

BMP Blackmore Partners

SPECIALTY SURGICAL PHYSICIAN-OWNED HOSPITALS

TEXAS

March 2016



1. Executive Summary
2. Hospital #1
3. Hospital #2
4. Post-Acquisition Plan
5. Risks and Mitigation
6. Management Team
7. Physician Owned Hospitals (POH) Background
 - POH Overview
 - POH Performance
 - POH Regulations
8. Contact.

Blackmore Partners has partnered with highly accomplished executives on an investment thesis to acquire from bankruptcy and turnaround two Specialty Surgical physician-owned hospitals.

Investment Thesis:

- Acquire one or two specialized surgical hospitals out of bankruptcy
- Form a Hospital Operating Company to provide close-to-home high quality surgical care
- Serve the upscale demographic in the Texas area that is friendly to physician-owned hospitals
- Differentiate through a combination of top-ranked surgeons, state-of-the-art facility, personalized attention, low nurse-to-patient ratio, and leading technology.
- The hospitals will participate in managed care plans, and, likely, accept Medicare
- The management team: CEO and Chief Clinical Officer with extensive experience and longstanding physician relationships are available, will be augmented with Chief Nursing and CFO.
- Interested physician partners have been secured.

Physician Ownership: Physician partners and additional physician groups and individuals have been secured, have made investment deposits. The ownership will be partly physician-based, up to 40%.

Investment: The potential investment includes \$5M working capital for each hospital; the leases can be negotiated from - hospital #1: \$3.7M/year, hospital #2: \$10M/year. Additional investment may be required for equipment and inventory.

Real Estate: real estate buyers have been identified, awaiting a credible operator.

Acquisition Targets: two physician-owned specialty hospitals located in Texas, 60 miles apart, specializing in orthopedic, pediatric, ENT, GYN, gastrointestinal, bariatric, brain, spine, and general surgery. Other specialties, such as Cardiology, are included in the post-acquisition plan.

Management Team: **CEO** with over 30 years of healthcare executive experience, including President/COO of a specialized hospitals network and Sr. VP of the surgical center and specialty hospital division of Universal Health Services, Inc. **Chief Clinical Officer** with 38 years of leadership experience in healthcare.

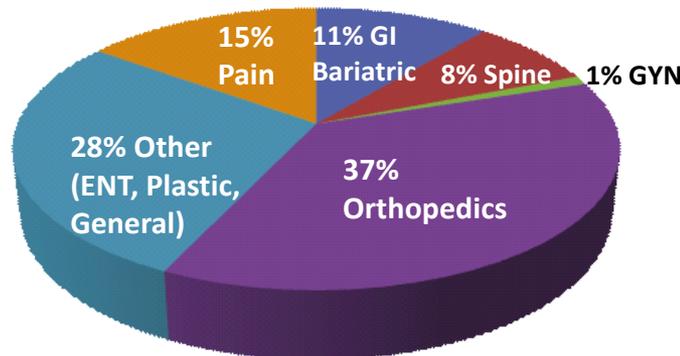
Hospital #1

- Opened in 2013 in a state-of-the-art facility, high-end amenities, Medical Credentialed staff of 215, prominent physician groups, infection rate of 0.006%.
- Started as non-Medicare/Medicaid, out-of-network provider; in 2014-2015 executed in-network agreements with three major insurers
- Located in Texas, demographic with the average household income at \$114,128 within a 5-mile radius
- The hospital is within a 113,375 sqft structure of which 57,680 sqft is the hospital and 55,695 sqft is medical office space.
- Facility and surrounding property provides a “medical campus” environment for hospital expansion opportunity as well as co-habitation with physician partners and referral sources.

Facility Breakdown

Operating Rooms 5
 Special Procedure Rooms 2
 Pre-Operative Beds 9
 Post Anesthesia Care Unit
 Beds 11
 Inpatient Beds 20
 Intensive Care Unit Beds 4

2014 Procedure Case Mix



2014 YEAR END

Inpatient Cases	174
Outpatient Cases	1,574
ER Visits	416
Total Net Revenue	\$20.5M
EBITDA	(\$9.5M)

- Strong Pediatrics program, unique to the market providing orthopedic, ENT, and general surgeries
- Center of Excellence in Gynecological surgery.

- As an out-of-network provider, the parent company experienced payment cuts, delays, and lack of payment from four large insurers. This critically constrained the company’s liquidity.
- In 2015, the parent company filed voluntarily under Chapter 11 of the U.S. Bankruptcy Code.

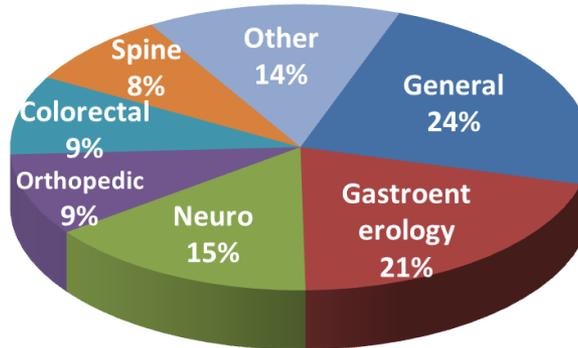
Hospital #2

- Opened in 2014 in a luxury facility, with 150-175 workers at the opening, highly trained physicians
- Non-Medicare/Medicaid, out-of-network provider initially, in-network provider since March 2015
- Located in Texas, in the area known for its world class healthcare organizations and its entrepreneurial physicians, friendly to physician-owned services and facilities
- Largest concentration of corporate headquarters
- The 150,000 sqft facility is located on 7-9 acres of a new development, connected to an 80,000 sqft medical office building.

Facility Breakdown

Operating Suites 12
 Intensive Care Rooms 6
 Full-service Imaging Center
 Private Inpatient Beds 54
 Family Suites
 Endoscopy Laboratory
 Full Emergency Department
 Ancillary Services

Jan – Aug 2015 Procedure Case Mix



January 2015 – August 2015

Inpatient Cases	288
Outpatient Cases	1,239
Total Net Revenue	\$20.4M
EBITDA	(\$17.9M)

- Specialization: Gastroenterology, Neuro, Orthopedic procedures, among other specialties
 - Da Vinci Xi Surgical Robot equipment, Mazor Robotics Renaissance equipment
 - Full emergency department, required of a full-service hospital.
- In 2015, the hospital was posted for sale, and consequently, the entity with the construction loan on the hospital filed for Chapter 11 protection
 - The CEO of the hospital does not expect the bankruptcy to affect the operations at the hospital
 - Prior to bankruptcy, operationally, the hospital was exceeding expectations.

Post-Acquisition Plan (1 of 2)

REAL ESTATE

- **Hospital #1:** potential real estate buyers have been identified, deal is contingent on a credible operator
- **Hospital #2:** a real estate buyer is available
- Rental income to be considered

MANAGED CARE CONTRACTS

- In-network Managed Care plans with the “big 4” payors: Cigna, Aetna, United Health, and Blue Cross Blue Shield
- Medicare will be considered.

PHYSICIAN OWNERSHIP

- Physicians will have up to 40% of the ownership
- Initially, a small stake to key physicians will be sold, and the remainder will be held for future partners
- Depending on the decision to accept Medicare (see the POH Regulations slide), the physician ownership will be of the operating company, real estate, or a management company
- Physician partners and additional physician groups and individuals have been secured, have made investment deposits.

Post-Acquisition Plan (2 of 2)

AVAILABLE PHYSICIAN PARTNERS

- **Hospital #1**

- Physician partners have stayed engaged
- A group of Orthopedic Surgeons, incl. Pediatric program
- ENT group
- Two Spine Surgeons
- Plastic Surgeons
- Two prominent GYN surgeon groups, perform laparoscopic hysterectomy
- Two GI/Bariatric Surgeons
- Pain Management Specialists
- 70-person interventional Cardiology group
- Space for a Cath Lab

- **Hospital #2:**

- #1 Neurosurgical group in the area
- Gastroenterology group
- Orthopedic group
- Pain Management
- GYN Surgeons
- Cardiologists and other physician groups.

Year 2 Projections (post ramp-up)

	Hospital #1	Hospital #2
Revenue	\$25M	\$50M
EBITDA	\$6.5M	\$15M
EBITDA Margin	26%	30%
Subsequent Annual Growth	25% - 30%	

Risks and Mitigation

#	Risk	Mitigation
1	Physicians Availability	Sufficient number of prominent and top-ranked physicians (groups and individuals) have been identified; many have made investment deposits.
2	Patients Availability	The volume growth in both hospitals has been positive: hospital #1 has reached 1,748/year cases by end of 2014, in slightly over one year after the opening, and hospital #2 has reached 250-270 cases/month by July 2015, after less than one year of operations. Operationally, hospital #2 was exceeding expectations, prior to filing for Chapter 11 protection.
3	In-Network Managed Care Contracts	Hospital #1: in 2014-2015, executed in-network agreements with three major insurers, has made progress in negotiations with the fourth insurer of the “big 4”. Hospital #2: is an in-network provider with the “big 4” insurers since March 2015. Depending on the timing of the Chapter 11 process, the contracts may be reinstated, otherwise, the Management is confident that similar contracts can be negotiated, will bring a credible consultant specializing in contract negotiations.
4	Equipment &Supplies	Additional funding might be required depending on the timing in the Chapter 11 process.
5	Licenses	Licenses might be reinstated as part of the Chapter 11 reorganization plan. Otherwise, the hospitals will apply for the licenses.
6	Regulations	The restrictive regulations apply to Medicare patients. There are two mitigation options: a) Exclude Medicare b) Include Medicare and provide physician ownership through real estate, management company or another ownership format.
7	Real Estate	Real estate buyers are available.

Management Team

Chief Executive Officer

Over 30 years of experience serving in various executive capacities with several healthcare organizations including The University of Texas M.D. Anderson Hospital, Medical Care International and Harris Methodist Health System. Served as VP Operations at National Surgical Care and Sr. VP Operations of the surgical center and specialty hospital division of Universal Health Services, Inc - one of the nation's largest healthcare management companies, operating through its subsidiaries acute care hospitals, behavioral health facilities and ambulatory centers nationwide.

Master's degree in Healthcare Administration from Trinity University, San Antonio, Texas and a B.A. degree from University of Texas at Austin.

Chief Clinical Officer

38 years of principal leadership experience in healthcare, starting as a staff nurse, continuing to focus on Anesthesia, and to holding key roles in the design, construction and management of successful surgery centers and hospitals across North Texas. The leadership roles include the owner/operator of several Anesthesia services companies and practice management responsibilities, including facility accreditation. Committed to a patient focused mission and a physician-centric operational approach.

Physician-Owned Hospitals (POH)

BACKGROUND

POH Overview

OVERVIEW

- Hospitals that are owned and run at least partly by doctors
- A majority of physician owners have less than a 2% interest in the hospital
- There are about 250 - 275 US acute care hospitals with a physician ownership stake
- As many as 75 POHs are in Texas – TX is among 15 states that do not require a state-issued “certificate of need”
- More often small (<100 beds), for profit, in both rural and urban areas, including full-service and specialty hospitals.

BENEFITS OF PHYSICIAN OWNERSHIP

- Higher professional control over the clinical environment and over the quality of care delivered
- Responsive, less bureaucratic environment
- Healthy competition in the community with big hospitals, alternative to patients and payors
- Attractive to top physician talent
- Attractive to patient due to narrow specialty focus and expertise; specialization has led to decreased costs and better outcomes

CRITICISM

Critics contend that that POHs:

- Have financial incentives to treat healthier and wealthier patients, treat fewer patients with Medicaid
- “Cherry-pick” the most profitable patients
- May unnecessarily refer patients and code patient comorbidities more completely than other hospitals, resulting in increased service utilization.

However, the performance of POHs and studies published by CMS and The British Medical Journal demonstrate that hospitals owned by physicians are often the most efficient, state-of-the-art facilities in the country, the result of doctors’ desire to be involved in making detailed decisions about the staff, equipment, training, and procedures that can best serve their patients.

POH Performance (1 of 2)

- Seven of the top 10 hospitals receiving quality bonuses in the Medicare's Hospital Value-Based Purchasing Program in 2015 were physician-owned hospitals. POHs represent less than 5% of the 5,700 hospitals nationwide
- In the Centers for Medicare and Medicaid Services (CMS) Star Ratings in 2015, more than 40% of physicians-owned hospitals received the top 5-star rating compared to only 5% of general hospitals.
- The Department of Health and Human Services found that patients are three to five times more likely to experience complications at general hospitals than at physician-owned specialty hospitals
- An analysis by Avalon Health Economics said that physician-owned hospitals are saving Medicare \$3.2 billion over 10 years.
- A CMS study found that POHs spend nearly 6% of their total revenue on community benefits compared to less than 1% for other hospitals
- An extensive study in 2015 by The British Medical found that
 - POHs may treat slightly healthier patients, but do not systematically avoid Medicaid patients or those from ethnic and racial minority groups
 - Moreover, overall costs of care, payments for care, and quality of care are similar between POHs and non-POHs
 - Policies that penalize all US hospitals with physician owners need to be re-evaluated.

POH Performance (2 of 2)

Examples of high performing POHs from the Becker's Hospital Review "82 Physician-Owned Hospitals to Know | 2014" located in the same market as the target hospitals:

- **Baylor Heart and Vascular Hospital in Dallas (64 beds):** Healthgrades' Patient Safety Excellence Award and Vascular Surgery Excellence Award, Outstanding Patient Experience Award, the Press Ganey Summit Award for patient satisfaction, other.
- **Baylor Orthopedic and Spine Hospital at Arlington (24 beds):** Joint Replacement Excellence Award from Healthgrades, Patient Safety Excellence Award and Outstanding Patient Experience Award, Joint Commission Gold Seal of Approval.
- **Grace Medical Center in Lubbock (123 beds):** Outstanding Patient Experience Award, Prostatectomy Excellence Award from Healthgrades.
- **Lubbock Heart Hospital (74 beds):** Healthgrades' Vascular Surgery Excellence Award, Pulmonary Care Excellence Award, Outstanding Patient Experience Award.
- **North Central Surgical Center in Dallas:** Healthgrades' Joint Replacement Excellence Award and the Outstanding Patient Experience Award.
- **Quail Creek Surgical Hospital in Amarillo:** Healthgrades' Joint Replacement Excellence Award and awards for excellence in gynecologic surgery and patient safety.
- **Texas Health Harris Methodist Hospital Southlake (16 beds):** Joint Replacement Excellence Award from Healthgrades, Patient Safety Excellence Award and the Outstanding Patient Experience Award from Healthgrades, ranked among the top in the country for patient safety and satisfaction.
- **The Heart Hospital Baylor Plano (116 beds):** one of only 87 recipients of the 2011 Summit Award in two areas — emergency department and inpatient satisfaction. The Summit Award is one of Press Ganey's most prestigious awards, honoring hospitals that sustain an overall rank above the 95th percentile for at least the past three consecutive years; Healthgrades' Outstanding Patient Experience Award.
- **USMD Hospital at Arlington (32 beds):** Healthgrades' Prostate Surgery Excellence Award, Gynecologic Surgery Excellence Award and Prostatectomy Excellence Award, Press Ganey Guardian of Excellence Award for patient satisfaction.
- **USMD Hospital at Fort Worth (8 beds):** ranked among the top in the country, Healthgrades' Prostatectomy Excellence Award, Prostate Surgery Excellence Award, Patient Safety Excellence Award, and Patient Experience Award.

POH Regulations

- In 2010, as part of the Patient Protection and Affordable Care Act, Congress banned the creation of new Medicare certified POHs altogether, greatly restricted the ability of existing POHs to expand, and further limited referrals by physicians to Medicare certified facilities that they own
 - Section 6001 of the Affordable Care Act of 2010 amended section 1877 of the Social Security Act to impose additional requirements for physician-owned hospitals to qualify for the whole hospital and rural provider exceptions. A physician-owned hospital is generally prohibited from expanding facility capacity. However, a physician-owned hospital that qualifies as an applicable hospital or high Medicaid facility may request an exception to the prohibition from the Secretary.
- Promoting Access, Competition, and Equity Act of 2015” was introduced in House in May 2015 by U.S. Rep. Sam Johnson, R-TX. This bill amends title XVIII (Medicare) of the Social Security Act to ease application criteria and procedures for physician-owned hospitals to expand their facilities.

The ACA regulation is applicable to Medicare patients. If the decision is made for the hospitals to accept Medicare, the physician ownership will be considered for real estate, management company, or another physician-ownership format.

Yelena Edelstein

Deal Partner

yelena.edelstein@blackmorepartnersllc.com

773-728-2763 (o), 847-875-7441 (m)

5050 N Broadway St, Suite 101,

Chicago, IL 60640