NATIONAL RURAL HEALTH RESOURCE CENTER

Delta Region Community Health Systems Development (DRCHSD)

2022 Financial Webinar Series Session 3

Qualifying Rural Value

National Rural Health Resource Center
Stroudwater Associates

Delta Region Community Health Systems Development (DRCHSD) Program

Delta Regional Authority

U.S. Department of Health & Human Services

HRSA

Federal Office of Rural Health Policy

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NATIONAL RURAL HEALTH RESOURCE CENTER

Diversity, Equity, Inclusion, & Anti-racism

Building a culture where difference is valued.

The Center is committed to DEI and anti-racism. We create an environment that reflects the communities we live in and serve; a place where everyone feels accepted and empowered to be their full, authentic selves; and where everyone belongs.

We understand the impact of and seek to defeat racism and discrimination in ourselves, our workplace, and the world. This guides how we cultivate leaders, build our programs and resources, and deliver our technical assistance.

We are an organization that honors, celebrates, and respects all dimensions of diversity. These principles are central to our mission and to our impact.

Read more at ruralcenter.org/DEI

NATIONAL RURAL HEALTH RESOURCE CENTER

Todays Speaker

Jeff Sommer, MPP
Managing Director
Stroudwater Associates

STROUDWATER

QUANTIFYING THE RURAL VALUE PROPOSITION:
FOR EXISTING AND PROSPECTIVE PARTNERSHIPS

Jeff Sommer, Managing Director
July 14th, 2022

INTRODUCTION

MEET THE PRESENTER

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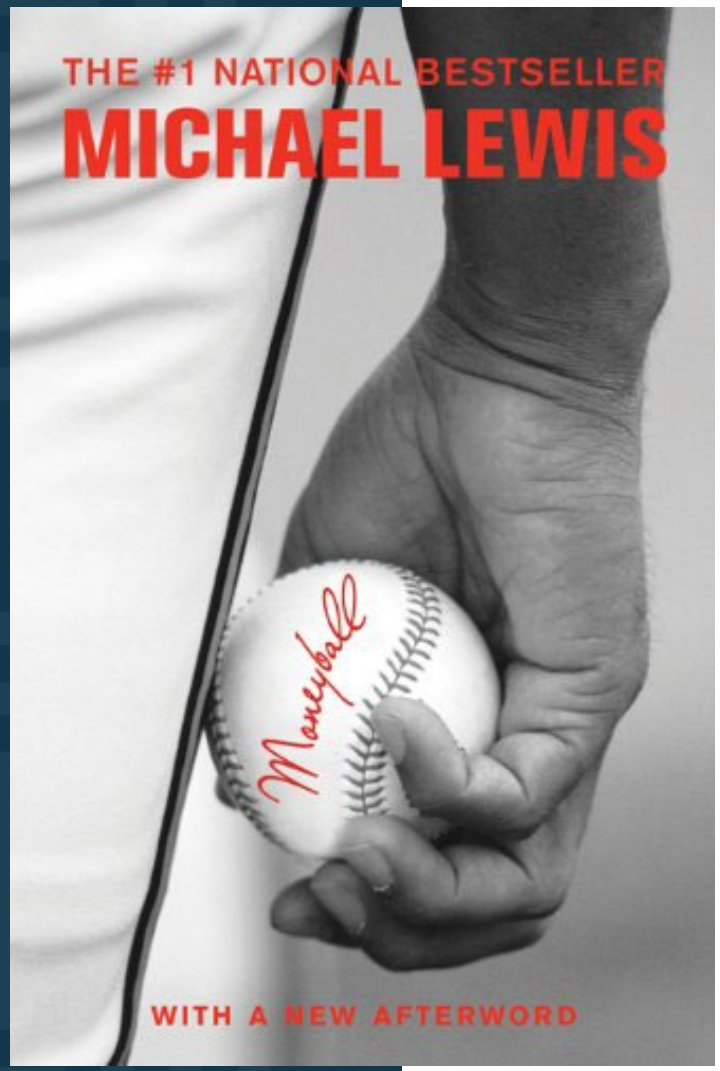
Stroudwater is a leading national health care consulting firm specializing in mission-critical strategic, operational and financial opportunities for health care leaders' most pressing challenges

MONEYBALL: WHAT CAN IT TELL US?



- The central premise of Moneyball (2003, Michael Lewis) is that the collective wisdom of baseball insiders (including players, managers, coaches, scouts, and the front office) over the past century is outdated, subjective, and often flawed.
- The best-known Moneyball theory was that on-base percentage was an undervalued asset and sluggers were overvalued.
- At the time, protagonist Billy Beane was correct. Jahn Hakes and Skip Sauer showed this in a very good economics paper.
- From 1999 to 2003, on-base percentage was a significant predictor of wins, but not a very significant predictor of individual player salaries.
- **The takeaway: players who draw a lot of walks were cheap relative to their actual value.**
- **Is something similar happening today with rural health systems?**

MONEYBALL: IS THIS HAPPENING IN RURAL HEALTHCARE?

- **Our experience says *yes***
- Many system parents that have significant rural operations do not optimize these operations:
  - Experience: missed annual payments approaching eight figures annually via flawed designations and alignment
  - Experience: cost-accountants undervalue incremental referrals from rural affiliates
- Rural health systems have too few or unattractive partnering options:
  - Experience: initial skepticism replaced by awareness of the value proposition and much more robust affiliation terms
  - Experience: initial, flawed LOI replaced by LOI that reflects value proposition and includes major investment commitment, service commitments and reserve powers
- **Many decision-makers bring assumptions regarding existing and prospective rural affiliates based on flawed or incomplete data, resulting in missed opportunities, flawed decisions and suboptimal affiliation structures**

WHY DOES THIS MATTER?

When larger health systems fail to understand the value of rural affiliates, the following happens:

- Under-investment or disinvestment in rural operations
  - Resulting in a sub-optimal allocation of resources and diminished access to needed services
- Risk of “leakage” of referrals and attributed lives for the parent system
- Failure to capitalize on opportunities, resulting in insufficient returns from rural operations, which depresses future investment
- Partnership terms not representing the value of the prospective affiliate
- Rural health systems’ partnership options not reflecting their actual value

WEBINAR OBJECTIVES

1. Ensure that rural hospitals and health systems understand the unique attributes and value that they bring to existing and prospective system partners

2. Outline the fundamental value drivers for rural provider organizations that existing and prospective partners should understand to create win-win, sustainable partnerships and affiliations

3. Provide a framework to help rural hospitals and health systems engage with existing and prospective system partners so appropriate resources and investments in rural communities are realized

4. Define the processes and structures that will best optimize the rural value proposition

INDUSTRY CONTEXT

CHALLENGING OUTLOOK FOR NFP HOSPITALS

"We expect margins to improve later this year but will likely stabilize at levels lower than those seen prior to the pandemic. Healthcare providers have generally been able to absorb what are now the well-known implications under surge conditions, but they no longer have the benefit of federal stimulus funds to boost liquidity and help cover higher incremental operating expenses or lost revenue."

– Fitch Ratings Sector Leader, Kevin Holloran, "US Not-for-Profit Hospital Margins Decline with Operating Pressures" May 12, 2022.

"We expect that healthy balance sheets, demand for services, and improved revenue yield will continue to support hospitals. But there are operating headwinds given significant ongoing expense and revenue pressures likely to continue over the next year."

- Per S&P, in its report "Outlook for U.S. Not-For-Profit Acute Health Care: A Booster May Be Needed" published January 6, 2022.

MARKET HAS NOT STOPPED MOVING DURING THE PANDEMIC

- The cost of healthcare is continuing to rise
  - Kaiser Family Foundation reports 2020 family health insurance premiums have risen to $21.3K
- Advances in technology and new market comfort for telehealth have led to an acceleration of new market competition
- Hospital IP and OP volumes are declining
- The federal government maintains commitment to transitioning payment system:
  - "We need to find a way to bring everyone along. We can't have fee-for-service remain a comfortable place to stay." Dr. Liz Fowler, Director CMMI
- Many rural/community hospitals will be returning CARES Act Funding
- Payment system is transitioning from FFS to accountable care

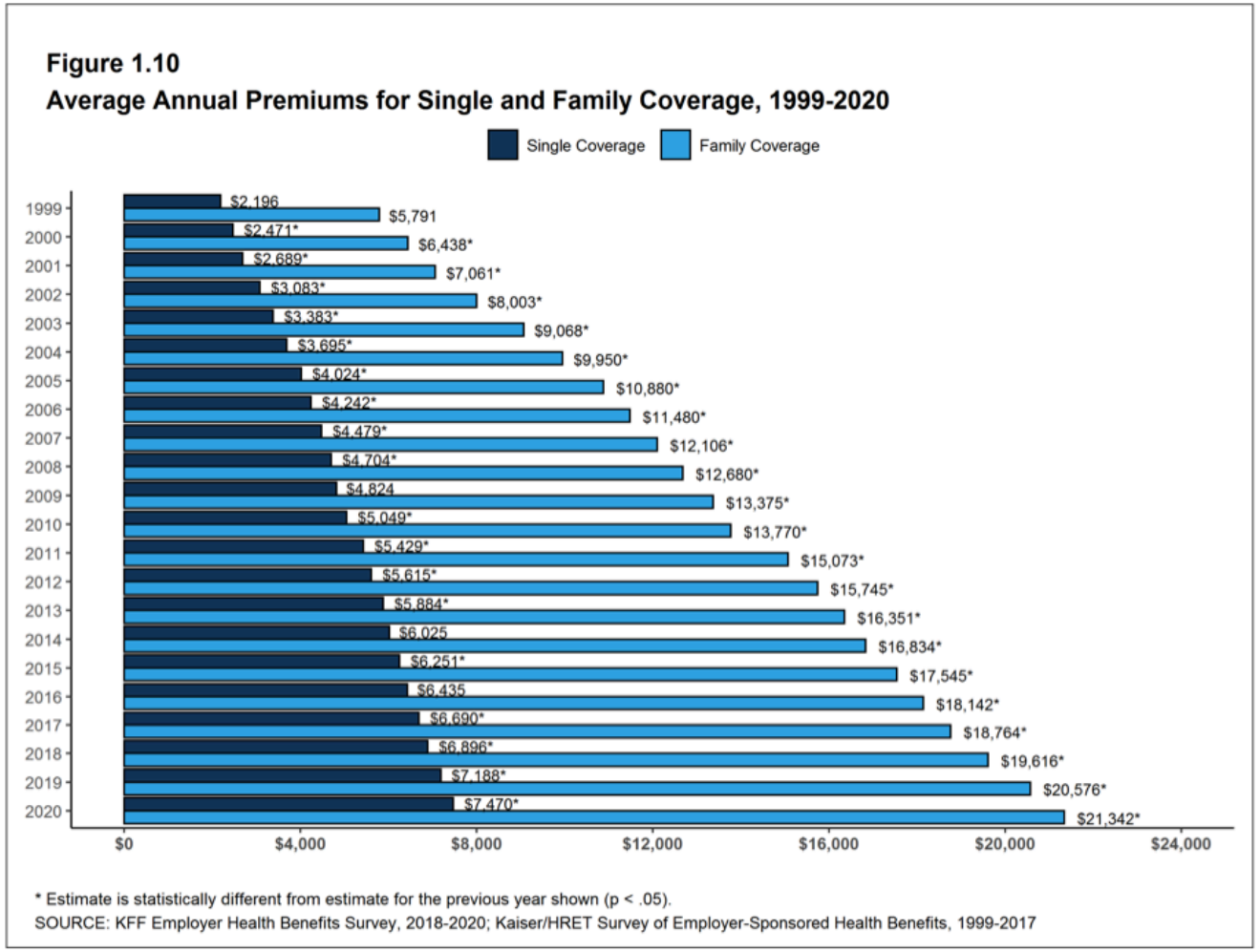
CALL TO ACTION: INSURANCE PREMIUMS

KFF

Employer Health Benefits

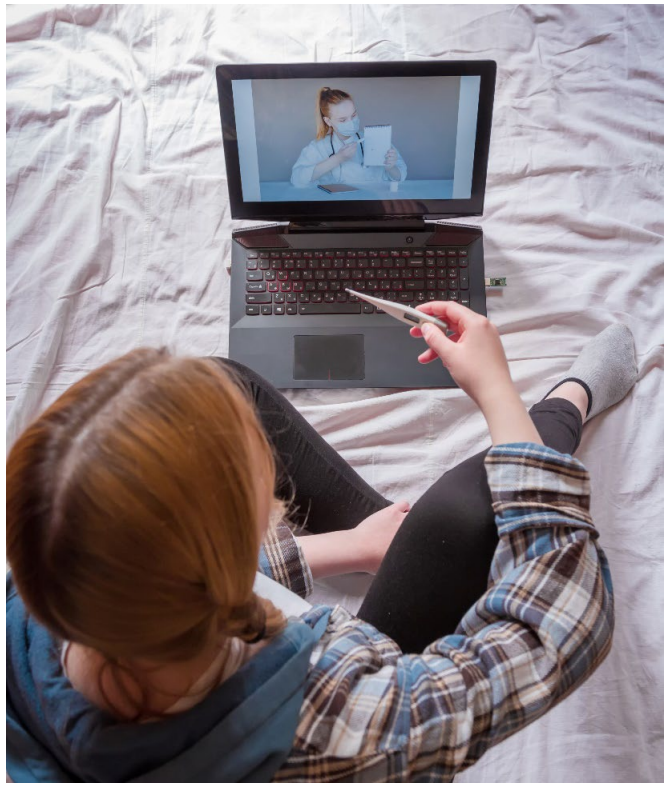
2020

ANNUAL SURVEY



AMAZON EXPANDS AMAZON CARE

- Amazon announced the expansion of Amazon Care, its first primary care offering accessible by non-Amazon employees
- Until now, Amazon Care has been available only to Amazon employees in Washington State. It is now available to employees in every state and will be available to non-Amazon nationwide later this year
- Amazon care has two components:
  - Telemedicine
  - In-person care, where a professional is dispatched to a patient's home
- "Amazon Care gives instant access to a range of urgent and primary care services, including COVID-19 and flu testing, vaccinations, treatment of illnesses and injuries, preventive care, sexual health, prescription requests, refills, and delivery, and much more."
- June 11th Update (Fierce Healthcare): Amazon reports having signed multiple corporate accounts as part of national expansion of Amazon Care



Source: https://www.aboutamazon.com/news/workplace/amazon-care-to-launch-across-u-s-this-summer-offering-millions-of-individuals-and-families-immediate-access-to-high-quality-medical-care-and-advice-24-hours-a-day-365-days-a-year; https://www.modernhealthcare.com/information-technology/amazon-jumps-healthcare-telemedicine-initiative?utm_source=modern-healthcare-am-Thursday; https://www.beckershospitalreview.com/strategy/amazon-care-has-its-first-enterprise-client.html

WALMART TELEHEALTH OFFERING WITH MEMD ACQUISITION

- Joining other major retailers such as CVS and Amazon, Walmart has acquired telehealth provider MeMD to expand its telehealth services
- The acquisition is still pending regulatory approval
- Founded in 2010, MeMD currently provides medical and mental health visits to 5 million members across the US.
- Among other healthcare ventures, Walmart currently operates and/or provides:
  - Walmart Health Centers within its stores
  - Freestanding health centers in Georgia, Texas, Arkansas, and Chicago
  - Direct-to-consumer telehealth through purchased app Ro
  - Telehealth partnership with Doctor on Demand to offer services to its 1.3 million workers at a reduced price
- July 19th Update: Walmart has filed paperwork to operate its healthcare business in 37 states, an increase of 17 states

> "Today people expect omnichannel access to care and adding telehealth to our Walmart Health care strategies allows us to provide in-person and digital care across our multiple assets and solutions."
>
> Cheryl Pegus, MD, executive vice president of health and wellness at Walmart

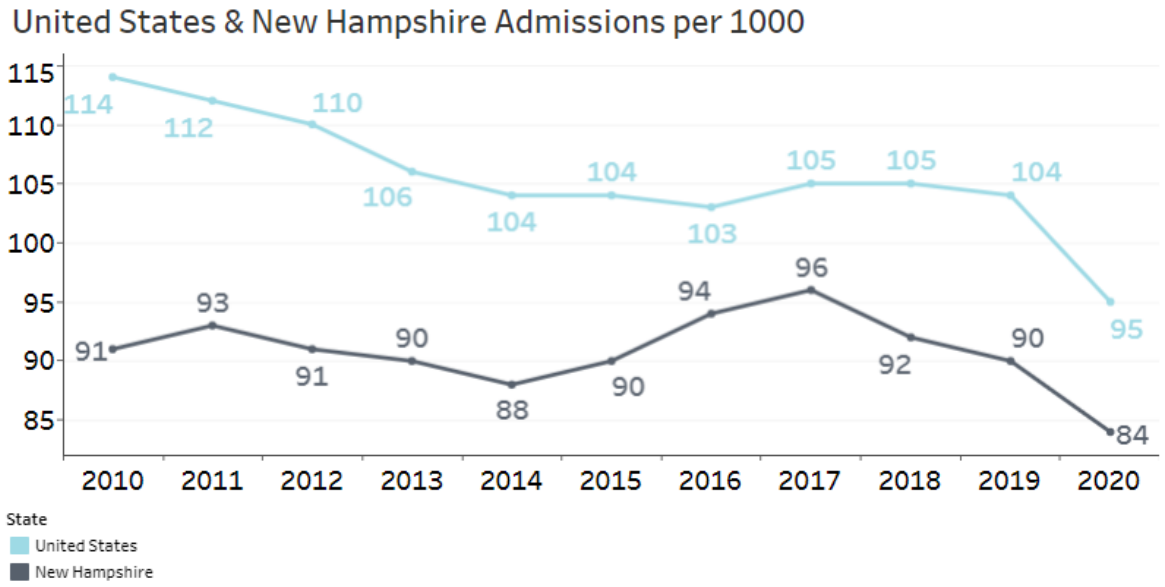
Source: Becker's Hospital Review, Walmart to bring telehealth nationwide with acquisition of MeMD: 8 details, Jackie Drees and Hannah Mitchell, 5/6/21 https://www.beckershospitalreview.com/telehealth/walmart-health-to-acquire-telehealth-provider-6-details.html?origin=CIOE

CALL TO ACTION – DECLINING HOSPITAL VOLUME

In 2018, US hospital outpatient visits declined for the first time since 1983, specifically in the number of emergency outpatient visits.

Per the American Hospital Association's 2020 Hospital Statistics report, 6,146 US hospitals delivered 879.6 million outpatient visits in 2018, 0.9% less than in 2017, when they delivered 880.5 million outpatient visits.

Most hospitals are seeing fewer admissions and must adjust operations to match lower levels of bed utilization. **Historically, New Hampshire has a lower rate of admissions than the US average and has seen a decrease in admissions since 2017.**

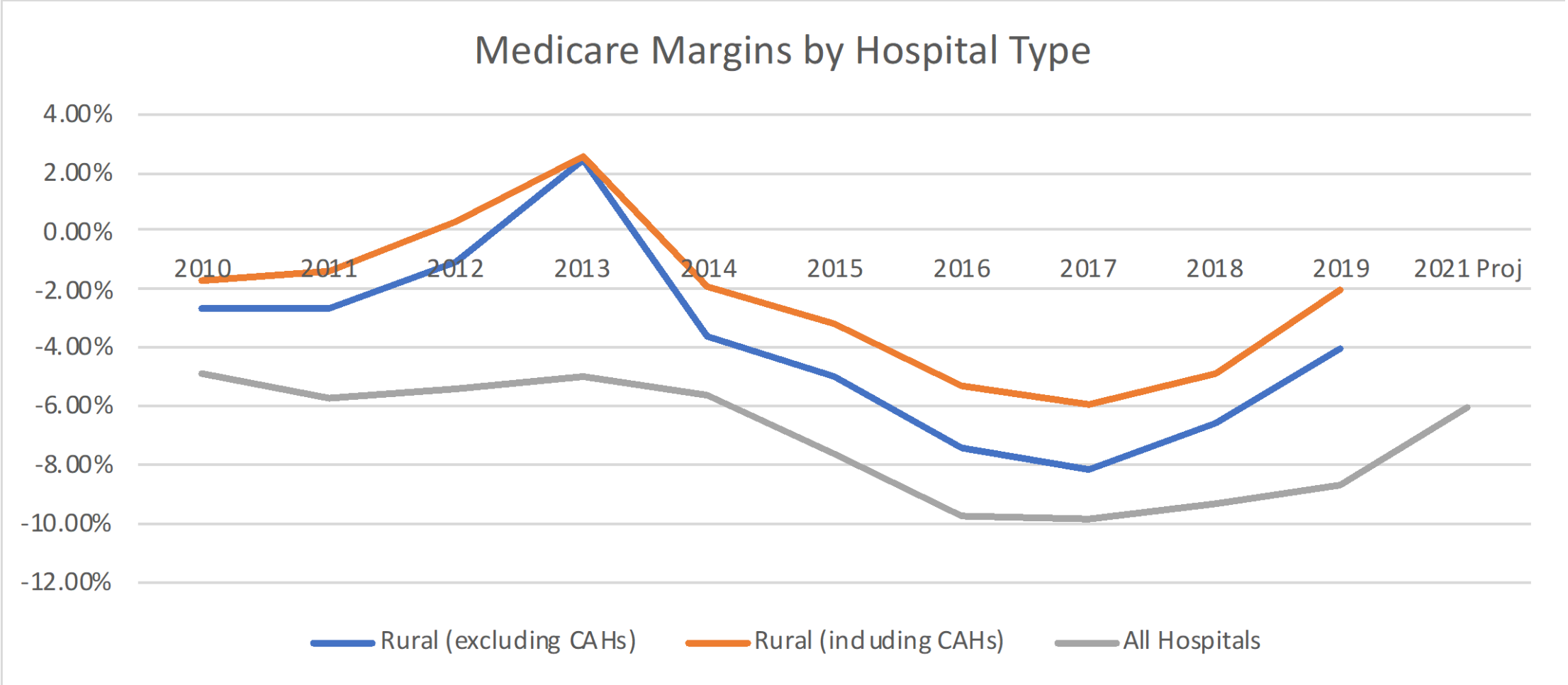


Source:KFF.org

Data are for community hospitals, which represent 85% of all hospitals. Federal hospitals, long term care hospitals, psychiatric hospitals, institutions for the mentally retarded, and alcoholism and other chemical dependency hospitals are not included.

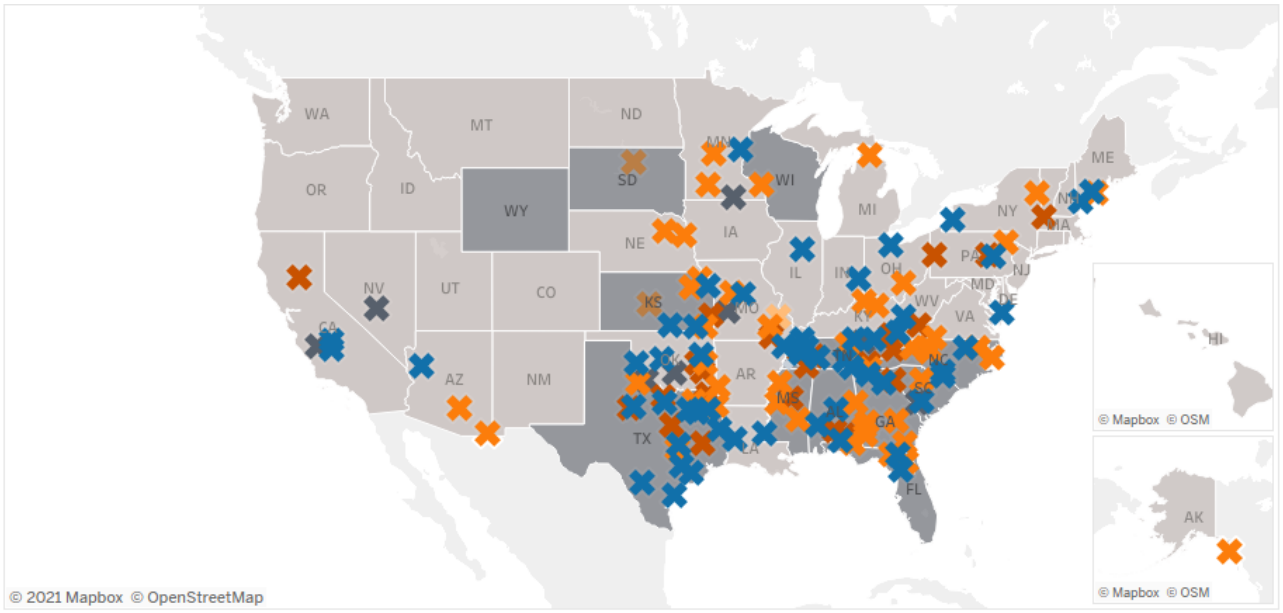
axis not at zero

CALL TO ACTION – NEGATIVE MEDICARE MARGINS

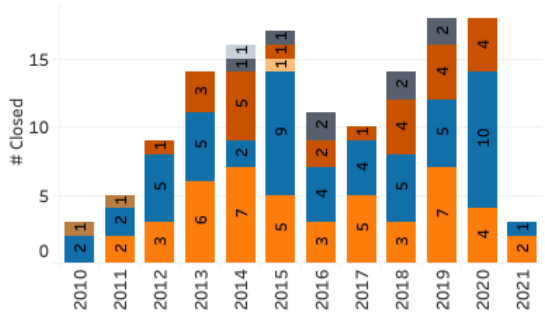


Source: MEDPAC Annual Report to Congress, March 2021

RURAL HOSPITAL CLOSURES



Closure Ye..	Hospital Name
2021	MercyOne Oakland Medical Center-NE
	Community HealthCare System- St. Marys-..
	Jellico Medical Center-TN
2020	Perry Community Hospital-TN
	Northridge Medical Center-GA
	Southwest Georgia Regional Medical Cente..
	Shands Lake Shore Regional Medical Cente..
	Cumberland River Hospital-TN
	Bluefield Regional Medical Center-WV



Sta..	# Closed
TX	21
TN	16
GA	8
KS	8
OK	8
MO	7
NC	7
AL	6
FL	5
MS	5
CA	4
MN	4
PA	4
SC	4
AZ	3
KY	3
ME	3
VA	3
NE	2
NY	2
OH	2
WV	2
AK	1
AR	1
IL	1
IN	1
LA	1
MA	1
MD	1
MI	1
NV	1
SD	1
WI	1

Closure Year	Prospective Payment System	Critical Access Hospital	Medicare Dependent Hospital	Sole Community Hospital	Re-based Sole Community Hospital	Disproportionate Share Hospital	Rural Referral Center	Total
2010	2				1			3
2011	2	2			1			5
2012	5	3	1					9
2013	5	6	3					14
2014	2	7	5	1		1		16
2015	9	5	1	1			1	17
2016	4	3	2	2				11
2017	4	5	1					10
2018	5	3	4	2				14
2019	5	7	4	2				18
2020	10	4	4					18
2021	1	2						3
Total	54	47	25	8	2	1	1	138

Medicare Payment Type
- Prospective Payment System
- Critical Access Hospital
- Medicare Dependent Hospital
- Sole Community Hospital
- Re-based Sole Community Hospital
- Disproportionate Share Hospital
- Rural Referral Center

Current Status of Medicaid Expansion Decision
- Adopted the Medicaid Expansion
- Not Adopting the Medicaid Expansion at this Time

Updated:7/12/2021

Sources: The North Carolina Rural Health Research Program (NC RHRP) at the Cecil G. Sheps Center for Health Services Research & kff.org

Design:@GreggLathrop

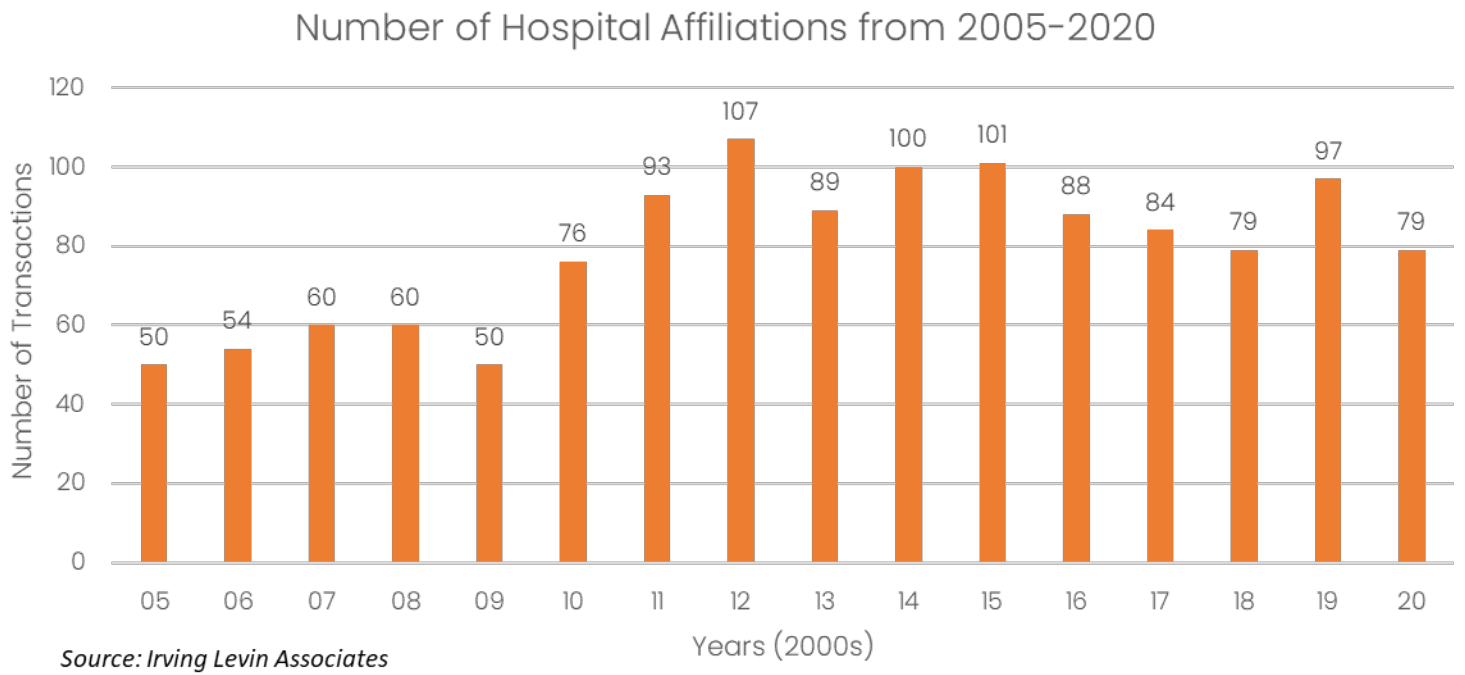
138 rural hospitals have closed since 2010. These counts include those that have closed and reopened. None of these hospitals have been in New Hampshire.

INDUSTRY CONSOLIDATION

Catalysts:

- Financial pressures
- Heightened competition
- Rising staffing costs
- Rising bad debt from high-deductible health plans
- Declining inpatient admissions
- Changing payment models
- Quality initiatives
- Physician recruitment
- Economies of skill

In response to industry disruption and regulatory changes, 993 hospital affiliations have taken place since 2010.



Source: Irving Levin Associates

KEY FINDINGS

- **Where does this leave Rural Health Systems?**

The industry is consolidating

Operating environment is becoming more challenging

Inpatient utilization is declining and developing outpatient care locations is crucial

National staffing shortages exacerbated by COVID-19

HOW TO BEST ENSURE EXISTING OR POTENTIAL PARTNERSHIPS REFLECT YOUR VALUE

VALUE LEVERS FOR RURAL HEALTH SYSTEMS

- The following value levers are often misunderstood or undervalued by existing and potential partners:
  - Cost-based payment
  - Cost-report optimization opportunities
  - Home office cost allocation
  - Access to 340B
  - Swing beds
  - Rural health clinics
  - Decanting volume and utilizing CAHs as specialized components of continuum of care
  - The value of attributed lives and a primary care base that is cash flow positive
  - The “true” value of incremental referrals

HOW WELL DO YOUR PARTNERS UNDERSTAND RURAL HEALTHCARE?

- Do your existing or prospective partners understand the value available via **home office cost allocation** for CAH affiliates?
- Do they appreciate the opportunity that CAHs have related to the **340B program**?
- Do they have any experience with **rural health clinics** and do they understand how to leverage this designation?
- Have existing or prospective partners optimized the designations and organization of their **existing rural affiliates**?

HOW WELL DO YOUR PARTNERS UNDERSTAND RURAL HEALTHCARE? (CON.)

- How well do they understand the operational and financial intricacies of **cost-based payment**?
- Do they have expertise in operating **swing bed programs**?
- To what degree have your existing or prospective partners demonstrated a **track record at their rural affiliates** of investing and expanding access to services?
- What value do prospective partners place on your **aligned primary care base, referrals** and **attributed lives**?

PARTNERING IS NOT A RISK-FREE ENDEAVOR

PROSPECTIVE PARTNERS

- Vet and select a strategically aligned partner
- Select an affiliation structure that fits your strategic objectives and constraints
- Craft contractually enforceable terms
- Do their strengths and commitments mitigate your risk profile?
- Assess their track record
  - Do they understand rural?
  - Does their track record back up their promises?

EXISTING PARTNERS

- Ensure that your partner understands your value proposition
- Ensure your affiliation structure enhances the value provided by the partnership for both parties
- Identify and quantify any missed opportunities
- Quantify the ROI of investments to reflect the unique rural value proposition
  - One size does not fit all
  - E.g., variable vs fixed cost allocation

EXAMPLES FROM THE FIELD

CASE STUDY: CAH & LARGE MULTI-STATE HEALTH SYSTEM

- Our client entered discussions with a large multi-state health system regarding a potential affiliation.
- While both parties saw strategic value for the engagement, the large health system misunderstood the value of the home office cost allocation, placing only $100K incremental value on this allocation vs an estimated $3M+ annual value calculated by Stroudwater.
- A greater than 50% share of cost-based payment also is critical to include in the prospective partner's evaluation of investment needs and opportunities at the CAH.
- The benefit of a modest change in referrals (+2.5% market share gain) would also generate significant additional ROI.
- Result: the prospective partner revised their offer from minimal capital commitment and virtually no local role in governance to an offer than included major investment commitments, major service commitments and a significant continuing affiliate role in governance.

CASE STUDY: QUANTIFYING THE VALUE

- Stroudwater was engaged by a CAH and regional referral center to explore the potential opportunities that an affiliation could create for both organizations.
- The scope of work focused on the following potential value drivers:
  - Service line operational and clinical opportunities, including decanting volume
  - Swing bed program opportunities
  - 340B program opportunities
  - Rural health center opportunities
  - Home office cost allocation opportunity
- Both organizations were concerned that the affiliation be a good “fit” strategically and not become a distraction relative to the potential value to be realized.

CASE STUDY: QUANTIFYING THE VALUE, CONT.

- The following table quantifies the financial opportunities based on the ability for each initiative to be operationalized at various levels of system integration ranging from each organization maintaining complete independence up through a formal affiliation.
- The deeper the level of integration, the greater the benefits produced through the formal establishment of a system relationship.

Summary Financial Opportunities	Independent	Limited Partnership	Full Affiliation	Clinical and Operational Benefits
Service Line Reassignments		$1.12M	$1.12MK	• Capacity constraint at Regional Referral Center is distributed to Critical Access Hospital ("CAH") in need of volume • Decanting volume to CAH will increase clinical capabilities
Swing Bed Program Growth	$140K	$180K	$180K	
RHC/340B Drug Pricing Program Net Revenue			$270K	• Creates improved financial environment for expanding qualified clinics
Net Impact of Home Office Allocation			$2.0M+	• Improved cost-based reimbursement on system overhead costs
Total Annual Impact of Opportunities	**$140K**	**$1.3M**	**$3.6M+**	

CAPTURING THE VALUE PROPOSITION

PARTNERSHIP PROCESS FOR EXISTING PARTNERS

- Unleashing previously untapped value should benefit both the rural affiliate and the parent.
- Quantify opportunities with a pragmatic and realistic mindset – do not over promise and under-deliver.
- Get some early wins on the board to build confidence and buy-in.
- Prioritize opportunities based on:
  - Low cost to implement
  - Quick ROI/time for payback
  - Ability to execute
  - Value to partner, affiliate and system
  - Strategic fit of the opportunity
- Focus on educating colleagues about recurring benefits and including benefits in future capital allocation decisions.

PROCESS RECOMMENDATIONS FOR NEW PARTNERSHIPS

For prospective partners, it is beneficial to have them compete for the privilege of being your partner.

- Use the process to gather information about your options
- Also, use the process to educate prospective partners as to your value
- Assess whether a partner is willing to adjust terms and commitments to reflect the quantification of your value
- Leverage the analyses of your value, the competitive process and the asymmetry of information to negotiate improved terms
- Evaluate prospective partners' track records with their rural affiliates
- Do not sign an exclusive Letter of Intent until you have an acceptable term sheet in hand

KEY TAKEAWAYS

KEY TAKEAWAYS

- The significant intrinsic value of rural health systems is too often missed or undervalued by existing and prospective partners.
- Know your value! Do your homework and engage with prospective and existing partners.
- Your value will be obscured and overwhelmed by poor fee-for-service based operating results.
  - Very few prospective partners will be interested in a prospective affiliate with a negative trajectory and no workable plan or turnaround progress.
  - If you have poor operating results, you need to have a plan to improve operations and be working that plan before your talk to prospective partners.
- You need to be able to explain and quantify your value to partners – either existing or prospective.
  - Ensure that your rural health system is appropriately valued to craft a sustainable, win-win partnership.
- You need to be persistent; don't assume that partners or leadership know the intricacies of rural payment, designations or cost reports.

QUESTIONS AND THANK YOU

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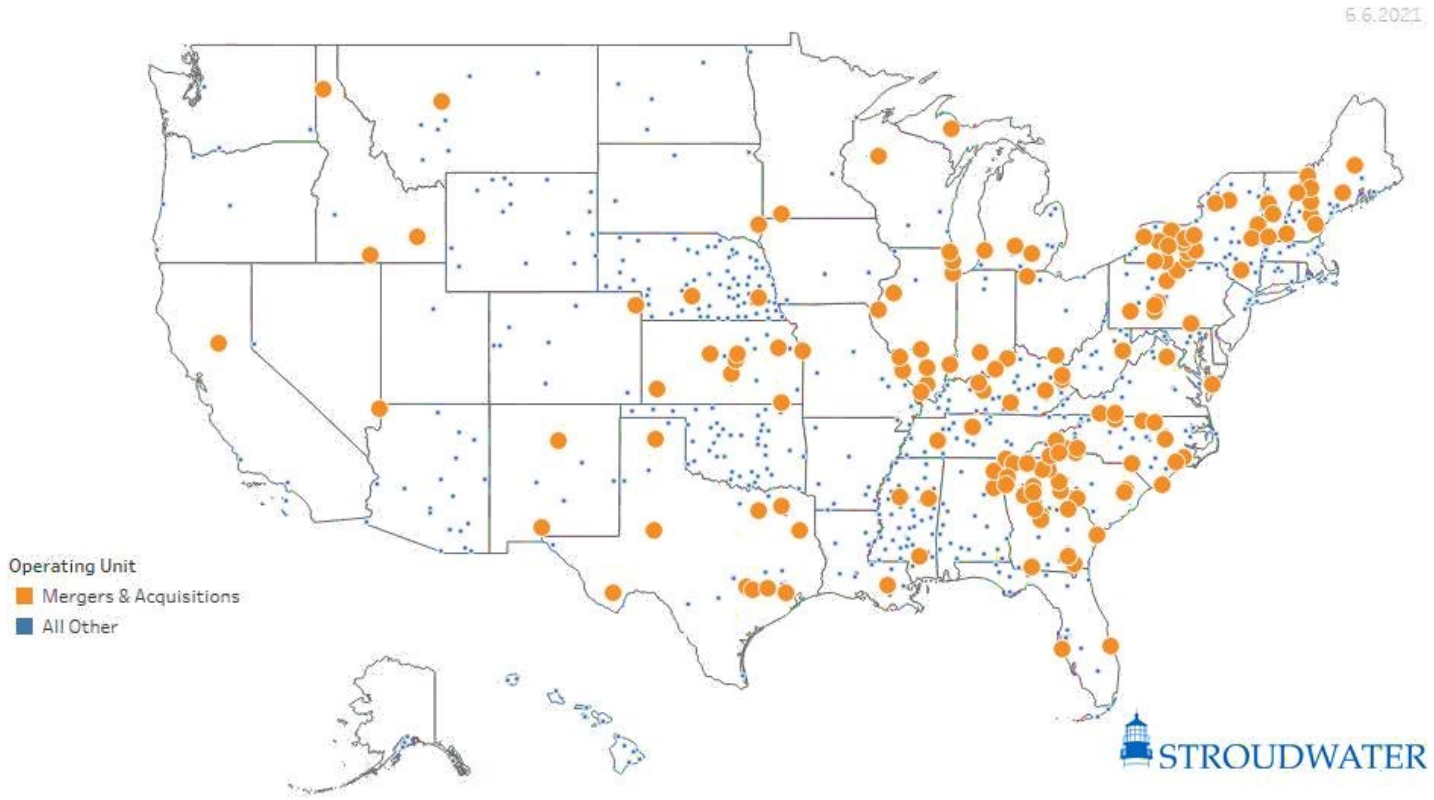
STROUDWATER CLIENTS:

A National Rural Health Perspective



STROUDWATER

Real-world, mission-critical, actionable advisory services as you and your community navigate the dynamic risks of today's healthcare environment.

Stroudwater Associates is a leading national healthcare consulting firm serving healthcare clients exclusively. We focus on strategic, operational, and financial areas where our perspective offers the highest value.

We're proud of our 37-year track record with rural hospitals, community hospitals, healthcare systems, and large physician groups.

Strategic Advisory

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- Capital Planning & Access
- Post-Acute Care Strategy

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- Provider Practice Operations Improvement
- Revenue Cycle Solutions
- Post-Acute Care Operations
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- Staffing & Productivity Improvement
- Cost Report Reviews and Analysis

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Get to know us better:
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