Investor-Owned Hospitals

Will Hospital Chains Find Profits Increasingly Elusive?

March 4, 2009
MODERN HEALTHCARE
Webinar

Presenting...

Jeff Villwock
Managing Director
Genesis Capital

Contact
JVillwock@genesis-capital.com
Investor-Owned Hospitals

Will Hospital Chains Find Profits Increasingly Elusive?

Federal Government Spending (% of GDP)

Source: Congressional Budget Office (CBO)
Investor-Owned Hospitals
Will Hospital Chains Find Profits Increasingly Elusive?

US Healthcare Spending (% of GDP) 1960-2005

Source: Congressional Budget Office (CBO)
Investor-Owned Hospitals

Will Hospital Chains Find Profits Increasingly Elusive?

US Healthcare Spending (% of GDP) 2007-2082

Projected Spending on Health Care

This growth is unsustainable – it must be fixed.

Source: Congressional Budget Office (CBO)
Investor-Owned Hospitals

Will Hospital Chains Find Profits Increasingly Elusive?

Federal Budget Implications

Federal Debt Held by the Public Under CBO’s Long-Term Budget Scenarios

CBO Estimates that Medicare is insolvent in 2019 – just 10 years from today!!

Source: Congressional Budget Office (CBO)
Investor-Owned Hospitals
Will Hospital Chains Find Profits Increasingly Elusive?

Medicare Beneficiaries Nearly Double by 2030

Number of Medicare Beneficiaries, CY 1970-2030

The number of Medicare beneficiaries will nearly double by 2030.
Investor-Owned Hospitals

Will Hospital Chains Find Profits Increasingly Elusive?

Rate of Beneficiary Growth Triples from 2002 to 2012

- Baby boomers hit Medicare starting in 2011
- Enrollment growth has already doubled from 1% annually in 2000-2002 to 2% in 2009 and will triple to 3% annually starting in 2012

Medicare Enrollment Growth Rate

Source: CMS & Genesis Capital
Investor-Owned Hospitals
Will Hospital Chains Find Profits Increasingly Elusive?

Implication of Baby Boomer Explosion

- Medical inflation is driven by
  - Increase of Medicare beneficiaries
  - Increase in new technology and increase in amount of services provided
  - Increase in price of services

Government has NO WAY to pay for these increases

Add the cost of the current “bail-out” and the US government has no choice but to print money and/or nationalize healthcare

- Long-term bull case for healthcare services has been built on a huge increase in demand, which is beginning

- Bull case ignored that government can’t pay
Investor-Owned Hospitals
Will Hospital Chains Find Profits Increasingly Elusive?

As % of GDP, Medicare needs to be flattened

Source: Congressional Budget Office (CBO)
Investor-Owned Hospitals

Will Hospital Chains Find Profits Increasingly Elusive?

Possible Fixes

• Only 2 Real Variables
  #1 – Number of people in the Medicare system
  #2 – Cost to treat a person
  Cost to treat is broken down into 1) the amount of healthcare provided (units) and 2) the cost of each unit of healthcare

First way to fix system is to limit the number of people in Medicare
  - Change entrance from age 65 to age 85 fixes the problem
  - Congress could alter Medicare in the same way as Social Security, but phase in takes a decade or more to be meaningful and moving from 65 to 67 doesn’t fix the problem

Second fix is to reduce the units of service
  - Ration care
  - Use IT to reduce unnecessary duplication
  - Change tort laws to reduce cost of litigation
  - Determine that an 85 year old doesn’t get an open heart procedure
  - Use the UK system of using the budget to eliminate or delay care
Investor-Owned Hospitals

Will Hospital Chains Find Profits Increasingly Elusive?

Possible Fixes

• **Third fix is to reduce the price for each service**
  If as a nation we won’t deny our seniors Medicare
  If as a nation we won’t ration or deny care
  Then the only variable left is price per unit of care

• **In my view …**

  Changing age of entry will be too little, too late – politically impossible

  Daschle and Obama like the UK system of rationing, but are we ready for rationing, and if we are, how long does it take to phase in? Politically difficult – “Grandma can’t get the care she needs”

  The default and easiest way to level off the cost of healthcare as a percent of GDP is to pay less per unit of care – Politically easy:
  “Get the greedy healthcare providers who are making money off our suffering.”
  “It is time in America when we need to put patient care ahead of profits.”
Investor-Owned Hospitals

Will Hospital Chains Find Profits Increasingly Elusive?

Medicare Bills Coming

- Expect full blown “Medicare Reform Bill” in 2009-2010

Across the board reimbursement reductions

Possibility of using Medicare pricing power in pharmacy and finding a court approved way to compete for oxygen and other DME supplies

Medicare Advantage Plans reimbursement will be significantly reduced

Obama mantra will be to lower healthcare costs for every American
  - Lowering costs is another way of saying “reducing profits”

Beginning with Tom Scully at CMS, Medicare officials have become experts in reading Wall Street research to determine profitability of each type of Medicare service

Medicare knows exactly what it costs to provide a healthcare service
Investor-Owned Hospitals
Will Hospital Chains Find Profits Increasingly Elusive?

Medicare Bills Coming

• Whatever bill is passed in 2009-2010 won’t be enough

Expect a continuing stream of initiatives that will be designed to slow or stop the rate of growth as a percent of GDP

Medicare can and will figure out how to price services to insure that providers stay in business, but don’t make money

Fiscal 2010 budget proposal is just the beginning

The “knock out punch” probably comes in 2013-2014

Modern Healthcare
Investor-Owned Hospitals
Will Hospital Chains Find Profits Increasingly Elusive?

Implication to Healthcare Service Companies

• For-Profit healthcare industry has been built on premise that For-Profit companies are more efficient than Not-For-Profit companies and have access to capital

• In last 15 years, Not-For-Profit companies have learned and have changed business practices

• Spread between efficiency of For-Profit and Not-For-Profit lowest in history

• This lack of spread gives Medicare the opportunity to cut reimbursement close to marginal cost of providing care without concern of large numbers of providers leaving the system

• Medicare will strip the profit out of all healthcare providers
  - Non-Profit can fall back on local contributions and local taxes
  - For-Profits have no fall back protections
Investor-Owned Hospitals
Will Hospital Chains Find Profits Increasingly Elusive?

Implication to Investors

The Catch-22 problem is ---

• Once investors get the sense that the landscape in Washington is changing, they will shun healthcare investments until the regulatory landscape is clarified

• I believe this change happened last week with the Budget

• Implication is either that buyers go away, or prices come down, or both – or everyone in healthcare is frozen in place until more clarity exists
Investor-Owned Hospitals

Will Hospital Chains Find Profits Increasingly Elusive?

Jeff Villwock
www.Genesis-Capital.com

3414 Peachtree Road
Suite 700
Atlanta, GA 30326