Maritime Disasters and Distressed Hospitals

What Every Board Should Know About Assessing Risk

July 19, 2017

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Key Questions for Hospital Leaders

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- ✓ How is the sector-specific risk profile of hospitals changing?
- ✓ What are the sources of this heightened risk profile?
- ✓ What lessons can we learn from the El Faro disaster?
- ✓ What does the trajectory of a stressed to distressed hospital look like?
- ✓ What steps can be taken to mitigate these risks?

Disaster for the El Faro

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On September 30, 2015 the cargo ship El Faro left port in Jacksonville, Florida, bound for Puerto Rico and aware of Tropical Storm Joaquin and its projected path

The ship's captain charted a course that would allow El Faro to reach San Juan while maintaining a safe distance from Joaquin's destruction

Twenty-six hours after setting sail, battered by winds and seas created by Category 3 Hurricane Joaquin, El Faro and all of its crew sank off coast of a Bahamian Island

With the benefit of advanced weather forecasts, satellite imagery and modern communications…

How did a disaster like the El Faro happen?

With the swells increasing in size and frequency, El Faro's Captain was asked about altering course.

"No, no, no. We're not gonna turn around."
El Faro Bridge Audio Recording

Another Gathering Storm: Disaster for Hospitals Across the US

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- Since 2010, approx. 150 hospitals across the county have closed
- Approximately 87 hospitals have sought the protection of U.S. bankruptcy courts since 2011
- While # of hospital closures may seem small compared to 4,862 community hospitals in the US, the industry has experienced fundamental structural changes that make closure or protection from creditors through bankruptcy courts visible on the horizon for many hospitals

By Marcus Bengtsson (Own work (Own picture)) [GFDL (http://www.gnu.org/copyleft/fdl.html) or CC BY-SA 3.0 (http://creativecommons.org/licenses/by-sa/3.0)], via Wikimedia Commons

"What's concerning me is that the umm – is that – the information we're getting from other sources is so much different from this."

El Faro's Third Mate after reviewing new weather advisories and expressing concern over the current course.

A Landscape Strewn with Wrecks

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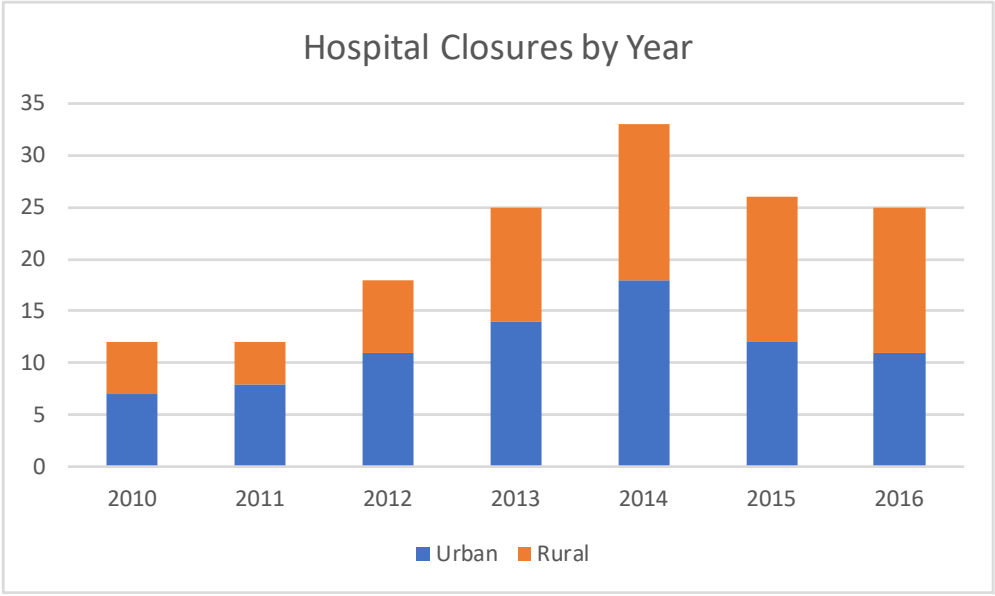
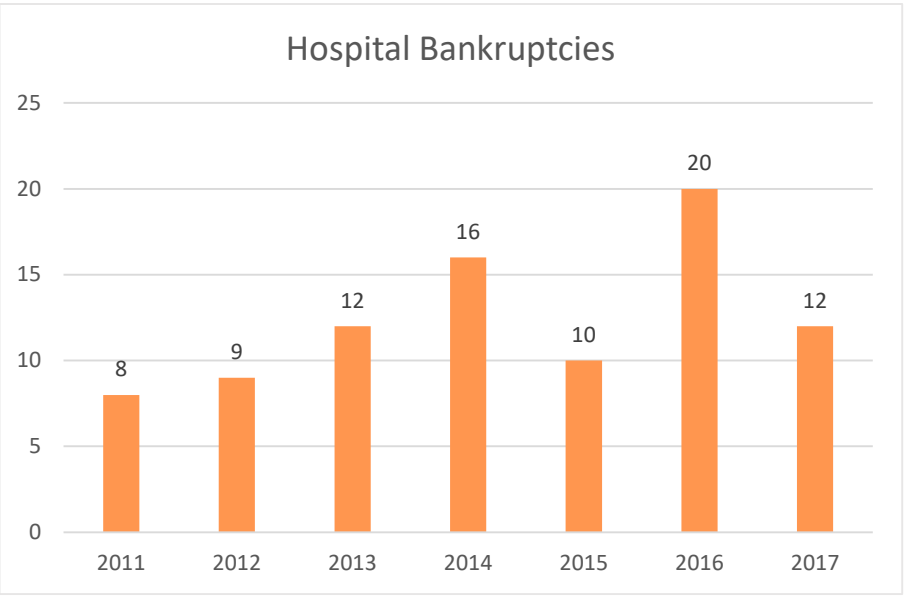
The number of hospital closures and bankruptcies since 2010 and 2011. Closures peaked in 2014 while bankruptcies peaked in 2016.





	Hospital Closures by Year							
	2010	2011	2012	2013	2014	2015	2016	Total
Urban	7	8	11	14	18	12	11	81
Rural	5	4	7	11	15	14	14	70
Total	12	12	18	25	33	26	25	151

2017 Outlook: Not-for-Profit Healthcare

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S&P Global Ratings

- S&P has extended its ***stable outlook*** for not-for-profit healthcare sector in 2017, ***but not without trepidation***.
- ***Health systems continue to do better than stand-alone hospitals***.
- "That's one leading indicator that ***if you are a little bit smaller, you're a little bit more constrained and you might not succeed going forward***," according to S&P.
- "As we look forward, ***it's our belief that the sector has peaked***," according to S&P.

2017 Outlook: Turbulent Seas

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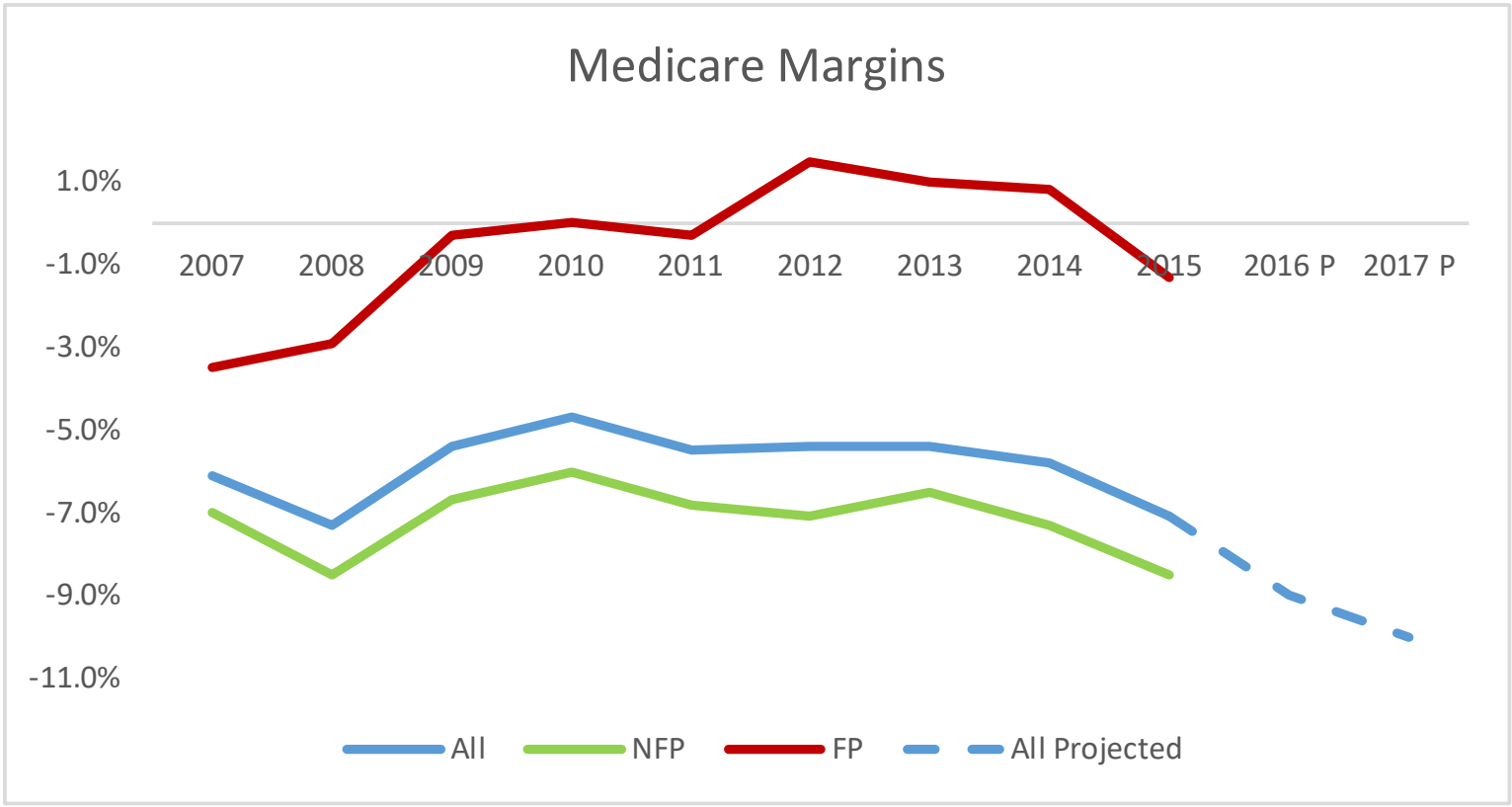
Fitch Ratings

- The sector outlook for U.S. not-for-profit hospitals and healthcare ***remains negative for 2017*** while rating outlook for 2017 is stable.
- The expected ***pressure on margins*** reflects the impact of continued ***erosion in payor mix*** in 2017 as aging baby boom generation moves into Medicare and newly eligible Medicaid patients access more healthcare services to address deferred care and chronic conditions.
- ***Growing wage and benefit pressures*** due to improving U.S. economy and increasing demand for nurses and mid-level clinical staff in particular.
- An ***elimination of the ACA's key coverage expansion*** provisions—resulting in rising uninsured and uncompensated care levels — ***would be credit negative.***
- "Over the longer term, the sector will be ***increasingly challenged by regulatory and political uncertainty***, the ***growth in Medicare and Medicaid payors***, and ***meager rate increases***," per Fitch.

Medicare Margins: US Hospitals



Medicare margins are expected to decline due to cessation of Meaningful Use funding and decreases in uncompensated care payments due to coverage expansion of ACA.

Source: MEDPAC

Sustainable? Follow the Money

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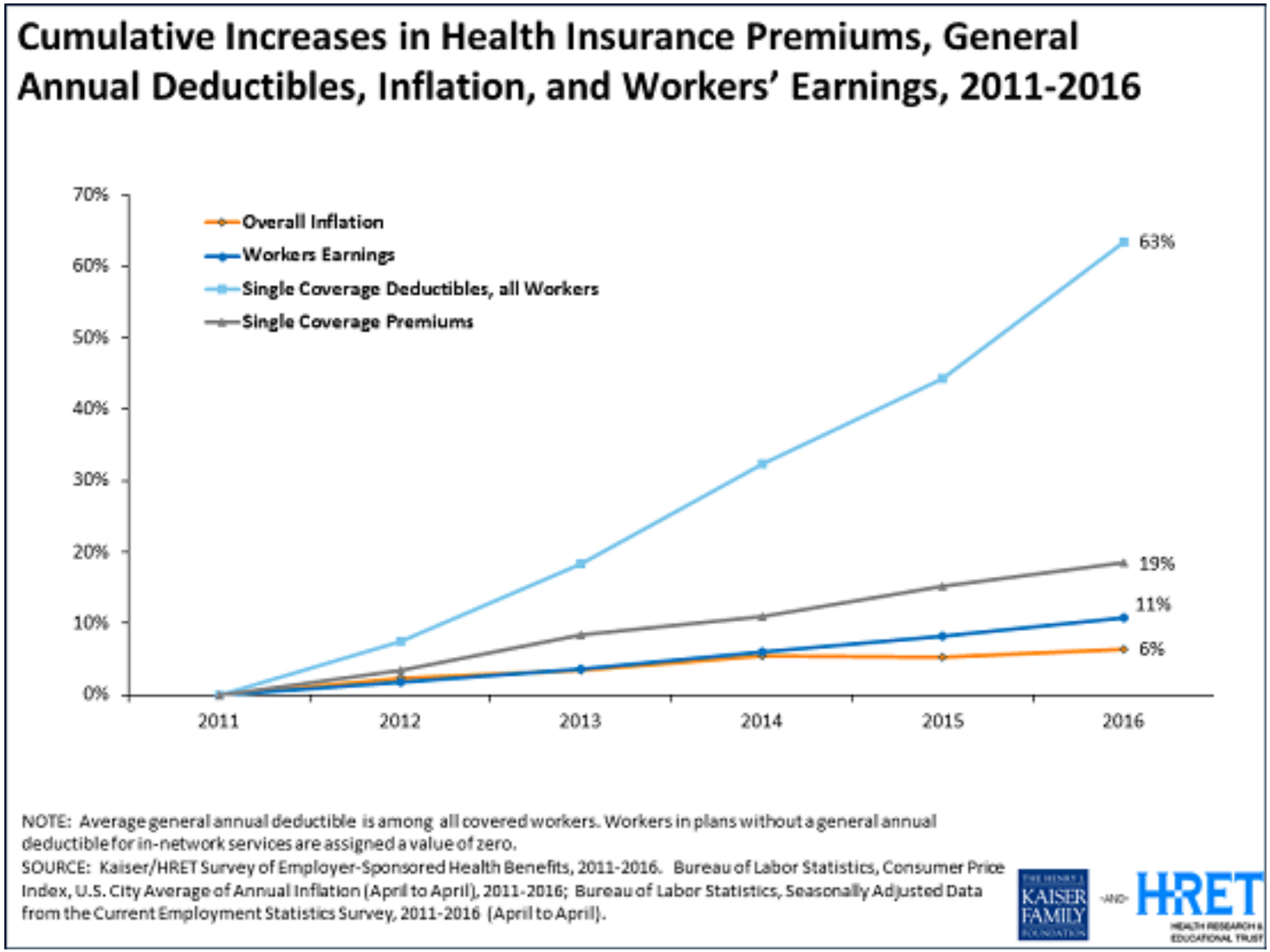

Premiums have grown nearly 2x wages and deductibles have grown nearly 6x wages from 2011 to 2016.

Source: http://www.thebody.com/content/77995/we-have-insurance-still-cant-afford-care.html

New Competitors

"While convenience is one factor, so is cost… cost differences matter not only to commercial insurers, but also to consumers with high-deductible health plans."

THE DOLLAR MENU

Chest pains mean rushing to the ER, but minor ailments like earaches have a cheaper and friendlier alternative.

Condition	Urgent Care Cost	ER Cost	Percent Savings
Pinkeye	$102	$370	72%
Earache	$110	$400	73%
Strep Throat	$123	$531	77%
UTI	$110	$665	83%

NYT: July 9, 2014: *"Race Is On to Profit From Rise of Urgent Care"*
Forbes: July 2, 2014: "Drive Thru Health Care: How McDonald's Inspired an Urgent Care Gold Rush"

Upending the Business Model

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"We're focused on population health as opposed to fee-for-service medicine"

"Our *Mobile Acute Care Team* will treat patients at home…"

"[The] *Preventable Admissions Care Team* provides transitional care services to high readmission risk patients"

Disruptive Technologies

Genomics leading to individualized treatments

IBM's Watson, cognitive computing, and healthcare

- Tools for minimizing clinical variation around evidence-based best practices
- Healthcare analytics will be a $21B industry by 2020 (IBM estimate)

Source: IBM Healthcare Web Page

The Forecast is…. Troubled

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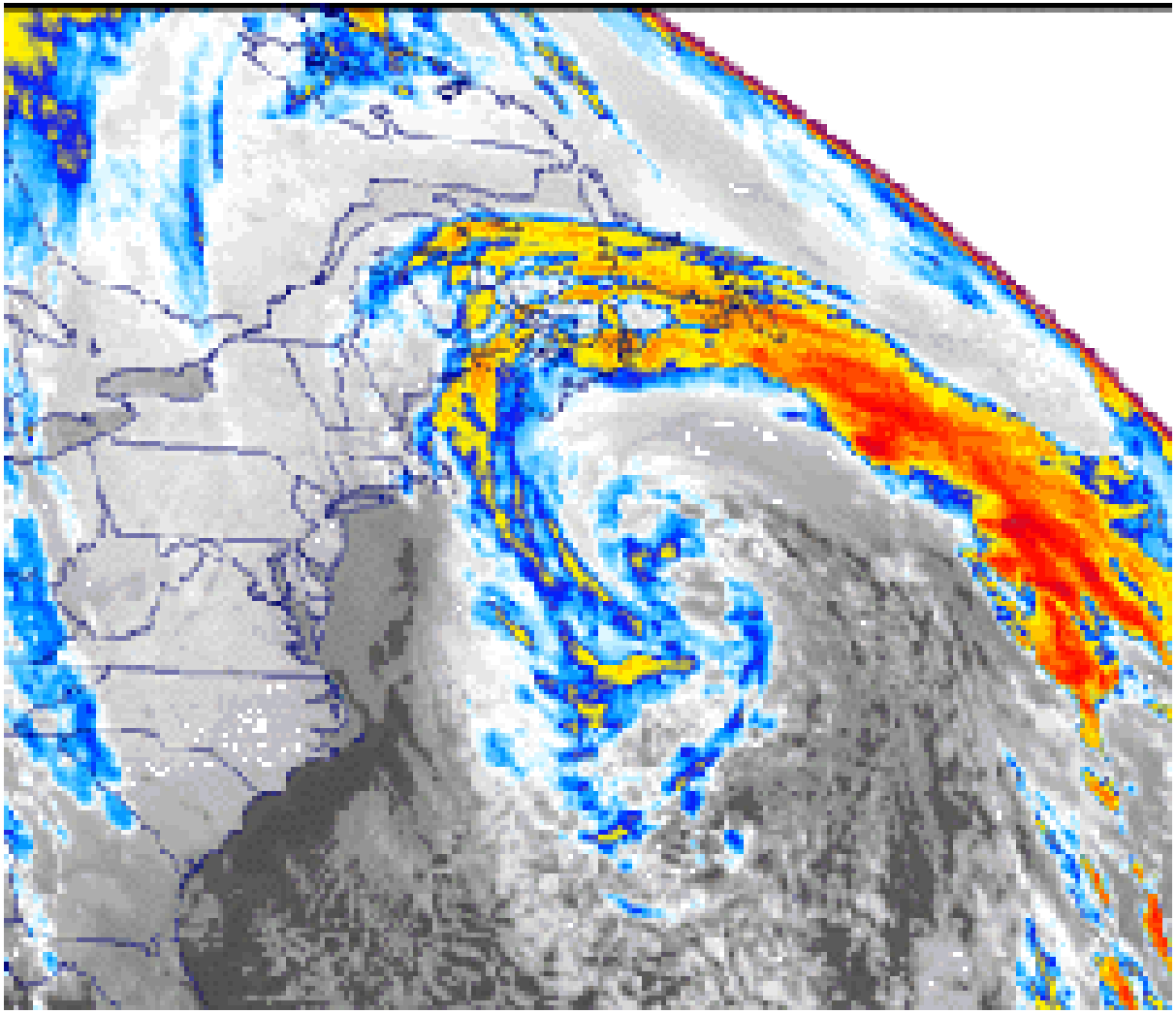

The fiscal fundamentals are unfavorable and unsustainable.

Disruptive technologies, new entrants offering lower costs and consumerism all threaten incumbent operators with high fixed-cost structures.

The advantage of scale in consolidating markets and the imperative to move beyond the four walls of the hospital to care for populations and avoid costly hospitalizations pose severe challenges for hospitals.

Hurricanes and Hospital Closures

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Like the captain and crew of *El Faro*, **many hospital management teams and governing boards are increasingly struggling just to keep their ships afloat**

With hindsight, we can ask of a hospital that has closed, **"Why didn't it change course, away from the threat, when it had time?"**

Whether regarding the *El Faro* or distressed hospitals, hindsight makes clear that **decision makers have not accurately assessed a changing set of environmental risk factors**

Lessons from the *El Faro* provide fitting analogs for those leading or advising hospitals and health systems in various levels of financial and operational stress

Warning Signs of Increasing Organizational Risk

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Category	Risk Indicator
Financial Indicators	• Operating Revenue Trend • Operating Cash Flow & Cash Flow Margin Trends • Days in A/R Trend • Debt Service Coverage Trend • Operating Margin Trend • Days Cash on Hand Trend
Operating Indicators	• FTEs per AOB Trend • Case Mix Index Trend • Payer Mix Trend • Key Volume Trends (O/P and I/P) • Practice Operations, Production and Losses Trend
Value Indicators	• Medicare Cost Position Trend • Attributed Covered Lives Trend • Quality Scores Trend
Market Position	• Market Share Trend • Provider Alignment, Recruitment and Retention versus Documented Need, Turnover, Productivity

"Mariners must be cautioned never to leave themselves with only a single navigation option when attempting to avoid a hurricane… More often than not, early decisions to leave restricted maneuver areas are the most sensible choice."

National Oceanic and Atmospheric Administration

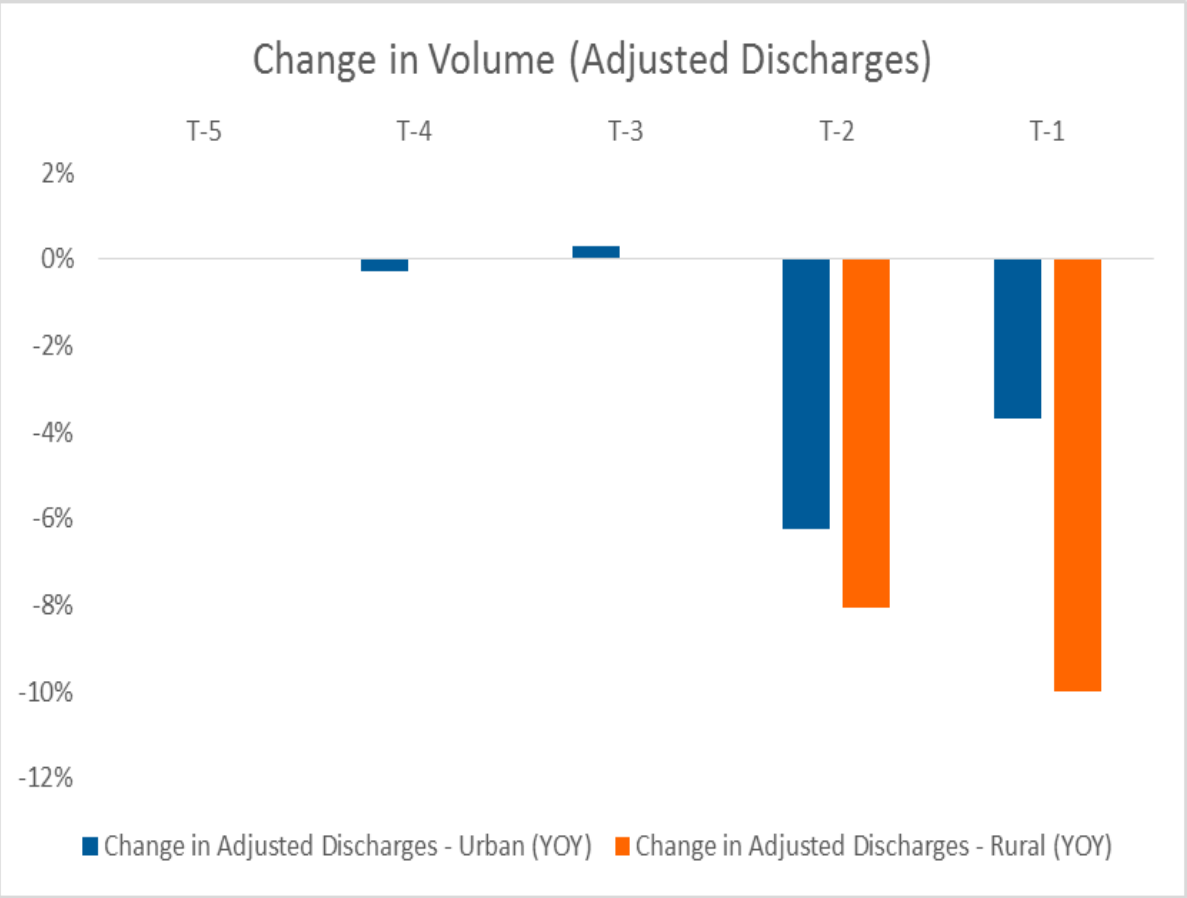
How Can We Avoid Disaster?

Every hospital board should examine its five-year trend line for warning signs annually

This conversation should involve management and a robust and pragmatic discussion of underlying trends

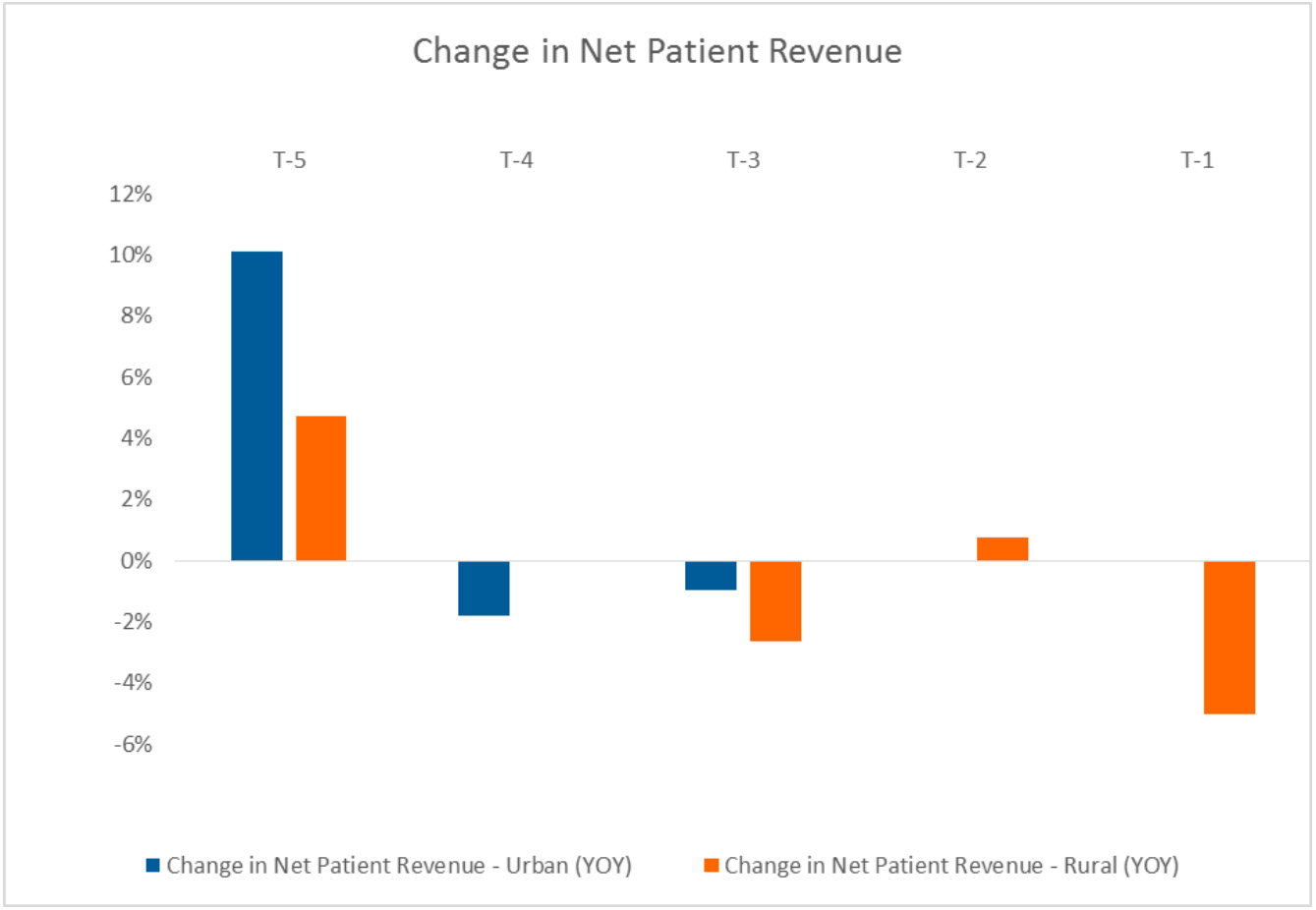
While undertaking expense reductions is a vital tool for many hospital turnarounds, “the process used to determine which services or facilities are eliminated” serves as an “important distinction that separates successful and unsuccessful turnarounds.”

Median Growth in Adjusted Discharges



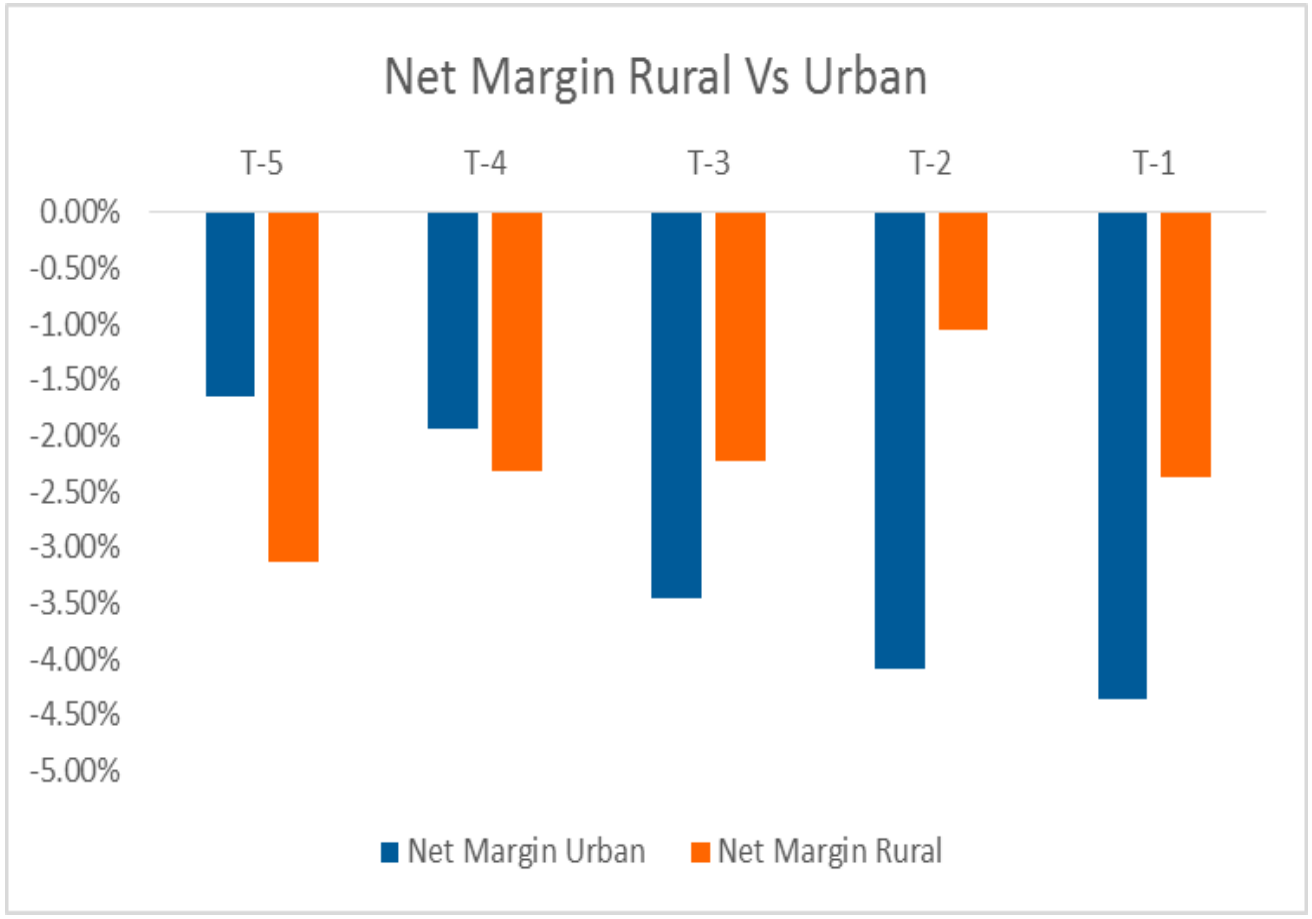
The cohort of hospitals that closed between 2010 and 2016 saw flat median volumes in five, four and three years before closure and steep declines in median volume in the two years prior to closure.

Median Growth in NPR 5-Years Prior to Closure



The cohort of hospitals that closed between 2010 and 2016 saw flat or declining median net patient revenue in the four years prior to closure.

Median Total Margin 5-Years Prior to Closure



Median net margin is negative for the five years leading to closure in both urban and rural hospitals. The median net margin for urban hospitals deteriorates steadily in the five years prior to closure.

Signs of Distress

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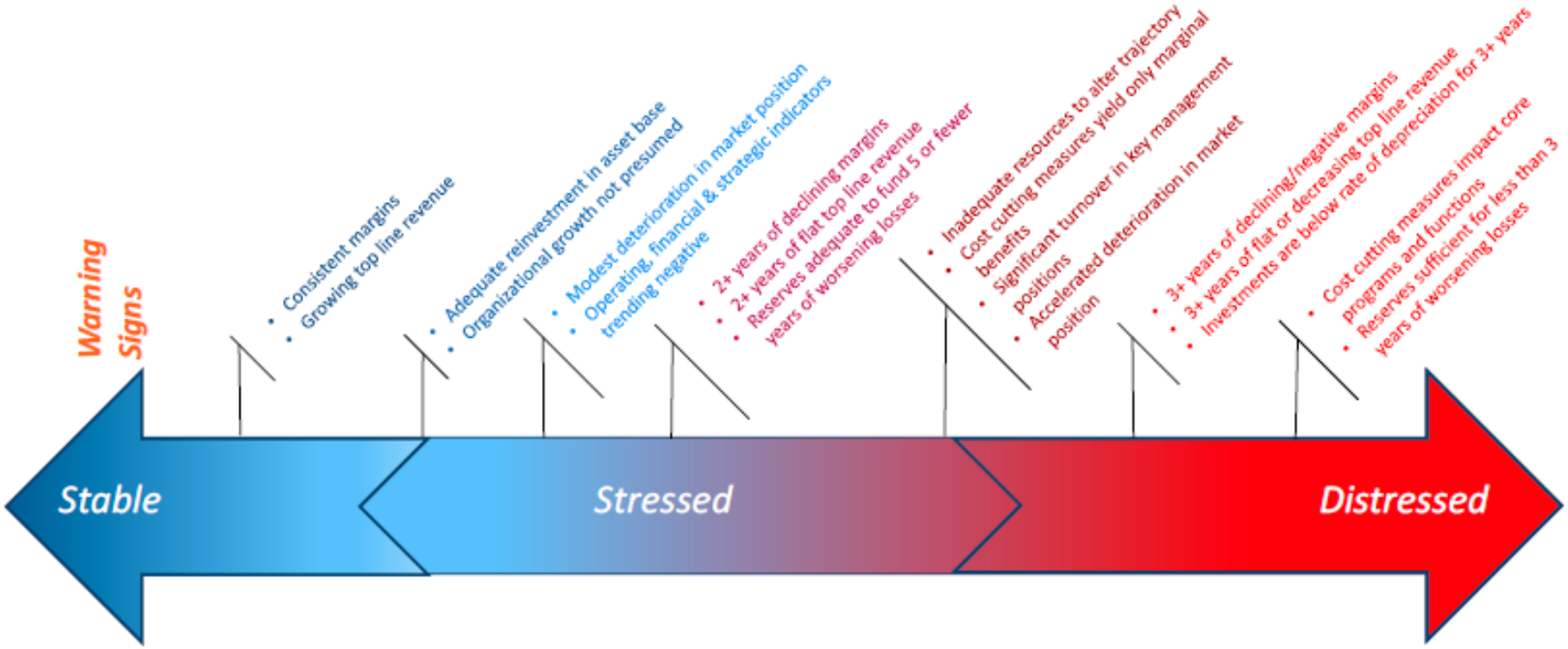

"Sometimes circumstances overwhelm you. You can do all the planning you want."

Steven Werse, Ship Captain & Secretary-Treasurer of the Master Mates and Pilots Union

Indicators, Warning Signs, and Navigation Options

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Stable / Stressed / Distressed	Indicators & Warning Signs	Navigation Options
Stable Level 1	• Consistent margins • Growing top line revenue	➢ Shape organization culture to match organization's objectives ➢ Engage in intermediate and long-term strategic planning ➢ Develop capital planning and use strategy
Stable Level 2	• Adequate reinvestment in asset base • Organizational growth no longer presumed	➢ Accelerate organization cultural alignment initiatives ➢ Analyze strategic options available to organization ➢ Develop a performance improvement plan and develop organization's personnel to execute on plan
Stressed Level 1	• Modest deterioration in market position • Operating, financial and strategic indicators trending negative	➢ Undertake a strategic options analysis ➢ Development of a performance improvement plan; recruit key personnel to execute on plan ➢ Task management with effectively executing on performance improvement plan with objective milestones and key performance indicators of success

Indicators, Warning Signs, and Navigation Options

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Stable / Stressed / Distressed	Indicators & Warning Signs	Navigation Options
Stressed Level 2	• 2+ years of declining margins • 2+ years of flat top line revenue • Reserves adequate to fund 5 or fewer years of worsening losses	➢ Commission a strategic options analysis developed by an outside party ➢ Seek out and realize improvements in revenue cycle management ➢ Consider placement of a Chief Implementation Officer
Distressed Level 1	• 3+ years of declining/negative margins • 3+ years of flat or decreasing top line revenue • Investments are below rate of depreciation for 3+ years • Cost cutting measures impact core programs and functions • Reserves sufficient for less than 3 years of worsening losses	➢ Commission a strategic options analysis, including analysis of liquidity position and creditor analysis ➢ Seek out and realize improvements in revenue cycle management to improve cash position ➢ Consider placement of a Chief Restructuring Officer tasked with realizing performance improvement opportunities ➢ Consider undertaking an affiliation process for a new owner/ operator
Distressed Level 2	• Inadequate resources to alter trajectory • Cost cutting measures yield only marginal benefit • Significant turnover in key management positions • Accelerated deterioration in market position	➢ Execute on strategic options that preserve value of the organization and best ensure long-term viability ➢ Retain a Chief Restructuring Officer ➢ Evaluate effectiveness of negotiating with creditors via out-of-court channels or the bankruptcy court ➢ Undertake an expedited affiliation process

El Faro: NTSB Findings and Relevance to Hospitals

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- "As we enter the 2017 hurricane season we are reminded of the power and devastation associated with these storms," said NTSB Acting Chairman Robert L. Sumwalt. "Storm avoidance is a life-saving skill at sea. And having frequent, up-to-date and reliable weather information is key to effective storm avoidance – and to saving lives."
- **What does this mean for hospital leaders?**
  - Waiting too long to assess options and possibly change course increases risk and could be highly damaging to your organization and its mission
  - Regular strategic reviews that provide updates on a dynamic risk environment are critical

Takeaways for Hospital Leaders

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- "The data also suggest that modifying the way the NWS develops certain tropical cyclone forecasts and advisories could help mariners at sea better understand and respond to tropical cyclones."
  - ✓ **Get an objective analysis of risk factors that looks at five year trends and projected organizational capital and resource requirements**
  - ✓ **Evaluate whether you remain "on course" or whether other factors suggest a change of course is prudent**

Good Data and Timely Action Matter

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- "When *El Faro* sank (about 0740 EDT on October 1), the center of the hurricane was 104 miles south of the position forecast for 0800 EDT that day and had an intensity 35 knots greater than what had been forecast in the NHC advisory issued 33 hours earlier, on September 29."
- "Few would dispute the loss of the ship El Faro and its cargo and most importantly the loss of 33 souls about the El Faro represents a colossal failure in management of the companies responsible for the safe operation of the El Faro," NTSB Investigator Roth Roffy said at the hearing.
  - Good data and analysis are necessary…
  - But are insufficient without decisive action by those navigating and responsible for the ship

Navigation Options for Distressed Hospitals

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Stable / Stressed / Distressed	Indicators & Warning Signs	Navigation Options
Stressed Level 2	• 2+ years of declining margins • 2+ years of flat top line revenue • Reserves adequate to fund 5 or fewer years of worsening losses	➢ Commission a strategic options analysis developed by an outside party ➢ Seek out and realize improvements in revenue cycle management ➢ Consider placement of a Chief Implementation Officer
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Understanding Operating Risk (and Opportunity)

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Quantitative Analysis: Operational Improvement Analytics

- ***Relevant benchmarking*** to peer group or cohorts
- ***Revenue Cycle assessment*** to gauge availability of revenue charge and collection improvements
- ***Pricing Analysis***
  - Gross Price per discharge (CMI and wage adj) is used to measure pricing relative to the cohort
  - Underpricing may leave money on the table; however, excessive prices can cause payers and consumers to balk
- ***Cash Flow Plan Development***
  - Sources and uses of funds analyzed to determine contribution margins of different service lines and hospital departments
  - Pro formas developed to model improvements in cash flow through short and interim periods under various improvement and stress testing scenarios

Correcting Course Before A Coming Storm

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- ✓ **Understand and monitor your risk factors**
- ✓ **Create an annual dashboard assessing financial, operational, value, and market risk factors and trends**
- ✓ **Use the dashboard as part of an annual board discussion**
- ✓ **Maintain robust cash monitoring procedures before liquidity issues arise**
- ✓ **Take timely action before risk factors escalate and remaining options fade away**
- ✓ **Understand that your risk environment is dynamic, past success is not an indicator of future performance**

Failing to recognize risk factor trends can greatly diminish strategic options, placing the organization in grave danger.

Questions and Discussion

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APPENDIX

Rural Hospital Closures Since 2010

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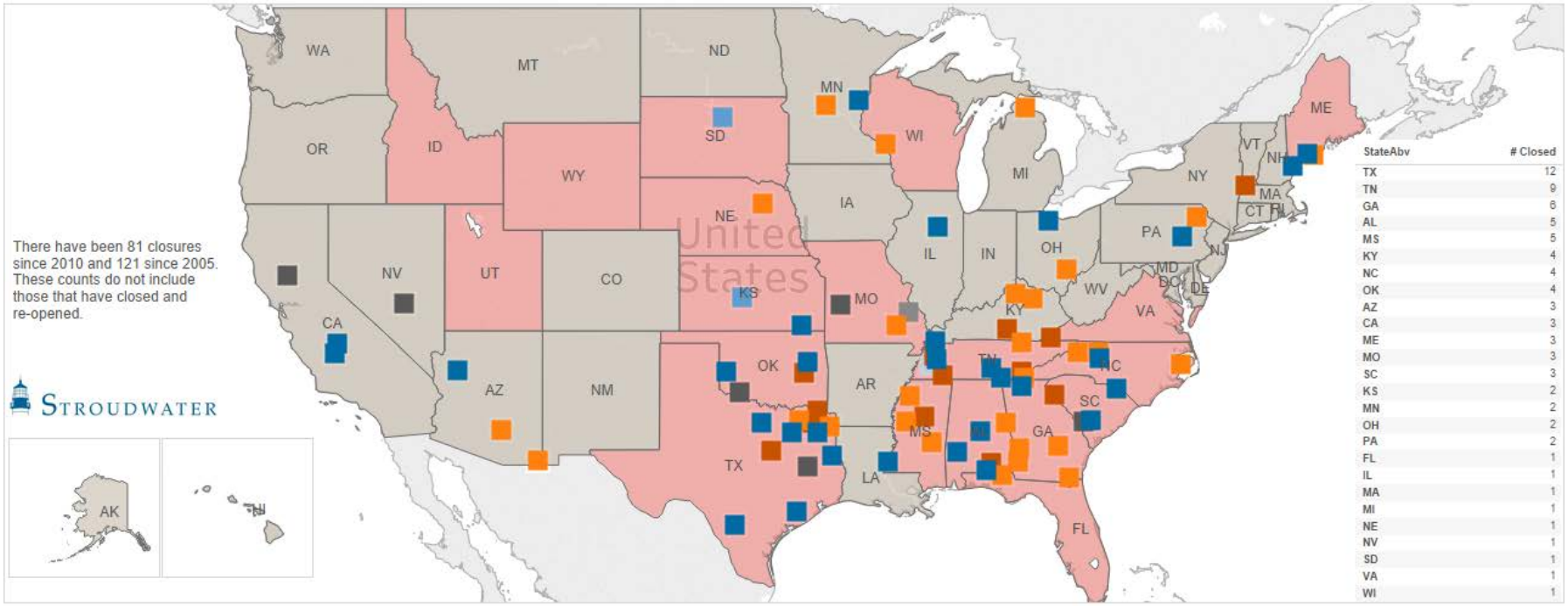
Closed Rural Hospitals

Updated:July 7, 2017 Source:The Cecil G. Sheps Center for Health Services Research & kff.org



StateAbv	# Closed
TX	12
TN	9
GA	6
AL	5
MS	5
KY	4
NC	4
OK	4
AZ	3
CA	3
ME	3
MO	3
SC	3
KS	2
MN	2
OH	2
PA	2
FL	1
IL	1
MA	1
MI	1
NE	1
NV	1
SD	1
VA	1
WI	1

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

Status of Medicaid Expansion Decision

- Adopted the Medicaid Expansion
- Not Adopting the Medicaid Expansion at this Time

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Medicare Payment Type

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	Grand Total
2010	2				1			3
2011	2	2			1			5
2012	5	2	1					8
2013	5	6	3					14
2014	2	7	5	1		1		16
2015	8	5	1	1			1	16
2016	5	4	3	3				15
2017	1	2		1				4
Grand Total	30	28	13	6	2	1	1	81

Strategic Imperatives and Risks

- **Investment** – Adequately fund investments to provide high quality, accessible and patient focused facilities and services
- **Competition** – Anticipate and blunt competitive moves by other providers; how to remain /become the provider of choice?
    - Value = Quality / Cost
- **Pricing** – Sustain a pricing advantage relative to other organizations while ensuring financial sustainability
- **Quality** – Build a demonstrated and understood quality advantage over competing options
- **Recruitment** – Renew an aging medical staff in the face of provider shortages
- **Technology** – Ensure adequate investment in new technology and adapt to technology impacts on demand for services
- **Operations** – Examine operations to identify and capture performance improvement opportunities
- **Agility** – Respond to the shift to outpatient settings, regulatory changes, new payment models, service area demographics and utilization changes