

April 8, 2020

Steward Strategic and Operating Assessment / Outline

Approach

Balanced View – Positive and Realistic. Comments should be regarded as hypothesis needing some clarification and validation.

Realistic:

Context

» ***Provider Healthcare***

- Has never been a sustainably consistent profitable portion of the healthcare ecosystem (i.e. Tenet, HCA, HealthSouth, etc.) vs. devices, pharmaceuticals, equipment, supplies, and distribution.

» ***Business System***

- Steward's Business System is reliant on expensive Doctor Base (owned and affiliated). The returns from this network take a long time (see Massachusetts example) and there is some doubt whether this strategy will really pay off.
- The Doc Network in new markets usually starts with expensive Specialists and then moves over time to a focus on Primary Care Physicians (PCP). Thus, an initial significant investment is required and takes 3 to 5 years for Doctor Subsidy to provide a potential return.

» ***Leader and Team***

- Steward is led by a brilliant founder with a strong perspective as to strategic and operating direction and decisions. Chairman and CEO have strong governance authorities....and exercises that broad authority.

The leadership Team is comprised of talented people, but not developed business leaders. They defer / abdicate most decisions to CEO. There is still a question of whether the Massachusetts model can scale....or whether leader has the ability to scale a geographically dispersed hospital group with differing business models.

Geographic Markets

- » **4 Markets are either under pressure or doubtful to make money without significant investments.**

Texas. Hospitals in need of investment, higher concentration of no-pay or Medicaid patients (low case mix and payor issues), and overall Texas reimbursement rates.

2. **Utah.** Currently profitable, however there is an 'arms race' with two very well capitalized competitors...Intermountain Healthcare and HCA. Note that there was Doc practice lost in Utah during liquidity crisis of Fall of 2019
- 3 **Arizona.** Too little infrastructure...not ideal locations or facilities.
4. **Massachusetts.** The Core...under competitive pressure....built under RDT and his current distributed / diluted focus has potential to negatively impact competitiveness of this core business.

The Core / Reality Numbers...Financial

- » **To keep the lights on:**

- Cap Ex	\$140
- Interest / Other	\$60
- <u>MPT Rent</u>	<u>\$310</u>
- TOTAL	\$510

- » **Real Operating Cash Production is below B/E level...the KPMG QofE EBITDAR was \$376.5. If anything – it might be lower. The business has deluded itself on real operating earnings by focusing on adjustments or measurements used by credit or real estate facilities. If looked at positively, the business is in a 'growth mode' and needs cash to fuel prospective growth.**
- » **The current business model as advocated by business team require CASH. Thus – before COVID 19 – the business likely was going to need 5 years and \$500M to impact system. Likely the COVID-19 has made that a 7 year /\$750M outlook.**

» **The projected cost of COVID-19:**

- Direct COVID-19 Cost	\$90M
- Electives Fall Off	\$110M
- Payor Mix	\$120M
- TOTAL	\$320M

- » Clearly, the business will need additional investment / money.....a new financial structure
- » Government Funding: There will be significant money available. However, it will be critical to understand and differentiate between loans / grants / sustainable changes in rates, etc. A key question is whether any of the monies will cover the opportunity cost (lost profit) from activities or whether it covers only directly incurred costs. Documentation and proper record keeping will be a multi-year process with a lot of oversight and review by government.

Positive (Why Keep the Business):

1. Using the Massachusetts model – while it took a long time and a lot of investment / cash, it is now profitable and produces cash. The Massachusetts case study still needs to be documented and verified.
2. Healthcare Provider Business will essentially become (one possible draconian outcome) a semi-nationalized business operated on a cost-plus model and/or with generous subsidies and grants. This will be especially true for those serving indigent populations (DSH Hospitals).

Note that both of the above scenarios will still most likely require significant cash investments.

Recommendation:

1. Ground everyone on Realistic state of the business.
2. Have real and direct conversations with MPT to ascertain the art of the possible.
3. Prepare business for systemic and comprehensive change.