered by the hospitals. While PCPs bring patients in the door, it’s specialties like orthopedics and cardiology—and their reimbursements—that help pay the bills. Some 57% of survey respondents are looking for orthopedic groups while 54% want cardiology groups.



ANALYSIS (continued)

Gross expects the acquisition of specialist groups to become more important and even surpass primary care acquisitions. He says that is already happening in the Tulsa area. “We spend six to eight hours each week looking at physician acquisitions and 90% are specialty groups.”

Behind physician practices, survey respondents indicated a high interest in acquiring acute care hospitals (35%), ambulatory surgery centers (29%), and diagnostic imaging centers (28%). Nearly one in five (18%) listed insurance/payer plans as a high-interest M&A target, and there are reasons to expect this category to grow in importance. Shapiro says that with hospitals facing declining patient volumes as well as declining case mixes, “we need to get more involved in the healthcare financing piece of healthcare delivery. We need to get a piece of the premium that is paid by employers to insurance companies.”

Gross agrees. He says his system is very interested in expanding its existing health insurance plan or creating, acquiring, or joint venturing with insurers in its marketplace. “Hospital systems have come full circle on that. Back in the 1990s, everybody had provider-sponsored healthcare plans to get upstream revenue in terms of premium dollars. Then hospitals divested themselves of the plans. The way we think now is you want to be at the top of the food chain to capture wherever these dollars go to pay for people’s care. We want to be close to the distribution of those dollars and then be able to control where the dollars get spent in terms of downstream payments for services and networks. The best way to do that is to have an insurance company.”

With Texas shifting its Medicaid program to managed care, Mansfield says it might make sense for Methodist Health System to have its own managed care organization. The health system is taking a cautious look at that possibility. “It’s on our to-do list but it’s a different business than developing a healthcare system and requires a different set of core competencies. We would only do it if we could acquire the talent, too.”

“It’s better to have someone who understands the physician world. That way everyone is comfortable. Deals happen when everyone is comfortable.”

—Robert S. Shapiro, CFO, North Shore-Long Island Jewish Health System, Great Neck, NY



ANALYSIS (continued)

Way down the list of possible M&A targets are nursing homes, dialysis clinics, and long-term acute care hospitals, which are all at the mercy of declining Medicaid reimbursements. “Everyone is gun-shy around Medicaid right now,” explains Mansfield.

Not all M&As are made in heaven; 58% of respondents have terminated an M&A over the past 12–18 months. Culture (49%), political/governance considerations (41%), and agreement on valuation (39%) are the top three reasons cited for deals that fell apart.

Carlson says those particular stumbling blocks may reflect the M&A focus on physician practices. “Physicians have to understand that they are being acquired and that they can’t keep doing things the way they did them before.”

Mansfield agrees. “There are more cultural hurdles in a hospital-physician practice acquisition than in a hospital-hospital merger.” He added that a governance issue can be something as simple as a hospital policy that prevents spouses from reporting to one another. “If the spouse runs the physician practice being acquired, then the spouse will have to go.”

Disagreement on valuation probably reflects the halcyon days of physician practice acquisitions when multimillion-dollar price tags were not unusual. Today the upfront dollars are usually small and cover only the medical records, equipment, and real estate. For hospitals the key part of the acquisition is getting physicians to commit to five- to 10-year employment contracts.

Given the focus on physician practices, Mansfield finds it somewhat surprising that 58% of respondents list access to capital as a moderate to major challenge. “Acquiring a physician group is not nearly as capital intensive as hospitals.”

“We need to get more involved in the healthcare financing piece of healthcare delivery. We need to get a piece of the premium that is paid by employers to insurance companies.”

—Robert S. Shapiro, CFO, North Shore-Long Island Jewish Health System, Great Neck, NY



ANALYSIS (continued)

Gross adds that no matter what the M&A target, “there’s capital sitting on the sidelines and good deals will always find capital.”

Healthcare leaders have a generally positive impression of the effect that recent consolidation has had on the quality and the cost of healthcare. Some 51% responded that M&A had a positive or strongly positive impact on the cost of care, while 49% said M&A had a positive or strongly positive impact on the quality of care. Only 16% responded that M&A had a negative or strongly negative impact on quality; 24% said M&A had a similar effect on costs.

Gross says the results reflect the ability of larger organizations to standardize protocols across an extended platform to ensure that “quality is baked in to the policies and procedures at each facility and there’s more opportunity to standardize the cost of materials/supplies.”

Margaret Dick Tocknell is health plans editor for HealthLeaders Media. She may be contacted at mtocknell@healthleadersmedia.com.

“Primary care practices are so important. It’s the piece that makes accountable care organizations and medical homes work.”

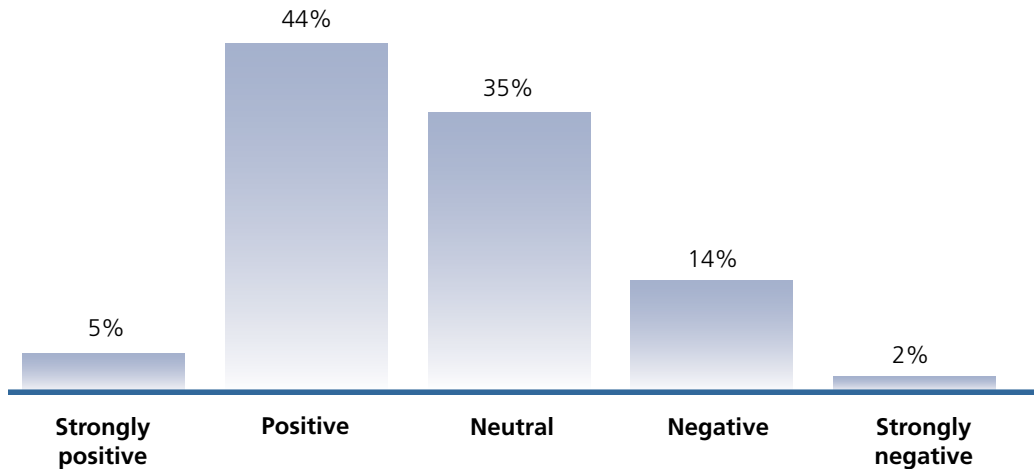
—**Stephen L. Mansfield, PhD,
FACHE, president and CEO,
Methodist Health System, Dallas**



Survey Results

FIGURE 1 | M&A Activity Impact on Quality of Care

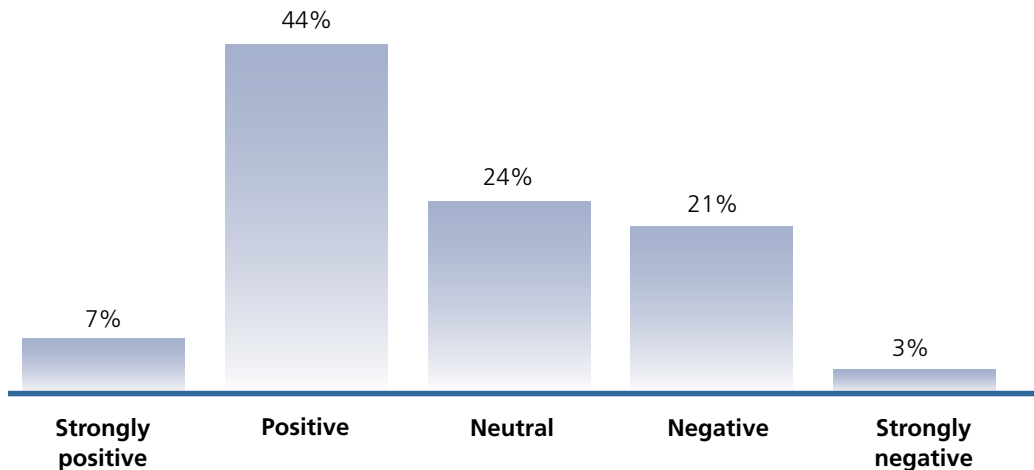
Q | Regarding the impact on quality of care, describe your assessment of the current M&A activity in the healthcare industry.



Base = 189

FIGURE 2 | M&A Activity Impact on Cost of Care

Q | Regarding the impact on cost of care, describe your assessment of the current M&A activity in the healthcare industry.



Base = 189



Survey Results (continued)

FIGURE 3 | Elements of Strategic M&A Goals

Q | Which of the following are elements of your organization’s strategic M&A goals?

To strengthen existing geographic markets	65%
To acquire physician practice organizations to strengthen current service lines	52%
To expand into new geographic markets	43%
To acquire physician practice organizations to strengthen new service lines	37%
To seek broad organizational partnerships or agreements with regional systems that stop short of full merger	37%
To seek clinical affiliations with academic medical centers or regional health systems	34%
To acquire ancillary organizations to expand into new services	29%
To acquire similar types of organizations to strengthen existing services	25%
To weigh full merger or acquisition offers from larger regional systems	17%
To maintain independence and enter into no M&A activity	13%
To divest components to sharpen strategic mission	10%
To weigh acquisition offers from for-profit hospital corporations	7%
To divest components to raise capital	6%
We have no M&A strategy	6%

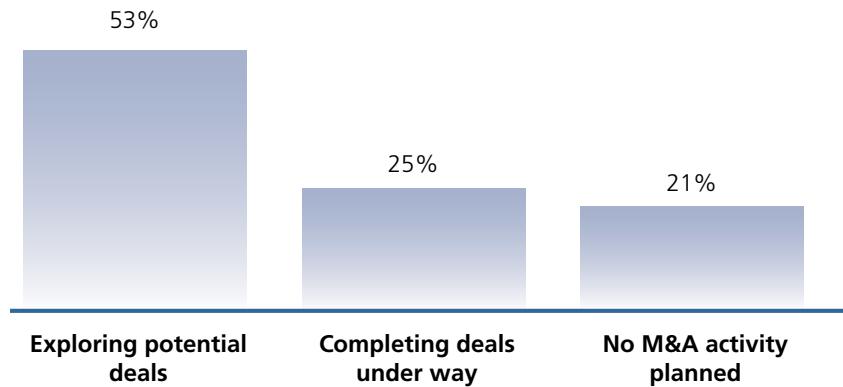
Base = 289
Multi Response



Survey Results (continued)

FIGURE 4 | Organization's M&A Plans for the Next 12-18 Months

Q | Describe your organization's M&A plans for the next 12-18 months.



Base = 189

FIGURE 5 | Sectors of Interest in M&A Activity

Q | Regarding M&A activity, which of the following sectors are of interest to your organization?

	High interest	Low to moderate interest	No interest
Physician practice acquisition and employment	59%	22%	20%
Acute care hospital	35%	28%	37%
Ambulatory surgery center	29%	31%	40%
Diagnostic imaging	28%	34%	38%
Insurance/payer plans	18%	30%	52%
Home health	16%	27%	57%
Hospice	13%	24%	63%
Rehabilitation	13%	28%	59%
Nursing home	8%	22%	70%
Dialysis	6%	20%	74%
Long-term acute care hospital	5%	21%	74%
Psychiatric hospital	5%	15%	79%

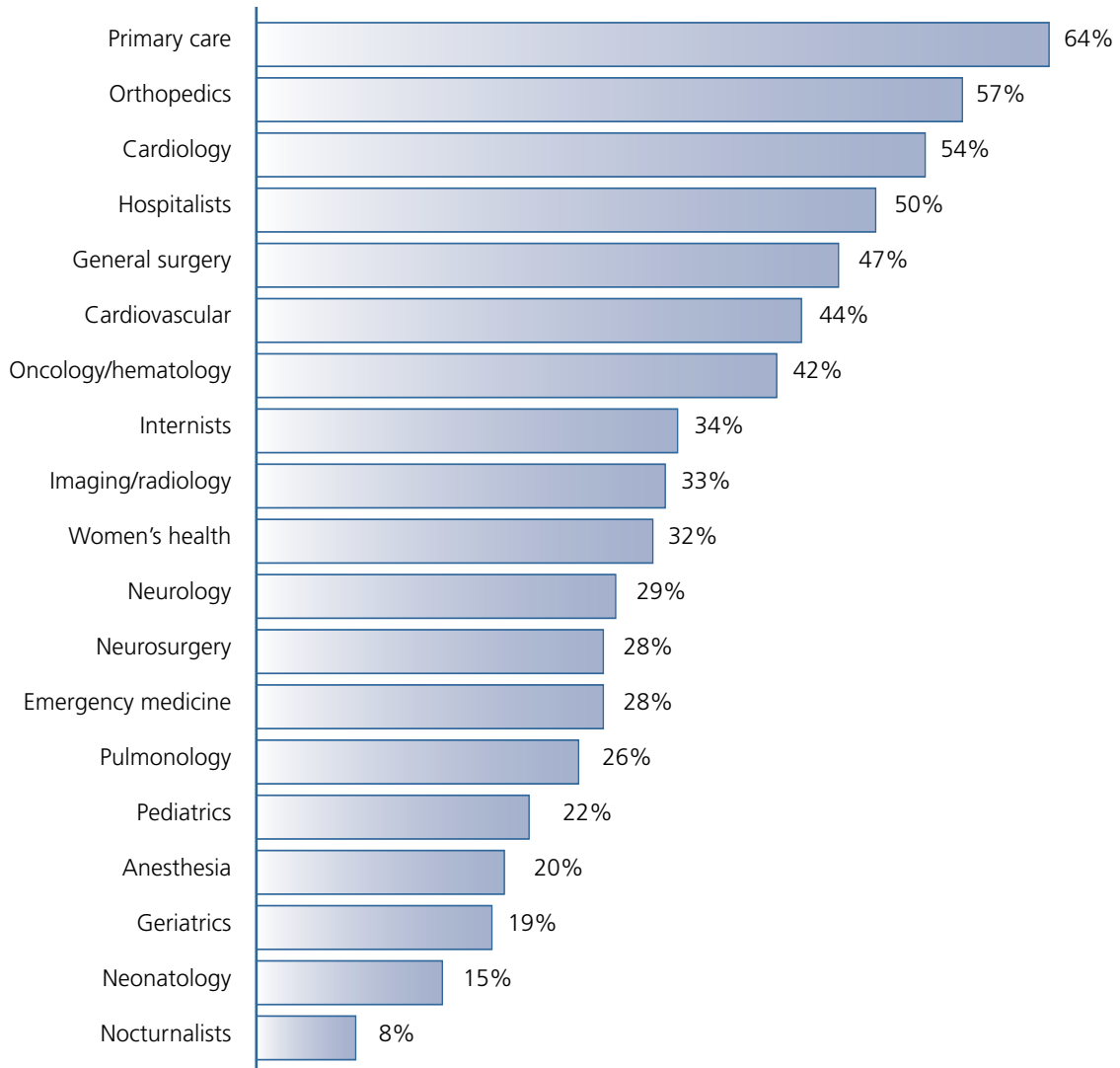
Base = 189



Survey Results (continued)

FIGURE 6 | Most Relevant Physician Specialties in M&A Strategy

Q | Which of the following physician specialties are most relevant to your organization's M&A strategy?



Base = 189
Multi Response



Survey Results (continued)

FIGURE 7 | Likelihood of M&A Type

Q | Which of the following transactions will your organization pursue in the next 12–18 months?

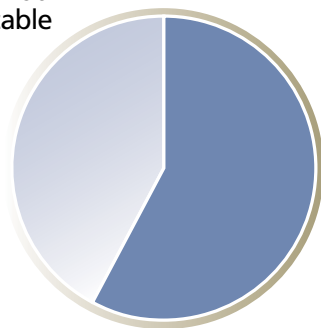
	Likely	Not likely	Not applicable
Acquisition	48%	40%	13%
Joint venture with another acute care hospital	33%	48%	19%
Merger of equals	15%	66%	19%
Distressed acquisition	13%	55%	32%
Private equity purchase	10%	54%	35%

Base = 189

FIGURE 8 | Issues Resulting in M&A Termination of Proposed Transaction in the Past 12–18 Months

Q | Which of the following issues in the M&A process has resulted in termination of a proposed transaction at your organization in the past 12–18 months?

42% Not applicable



58% Applicable

Base = 189

	Percent
Culture	49%
Political/governance considerations	41%
Agreement on valuation	39%
Access to capital	25%
Mistrust between parties	24%
Medical staff issues	24%
Community considerations	19%
Integration	15%
Resolution of regulatory compliance issues	10%
Regulatory compliance issues	9%
Identifying the target	6%

Base = 110

Multi Response



Survey Results (continued)

FIGURE 9 | Challenge of M&A Strategy Issues

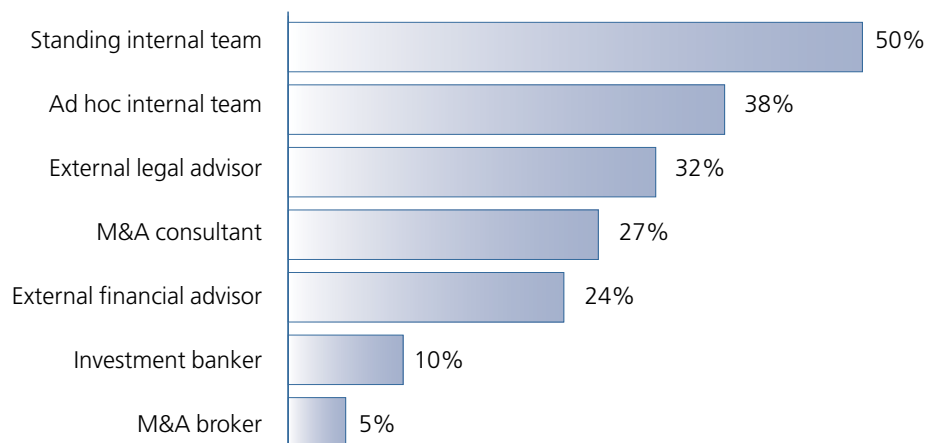
Q | How challenging are the following issues to your organization's M&A strategy?

	Major challenge	Moderate challenge	Minor challenge	No challenge	Not applicable
Access to capital	29%	29%	19%	13%	10%
Political/governance considerations	20%	35%	23%	9%	13%
Medical staff issues	19%	31%	23%	13%	15%
Competition for targets	14%	34%	26%	10%	16%
Community considerations	13%	29%	28%	16%	14%
Integration	12%	38%	28%	7%	16%
Agreement on valuation	10%	38%	30%	6%	16%
Resolution of regulatory compliance issues	8%	23%	38%	14%	17%
Identifying the target	7%	24%	34%	21%	14%

Base = 189

FIGURE 10 | Team Members Involved in M&A Functions

Q | Which of the following does your organization rely on for M&A functions?



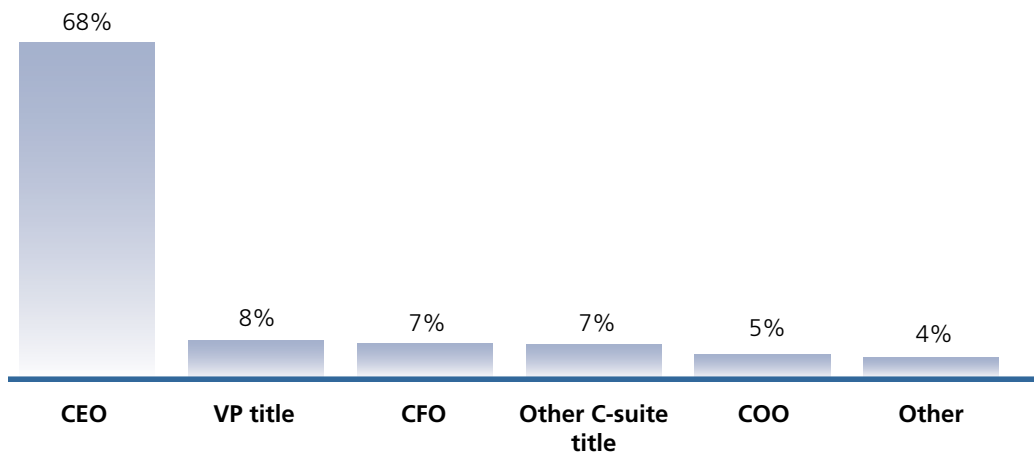
Base = 189
Multi Response



Survey Results (continued)

FIGURE 11 | Strategic Leader for M&A Activity

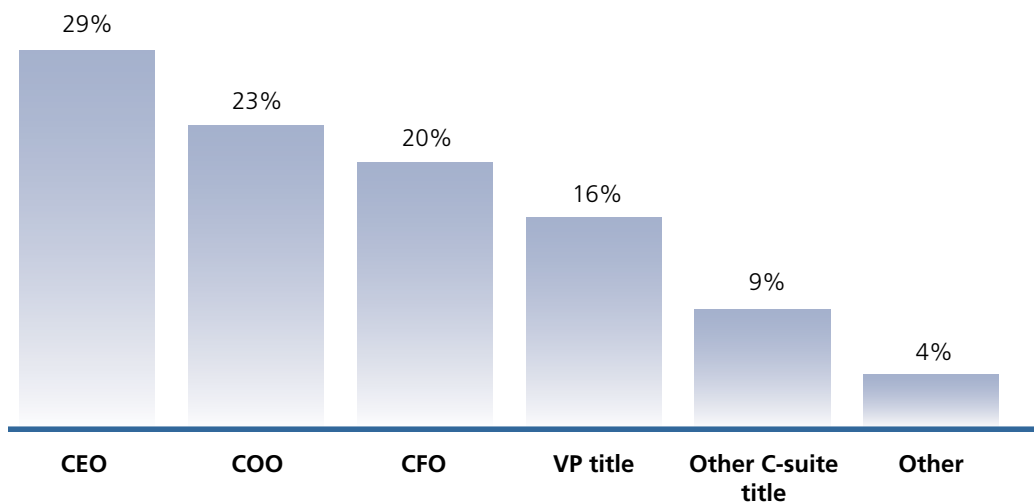
Q | Who in your organization is designated to lead M&A activity, strategically?



Base = 189

FIGURE 12 | Operational Leader for M&A Activity

Q | Who in your organization is designated to lead M&A activity, operationally?



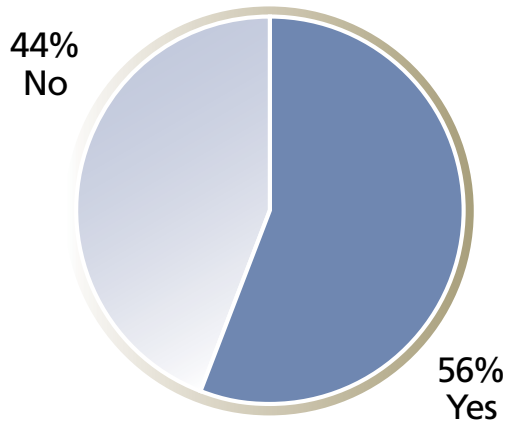
Base = 189



Survey Results (continued)

FIGURE 13 | Specific Team Dedicated to Hospital-Physician Practice Acquisition

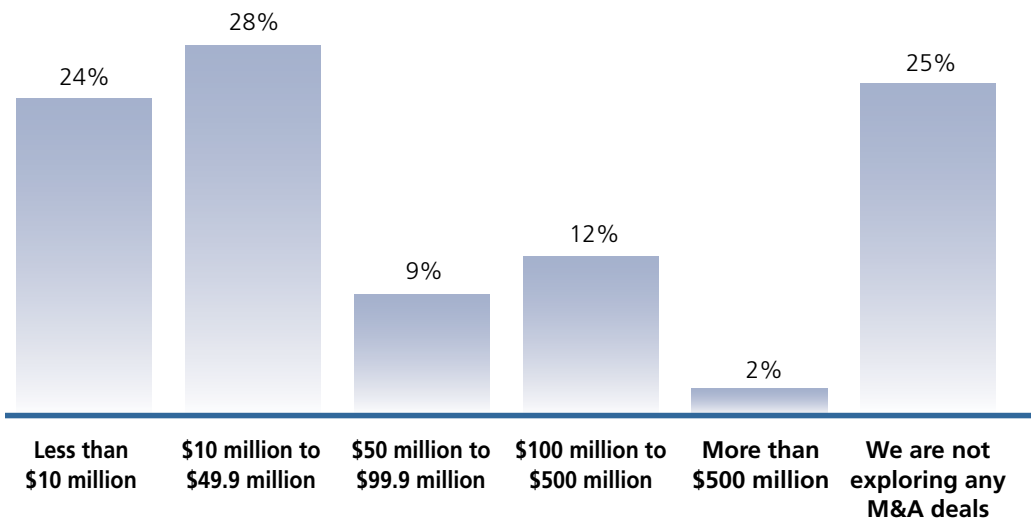
Q | Does your organization have a specific team dedicated to hospital-physician practice acquisition opportunities?



Base = 189

FIGURE 14 | Estimated Total Dollar Value of the M&A Deals in the Next 12-18 Months

Q | Please estimate the total dollar value of the M&A deals you are exploring in the coming 12-18 months.



Base = 189