

# Hospitals & Physician Organizations Summary Report—November 2017

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## 1. Key Findings

- **Uncertainty and pressures continue to mount for healthcare providers, creating a new operating environment** – Uncertainty around Medicaid and other programs, the shift to value-based care, margin pressures, the need to search for new revenue streams, recruiting and retention challenges and rising regulatory and cybersecurity concerns are creating a new operating environment for healthcare providers at both the hospital and physician organization level.
- **In response to this rapidly changing landscape, many providers are seeking strategic opportunities, fueling more and more transactions in the industry** – Transaction activity continues to rise, and the number of large transactions in FH 2017 alone outpaced the number of large transactions in all of 2016. Transactions are no longer purely financial-driven, rather health systems are looking at opportunities to scale, create efficiencies and improve their value proposition for consumers and insurers, among other factors. Notably, physician organizations transaction activity has stabilized, as they wait to see the outcome of healthcare reimbursement and reform. This group has, however, continued to be very active in the ACO and CIN space.
- **As the number – and size – of transactions continue to rise, antitrust concerns continue to build, creating a new norm for healthcare industry transactions.**

## 2. State of Industry – Hospitals

### Hospitals – Growth Outlook

- **U.S. non-profits:** Outlook is stable, though lower revenue growth and rising expenses are expected to reduce profit margins, according to an August 2017 report from Moody's Investors Service. This report follows an earlier assessment that the median operating margin fell in FY 2016 as expenses grew, according to preliminary financial data compiled by Moody's.
- **U.S. for-profits:** Outlook is also stable. Earnings are expected to grow in the low-single digits over the next 12 to 18 months, while volume and pricing trends will continue to be modestly positive. Profit margins will stabilize after a significant drop between 2015 and 2016, according to Moody's Investors Service.
  - Patient volumes are expected to increase 1% to 2% over the next 12 to 18 months, with declining unemployment and an aging population among the macro trends that will continue to spur demand for healthcare.
  - Structural shifts in payor programs that aim to reduce utilization and the cost of care by shifting patients to lower-cost settings will offset these positive trends.
  - Many companies' margins will benefit as they integrate acquisitions and divest less-profitable facilities.
  - Higher private payor rates will be the main driver of revenue growth over Moody's outlook period.
  - Medicare rates for inpatient services will rise, though cuts to laboratory and outpatient reimbursement and reduced Medicaid disproportionate share hospital (DSH) payments will constrain growth.

### Hospitals – Medicaid/Medicare

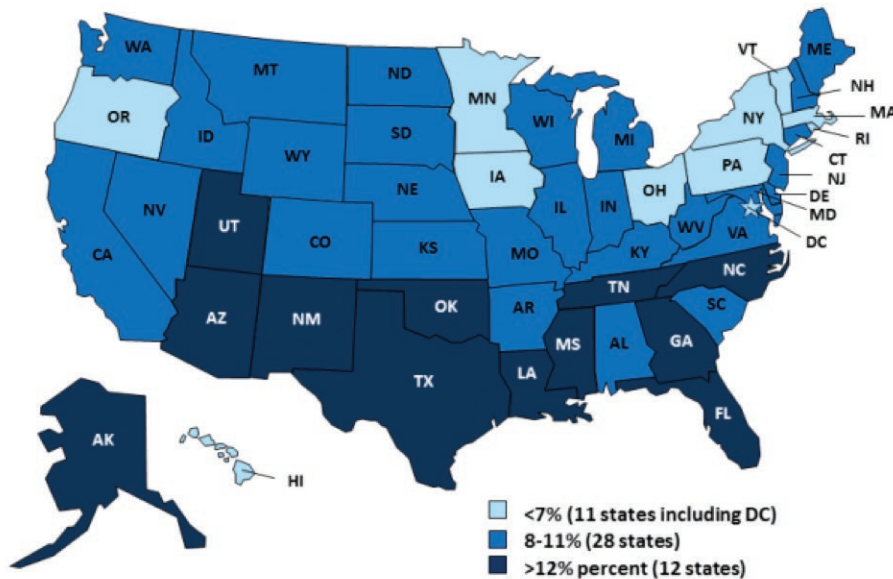
- **Medicare Advantage enrollment on the rise** – Ohio's Medicare Advantage enrollment increased by a net 39,084 individuals, or 5%, in 2017. According to an analysis by the Kaiser Family Foundation, Medicare Advantage plans have played an increasingly larger role in the Medicare program nationally as the share of beneficiaries enrolled in Medicare Advantage has steadily climbed over the past decade. The trend in enrollment growth is continuing in 2017, and has occurred despite reductions in payments enacted by the Affordable Care Act of 2010 (ACA).
- **Medicaid funding proposals expected to hurt hospital margins** – Proposals to move Medicaid funding to block grants and eliminate the ACA's individual mandate would hurt hospital revenue and cut into hospital margins, according to the bond rating agency S&P Global Ratings. Neither of these proposals have been enacted to date, but they were key positions of "repeal and replace," and have surfaced in other legislative proposals including the tax reform legislation.
- **Emergency room charges drive healthcare spending** – A Johns Hopkins University School of Medicine study published in May 2017 found that people in ERs are charged, on average, 340% more than what Medicare pays for services and treatments, with minorities and uninsured patients bearing the brunt of overcharges. Emergency departments that charged the most were more likely to be located in for-profit hospitals in the southeastern and Midwestern U.S. and served populations of uninsured African-American and Hispanic patients.

## Hospitals – Uninsured

- **Medicaid expansion helps keep Ohio's uninsured rate at bay** – Ohio has one of the [lowest rates of non-elderly uninsured](#) in the country, according to a September 2017 report by the Kaiser Family Foundation. Currently at 6.5%, that rate has declined from 13.9% in 2013. Ohio's Medicaid expansion program accounts for a portion of this change.

Figure 5

## Uninsured Rates Among the Nonelderly by State, 2016



NOTES: Includes nonelderly individuals ages 0-64.

SOURCE: Kaiser Family Foundation analysis of the March 2017 Current Population Survey, Annual Social and Economic Supplement.



Source: [Kaiser Family Foundation](#)

- **Microhospitals emerge as “new kid on the block”** – Small hospitals across central Ohio are [opening](#) their doors to help address the uptick in demand for outpatient care. OhioHealth is seeing opportunity in this model, and is building a small hospital with an ASC, medical office building and emergency department. According to Ohio Hospital Association spokesperson John Palmer, microhospitals are emerging as the new kid on the block, offering “right size” medical facilities for community needs.

### 3. State of Industry – Physician Organizations

- **ACOs on the rise** – 2017 saw a significant jump in the percentage of [physicians who are participating in ACOs](#) nationally – from 31% to 36%. This continues a steady increase since 2012, when just 3% were participating.
- **Hiring on the rise** – More than half of healthcare employers and recruiters anticipate hiring more professionals than they did during the last half of 2016, according to a report published in March 2017. [This hiring growth is expected to pose challenges](#) for provider groups and hospitals, coming at a time when a lot of healthcare employers are “experiencing an increase in employee turnover and longer times to hire.”
- **Providers push back on price transparency law, claiming it’s a hinderance to patient care** – Ohio’s Healthcare Price Transparency law – which passed unanimously two years ago – is being [challenged by physicians and hospitals](#), who claim the law is too broad and would create an undue administrative burden that would slow down patient care. The legal challenge has delayed the planned January 2017 implementation, and may block the act altogether.

### 4. Government & Regulatory

#### U.S. Developments

- **Medicare fraud in the spotlight** – In July 2017, the FBI and HHS announced charges against more than 400 individuals — including doctors, nurses, and licensed medical professionals — for their roles in fraud schemes involving around [\\$1.3 billion in false Medicare billings](#).
  - Additionally, HHS began suspending 295 providers — including doctors, nurses and pharmacists — so they can’t participate in federal health programs like Medicare, Medicaid and TRICARE, a health insurance program for veterans and the military.
  - A quarter of the charges involved opioid-related crimes, and the FBI and HHS stated they are targeting the physicians and other providers enabling the opioid epidemic.
- **Data protection continues to be a critical issue** – HHS continues to step up its enforcement activity related to the Health Insurance Portability and Accountability Act (HIPAA). 2016 was a [record year](#) for large HIPAA breaches, with covered U.S. healthcare entities reporting 133 cases that affected the private information of at least 500 individuals each. 2017 is on pace to more than double that figure, with 221 major breaches reported to federal authorities as of September 20, 2017. Further, in the first enforcement action of its kind – and one that could affect healthcare providers and payers – the HHS Office for Civil Rights (OCR) levied a \$475,000 fine in January 2017 against a health system that [took too long to notify patients and the government](#) after a breach of unsecured protected health information.
- **CMS proposes rule to scale back MACRA provisions** – The proposed rule would [reduce](#) the number of clinicians subject to MACRA’s requirements for the 2018 reporting year, which would affect payments providers receive in 2020. [Providers largely support](#) the move, though the American Medical Association and the American College of Rheumatology are questioning how the changes will affect payment calculations.
- **ACA individual cost-sharing subsidies set to end** – The President signed an order in

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October to end federal cost-sharing subsidies to individuals who bought insurance policies through ACA exchanges.

- The Kaiser Family Foundation calculated that [7.1 million of the 12.2 million people](#) who bought policies through the exchanges receive cost-sharing payments, concluding the payments reduced out-of-pocket expenses for the typical family by roughly \$5,500 a year.

### Ohio Developments

- **Medicaid expansion freeze off the table, for now** – Governor Kasich [vetoed](#) a provision of the 2018 Ohio budget that would have frozen the state’s Medicaid expansion program. In September, state legislators were [considering an attempt to override](#) that veto.
  - As of February 2017, some [723,000 Ohio residents](#) were enrolled in Medicaid as a result of Medicaid expansion, which authorized individuals who earned up to 138% of the poverty level and didn’t qualify under other categories.
- **Hospital rate reduction for state’s Medicaid program on the horizon** – The Kasich administration announced its intention to implement a 5% hospital rate reduction for its Medicaid program in 2018, designed to keep spending within the budget’s appropriation level. Ohio Medicaid will file the hospital rate adjustment with the Joint Committee on Agency Rule Review in October, with an effective date of Jan. 1, 2018. The final rate will be determined in early November based on updated projections of the Medicaid budget.
  - The Ohio Hospital Association and other provider industry groups [oppose](#) the move as “drastic and unnecessary.”
- **Potential for disruption of all state Medicaid funding** – However, a dispute between the Ohio legislature and the Governor’s office could potentially [disrupt all Medicaid funding in the state after May 2018](#). The state’s Controlling Board is expected to vote on whether to approve the Governor’s plan on Oct. 30, 2017.
- **ACA/Medicaid navigators shutdown following federal funding cuts** – An Ohio service that enrolled nearly 10,000 residents in ACA and Medicaid plans last year is [closing](#) due to federal funding cuts to organizations called “navigators” that help people enroll in Medicaid and ACA insurance coverage. The news comes after the federal administration [revealed](#) nationwide cuts to navigators could be as high as 92%. Federal officials have cited inefficiency in terms of money spent compared to the number of people signed up as reasoning behind the decision.

## 5. Transaction Environment

### Hospitals

- **Hospital and health system transactions on the rise** – Building on momentum from 2016 and Q1 2017, Q2 2017 [continued](#) to see a rise in hospital and health system transactions, which were up 15% compared with Q2 2016, according to consultancy Kaufman Hall. Among these second-quarter transactions, 22 were not-for-profit acquirers, eight were for-profit and one was a for-profit/not-for-profit combination acquirer. Pennsylvania and Texas saw the most activity.
- **Large transactions happening at increasing rate** – There were a total of six transactions in Q1 2017 among large organizations with revenues around or above the \$1 billion mark. This compares to four deals of this size in all of 2016. Q2 2017's announced mega deals include:
  - Steward Health Care and IASIS Healthcare's merger, which makes Steward the nation's largest private-for-profit hospital operator with 36 hospitals in 10 states;
  - Partners HealthCare's acquisition of Care New England Health System; and
  - The merger of Greenville Health System with Palmetto Health.
- **Transactions are strategic in nature** – Unlike in the past, when transactions were largely driven by financial decisions, today's transactions are strategic in nature. According to Kaufman Hall, healthcare systems are looking to scale and build the capabilities needed to remain competitive in today's fast changing healthcare environment, characterized by uncertainty and changing consumer behaviors.
- **Health systems look to expand footprint** – Health systems are banding together to [achieve](#) regional – and sometimes national reach – to improve their value proposition for both patients and insurers.
- **The rise in large transactions means more antitrust scrutiny** – The FTC is expected to [continue its aggressive approach](#) in reviewing hospital mergers for potential antitrust violations, given the rise in large transactions and following a late-2016 court decision in Chicago in favor of the government.
- **Hospital acquisitions generally result in a two-year decline in operating margins** – According to a [survey](#) by the Deloitte Center for Health Solutions in collaboration with the Healthcare Financial Management Association, on average, acquired hospitals experience a two-year decline in operating margins, revenue and expenses. The two leading factors in these declines are changes in revenue and capital investments that are made post-transaction (i.e., nearly 80% of acquiring entities made significant capital investments into their acquired facilities).



## Physician Organizations

- **Physician organization transactions take a pause** – After a spike in deals in the first quarter, transactions involving physician organizations were down sharply in the [second quarter](#), as uncertainty regarding reimbursements and healthcare reform fostered a cautious approach.
  - Many of the deals that did go through in Q2 were for specialist practices: “With the fate of reimbursement up in the air, buyers are more comfortable targeting the specialty practices,” commented Lisa Phillips, editor of the Health Care M&A Report.
- **Ohio physician groups push back on joining larger systems** – Earlier this year, two physician groups in Northeast Ohio (Premier Physician Centers and Jubilee Healthcare) merged (now doing business as NorthShore Healthcare) in an effort to [avoid](#) both having to join larger healthcare networks. The effort to protect the “independent” model, according to the groups, helps protect clinical quality, patient care and access to providers.
- **PE firms turn investment toward specialty physician groups** – The number of transactions involving physician-led practices has been [on the rise](#), with orthopedic and ophthalmology practices joining dermatology and dentistry as attractive targets in the current market – due to their routine, high-profit type of medicine.
- **Antitrust concerns evident in the physician market as well, but no uptick in enforcement** – According to a recent Health Affairs [study](#), the growing concentration of physician markets throughout the U.S. has been raising antitrust concerns. It [found](#) that the increase in physician practice sizes and market concentration has been the result of numerous small transactions, not a few large transactions. The study also found, that as it appears now, the DOJ and FTC have only challenged a small number of transactions in this space.

## Select Transactions – National

- **CHS is on a selling spree**, with [30 planned divestitures](#) planned following significant losses in 2016. Three Ohio hospitals were sold to Boston-based Steward Health Care, which [eliminated](#) CHS’ entire Ohio presence.
  - CHS spinoff Quorum Health has also been selling hospitals, as it restructures its portfolio to improve financial performance.
- **Steward Health Care** [entered](#) a definitive agreement to acquire Tennessee-based IASIS Healthcare. The deal makes Steward the largest private for-profit hospital operator in the U.S.
- **Partners’** acquisition of **Care New England** was announced in April 2017, but the mega deal has been shrouded with uncertainty since then. Most recently, Partners’ is [holding off](#) on moving forward until it can be determined that Care New England can sell off Memorial Hospital.
- **Five health systems in Massachusetts** are [set to merge](#), pending regulatory review. The merger would be the biggest deal in the state in decades.
- **Cleveland Clinic continues its efforts to expand globally**, [reportedly](#) signing a management consulting agreement to build a hospital in Shanghai. It also [entered](#) into a strategic agreement with Boston Children’s Hospital to provide complex pediatric heart services through its national network, a first of its kind collaboration.
- **Jefferson Health** [completed](#) its merger with **Kennedy Health**, marking the first time a Philadelphia system has merged with a southern New Jersey health system.

*This list of transactions is not comprehensive, rather includes certain notable transactions in 2017.*

## Select Transactions – Ohio

- **Central Ohio Primary Care (COPC)** has become the largest practice of its kind in the U.S., in recent years [acquiring](#) three to four practices annually – this pace is set to slow, however, as the number of independent small offices starts to dry up.
- **Commonwealth Orthopaedic Centers** [merged](#) with **Reconstructive Orthopaedics & Sports Medicine**, [creating](#) Greater Cincinnati's largest orthopedic practice.
- **Alliance Aultman Health Foundation** is in the [process](#) of purchasing **Alliance Community Hospital**. The deal is expected to close early 2018. The purchase is a move to help Aultman become a regional healthcare system.
- **Premier Physician Centers** and **Jubilee Healthcare** [merged](#) and are now doing business as Northshore Healthcare.
- **Union Hospital** (+100-bed, non-profit facility in Dover) will [join](#) the Cleveland Clinic Health System. The transaction is expected to finalize in January 2018.
- **TeamHealth**, a physician services organization, [acquired](#) the clinical operations of **Synergy Emergency Physicians**, which provides care to approximately 40,000 patients in Ohio annually, through staffing and management of the emergency department at Mercy Health – St. Anne Hospital.

*This list of transactions is not comprehensive.*