



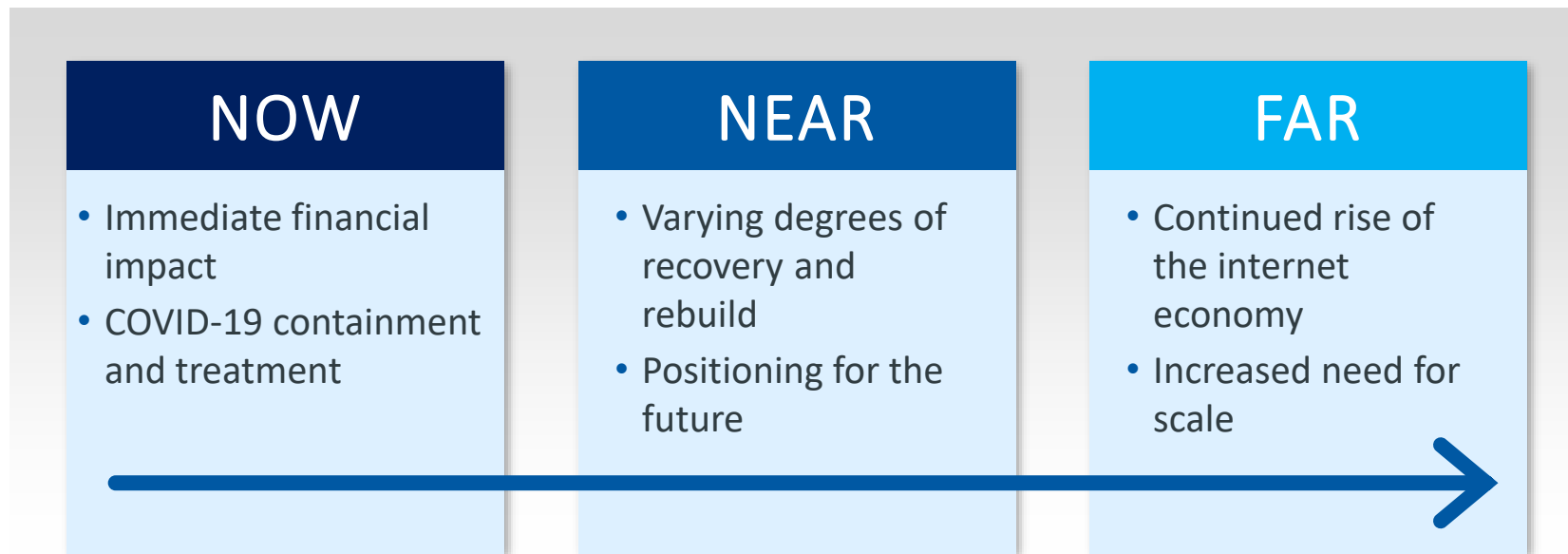
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The Journey Forward from COVID-19: Financial Recovery for Hospitals and Health Systems

Mark Grube, Managing Director and National Strategy Leader
IHA Virtual Leadership Summit | October 22, 2020

COVID Has Significantly Changed Healthcare's “Now, Near, and Far”

- Strategic planning has been upended by COVID-19, drastically changing the way that health systems look at the “Now,” “Near,” and “Far” of healthcare
- Health systems need to rethink how they are positioning themselves strategically and financially to address the new immediate, short-term, and long-term landscape



Before COVID, Hospital Operating Margins Were Modest at Best

IN 2019

- ▶ Median hospital margin was a very modest **3.5%**
- ▶ **One-third** of hospitals had negative operating margins

Source: Kaufman Hall Adjusted Operating Margin Index; Kaufman Hall analysis

Year to Date, COVID Has Hammered Hospital Financial Performance

Medians, Jan.-Sept. 2020 from Jan.-Sept. 2019		
Margin	Median Operating Margin (w/out CARES)	↓ From 3.2% to -2%
	Operating Margin (w/ CARES)	↓ From 3.2% to 1.9%
Volume	Adjusted Discharges	↓ 12%
	OR Minutes	↓ 14%
	ED Visits	↓ 16%
Revenue	Gross Inpatient Revenue	↓ 3%
	Gross Outpatient Revenue	↓ 8%
Expenses	Total Expenses per Adjusted Discharge	↑ 15%

Source: Kaufman Hall National Hospital Flash Report

Rating Agencies' Outlook for NFPs Remains Negative

- S&P, Moody's, and Fitch all carry negative outlooks for the not-for-profit healthcare sector
- Despite the outlook, upgrades are still happening: agencies remain focused on organizations' individual performance
- Rating agencies are shifting attention from how hospitals first addressed COVID-19 to their future trajectory
- Uncertainty about the long-term impact of COVID is likely to persist
- Building resiliency across the capital structure—and communicating about it—will be critical

“The initial [COVID-19] response is not as relevant now. It’s more about where you go from here.”

—Kevin Holloran
Senior Director
Fitch Ratings

Source: Kaufman Hall 2020 Healthcare Leadership Conference: How Rating Agencies View Healthcare's New Normal

COVID Is Likely to Stay With Us as a Chronic Condition

- After eight months of fighting the virus, we are at the greatest level of uncertainty yet
- What are the best-case and worst-case scenarios?
 - 90% of typical volume and revenue levels?
 - An inflection point for positive transformation?
 - Catastrophic change?
- At the moment, there isn't any way of truly knowing what the outcome will be
- What we do know is that COVID is not a temporary problem

“We will be dealing with this virus forever. We’re not going to be vaccinating our way out of this...”

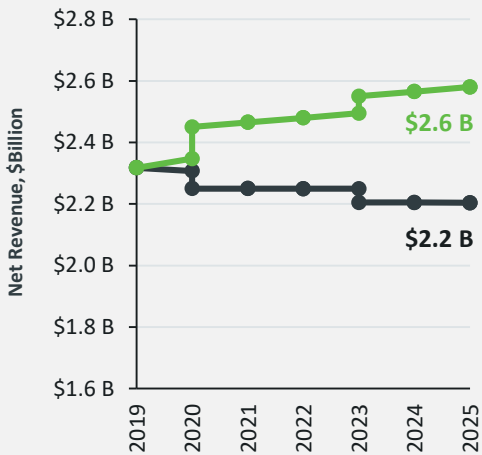
—Michael Osterholm, PhD
Center of Infectious Disease
Research and Policy
University of Minnesota

Other Major Environmental Shifts Are Very Possible

Illustrative

1 Competitive/Value

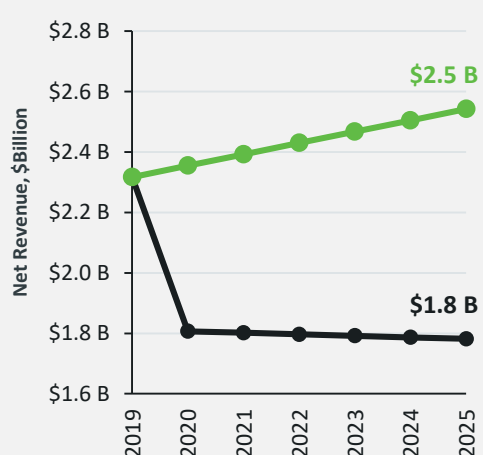
Aggressive market consolidation of covered lives via health plans, health systems, and/or healthcare verticals



Scenario 1 will likely be stepwise given it is driven by a compilation of large discrete transactions vs. organic growth over time

2 Regulatory

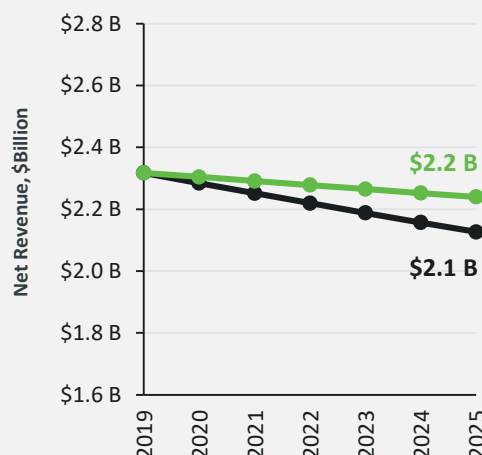
Increased state and/or federal government engagement with the healthcare industry



Scenario 2, Regulatory, is anticipated to be a single concentrated shock based on government action (shown in 2020 on graph)

3 Consumer

Large-scale shift in consumer engagement and/or value drivers that impact decision-making



Scenario 3, Consumer, is anticipated to be a gradually increasing trend over time as consumers begin to activate and select away from high-cost care settings

— With management intervention — Without management intervention

The Election Could Influence Finance and Strategy

No matter which party wins the White House and which party or parties control Congress, expect:

- Continued pressure on Medicare and Medicaid payment
- Continued intense scrutiny of all mergers and acquisitions

Trump healthcare priorities:

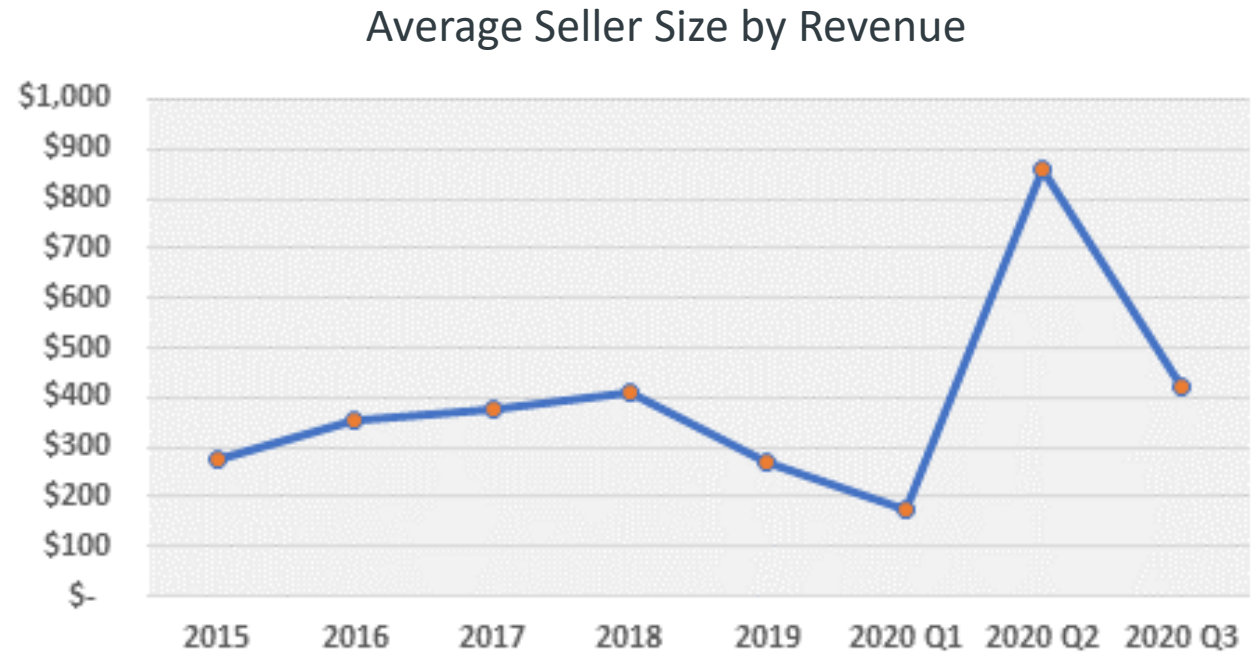
- Continue attack on the Affordable Care Act
- Limit Medicaid eligibility
- Require hospital price transparency
- Lower drug costs
- Fight consolidation

Biden healthcare priorities:

- Protect Affordable Care Act
- Expand Medicare-like public option
- Lower drug costs
- Fight consolidation

Health System Consolidation Appears to Be Accelerating

- More than ever, scale is a priority: 2020 Q2 and Q3 saw historic highs for average size of seller by revenue
- We are seeing signs that health systems are moving beyond their geographic tradition
- The pandemic has accelerated the need to transform care delivery models and reimagine health system configuration
- Systems are beginning to restructure their portfolios as they look for opportunities to monetize or exit underperforming assets and strengthen their financial viability

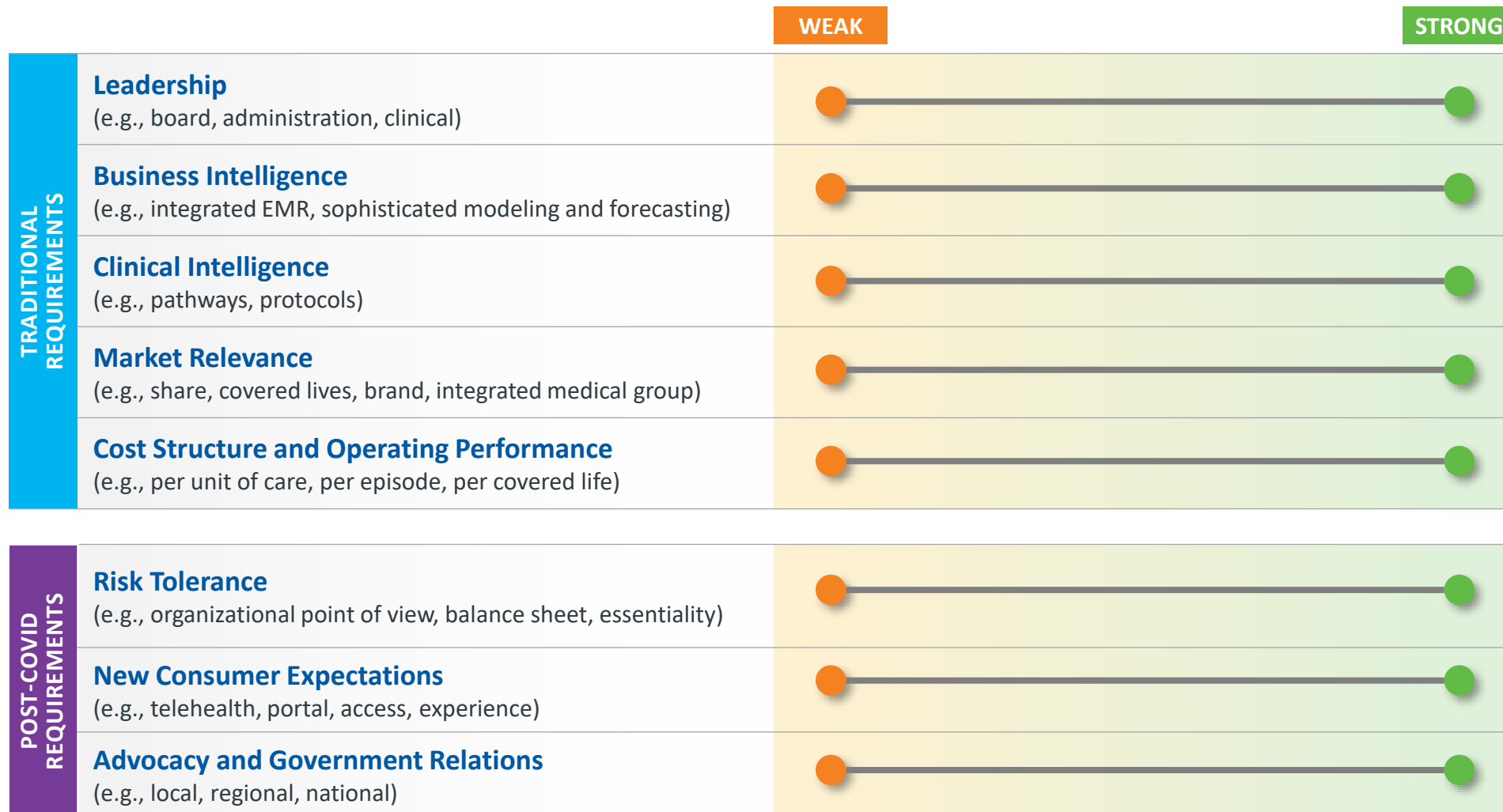


Source: Kaufman Hall Q3 M&A Report

COVID-19 May Accelerate Partnerships Between Health Plans and Providers



The Requirements for Achieving Success Are Changing



Hospitals Will Need to Enhance Telehealth Expertise

- Forrester Research predicts more than 1 billion virtual care visits in 2020, up from an initial estimate of 36 million
- CMS has dramatically expanded the number of covered telehealth services
- Patients report positive experiences with telehealth
- A rise in telehealth demand could mean less revenue for organizations already damaged by revenue losses from COVID-19
- If telehealth demand is sustained, hospitals may be able to rethink some facility and real estate expenses
- Providers whose telehealth services are limited in scope, capacity or functionality will have difficulty competing against more sophisticated solutions from other providers or new entrants
- The question remains: How broad and sustained will telehealth demand be?

Hospitals Will Need a New Cost Structure

- Basic math provides the impetus: each hospital's new cost structure will depend on the slope of its revenue recovery curve
- Hospitals will need to make major changes to operations in order to adjust to a loss of revenue whose exact level remains unknown
- What will the resulting healthcare delivery system need to look like? What are its core functions? What is its most effective structure? What is the optimal workforce? What technology support is needed? What facilities are needed?
- At this point, executives have only a hazy idea of what their new cost structure will need to be

Hospitals Need to Balance Risk and Resiliency

- **Balance sheets** will be an anchor
- **Operations** will be a credit variable



While External Risk Is High, Hospitals Need to Focus on Internal Risk

- Two kinds of risk:
 1. **Operating risk:** Risk internal to the organization
 2. **Event risk:** Risk external to the organization
- Economic rule of thumb: When event risk is high, reduce operating risk
- Active Risk Mitigation
 - Convert short-term financing (lines of credit) to permanent financing. Do this now while capital markets are operating within a normal range.
 - Scrub your operating model for accumulated assets that have increased operating risk but are not positively contributing to operating performance.

Pre-COVID State and COVID Impact Will Influence Post-COVID Strategic-Financial Planning

Heavily Affected

- Weak Capitalization Pre-COVID
- Short- and Long-Term Post-COVID Viability Concerns



- Create consensus on situation
- Establish partnership goals
- Identify potential partners
- Execute structured evaluation process

Moderately Affected

- Median Pre-COVID liquidity, leverage, and profitability
- Short-Term Post-COVID Operating Pressures
- Long-Term Strategic and Operational Options



- Re-establish targets and control methods
- Reinvigorate the operating model
- Actively pursue “Deals” in the environment

Lightly Affected

- Strong Capitalization Pre-COVID
- Limited Balance Sheet and Operating Damage
- Continued Stability and Broad Options



- Determine objectives aligned with vision of “far”
- Allocate capital and leadership to pursue options
- Seize the “once in a generation” opportunity

Weaker and Weakened Organizations Are Focusing on Immediate Financial Pressures

As of September 2020

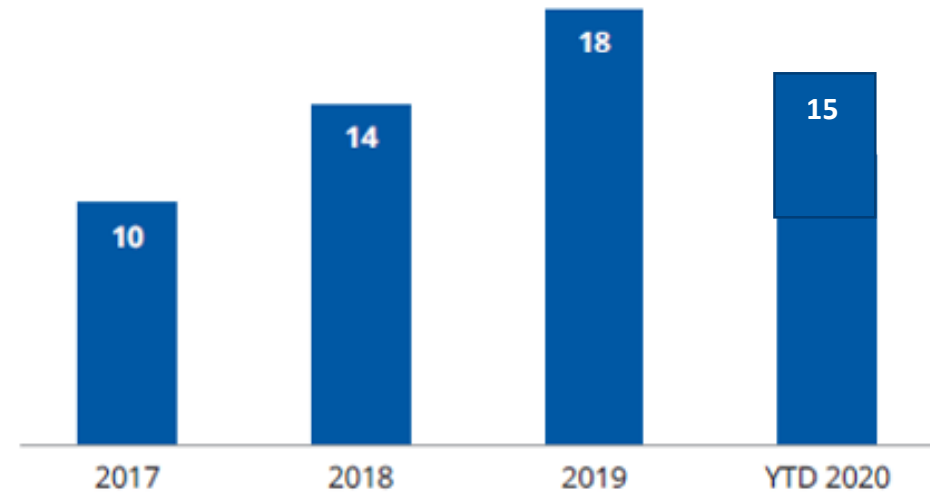
45 healthcare sector bankruptcies

36 hospital bankruptcies

(equals last year's total)

Sources: S&P Global, Bloomberg

Rural Hospital Closures YTD Are Already Near Last Year's Record High



Source: UNC Sheps Center

Partnership strategies would focus on immediate and long-term financial pressures

- Change in operations and debt structure to return to performance objectives
- Pursuit of fundamental business and capital structure changes to achieve goals

Moderately Affected Organizations Are Securing Operations While Investing Selectively

Evaluate and Streamline the Operating Model

Organizational Structure:

Formal reporting relationships: spans and layers

Roles and Decision Rights:

Individual and group accountability and authority

Key Processes:

Formal approaches to conducting essential business activities

Methods and Data:

Institutional norms of how information is distributed and work conducted

Vigorously Pursue Cost Structure Opportunities

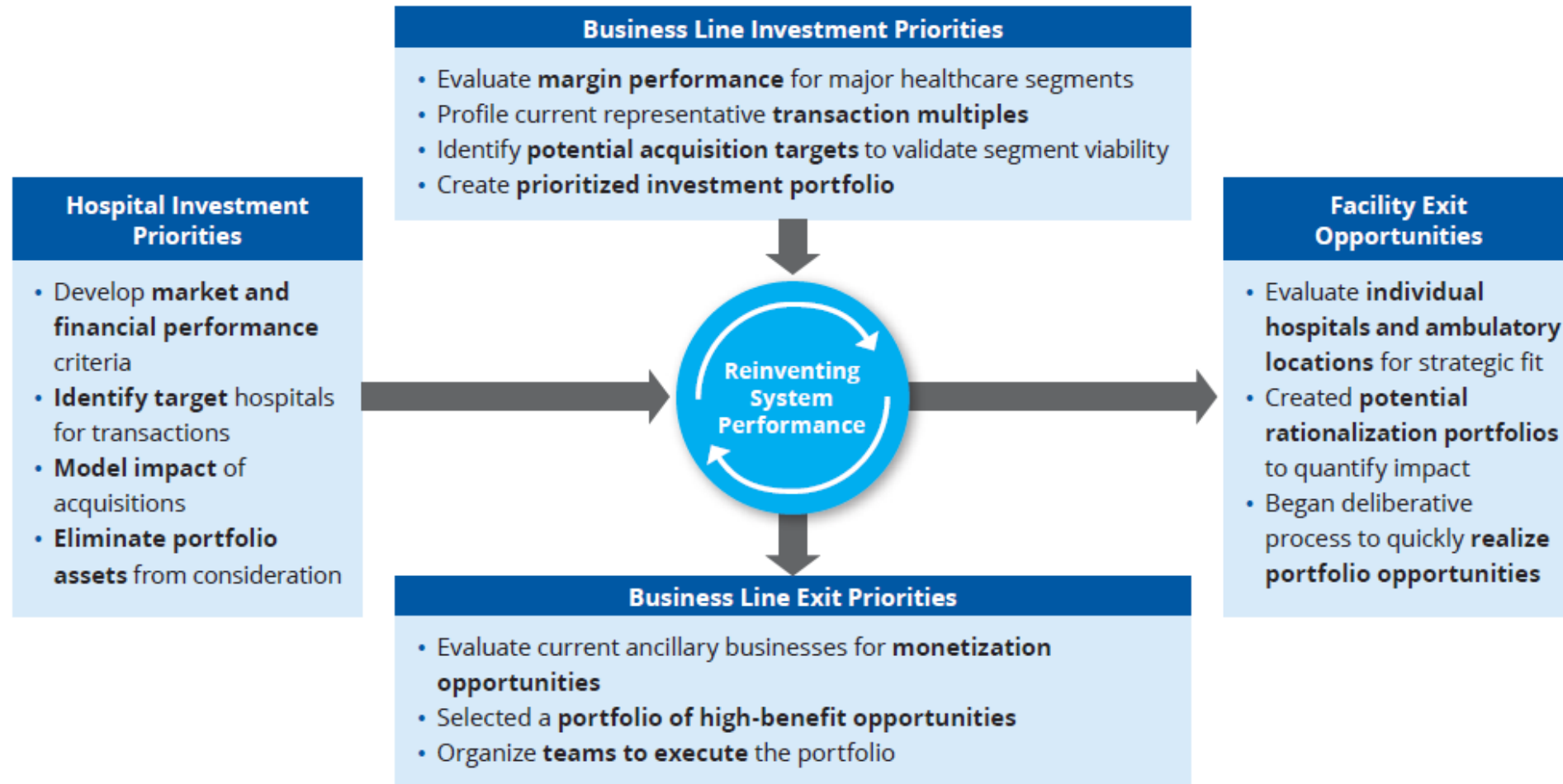
Example: Purchased services cost opportunities

- Blood procurement and use
- Equipment leases and financing
- Biomedical engineering
- Dialysis
- Facility energy solutions
- Environmental services
- Banking services

Partnership and investment strategies would be opportunistic

- Physician practice opportunities
 - High-margin business lines
- Hospital acquisition opportunities

Stronger Organizations Are Addressing Care Gaps and Redefining the System



Four Things We Know

- Organizations with strength are in the best position to lead
 - A strong balance sheet, scale, and diversification in revenue help weather uncertainty
- Organizations with the habit of discipline have an advantage
 - At the very start of the outbreak, disciplined organizations immediately put together focused command structure for response, recovery, and reimagining the new environment
 - That discipline needs to include controlling of internal risks to combat uncontrollable external risks
- Math has never been more important
 - Highly sophisticated monitoring, modeling, and analysis are more necessary than ever to understand current position and future scenarios
- Multi-taskers will have the broadest options
 - The ability to simultaneously recover and reimagine strategic position