SHSMD23 CONNECTIONS
Health Care Strategy & Market Development

Growth for Scale & Ownership: Different Options to Develop Partnerships

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AHA Events

Speaker Biography

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Dana-Farber Cancer Institute

Greg Calosso is the Senior Director of Business Initiatives and Alliances at the Dana-Farber Cancer Institute. At Dana-Farber he leads all corporate development and network relationships inclusive of transactions, JVs, JOAs, and contractual Collaborative Memberships or Strategic Alliances.

Previously, he was the Chief Strategy Officer for Tenet Healthcare where he was responsible for strategy and transactions for 3 hospitals in Massachusetts. Prior to his role with Tenet, he served as the Director of Strategy for Penn State Health, in a strategy role with Lehigh Valley Health Network, and in management consulting. He holds a bachelor of science and master of health administration degree, both from Cornell University, where he has served on the Board of Directors for the Cornell University Jeb E. Brooks School of Public Policy and Sloan Program in Health Administration since 2013.

He is an experienced healthcare strategist focused on transactions and corporate development with experience planning and executing five non-profit hospital transactions, thirty-two physician practice transactions, one payer-hospital minority equity transaction valued at over $1B, and a multitude of contractual relationships. His strategic planning work has also led to the de novo development of three hospitals, PHO/IPA development, and dozens of partnerships.

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Outline/Agenda

1. Discussion of different partnership types
   - Why do we partner?
2. Deeper dive on setting up different types of Joint Ventures and Joint Operating Agreements
   - Transaction considerations
   - Financial & Legal considerations
   - Ongoing Operational considerations
3. Examples of work at Dana-Farber and ongoing operations
   - Minority equity physician practice transaction (JV)
   - Hospital service line Joint Operating Agreement (JOA)
4. Summary take-away to start this process yourself

- Learning Objectives
  - Different types of partnership models and transaction types with varying integration.
  - Financial and legal considerations for partnerships.
  - Ongoing operational considerations of those partnerships.

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How often have you heard …

"If you aren't growing, you're shrinking"

In healthcare, that often leads us to think about growth for scale and ownership.

Common thought process in leadership & strategy:

- Organic growth isn't enough. We need to take market share.
- We can grow our way out of losses.
- Scale will ultimately be what turns us around.
- More sites, larger network, greater chance for profit.
- We should merge/acquire other hospitals or health systems to grow and create scale.
- We should acquire physician practices or employ more doctors in our medical group to grow our network and create scale.
- Acquiring this practice is a strategic priority and will help preserve our business.
- We need to have control.

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How many people in the room today have participated in a.. (whether on the acquisition team, integration team, operations team post-transaction, or having been in an organization that was acquired/merged yourself?)

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If you have participated, how many of you have had a transaction go smoothly, without issues?

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Why do we merge or acquire?

	Hospitals	Physician Practices
1.	Create network access, scale and purchasing power	Create network access, scale and purchasing power
2.	We can spread costs associated with management services, IT, rev cycle, etc, which we can centralize to our hospital	We can decrease the burden of practice management, which we can centralize to our medical group
3.	Solidify strategic position in a market and channels for patient acquisition and retention in a market, including synergies from increasing high acuity cases and/or decanting of low acuity cases	Solidify strategic position in a market and channels for patient acquisition and retention, including increasing “loyalty”
4.	Potential for growth (gains in market share)	Potential for growth (gains in market share)
5.	Defensive (retain existing share & patient flow)	Defensive (retain existing share & patient flow)
6.	Acquired wants access to capital for pent-up CapEx (potential hurdle in bond market or low investment from current owner)	Acquired has seen decreased income and has delayed capital expenditures and now needs access to capital for pent-up CapEx and wants to preserve income
7.	Acquired is hesitant to give up control, but feels they now must	Acquired is hesitant to give up control, but feels they now must
8.	Acquired sees cultural fit with Acquirer	Acquired sees cultural fit with Acquirer

If an opportunity arises, do we try to merge/acquire it?

- ***Solution in search of a problem***

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But there are so many risks…

1. ***Capital heavy & operating expense heavy***
   - Acquisition costs (including capital commitment)
   - Standard legal costs, consulting costs, valuation costs
   - Challenges by Attorney Generals or FTC and legal & consulting costs associated
   - Integration effort costs (IT, rev cycle, HR, etc)
   - Forecasted short-term or long-term losses/subsidies

2. ***Upon acquisition, losses increase***
   - Unexpected capital expenditures required
   - Unexpected increased operational complexity of integration
   - Issues with EMR integration
   - Issues with revenue cycle integration
   - Unexpected attrition of key staff
   - Lack of cultural fit of leadership or providers in new model
   - Slowed physician productivity
   - Issues with succession planning of physicians
   - Labor market crunch on staff
   - Addressing unfunded pension liabilities
   - Collective bargaining

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Are there alternative options?

Traditional Methods

- CIN, ACO, or PHO participation
- Professional services agreements (PSAs), lease agreements
- Co-Management Agreements
- Space lease agreements
- JVs on surgery centers, post-acute settings, or non-core ancillary services
- Contractual affiliation agreements (strategic alliances, collaborations, etc)

Less controllable/not sticky, generally easy to execute, potential for simpler operation and lower integration effort, lower financial risk

Less Common Methods

- Joint Operating Agreements
  - Share in growth of revenue or margin
- Joint Ventures
  - Including Minority Equity transactions
    - Done more commonly in private equity transactions
- Combinations of PSAs, Management Services Agreements, and Brand Licensing agreements; potentially with the above

More difficult to unwind, difficult to execute, potential for simpler operation and lower integration effort, lower financial risk

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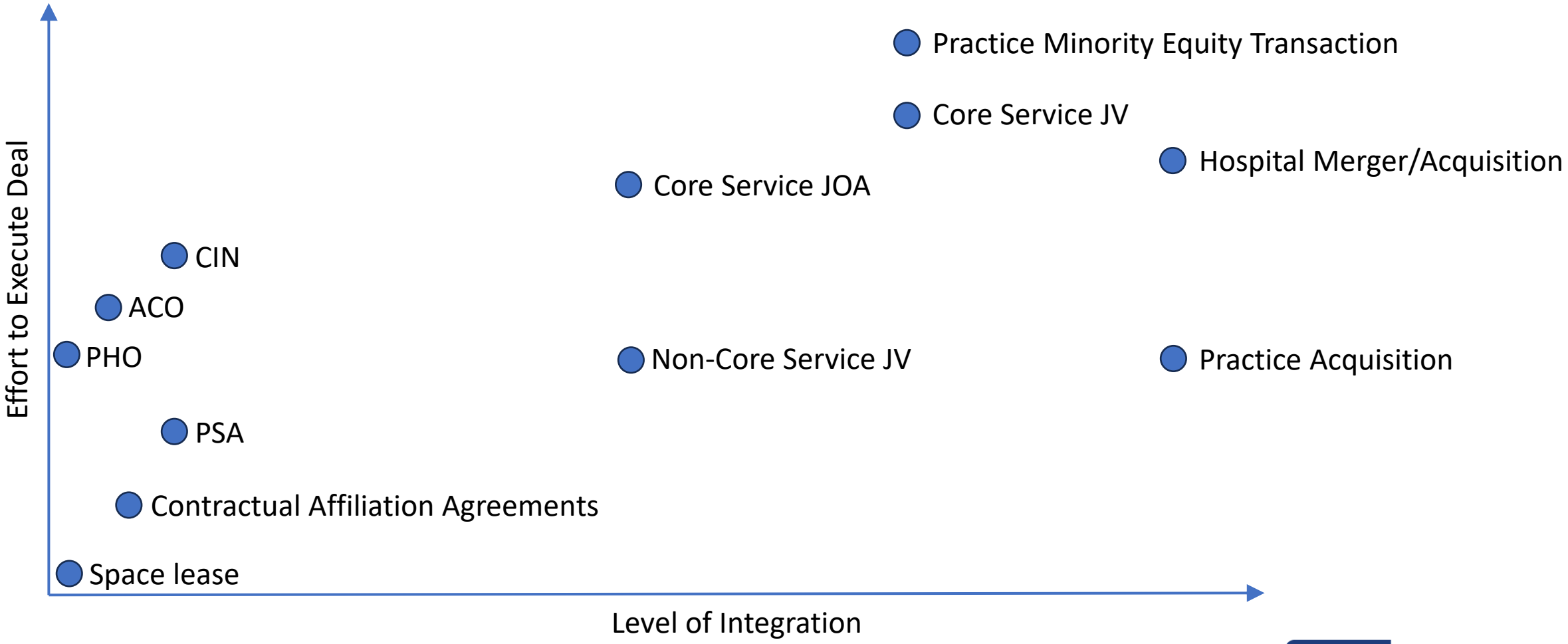
Varying Levels of Integration



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Has anyone in the audience ever worked on a joint operating agreement or acquired minority equity in an existing entity (hospital or physician practice) to become a partial owner?

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Less Common Methods, described

Joint Operating Agreements

1) Less executable with a local practice (referral source); more executable hospital to hospital, especially on a service-line basis; contractual in nature, but should be purposefully structured as sufficiently difficult to unwind
2) Must clearly define goals for the relationship inclusive of any management services provided (may include strategy/growth services or operational expense management, nursing improvement, quality improvement, provider recruitment, etc.) and hold parties accountable to their responsibilities
3) Requires strong financial team to define the service line financials, benchmark against them, and track against them for the foreseeable future
   - Must define a “baseline year” and track on-going financials against that year
   - Can structure to share in incremental revenue or margin (inclusive of expense structure) – which should align to goals and services agreed upon
4) Requires legal analysis of AKS/Stark risks to ensure viability and compliance
5) Financial distributions made to sharing party

Joint Venture (Minority Equity)

1) Acquire a minority equity stake in a hospital/health system or physician practice
2) Become a shareholder & board member; have a seat at the table and strong voice without being able to control a deciding vote.
3) Allow the organization to continue successful independent operations, while providing a cash infusion via the transaction
4) Must clearly define goals for the relationship, which can be managed via a living “goals document” (which may resemble a strategic plan) from which to manage to and vote on at least annually at the board-level
5) Should negotiate protections on both sides including any put/call rights, rights of first refusals/offers making the relationship difficult to unwind; and work with AKS/Stark attorneys to ensure there are documented methods in place via a transaction document and/or shareholder agreement to ensure compliance
6) In practice transactions, invests in practice’s independence and may help to alleviate some stress and burden on the physicians as small business owners (allows physicians to be physicians, but still own); especially if offering any management services through a separate agreement
7) Financial distributions to owners

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Can these types of relationships solve these concerns?

	Hospitals	Physician Practices
1.	Create network access, scale and purchasing power	Create network access, scale and purchasing power
2.	We can spread costs associated with cycle, etc, which we can centralize to	he burden of practice management, which we ur medical group
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8.	Acquired sees cultural fit with Acquirer	Acquired sees cultural fit with Acquirer

YES

But they are not without issue or difficulty…

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Dana-Farber JOA relationship with distant community hospital in New England on Cancer Service Line

- Hospital continues to bill and provide all services; ***2019 baseline***; ***margin share***
- Dana-Farber becomes involved in:
  - Providing guidance on best practices to improve quality of care
  - Hosting joint events including speakers and tumor boards including invitations to referring providers to see integration and collaboration on care
  - Recruiting providers
  - Identifying revenue cycle issues to fix including improved prior auths and denials process
  - Identifying operational efficiencies and expense elimination measures
  - Identifying market opportunities for growth
  - Pushing to execute against a business plan or strategic plan
  - Implementation of many templates linking back to DFCI IT to improve workflows
  - Implementation of DFCI Clinical Pathways product to align model of practice
  - Brand licensing agreement of DFCI brand for branding to local market
  - Joint operating committee including multiple sub-committees on clinical care, nursing, pharmacy, operations, finance and growth
- Deal process was 2-3x more difficult and time intensive for strategy & finance teams than a standard contractual relationship; however, operations have been easier due to increased alignment of incentives

Dana-Farber JOA relationship with distant community hospital in New England

Results thus far since 2019 baseline:

- 19% increased top-line revenue – ***no decrease in revenue nor losses incurred during Covid***
- Significant improvement in clinical care – decreased complications, increased survival rate, increased patient retention, increased trust from referring providers.
- Recruitment of 4 new physicians (originally 9 physicians, now 11 due to 2 departures) and new highly skilled management
- Services fees and shared 50/50 margin has produced:
  - ***Over $2.5m in new revenue for Dana-Farber***
  - ***Over $2.5m in incremental margin for the community hospital***
- Challenges included cutting costs, workflow changes, implementation of the Dana-Farber Clinical Pathways Solution and requiring adherence, turnover in physician and administrative leadership, agreeing to this as Covid started and facing immediate challenges.
  - However, due to not fully integrating or having full responsibility for this program, both our organizations were at half the downside risk, and the organizations were more willing to work as equal partners

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Dana-Farber Minority Equity transaction (JV) with large physician practice in New England

- Acquired 5% interest in January 2022 of a $200m net revenue practice; agreed to a brand license agreement and services agreement; resulting in a very small net expense to Dana-Farber upon close
- Dana-Farber becomes involved in:
  - Providing guidance on best practices to improve quality of care
  - Recruiting providers
  - Identifying revenue cycle issues to fix including improved prior auths and denials process
  - Providing assistance navigating drug shortages
  - Identifying operational efficiencies and expense elimination measures
  - Identifying market opportunities for growth
  - Pushing to execute against a shared living Goals Document serving as a business plan & strategic plan for the relationship
  - Implementation of DFCI Clinical Pathways product to align model of practice
  - Brand licensing agreement of DFCI brand for branding in local market
  - Board voting membership as well as sitting voting membership on management committees on clinical care, nursing, pharmacy, operations, strategy, and finance
- Deal process was 3-4x more complex and time intensive than a standard practice acquisition; however, operations have remained fully separate and have not required integration efforts or incremental management for DFCI

Dana-Farber Minority Equity transaction (JV) with large physician practice in New England

Results thus far since January 2022 transaction close:

- 12% revenue growth in year 1 with more significant growth YTD in 2023
- 5 new physician hires (net new, including 3 hires from in-market competitors)
- Guiding shareholders and management on strategic growth opportunities
  - Practice executed a new professional services agreement and co-management agreement with nearby community hospital
  - Opening a new “flagship office” site in 2024
  - Pursuing additional medical service offerings and ancillary service offerings as well as having the practice offer management services to other local independent providers
- Nursing and pharmacy operational and quality improvements
  - Successfully navigated drug shortages thus far in 2023
- Implemented our Dana-Farber clinical pathways product and templates linked back to DFCI IT
- As an owner, we have experienced ***small distributions coming back to DFCI annually rather than any post-acquisition subsidy***

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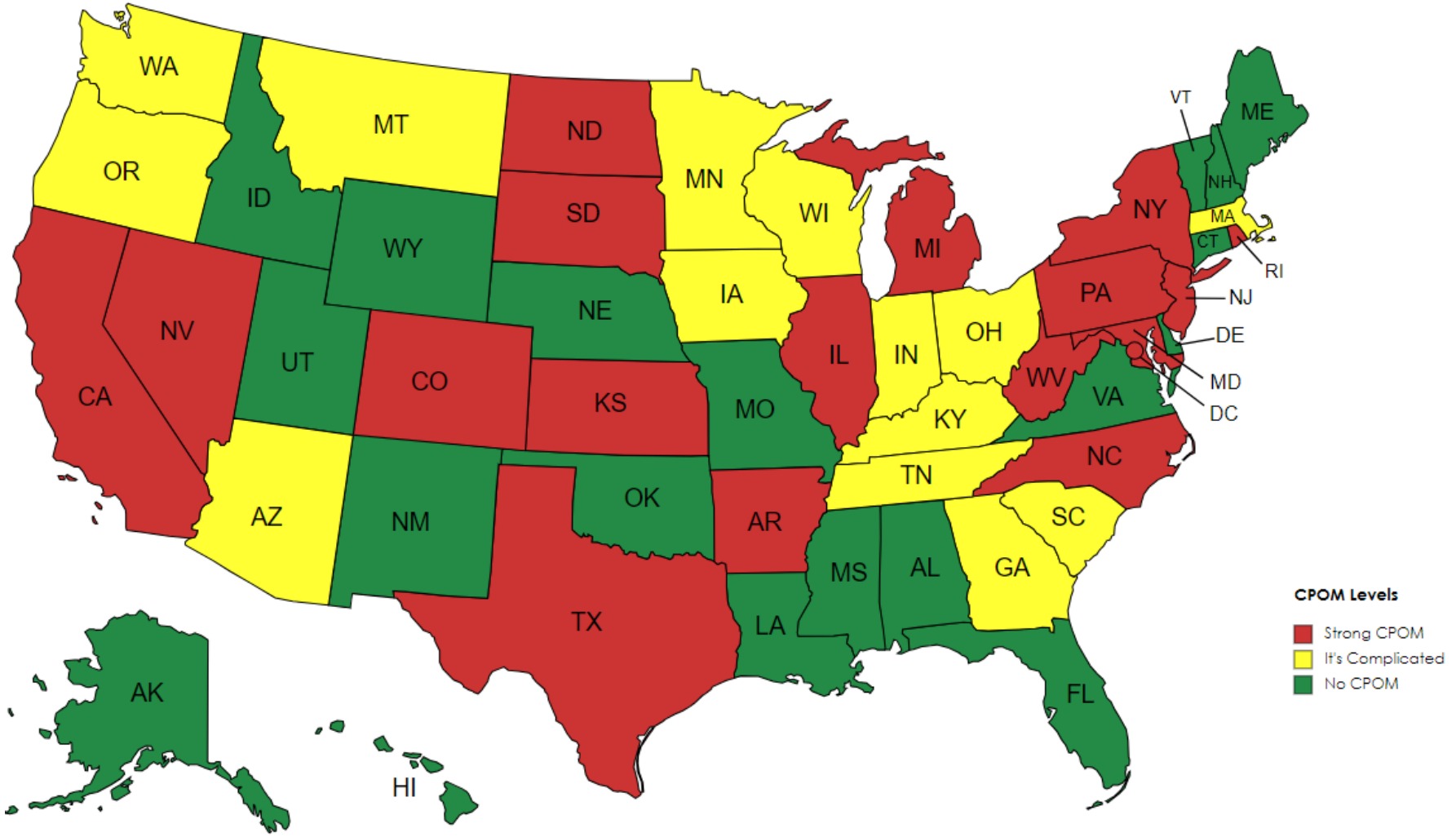
Considerations

- Organizational appetite for risk, all must be done at FMV and require significant AKS/Stark assessment
  - Geographic proximity may change risk levels
- Increased effort in transaction process – complex transactions requiring skilled legal team and skilled negotiators on both sides
- Strong third-party valuation firm able to understand the intricacies of the transaction and establish FMV
- May require some investment in some management infrastructure including a skilled collaboration- focused contract manager dedicated to these partnerships and investment of time into relationship building and maintenance
- JOA financial models can be revenue or margin share based. Ensure the financial model and its incentives align with your operating model and goals.

For physician practice transactions:

- Corporate practice of medicine regulations in your state
- Variances in S-Corp vs. C-Corp corporate structure of practice
- Regulations on professional corporations in your state
- Ways to avoid these issues may include establishment of an MSO and transacting with that MSO
- Tax implications for corporation or shareholders including dividends/distributions made at year end

Corporate Practice of Medicine Reference Guide



Reference: Discussions with McDermott, Will, & Emery

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Ongoing Operational Considerations

- **Be communicative, transparent, and direct in negotiating and on-going relationship operations**
  - No hidden agendas, get everything out on the table
  - Play “cards face up” while negotiating – you don’t want one party to feel they “got a bad deal” after the fact
  - Be open about the fact that you may have to change parts of the agreement in the future depending on how things are going – and leave provisions in there that are meant to be changed
  - Never lie – a partnership is all about trust. If you think someone is lying or bending the truth, ask them
  - Don’t “overforecast” financials to “get the deal done” – if you can’t hit financial targets, this type of partnership is destined to fail and better to find a different model now
- **Continuously communicate with that organization post-close:**
  - Just because you are a minority shareholder or not an owner at all doesn’t mean you should take any steps back – now is the time to get closer and when the work begins!
  - Just because you finished a deal with another larger organization doesn’t mean that you want to go back to being independent – you want them involved in executing your goals!
  - A Board meeting or JOC is not the time to bring up issues for the first time – it is the time to vote on issues that have been discussed in other committee meetings at length
- **Be solution oriented and vulnerable:**
  - When one side feels like they are losing, have an open dialogue and come up with way to solve the problem, and if necessary, edit legal documents to ensure both sides feel the problem is solved! (Collaboration-focused contract/relationship manager)
  - It’s likely that one or both parties have never had a relationship like this before, but if there is a level of trust, that will allow the partnership to go smoothly.
  - We work in healthcare, we are used to providing compassionate care to people at their most vulnerable state, let’s translate that mentality into business partnerships
  - If one side loses, you create resentment and you both lose. Remember, you are pushing for a win-win.

Steps to starting a JOA

1) Have an open discussion with leadership at an organization you might want to partner with, including benefits and risks to contractual relationships and potential benefits and risks of a JOA
   - Alignment of interests, sharing in a way that organizations maintain control but are difficult to unwind
   - Develop a list of goals and interests that both parties would like to solve out of a potential partnership and ensure to document services that each side can provide and actions each side can take to contribute to achieving such goals
2) Have “host” side work with their financial team to evaluate competencies by asking to define a “Baseline Year” from which to benchmark against with extremely detailed revenues and expenses.
3) Work with a third-party firm to financially forecast (5-7 years, with sensitivities) what the operation will look like, including financial indices (NPV, IRR) for both organizations to ensure likelihood of a win/win
   - Determine a share of Revenue (does not take cost variances into account) or Margin (takes cost variances into account) that is palatable for both entities. Ensure that if a goal is to manage expenses, that Margin is what is targeted.
4) Work to identify issues that both sides don’t agree on and create an issues list to address
5) Work with legal teams to develop terms sheets to begin the process, including paying attention to the issues list and making vulnerable proposals within that issues list. Perform a significant amount of editing in the term-sheet phase prior to any drafting of actual agreements
6) Determine all agreements necessary based on current business plan and begin drafting. More negotiations will follow
   1) Joint Operating Agreements
   2) Professional Services Agreements or staffing agreements (if applicable)
   3) Branding Agreements (if applicable)
   4) Management Services Agreements (if applicable)

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Steps to starting a JV minority equity transaction
MOSTLY THE SAME!

1) Have an open discussion with leadership at an organization you might want to partner with, including benefits and risks to contractual relationships and potential benefits and risks of a JV minority equity transaction
   - Alignment of interests, sharing in a way that organizations maintain control but are difficult to unwind
   - Develop a list of goals and interests that both parties would like to solve out of a potential partnership and ensure to document services that each side can provide and actions each side can take to contribute to achieving such goals
2) Work with a third-party firm to perform a valuation and discounted cash flow analysis including modeling for future potential shareholder distributions of earnings
3) Work to identify issues that both sides don't agree on, and create an issues list to address
4) Work with legal teams to develop terms sheets to begin the process, including paying attention to the issues list and making vulnerable proposals within that issues list. Perform a significant amount of editing in the term-sheet phase prior to any drafting of actual agreements. Be open, transparent, communicative, and vulnerable.
5) Determine all agreements necessary based on current business plan and begin drafting. More negotiations will follow
   1) Transaction documents (purchase/sale agreement)
   2) Editing of any existing shareholder agreements (sometimes, creation of a shareholder agreement)
   3) Any specific right of first offer/refusal or put/call option agreements (if applicable)
   4) Professional Services Agreements or staffing agreements (if applicable)
   5) Branding Agreements (if applicable)
   6) Management Services Agreements (if applicable)

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Hopefully you've learned:

KEY TAKEAWAYS:

1. New ways to partner, or, more about potential less-common partnerships like JOAs or minority equity JVs; including varying levels of integration of types of partnerships

2. Legal & Financial considerations, including your state's Corporate Practice of Medicine status, FMV considerations, and financial models to consider

3. Operational considerations, the need for communication & trust, and steps to begin to perform this work when you return to your organization

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Questions?

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Audience Q&A Session

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