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ModernHealthcare

May 4, 2013

Stand-alones suffering

By Beth Kutscher

Small hospitals finding fewer options

Scott County, Tenn., a community of 22,000 people about an hour northwest of Knoxville, has been without a hospital for the past year, but the Oneida-based medical center may soon be reopened.

County officials are closing in on a deal that would reopen the 25-bed facility after it was forced to suspend operations last May.

The hospital's closure illustrates what may become increasingly common across the country as deep-pocketed systems become choosier about what they buy and standalone hospitals find it harder to go it alone.

Facilities that can't find larger partners have few fallback options.

Scott County Hospital shut its doors after previous owner Health Management Associates failed to find a buyer for the facility. Naples, Fla.-based HMA assumed the lease on the hospital as part of its \$525 million purchase of Mercy Health Partners-Tennessee from Catholic Health Partners, Cincinnati, but did not intend to operate it.

Trey Crabb, managing director at investment bank Ziegler, calls it the plight of small hospitals. Single hospitals with less than \$75 million in net patient revenue are in danger of becoming extinct, he said, as they're too small to be interesting to larger chains looking to build market share in the places where they already are. "It doesn't move the needle," he said.



MARK L. CLASTER
President, Carl Marks

It's not as if financing has dried up for acquisitions, said Mark Claster, president of consulting firm Carl Marks & Co. "Instead, many M&A targets aren't as attractive as they previously were – and this is based upon the changes in the way hospitals are doing business, getting paid and other external forces and pressures they are facing."

Hospitals as they currently operate are "a dying business," Claster said. Changes in healthcare delivery – and declining inpatient admissions – mean that providers have to be not just acute-care facilities, but integrated delivery systems.

Large regional systems may still find some smaller hospitals attractive if those facilities increase their catchment area and draw additional patients into their networks. Yet many rural communities offer limited opportunities to grow market share as they face a stagnant or even declining patient base, said Tony Kong, director at management and technology consulting firm West Monroe Partners.

In addition, many would-be consolidators are taking a breather from the rampant buying spree of the past few years as they

consider their next move. "Starting this year, in Q1, there's been a significant slowdown," Kong said. "I think everyone is becoming a bit more selective."

In Scott County, the hospital's closing on May 24, 2012, has meant patients must make the 55-minute trip to North Knoxville Medical Center, another HMA facility, for emergency care, putting "major wear and tear on the ambulances," said Mayor Jeff Tibbals.

But officials never stopped looking for a partner. And at a March special-session meeting, the county's board of commissioners voted unanimously in favor of allowing Pioneer Health Services, a former suitor, to submit a new letter of intent to acquire the facility.

The state attorney general received the asset purchase agreement last week and the approval process is expected to take 45 days. "We're almost there," Tibbals said. The target date to reopen the hospital is July 1.

Scott County may well be one of the lucky ones. Across the country, hospitals that fail to find buyers are finding that they have no choice but to shut their doors.

Two other rural facilities in Georgia have also suspended operations this year: 25-bed Stewart-Webster Hospital in Richland and 25-bed Calhoun Memorial Hospital in Arlington.

A report last month from Moody's Investors Service showed that five of the six hospitals downgraded last quarter had revenue under \$500 million. Small hospitals, the credit ratings agency said, are particularly vulnerable because they lack the scale to negotiate with payers and vendors, and are overly reliant on a few physicians, who would be difficult to replace if they left.

Rural hospitals can apply for federal funding to help them stay in business, Kong noted. Yet he has not yet run across a hospital that has been successful in taking advantage of the federal program.

Tibbals denies that being a small, rural hospital made the search for a partner more challenging. He said the county talked to seven-hospital Covenant Health as well as the University of Tennessee, both in based in Knoxville. "UT said it didn't fit their model, but they helped along the way," he said.

When Scott County originally selected Pioneer in 2011, the group couldn't agree on financial terms with HMA, Tibbals said. After its closure, Scott County then tried to secure a deal with S.M. Promen, but the startup ultimately couldn't provide adequate proof of net worth to operate the hospital.

Based in Magee, Miss., Pioneer's entire business model is based on running rural facilities. The six-hospital system did not respond to a request for comment.

At this point, it is getting a bargain. The only financial commitment of the deal requires Pioneer to pay off a \$106,000 loan on the medical office building, Tibbals noted. "We're giving it away to Pioneer Health Services," he said.