

The Governance Institute presents

# Service Line Joint Ventures: Opportunities for Health Systems

February 15, 2024 | 2:00–3:00 p.m. Eastern

A Governance Institute Webinar  
*presented by*

Victoria S. Poindexter, Managing Director  
Michael Tierney, Executive Director  
H2C



# Today's Presenters



**Victoria S. Poindexter**  
Managing Director, H2C

Ms. Poindexter has over thirty years of experience in investment banking, including corporate and municipal finance and mergers and acquisitions. With a primary focus on the acute and managed care sectors, Ms. Poindexter has provided a broad spectrum of strategic capital markets, and merger and acquisition advisory services to support the strategic and financial goals of providers and payors nationwide.



**Michael J. Tierney**  
Executive Director, H2C

Mr. Tierney brings over ten years of experience in healthcare banking, primarily working with not-for-profit hospitals and health systems. At H2C, Mr. Tierney provides advisory services to healthcare clients in connection with strategic initiatives, joint ventures, partnership strategies, mergers and acquisitions, and capital raising activities.

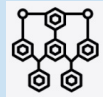
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# Learning Objectives

After participating in this Webinar, attendees will be able to:



Define the benefits of joint ventures and motivations of both parties.



Identify the typical legal and operating structure of a joint venture and key issues that should be considered.



Describe the deal process and the approach to valuing assets contributed to the joint venture.

# Continuing Education



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**Criteria for successful completion:** Webinar attendees must remain logged in for the entire duration of the program. They must answer at least three polling questions. They must complete the evaluation survey in order to receive education credit. Evaluation survey link will be sent to all registrants in a follow-up email after airing of the Webinar.

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**Field of study:** Business Management & Organization

**Program level:** Overview

**Prerequisites:** None

**Advanced preparation:** None

**Delivery method:** Group Internet based

**Maximum potential CPE credits:** 1



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## Health systems are executing strategies to accomplish a variety of objectives:

- Building scale through partnerships with other health systems
- Optimizing **underperforming assets/services** through service line partnerships
- Monetizing non-core assets and businesses

## Common Issues Facing Health Systems with Non-Core Business Lines

- 1 Growing Demand for Non-Core/Ancillary Services
- 2 Limited Capacity to Treat Patients
- 3 Lack of Operational Expertise
- 4 Recruiting Challenges
- 5 Unprofitable Service Lines
- 6 Older Infrastructure
- 7 System-wide Capital Constraints

## Polling Question #1

- Which of the following service lines are in demand but underperforming and/or need capital in your organization?
  - Behavioral Health
  - Home Health
  - Rehabilitation
  - SNFs/Senior Living
  - All of the above
  - None of the above

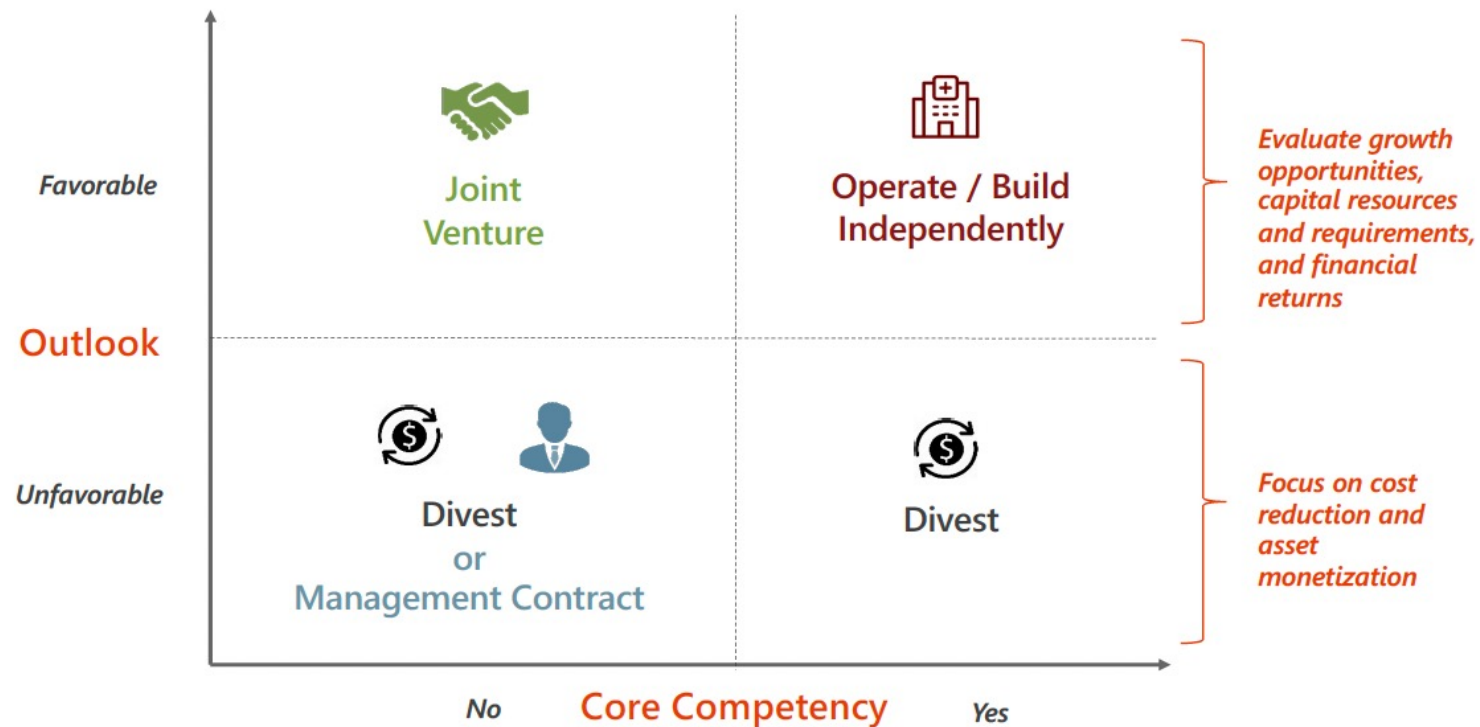


A broad range of service lines offer partnership and monetization options.



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Non-core business strategy should reflect the health system's view of its **core competencies** and the **outlook** for these businesses.



## Polling Question #2

- How have you dealt with these services in the past?
  - Continued operating
  - Divested
  - Formed partnership
  - All of the above

# Strategic Alternatives | Build Internally



Build



Mgmt. Agreement



Partner



Divest

## Advantages

- ✓ System preserves full control over future decisions
- ✓ No dilution for the system's DSH or financials
- ✓ Avoids potential risk associated with a partnership

## Considerations

- System is solely responsible for the business
- If underperforming, the system will have to "subsidize" operations
- Requires the system to provide capital
- May be difficult to alleviate burden on the system's emergency departments
- May be difficult to enhance programs and services provided
- Continuing dedication of management's time

## Strategic Alternatives | Contract with Management Company



Build



Mgmt.  
Agreement



Partner



Divest

### Advantages

- ✓ Manager brings operational expertise
- ✓ Manager provides day-to-day management
- ✓ No dilution for the health system
- ✓ Increased satisfaction from all parties
- ✓ Transfer of responsibility can reduce stress on the system
- ✓ System benefits from improved profitability

### Considerations

- Manager is not “at-risk”
- System still maintains full risk and exposure in downside scenario
- Requires the system to provide capital for facilities
- Cost of raising necessary capital may be expensive

# Strategic Alternatives | Partner with Qualified Operator



Build



Mgmt. Agreement



Partner



Divest

## Advantages

- ✓ The partner brings expertise
- ✓ Leads to increased satisfaction for providers and patients
- ✓ The partnership allows for growth
- ✓ It enhances the provider network and program offerings
- ✓ The system benefits from increased profitability and cash distributions

## Considerations

- System will forgo majority ownership in and majority economic distributions from the assets
- System will lose some control over governance
- Ensuring strategic alignment among parties is critical
- Partnerships can be complicated to structure

## Strategic Alternatives | Divest Business



## Polling Question #3

- What is your biggest concern regarding a joint venture?
  - Lower quality of service
  - Losing control of patients
  - Effect on health system brand
  - Lack of partner mission alignment
  - All of the Above

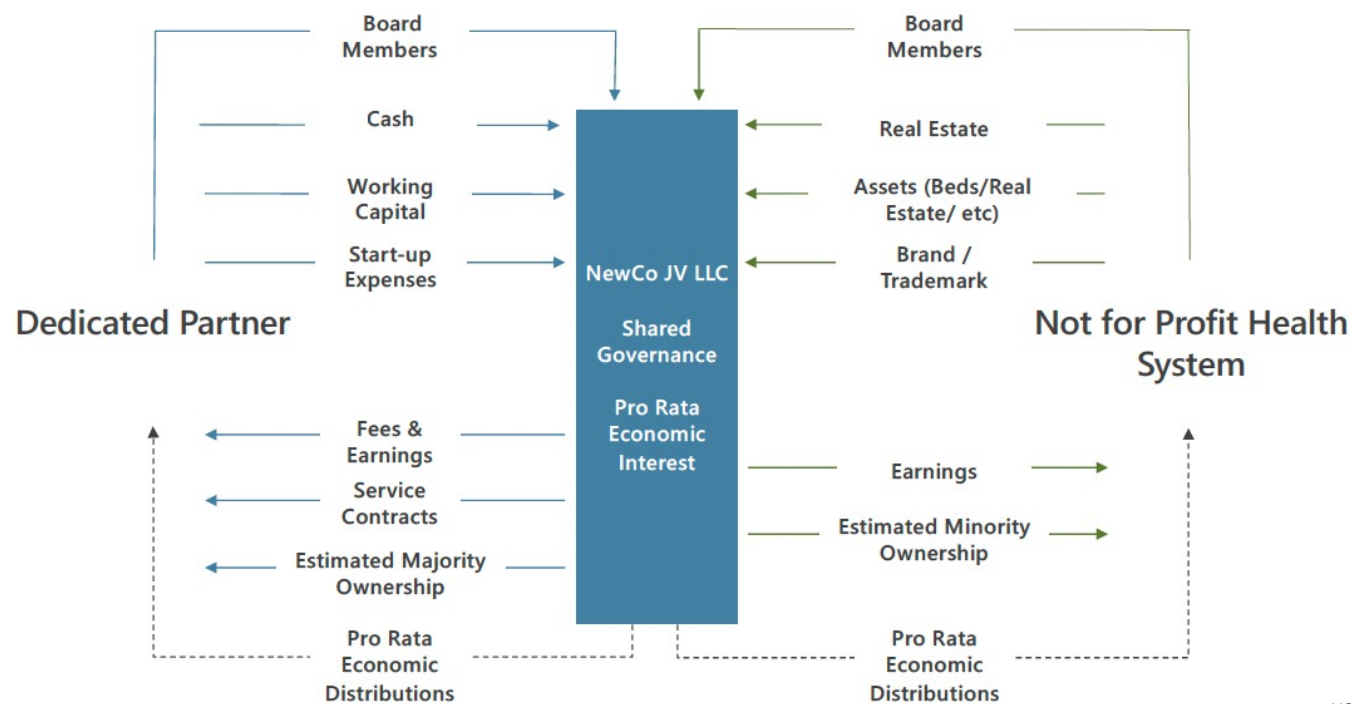


# Illustrative Joint Venture Structure and Contributions

## Representative JV Board Powers

- Ratify Administrator
- Ratify CMO
- Oversee quality of care
- Governance changes
- Incurrence of debt
- Changes to service line
- Capital contributions
- Operating budget
- Contracts
- Distributions
- Divestitures

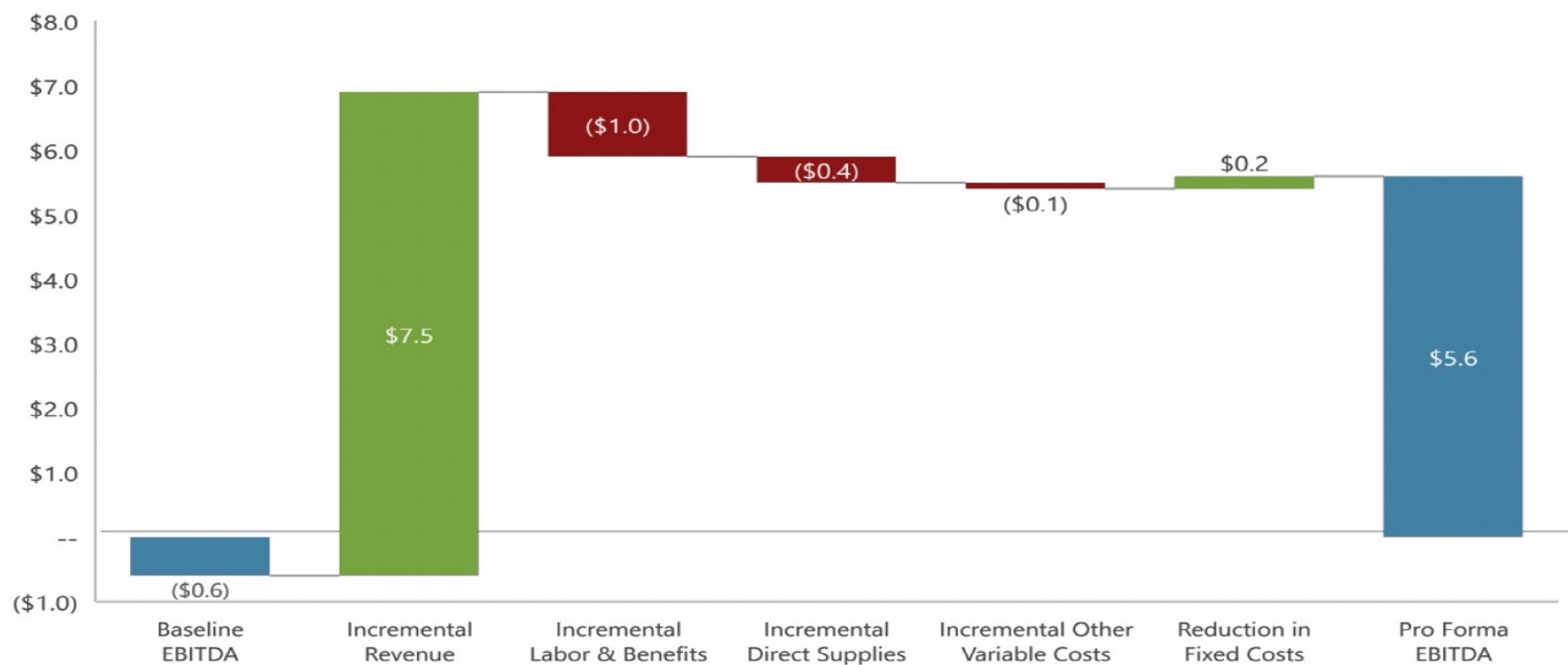
## Example of a Joint Venture Structure



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## Illustrative Joint Venture Financial Benefits

Pro Forma EBITDA Bridge (\$ in millions)



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## Polling Question #4

- What are typical EBITDA margins for a joint enterprise at scale?
  - 5-10%
  - 11-15%
  - 16-20%
  - 21-25%
  - 26-30%
  - 30%+

## Joint Venture **Valuation**: Assets Generally Contributed by the Health System

### Behavioral Health & Inpatient Rehabilitation Facilities

- Existing inpatient units located within an acute care facility or freestanding facility
- Non-operational beds if licensed through a certificate of need process
- Land/royalty-free long-term ground lease
- Existing buildings/real estate if a standalone facility already exists that can be utilized by the JV.
- Royalty free license to use the health system brand and trademarks

### Home Health & Hospice

- Existing outpatient operations
- Royalty-free license to use the health system brand and trademarks

## Joint Venture **Valuation**: Key Considerations

- 1** **Scale.** Extremely important to achieve profitability. Significant and increasing divergence in valuations based on size of business.
- 2** **Payor mix.** Existing payor mix may not be indicative of the future mix, and desired mix is different based on type of service.
- 3** **Commercial reimbursement.** Are historical hospital commercial rates attainable by a freestanding JV?
- 4** **Market Demographics.** Size, population growth, and income levels affect level of interest and valuations.
- 5** **CON State?** CON requirement can create large barriers to entry and increase the value of the operation, even absent positive projected cash flow.
- 6** **Financial Basis.** Valuation is typically not based on contribution margin but simulates performance on a standalone basis; needs to include revenue cycle costs, HR, IT, finance, etc.

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The universe of potential service line **partners and/or acquirers** continues to expand as health systems pursue alternative models.

Behavioral Health	Home Health	Diagnostics	Urgent Care	Inpatient Rehab	Senior Living	Health Plans	Home Medical Equipment
      	         	  	     	  	    	         	        

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## Service line **partnerships** can provide significant advantages to both parties.



**Operator Expertise.** Operators provide unique insights paramount in navigating potential financial, operational, political and legal hurdles



**Turn-Key Operations Management.** Seasoned in-house management can oversee every aspect of operations



**Economies of Scale.** Achieved in a variety of areas through volume-based vendor relationships, in addition to management and clinical services



**Capital.** Lower financial risk by splitting capital contributions necessary to cover start-up and ongoing investments



**Cost Savings.** Lower financial risk through shared resources and increased efficiency



**Access to New Markets.** Opportunity for accelerated expansion into new target markets; benefits of partner's strong brand name can aid in penetration into new and desirable markets



**Flexible Approach.** Partnerships can provide flexible structures to match management's goals and objectives

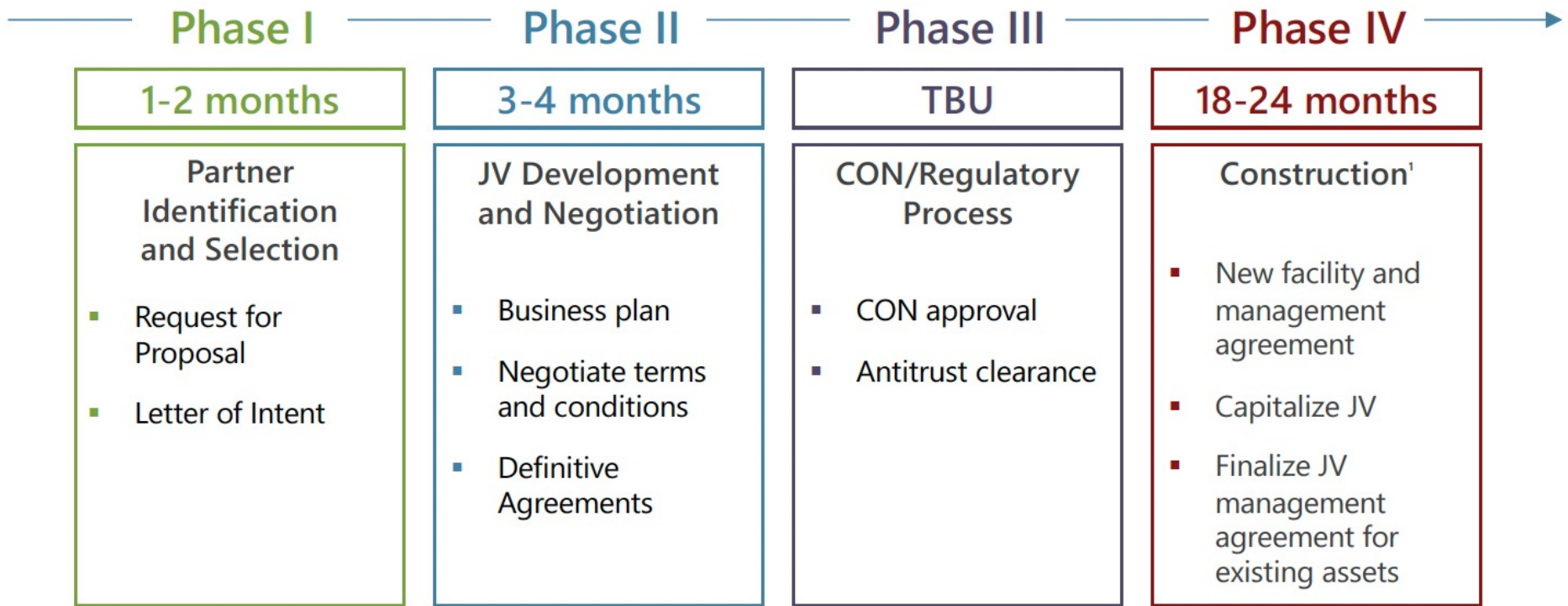
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## Polling Question #5

- Does your organization have readily available data on service line profitability, inclusive of ancillary costs?
  - Yes
  - No
  - High level, but not a priority



## Illustrative Joint Venture **Process Timeline Summary**



(1) Applicable to Behavioral, Inpatient Rehab, LTACH, and other services where a new facility is required.

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## Conclusion: Each Partner **Adds Value** to Benefit the Community



## Questions & Discussion

# Contact Us...



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