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Challenges Facing Not-for-Profit Healthcare 2023 IHA Leadership Summit

Lisa Goldstein, Senior Vice President

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Agenda

1. State of the Industry
2. Healthcare's Wicked Problems
3. Recent Rating Activity
4. Building High Reliability Organizations
5. Discussion, Questions

State of the Industry

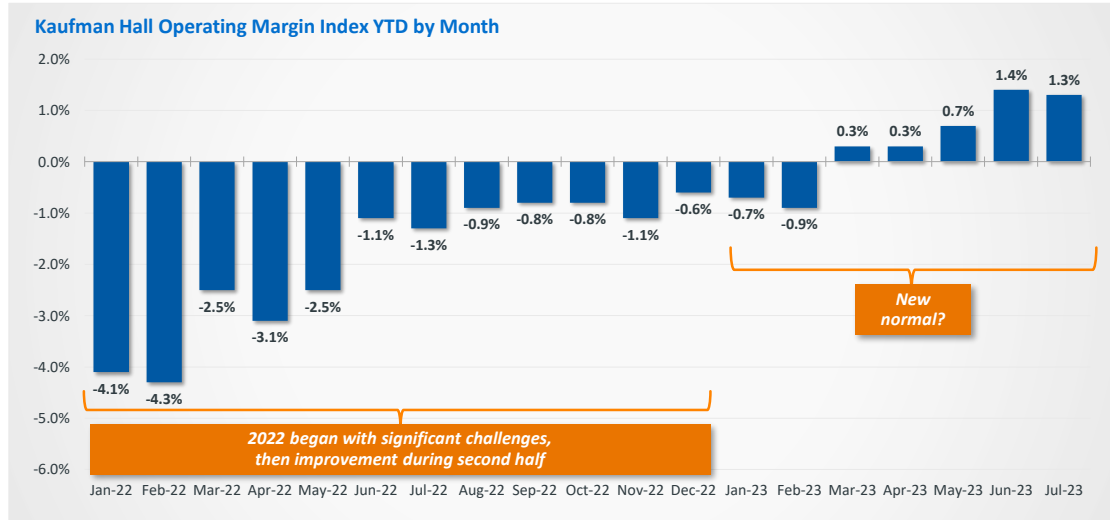
The Industry Remains in a State of Rapid Transition

- Volume trends are mixed and highly dependent on location
- Labor and supply inflation remains relentless
- Payer mix shift away from commercial and toward more governmental
- Well-funded disruptors embrace speed-to-market
- Liquidity remains integral during periods of industry or organizational volatility

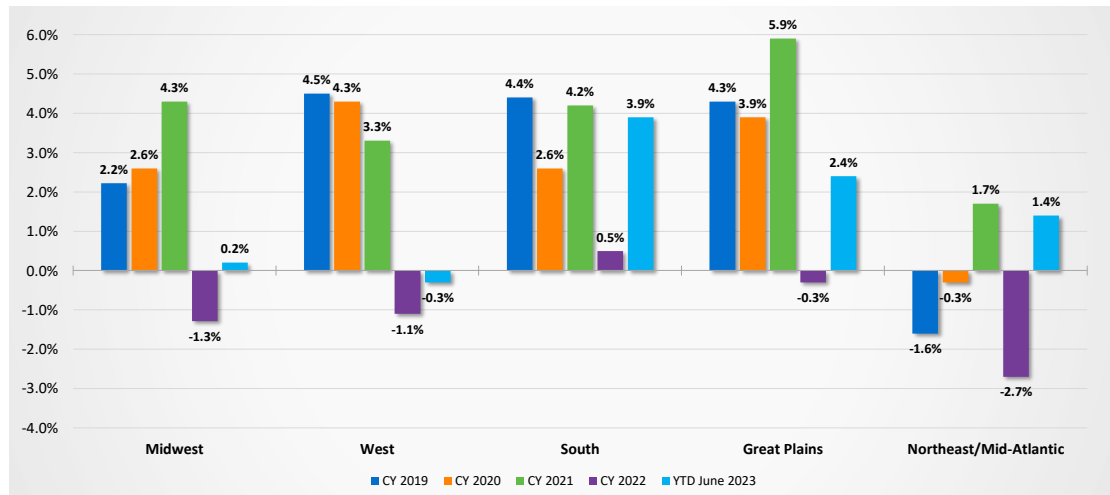
“...the very actions to solve healthcare’s wicked problems may likely make aspects of the strategic problem worse.”

— Ken Kaufman, *Healthcare’s Wicked Problems*

After a Difficult 2022, Have We Reached a Turning Point?



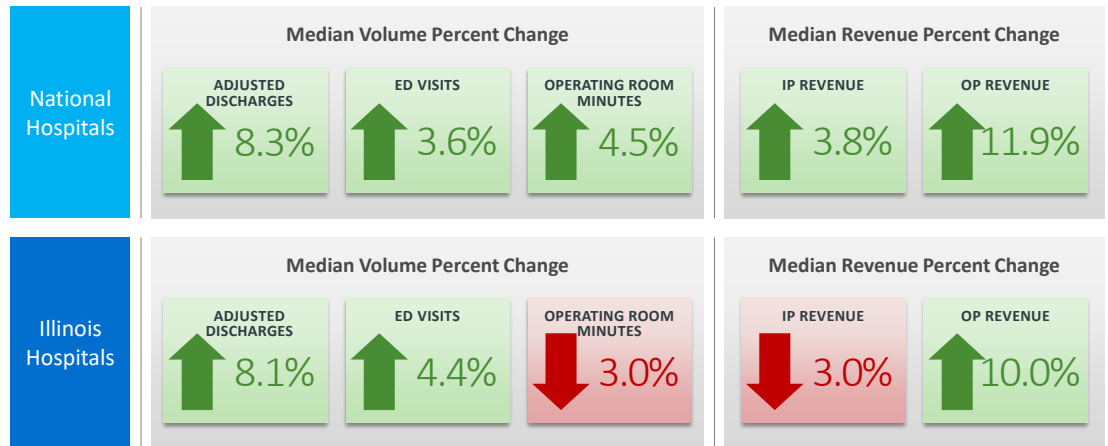
Operating Margin Trends Show Wide Array by Region



Source: Kaufman Hall; all values represent median for each respective region; operating margin includes CARES Act funds
Sample size: Midwest = 185; West = 149; South = 246; Great Plains = 91; Northeast/Mid-Atlantic = 128

Illinois Hospitals Volume Trends are Largely in Line with National Trends; Revenues Show Divergence

JULY YTD 2023 COMPARED TO JULY YTD 2022



Source: Kaufman Hall National Hospital Flash Report

Financial “Twindemic” Hits Both Margins and Cash



Financial Performance Has Reached All-Time Low

- Intractable labor issues
- Unpredictable volume recovery
- High average length of stay
- Limited relief from payers; end of the CARES Act; sequestration re-starts



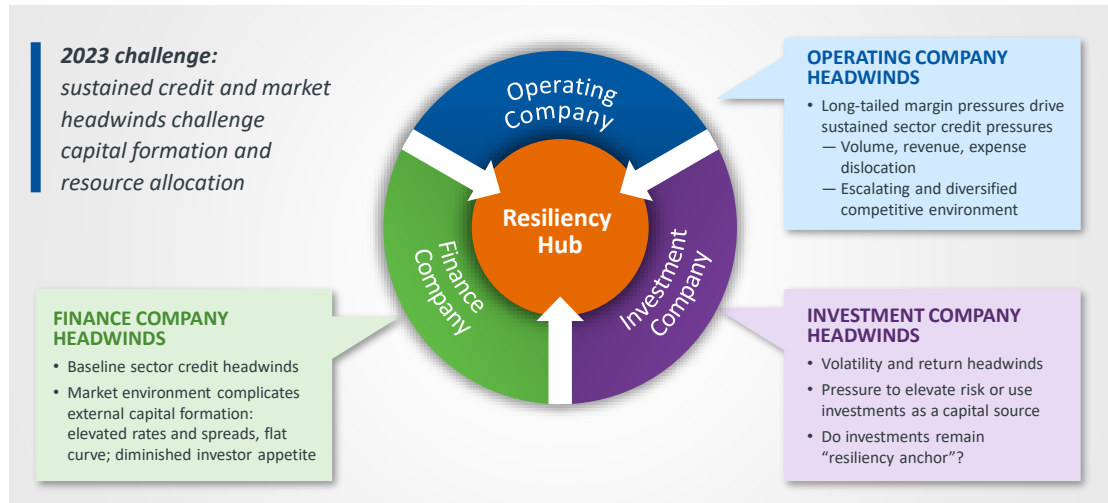
Financial Position Has Sharply Declined

- Use of cash to fund operations
- Investment losses
- Outsized daily operating expenses reduces cash on hand
- Payers slow to pay

Capital is a hospital's oxygen and hospitals can no longer afford to hold their breath.

— Eric Jordahl, Moving Into and Through 2023

No Haven: Sustained Headwinds in 2023 Challenge Every Component of the Business Model



Healthcare’s Wicked Problems

Healthcare's "Wicked Problems"

What is a "Wicked Problem"?

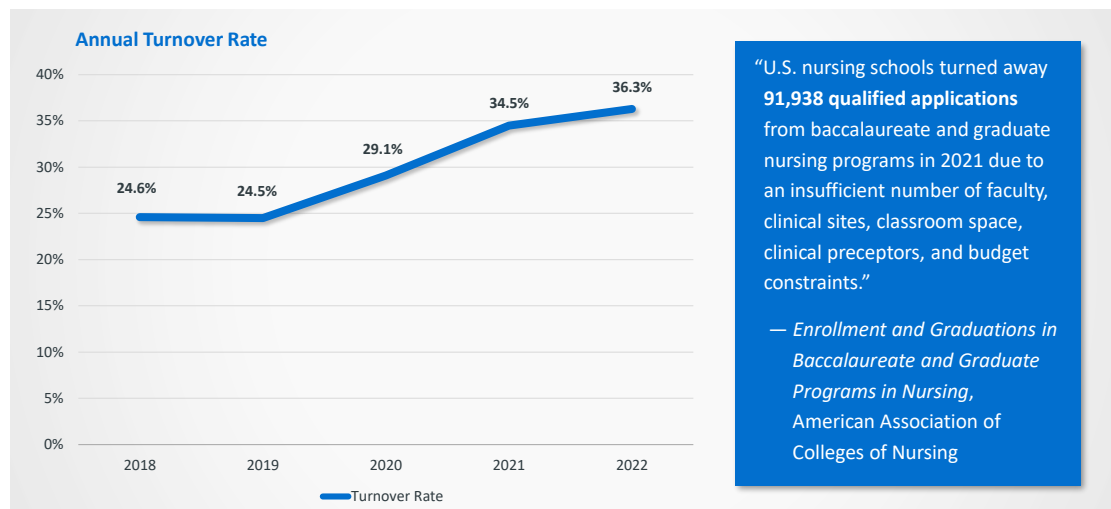
1. Hard to define;
2. Hard to know when they are solved;
3. Potential solutions are not right or wrong, only better or worse;
4. No end to the number of solutions or approaches; and
5. No way to test the solution to a wicked problem; solutions are not easily reversible and may affect many people in profound ways

"This is the new role of healthcare leaders: solvers of wicked problems"

— Ken Kaufman, *Healthcare's Wicked Problems*

Source: Horst Rittel and Melvin Webber, 1973

Labor Remains a Significant Challenge



Source: Kaufman Hall, *Comments on Current Management Issues in the Healthcare C-Suite: Management of Labor in Trying Financial Circumstances*

Hospital Workforce Challenges Didn't Happen Overnight



Environment

- The workforce ship was rickety before the pandemic
- The worst of the workforce resignations have been in the acute-care setting
- The team concept, historically the heart and soul of acute-care delivery has collapsed
- The image of the healthcare working environment has suffered—how do we make the field attractive?



Workforce Needs

- A portion of the healthcare workforce is prioritizing flexibility over money, and hospital scheduling has been very inflexible
- First-year turnover is higher than ever—signaling a need for mentoring
- Work-from-home issues are complicated, particularly mentoring and promotion

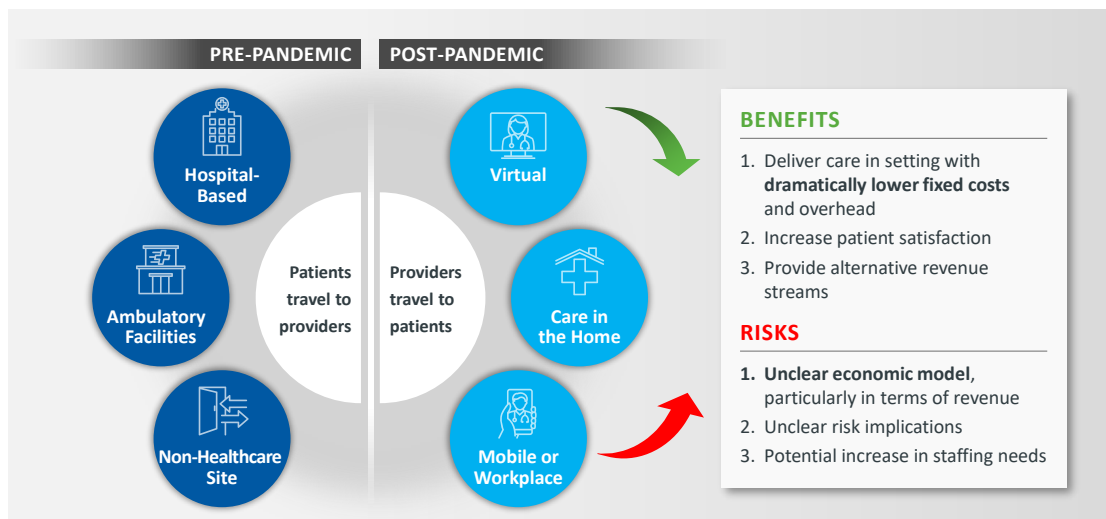


Hospital Issues

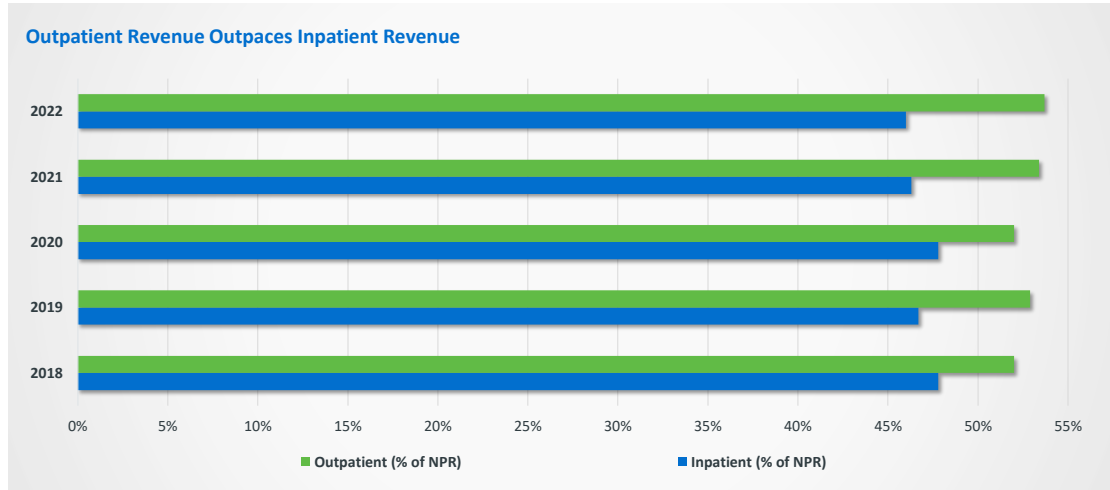
- Leadership matters more than ever, especially at the middle-management level
- Hospitals have been slow to adopt technology to support workforce flexibility

**These challenges are long-term, at least 5-10 years before the ship is righted
Organizations need to favor prompt, aggressive, innovative, and tailored actions**

Demand for Lower Cost Settings of Care Accelerated



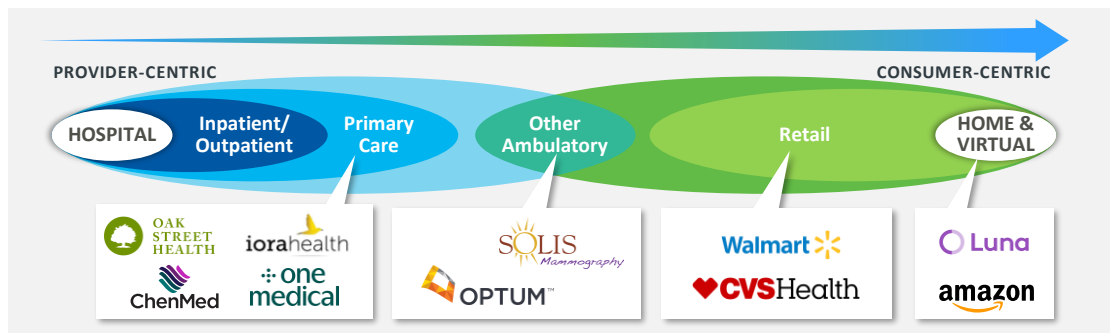
Outpatient Comprises Over Half of Total Revenue, Even Before the Pandemic



Source: Moody's Investors Service 2022 Not-for-Profit Hospital Medians

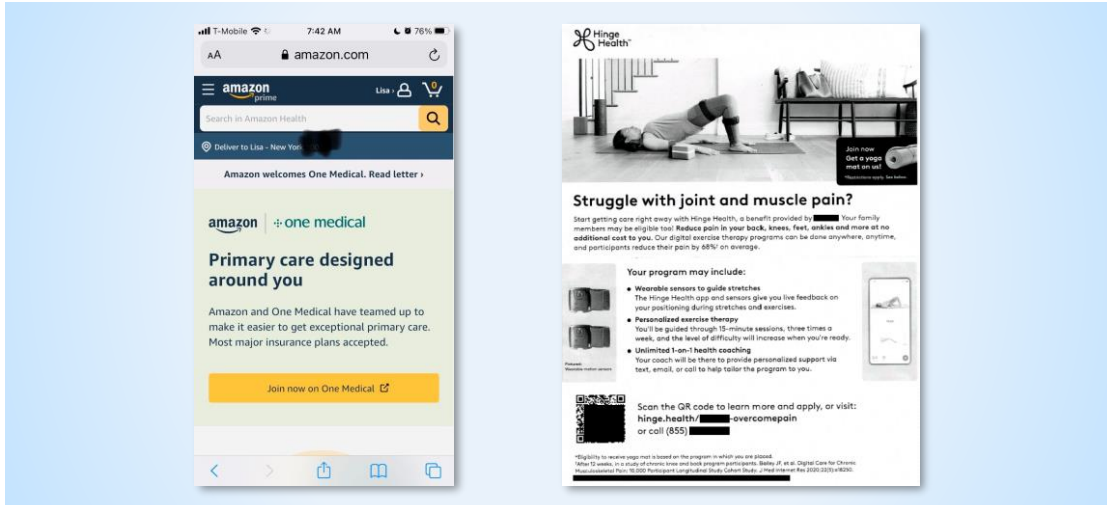
Enter The Disruptors...“The Doctor Will Zoom You Now”

- Well-capitalized to pursue aggressive growth strategies
- Hyper-focused on select market segment(s) and have tailored their value proposition accordingly
- View strategic partnerships with existing players as worthwhile to increase visibility, market share, and financial resources, though not necessary to survive
- Leverage technology and non-traditional business models, though not entirely novel



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The Disruptors Give New Meaning to Traditional Direct Mail



Recent Rating Activity

All Rating Agencies Maintain Negative Outlooks on the Sector

S&P Revises Outlook to Negative

MOODY'S

Outlook: *Negative*

S&P Global

Outlook: *Negative*

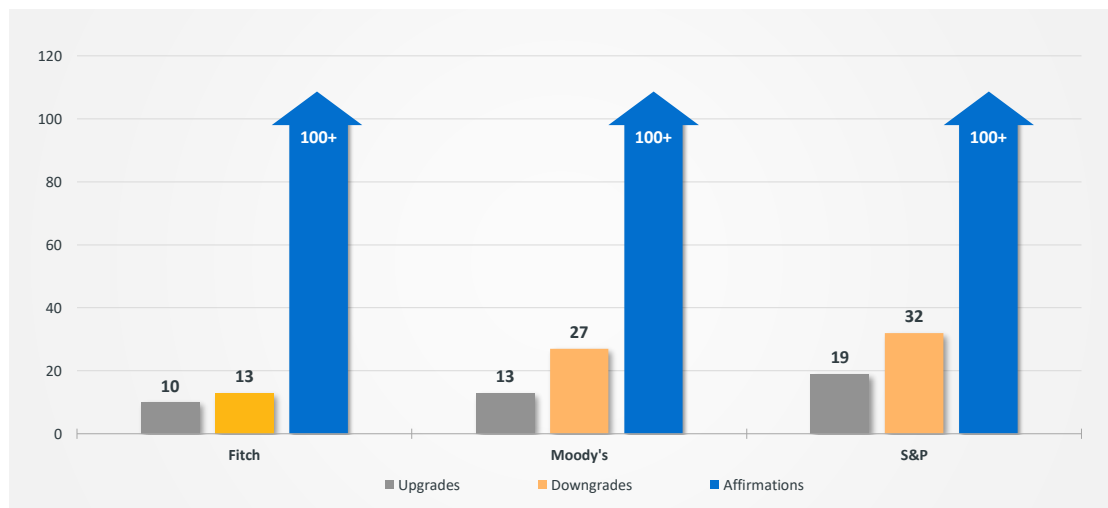
FitchRatings

Outlook: *Deteriorating*

- **The sector continues to experience severe labor shortages** and will be the largest driver of operating challenges
- **Operating performance remains under pressure**, as expense growth will likely outpace revenue growth; performance will have a longer runway to pre-pandemic margins
- **Revenue gains will be limited**, in part, due to, the inability to meet demand because of labor constraints, deteriorating payer mix and the continued shift of care to low-cost settings
- **Unpredictable volumes** will make budgeting and forecasting increasingly difficult
- **Liquidity will decline** as market turbulence continues, cash flow is weak and capital spending increases following some delay during the pandemic
- **Organizations with strong balance sheets are less likely to experience a negative rating or outlook action**; weaker credits may continue to struggle
- **M&A activity will continue** as providers seek size and scale to achieve stability although tougher regulatory oversight may slow activity
- **Partnership opportunities** for efficiencies and strategic investments are likely to evolve
- **Significant shifts in care delivery models are occurring**, with disruptors speed-to-market advantage
- **The credit quality gap may continue to widen** between stronger and weaker providers

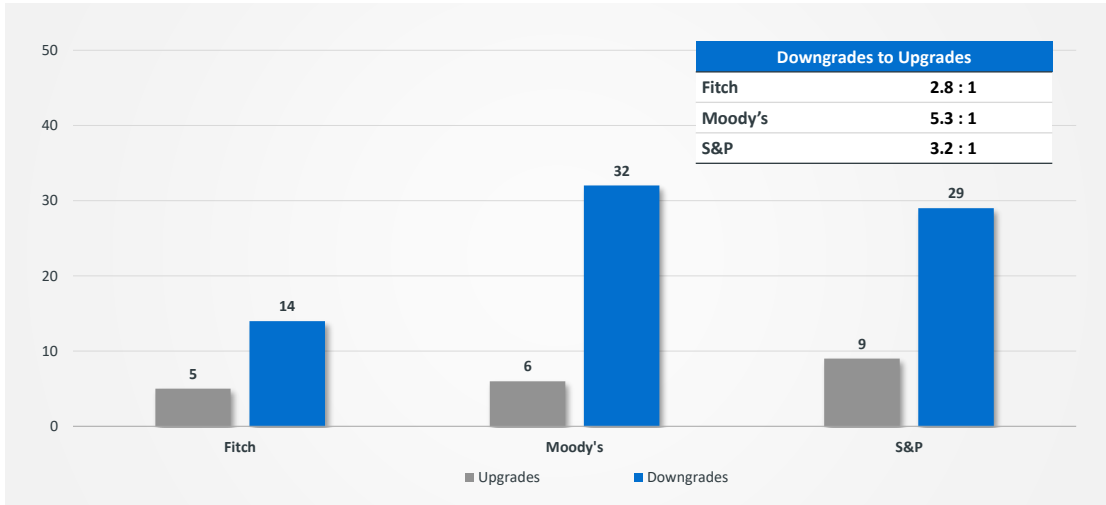
Sources: Fitch Ratings, Moody's Investors Service, S&P Global

Affirmations Remained the Predominant Rating Action in 2022



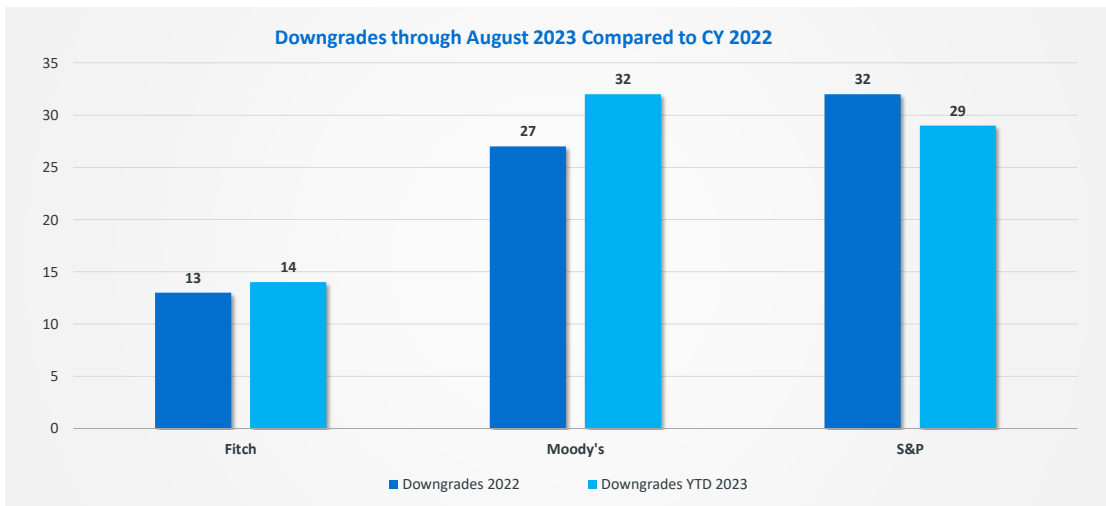
Source(s): Fitch Ratings, Moody's Investors Service, S&P Global

Downgrades Far Outweigh Upgrades through August 2023






Sources: Fitch Ratings, Moody's Investors Service and S&P Global

Downgrades have Escalated Through August 2023

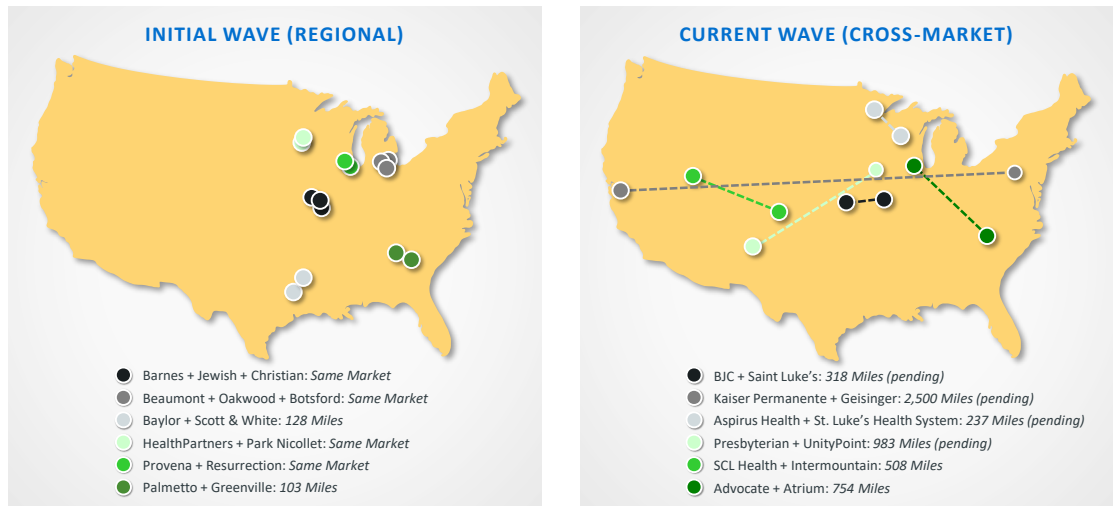


Sources: Fitch Ratings, Moody's Investors Service, S&P Global

Characteristics of Healthcare Systems “Bucking the Trend”

High-Growth Service Area	Proactive Expense Strategies	Identified Levers & Tough Decisions	Manageable Debt Positions
 <p>Population growth driving increasing volumes</p> <p>Located in growth markets with diversified economies and affordable housing</p>	 <p>Enacted early-on expense control strategies during the pandemic and doubled down on efforts during the 2021 margin rebound</p>	 <p>Implemented levers for improvement such as labor force reallocation/reduction, pension suspension</p> <p>Executed exit strategies for certain non-core services or facilities</p>	 <p>Adequately managed debt capacity to fund future growth strategies or to replenish reserves for prior capital</p>

Drive for New Capabilities Creates Cross-Market Strategy



Note: Includes New System Formation Transactions among Regional/Super-Regional Systems with the Smaller Organization Revenue Base > \$1B

Healthcare Organizations are Adapting

Hospitals and Health Systems Are...

Organizing regional markets, **engaging in ‘mega-mergers’ and acquisitions with organizations with complementary capabilities** to extend market reach, cultivate coordinated care networks, gain access to scale and diversify service offerings

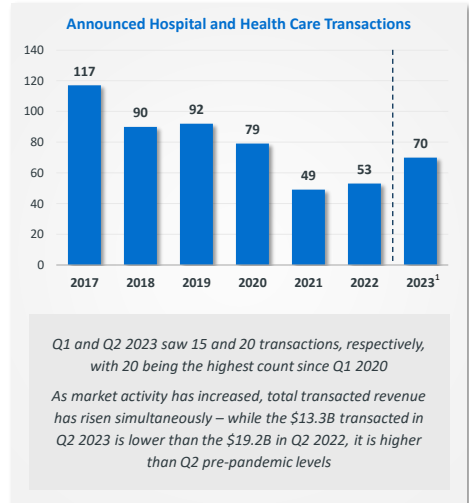
Froedtert **ThedaCare** **AdvocateAuroraHealth**
Atrium Health

Shifting from market-based scale to **capability-based scale to adapt to the changing healthcare environment and improve care outcomes**; key capabilities include value-based readiness, population health management, digital tools and ambulatory presence

RISANT
KAISER PERMANENTE **Geisinger** **SSMHealth** **Optum**

Repositioning themselves in response to sustained cost pressures and disruptors’ market entry by **divesting non-accretive businesses and partnering with dedicated for-profit operators**, including outreach laboratories and rehabilitation facilities

Peace Health **Lifepoint Health** **Summa Health** **Quest Diagnostics**



Note: (1) Reflects annualized data as of June 30, 2023.

Partnerships Will Become Increasingly Important

- What is our core business and where is there strong consumer need/demand?
- Are there potential partners who can provide these services better than we can?
- What do we offer to potential partners?
- What degree of control do we need/want in the partnership? Do we need to own it?
- What is the optimal structure for the partnership (e.g., ownership, branding, financial commitment, governance, clinical decision-making)?



Source: Kaufman, Hall & Associates, LLC

Building High Reliability Organizations

Not-for-Profit Hospitals Define “Agility” Through the Decades



Conversion to PPS in 1983

- Industry ill-equipped to change from cost-based payments
- Leveraged hospitals defaulted, filed for bankruptcy, or closed



Medicare reductions via BBA of 1998

- Medicare rates frozen with teaching hospitals particularly hard hit
- Medicare typically represents about half of a hospital's revenues



Liquidity crisis and Recession in 2008

- Auction rate securities failures
- Bank liquidity became expensive, if attainable
- Decline in volume, rise in unemployment and bad debt



Coronavirus pandemic in 2020

- Clinical crisis with unknown treatment plan
- Mandated shutdown of non-elective services
- Labor shortage contributes to financial losses

Liquidity is Paramount to Long-Term Sustainability

Six Reasons	Six Examples
<ol style="list-style-type: none"> 1. Cash for rainy day events 2. Pursue community mission 3. Strong liquidity gives access to capital 4. Source of capital when debt is limited 5. Financial cushion when debt increases 6. Key metric for the rating agencies 	<ol style="list-style-type: none"> 1. Mandated shutdowns in March 2020 2. Healthcare, shelter, food banks, laundry 3. Spiraling cost of PPE, ventilators 4. Liquidity bridge before CARES, MAPP 5. Collateral for lines of credit 6. "Triage" hospital ratings at risk

The Journey Toward Building a High-Reliability Organization



- How do we create reliable hospital organizations in the near term to sustain the organization for the long term?
- Every organization is on a different phase of their journey, but all need to move with urgency
- Strategies and capital spending are under review, if not being given a complete makeover
- Local market dynamics, coupled with state and federal scrutiny, will also inform strategies

Bold Leadership Needs to Build A Path To Sustainability

- 1 What is required to reach a sustainable operating path? What are key associated assumptions and factors driving uncertainty?
- 2 How do we stress-test our strategy and financial trajectory in light of changing market conditions?
- 3 How do we ensure the resiliency of our organization by pivoting our decision-making? What mitigation levers are available?

Approach

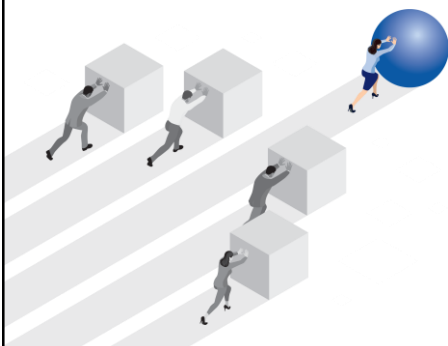
Refresh the strategic plan

Quantify the long-range financial trajectory

Stress-test the results and identify key drivers, risks, and opportunities

Monitor actual performance and market developments and communicate transparently

Think Differently.
Lead Differently.



1

“We Do It Best.”

- Can partners aid in delivering the best outcomes to patients?
- What is the ‘it’ that matters most today?
- *Focus on what you do well and measure performance against these parameters, recalibrating where needed*

2

“We Must Do It All.”

- Is it time to rethink what a provider must be for their community?
- Where are we expending resources (tangible and intangible) that fulfill or detract from promises to our community?
- *Reimbursement and scale are not reasons to define our core business*

3

“We Can Do It Ourselves.”

- Are we the most effective agent of change for our organization?
- Have we defined our competitor and collaborator relationships?
- *Recognizing where we have the most to fuel transformation is only one part of the solution; the remainder may be where we align with others*

Discussion, Questions

Thank You

Lisa Goldstein

Senior Vice President

lgoldstein@kaufmanhall.com

646-515-0142

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