

### **Henry Ford-Allegiance Health Deal Likely a Harbinger**

May, 2016

As Henry Ford Health System added its sixth hospital in early April, the trend toward consolidation both in Michigan and nationally continued.

The incorporation of Allegiance Health into its fold will extend HFHS's reach into the mid-Michigan market and give Allegiance access to physicians, information technology and other assets it would be unlikely to afford on its own, said Greg Hagood, senior managing director and head of investment banking at SOLIC Capital, LLC, an Evanston, Illinois-based capital restructuring firm. Hagood says he advised Allegiance during the deal.

"Allegiance wanted to have a full-service regional medical center," said Hagood. "What Henry Ford brings is a very large physician organization and a strong brand." He said Allegiance needed a partner that could provide physicians and brand recognition to services that Allegiance would not have been able to afford offering on a full-time basis. With Henry Ford only an hour-and-a-half away, Henry Ford physicians can work part of the time at Allegiance and fill the 475- bed hospital's needs.

"Theoretically, the physicians that are employed by Henry Ford, you can give them additional volume – better utilization, better capacity," said Hagood. "For Allegiance, if you had to recruit your own urologist, your own neurosurgeon, your own hip replacement guy – it becomes difficult to support that guy."

The deal could ebb the outmigration flow of patients to nearby tertiary care hospitals, such as St. Joseph Mercy Health System (part of the Trinity system) and the University of Michigan Health System, both in Ann Arbor. Hagood added that a deal between U of M or St. Joseph's and Allegiance might have been too close geographically to make sense for the larger systems.

Henry Ford will pour \$300 million into the new venture and the Jackson area, said HFHS COO Bob Riney. The money will be used for new facilities, information technology and other new programs and services.

"Allegiance Health physicians, executives, and community members will continue to represent local interests on the board of trustees and governance committees, as well as other leadership roles," according to a statement from HFHS.

Henry Ford CFO Edward Chadwick told Crain's Detroit Business last week that the additions of Allegiance and Flint-based managed care plan HealthPlus of Michigan will add more than \$500 million to Henry Ford's bottom line.

In the same article Crain's reported that Henry Ford "recorded a 303 percent increase in operating income to \$111.9 million for fiscal 2015," which ended in December. Henry Ford's operating revenue rose from 0.5 percent to 2.2 percent from 2014 to 2015, according to the Crain's article.

Hagood said many independent hospitals and small systems will be merger and acquisition candidates in coming years. He said while he doesn't see a situation like the airlines, in which there three or four major carriers, he does see the nation's approximately 5,000 hospitals possibly organizing into 100 or so systems of 50 hospitals each.

In Michigan, he thinks the ultimate number will end up at about four health systems.

Regardless of the type of system — faith-based, not-for-profit, for profit — systems will try to organize geographically, said Hagood.

"So you at Trinity (Health) in Iowa and Michigan, and now the Northeast, and they want to be able to say, 'I've got six to 12 hospitals there, I've got a market leader, I've got my affiliations with the local academic medical centers, I can cut deals for capitated care.' So they want that concentrated market position," said Hagood.

While market consolidation might provide cost savings to the entities involved, at least so far it has not resulted in lower prices to those buying care from them.

"There are two ways to look at that," said Hagood. "Clearly these mergers create efficiencies and better access to care. It actually makes the system more efficient and reduces the cost to deliver care, but, at the same time it creates market power to charge more. And what we've seen is they do charge more.

"You have to look at it from both sides of that perspective. It's a good thing for ultimately being able to reduce the cost of care and bringing higher quality and greater access to care, but in the current environment, it's also leading to higher prices."

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