The U.S. Healthcare Bubble and The Global Race For Value

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“2010 Environmental Assessment”

“MHA Institute Talk”

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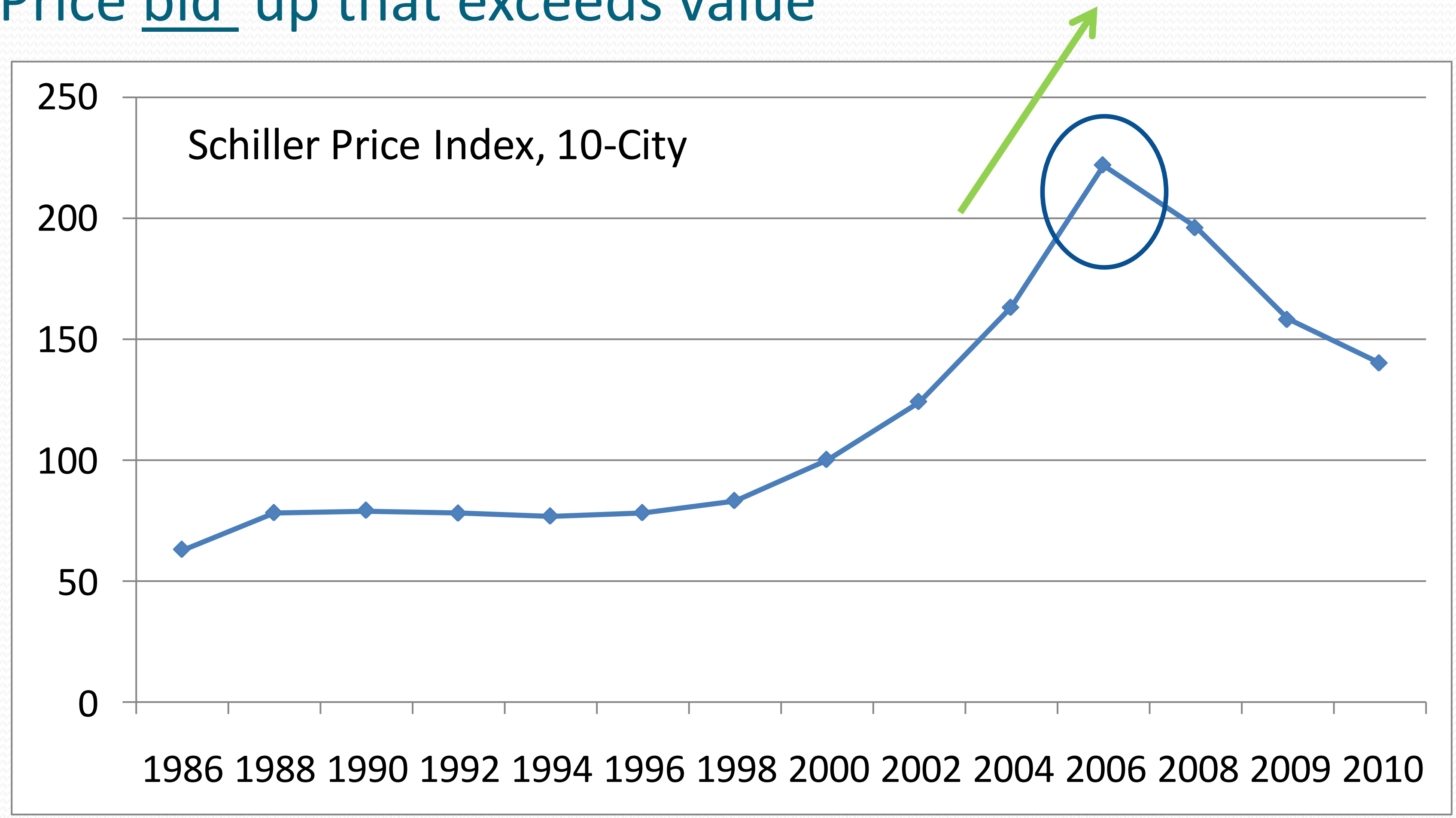
What do AIG and Healthcare have in common?

6%

The Housing Bubble

Price bid up that exceeds value

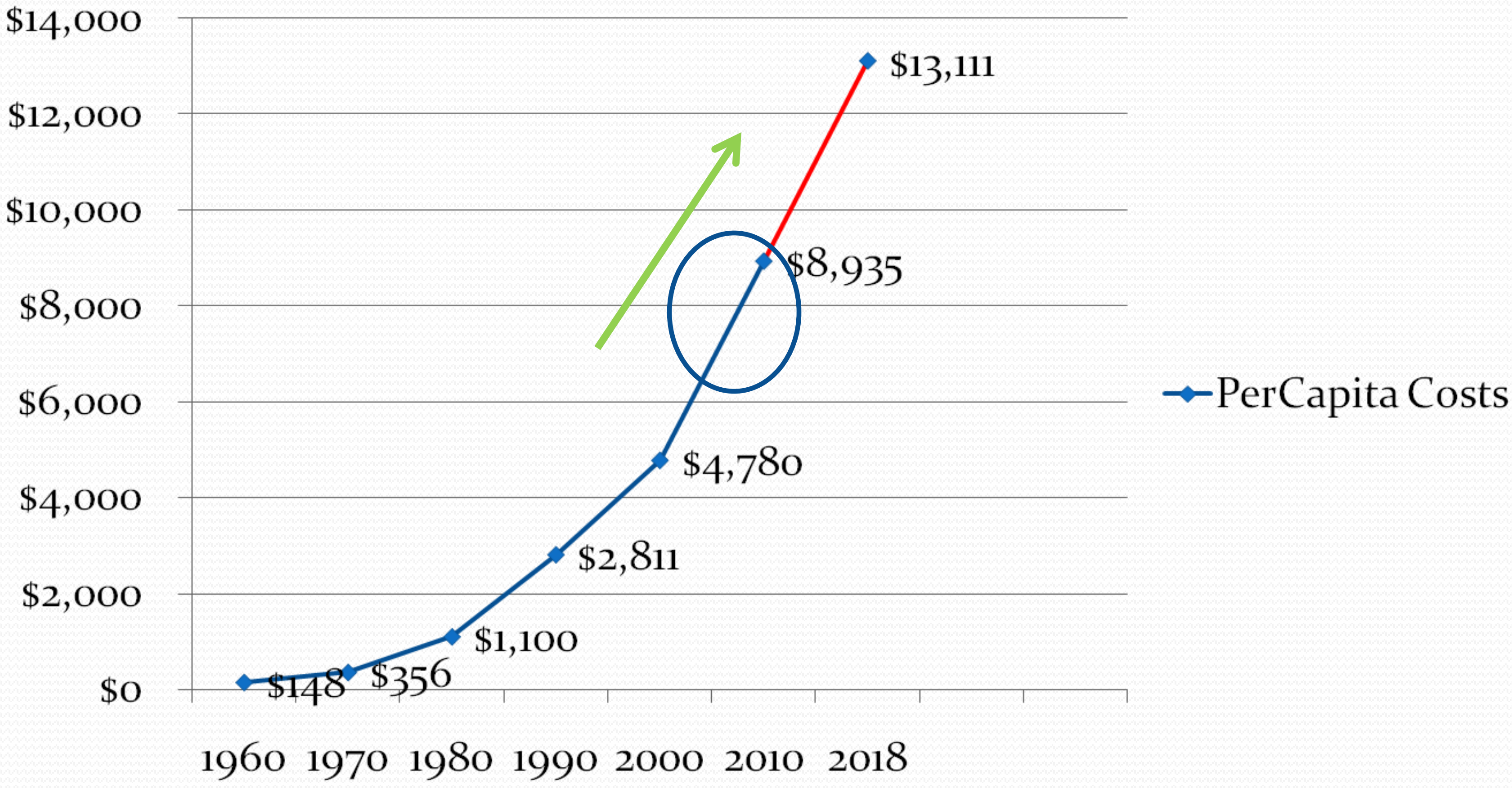


Source: Standard and Poor's

Total Expenditures – The Healthcare Bubble

1960-2008: Population has grown 1.8X, healthcare expenditures 88.9X

Price <u>built up</u> that exceeds value



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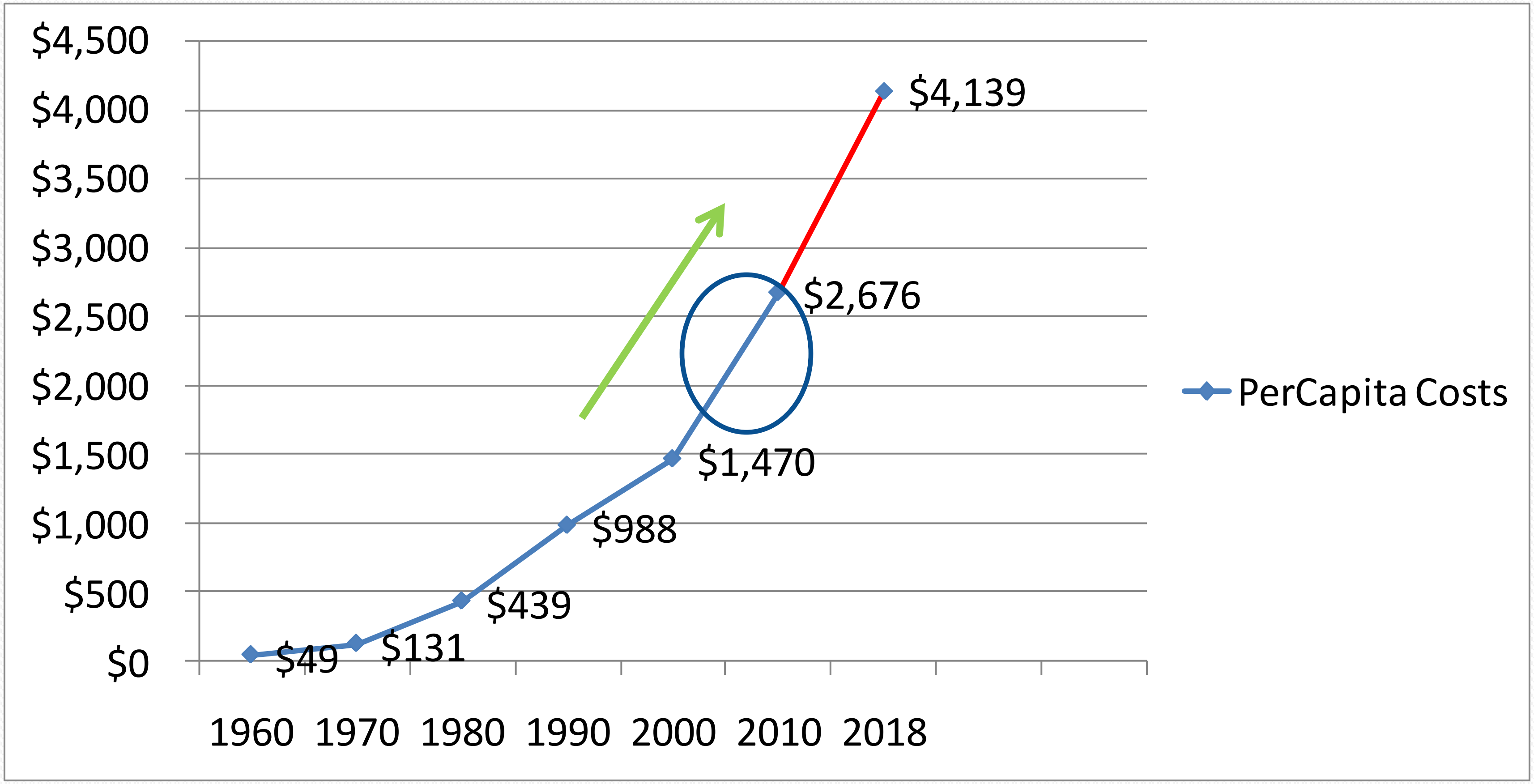
Total Hospital Expenditures – The Healthcare Bubble

1960-2008: Population has grown 1.8X, hospital expenditures 85X



Source: CMS

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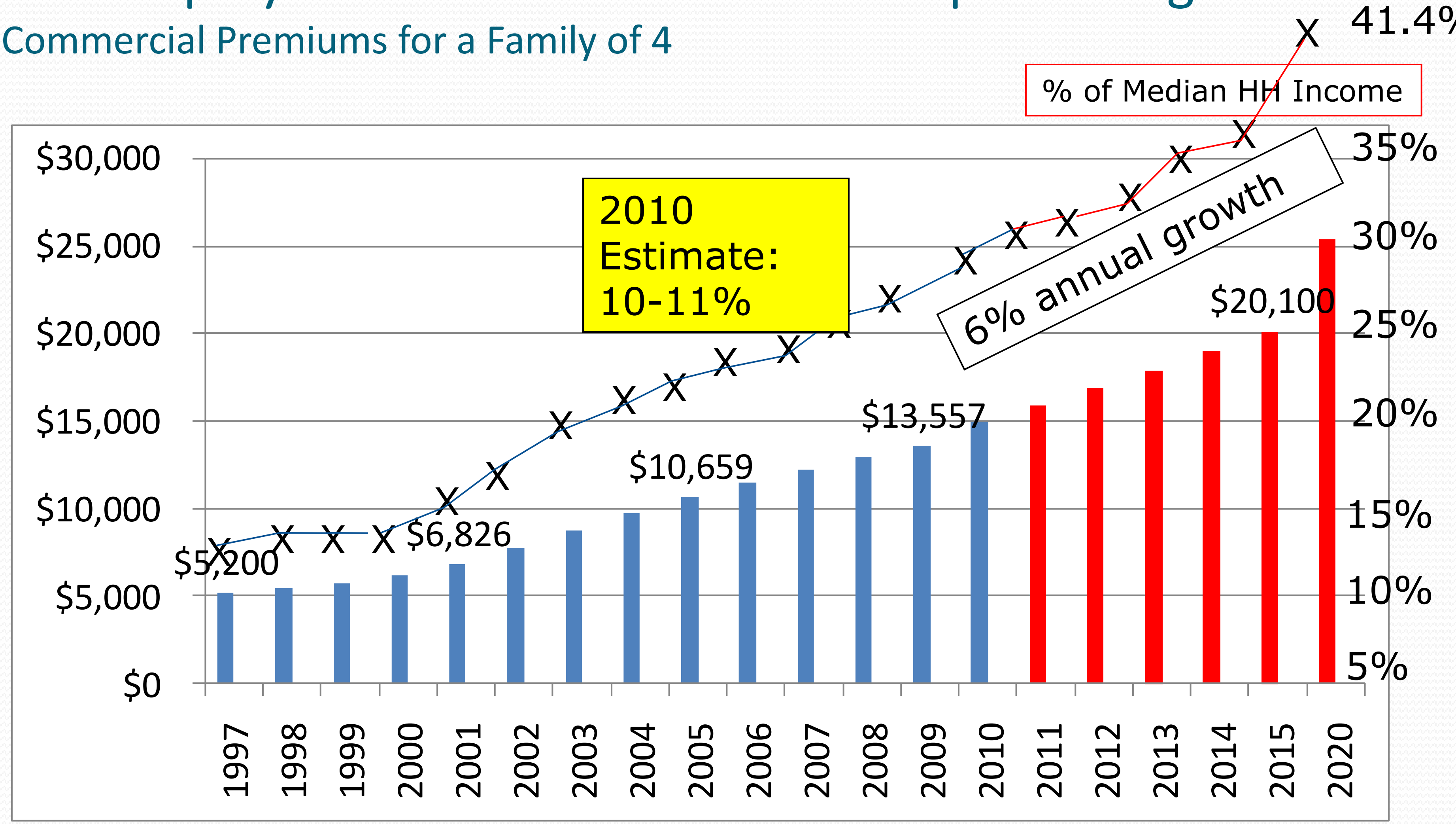
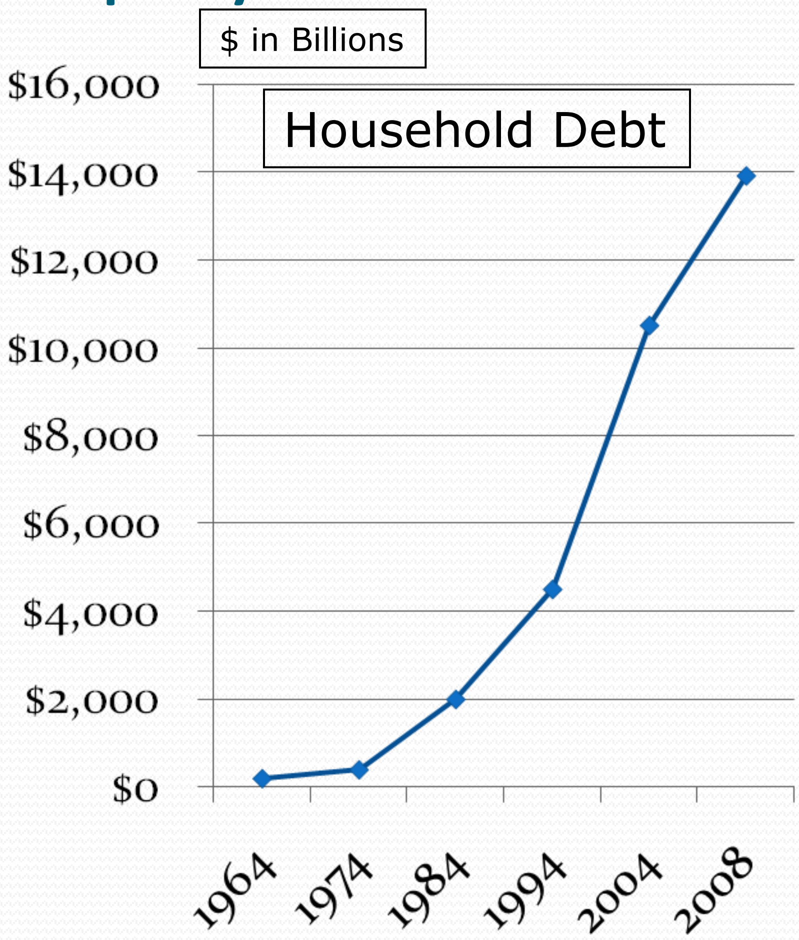
Will Employers Allow the Bubble To Keep Growing?

Commercial Premiums for a Family of 4



Source: Kaiser Family Foundation, MedTrend analysis, PriceWaterhouse Coopers

Employers and Consumers Maxed Out



Source: Bloomberg

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Massive Downsizing of Perceived Wealth

- $17 Trillion loss of value in real estate, stocks as of 11/09
- Under-saved, under-pensioned and realizing it
- <u>Median household income dropped 3.4% in 2009; now lower than a decade ago</u>
- Company margins will feel pressure without the benefit of rising asset values sneaking into margins
- = New Pressure On Healthcare

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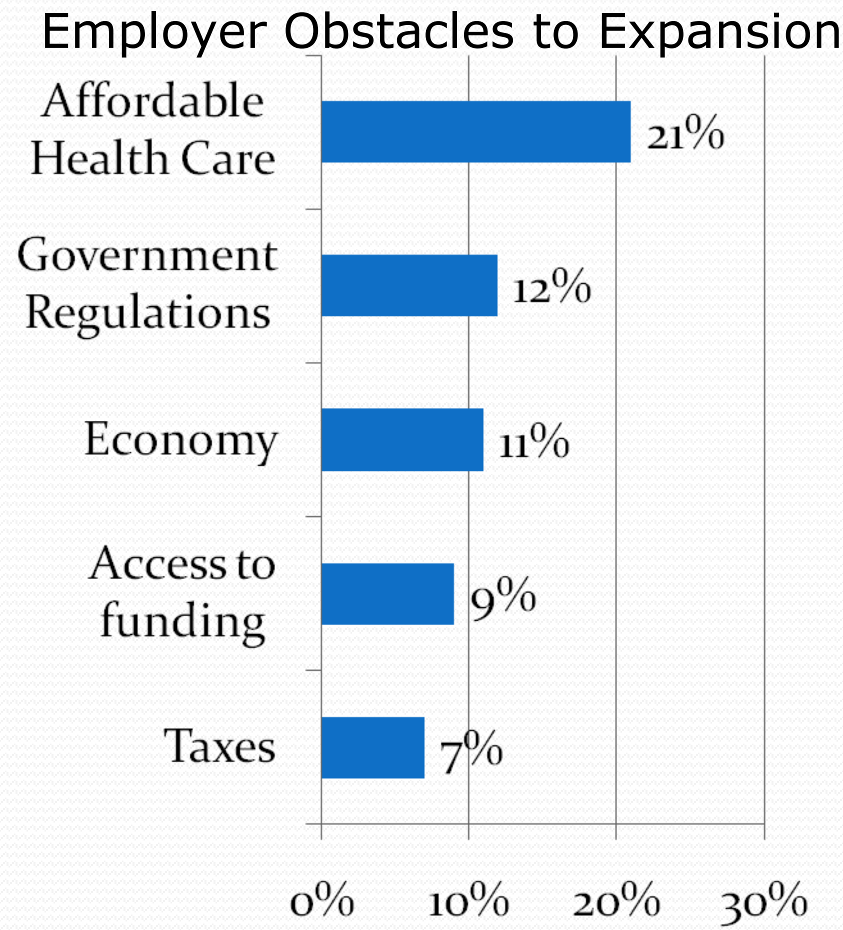
The New Economy

- Loss of 12,000,000 jobs
- Long, slow recovery
- MN and WI employers survey on "Obstacles to Expansion" –
- Affordable Healthcare is #1



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What No One Knows

Single Payor

Consumer Driven

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The End Game is Clear

- The core implication to hospitals (and their suppliers) is <u>the same </u>regardless if we end up single payer or more consumer driven:
  - In either scenario the #1 issue is affordability.
  - <u>**The healthcare growth bubble will burst.**</u>

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The Old Healthcare Story

- BRICKS – If you build it they will come…

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Healthcare Bubble: So What?

- Margin =

(Volume X

Price)

- Cost

- Escalating War on Volumes: Reduce Insatiable Demand
- Your Price = Medicare Reimbursement
- Cost Destruction …. Or Die

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Healthcare will change more between 2010 – 2020 than it did between 1965 – 2009

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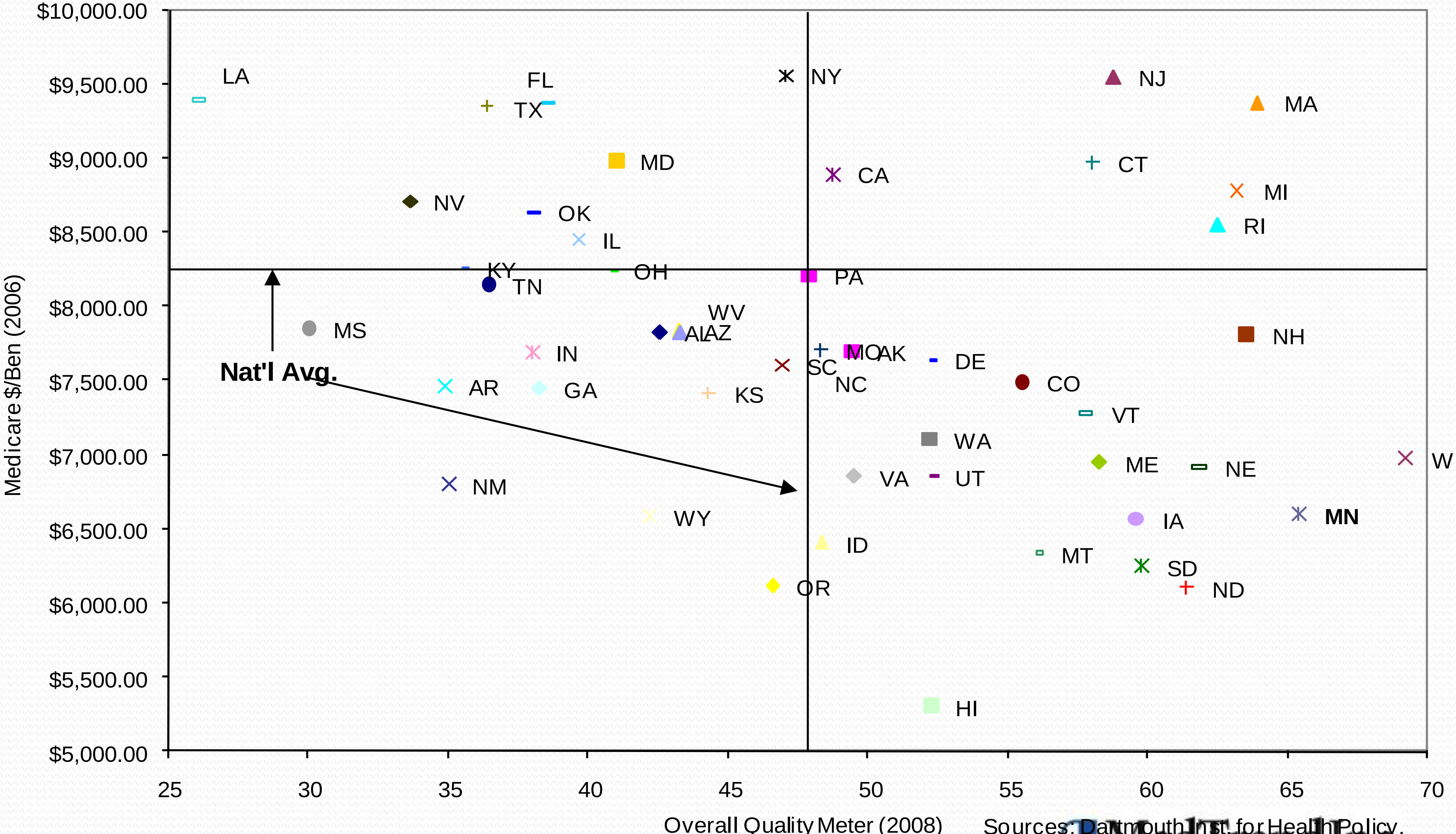
Value Comparison by State



Sources: Dartmouth Inst. for Health Policy, 2008 NHQR State Snapshots

Source: Dartmouth Atlas, MedTrend Analysis

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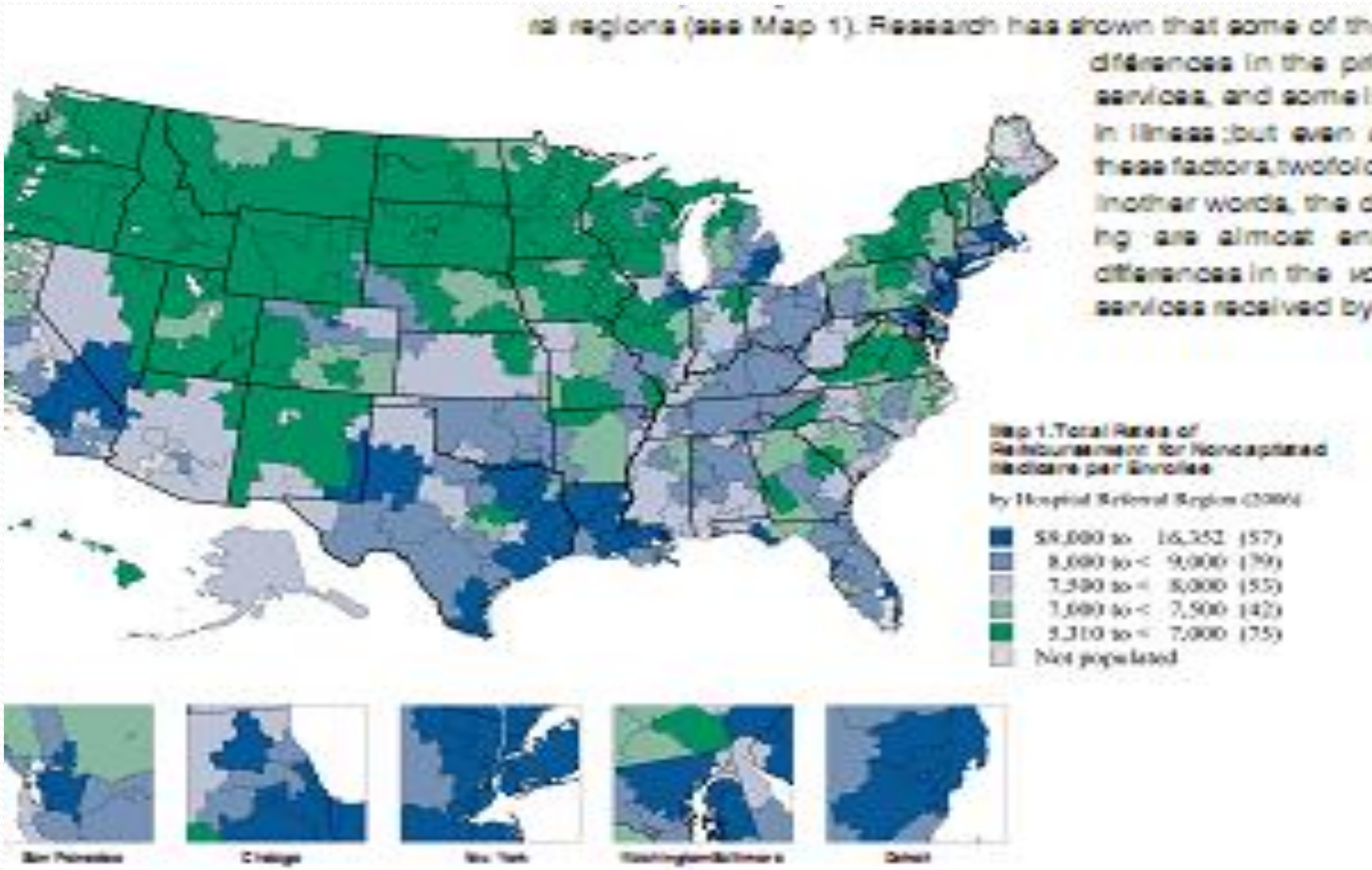

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Minnesota: Are We Different?

Inpatient

INPATIENT	2005	2008	Change
Admissions	630,577	637,183	6,606 (+.33%/yr)
Days	2,987,706	2,943,441	44,265 **(+.5%/yr)**
Surgeries	204,762	186,775	(17,987) (-3%/yr))
Population	5,105,000	5,220,000	115,000 (.75%/yr)
Gross Inpatient	$13,866,748,412	$17,008,252,322	+$3,141,504,000
Gross/Day	$4645	$5780	24% or **8% /year**
Per capita	$2715	$3260	20% or **7%/year**

Source: AHA Hospital Statistics, 2010 Edition

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Minnesota: Are We Different?

Outpatient

OUTPATIENT	2005	2008	Change
ER Visits	1,717,155	1,772,982	55,827 (1%/yr) **
Other Visits	7,725,310	8,233,087	507,777 (2.2%/yr)
Surgeries	300,667	294,628	(6039) (-.7%/yr)
Population	5,105,000	5,220,000	115,000
Gross Revenue	$9,152,203,000	$12,005,677,625	+$2,853,464,000
Per capita	$1793	$2300	28% **or 9.4%/year**

Minnesota has 54 freestanding surgical centers; 15 new centers opened Between 2005 and 2008. These are not included above.

Source: AHA Hospital Statistics, 2010 Edition

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Minnesota Hospital Cost Inflation

2005-2008

	2005	2007	% Change
NET Per Capita Expense	$1992	$2376	19% or **6.4%/year**

Source: AHA Hospital Statistics, 2010 Edition

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Pressures to Re-design Delivery Costs

Government:
REFORM

Marketplace
Changes

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Federal Reform: When It Happens… Areas of Consensus

- Insurance Exchange
- Guaranteed issue and renewal
- Individual mandate
- Premium subsidies
- Medicaid expansion
- Readmissions payment policy
- Administrative simplification

Cover more Americans

Pay for value/ results

Reduce admin costs

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The Big Deal = New Payment Methods

- **Regardless of reform**
- Incentives drive behavior = how medicine is practiced and delivered
- <u>Undergoing a sea change NOW</u>
- Bundled payment Medicare demonstration projects (5+) : acute and post acute

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Changing Reimbursement Models

Volume Based → Performance Based

CURRENT	IN DEVELOPMENT	IN DEVELOPMENT	FUTURE
MN Medical Home	In the Federal Bills	In the Federal Bills	
Pay-for-Performance • a strategy to offer incentives to providers for providing high quality care	**Value Based Purchasing** • a strategy that holds a percentage amount of reimbursement at risk that can be earned back through high performance	**Bundled Payment** • a strategy that provides a single payment for episodes of treatment to be shared by doctor and hospital	**Global Payment** • a strategy where all services are included in a payment that manages the patient across the delivery system

Source: Pricewaterhouse Coopers 2009

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The Direction of Payment Change: Less $, More Risk

- MN: GAMC cuts…impact of medical homes
- REFORM
  - Market basket cuts –
- Value based reimbursement : +/-3%
- Bundled reimbursement – 3 days prior to 30 days post discharge
- Accountable Care Organization: gainsharing on Medicare savings

- MEDPAC
  - Inpatient at .2%
  - Pay for performance

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Result of Payment Changes?

- Formation of "Accountable Care Organizations":
  - Can manage the payment/ risk; integrate/ coordinate the care
  - Drive for best outcome at best price
  - System based or virtual; Everyone is working on it…

  - Independent hospitals have to determine their strategy

  - Best performers will have:
    - Integrated clinical care
    - Integrated data/ EMR
    - Referrals tied to performance

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Result of Payment Changes?

- Acceleration in consolidation/ acquisition/ integration
  - Experts predict majority will occur among non-profit rural and urban hospitals with greater percentage of Medicare, Medicaid, uninsured
  - "Price" of acquisition ½ of what it was 3 years ago
    - HMA and Irving Levin Associates Report 2010

MN Consolidation/ Integration

- Long term: end of the independent hospital + independent clinic --- to Regional Systems
- Options for independent hospitals
  - (1) Become part of a system
  - (2) Integrate with doctors and fight
    - Drivers: Payment change, EMR meaningful use, declining MD incomes, medical home

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Reform Impact on CAH?

- Preserve CAH funding
- Demonstration projects with CAH for bundled payment/ episodic payment
- Potentially more coverage- likely Medicaid
- (But I see increased activity now in physician-hospital collaboration; physician involvement)

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Doctors Rising Up

- Coming declines in reimbursement
- KNOW they drive the hospital revenues
- Won't accept more declines in income – new level of anxiety and desperation

- Driving EMR decisions within the hospital
- Demanding more help financially in multiple ways
- Most anxious – align with a system now
- Opportunity to get alignment in place

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Medicare 2010

- May 1 2009 Announcement:
  - 2010 increases well below 1%
    - .2% for acute care hospitals
    - .6% for long term care hospitals
- Signaled *larger* reductions coming in next two years

- Glenn Hackbarth, chairman of the Medicare Payment Advisory Commission (MedPAC), <u>Medicare payments are still "adequate to cover the costs of efficient hospitals."</u>

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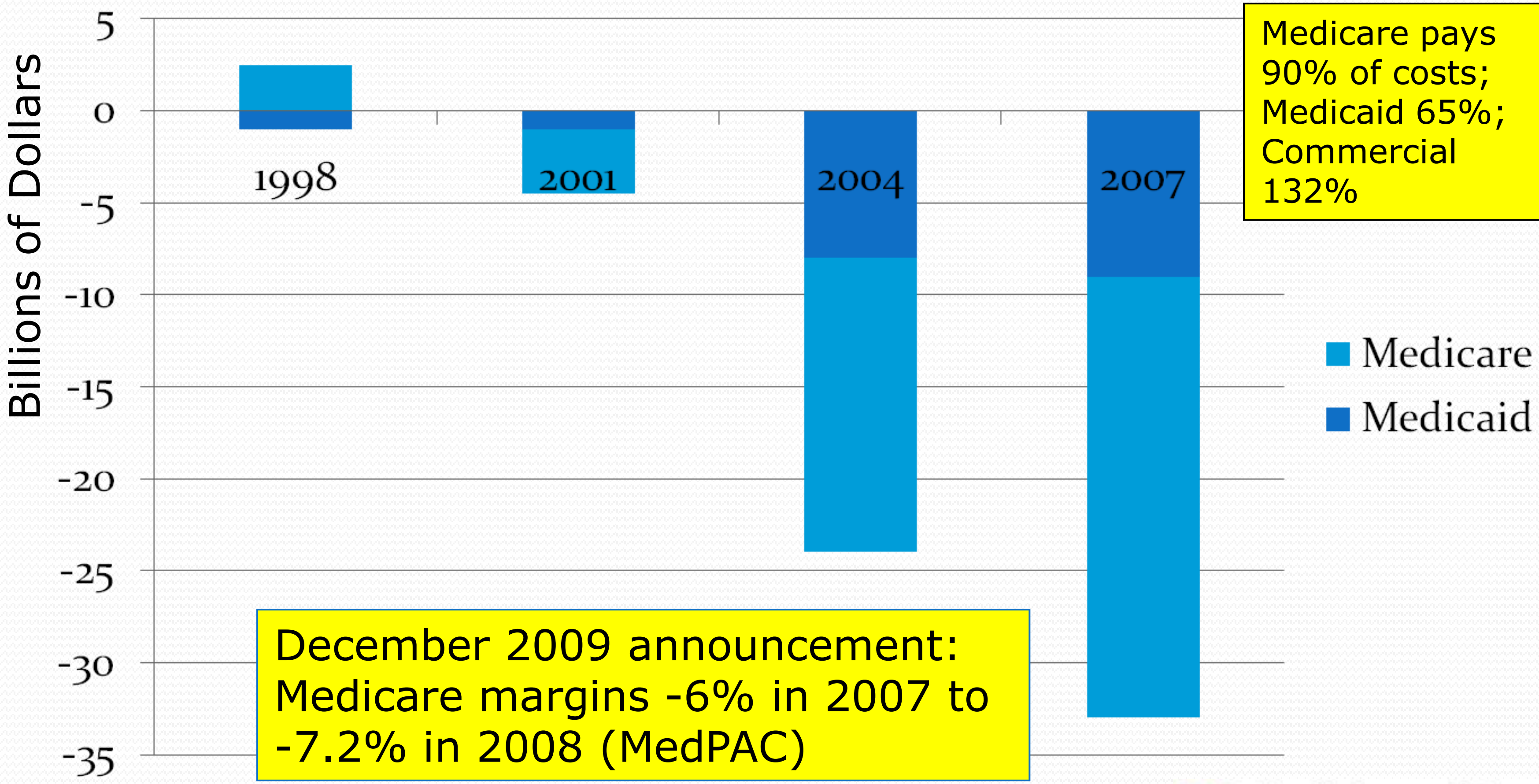
MedPac Jan 15 2010

- Recommendation to Congress:
  - 2011 market basket update +2.4%
  - Implement new pay-for-performance
  - Inpatient payments down 2%
  - <u>NET payment on inpatient 2011 : +.4%</u>
  - <u>Physicians +1% - BUT -21% coming…</u>

Growing Gap: Reimbursement versus Cost

Hospital Payment Shortfall Relative to Costs for Medicare and Medicaid



Medicare pays 90% of costs; Medicaid 65%; Commercial 132%

December 2009 announcement: Medicare margins -6% in 2007 to -7.2% in 2008 (MedPAC)

Source: AHA

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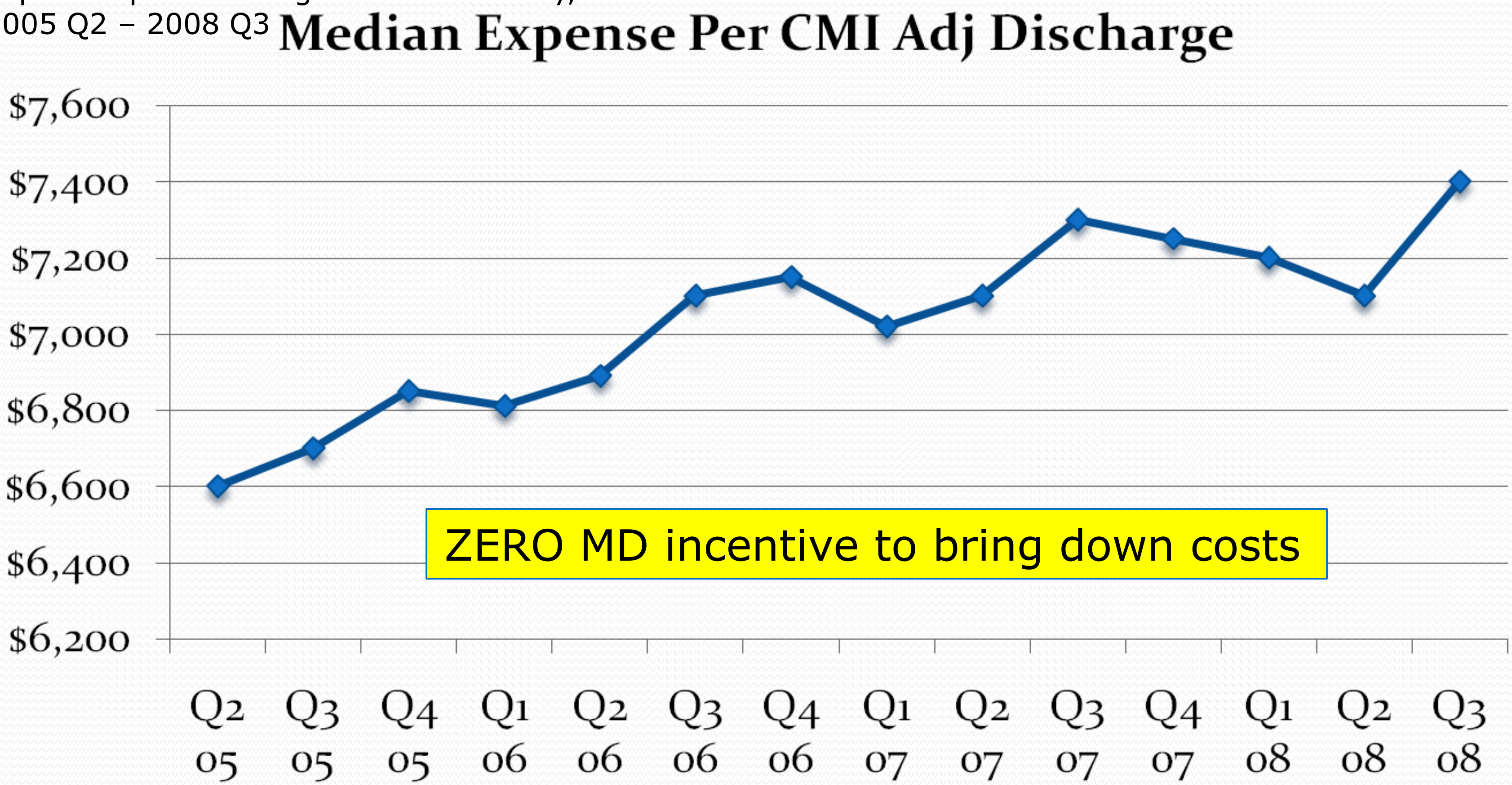
Looking Like GM:
No Evidence of Hospital Cost Reduction

Expenses per Discharge and Patient Day,
2005 Q2 – 2008 Q3



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Source: Thomson Reuters, 2009

The Unthinkable

You have to figure out how to make money on Medicare

“Forward thinking hospitals are concentrating all their efforts into being able to make money on Medicaid and Medicare” Tim Ranney, MD, EVP Catholic Health Initiatives Nebraska

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Impact to Hospitals

- Focus: cost, cost, cost – get it out
  - Strategy: Our price = Medicare
  - Strategy: Align with the doctors
  - Strategy: Consolidate – get scale
  - Strategy: Get price concessions from vendors
  - Strategy: Right size/ downsize/ layoff
  - Strategy: Re-design (IT, etc.)
  - Strategy: Close some product lines down
- How do we accept bundled payment?

Commercial Market Forces for Change:
Reduce Demand
Increase Value Competition

Commercial Insurers/ Employers Will Not Continue To Pay 132% of Cost….

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Healthcare History: If You Build It They Will Come

- No rational market : Dartmouth Atlas…
- <u>*Elasticity of demand enters healthcare*</u>
- Small changes in demand = big impact in high fixed cost industries
  - Airlines, Automobiles, Housing….. HEALTHCARE

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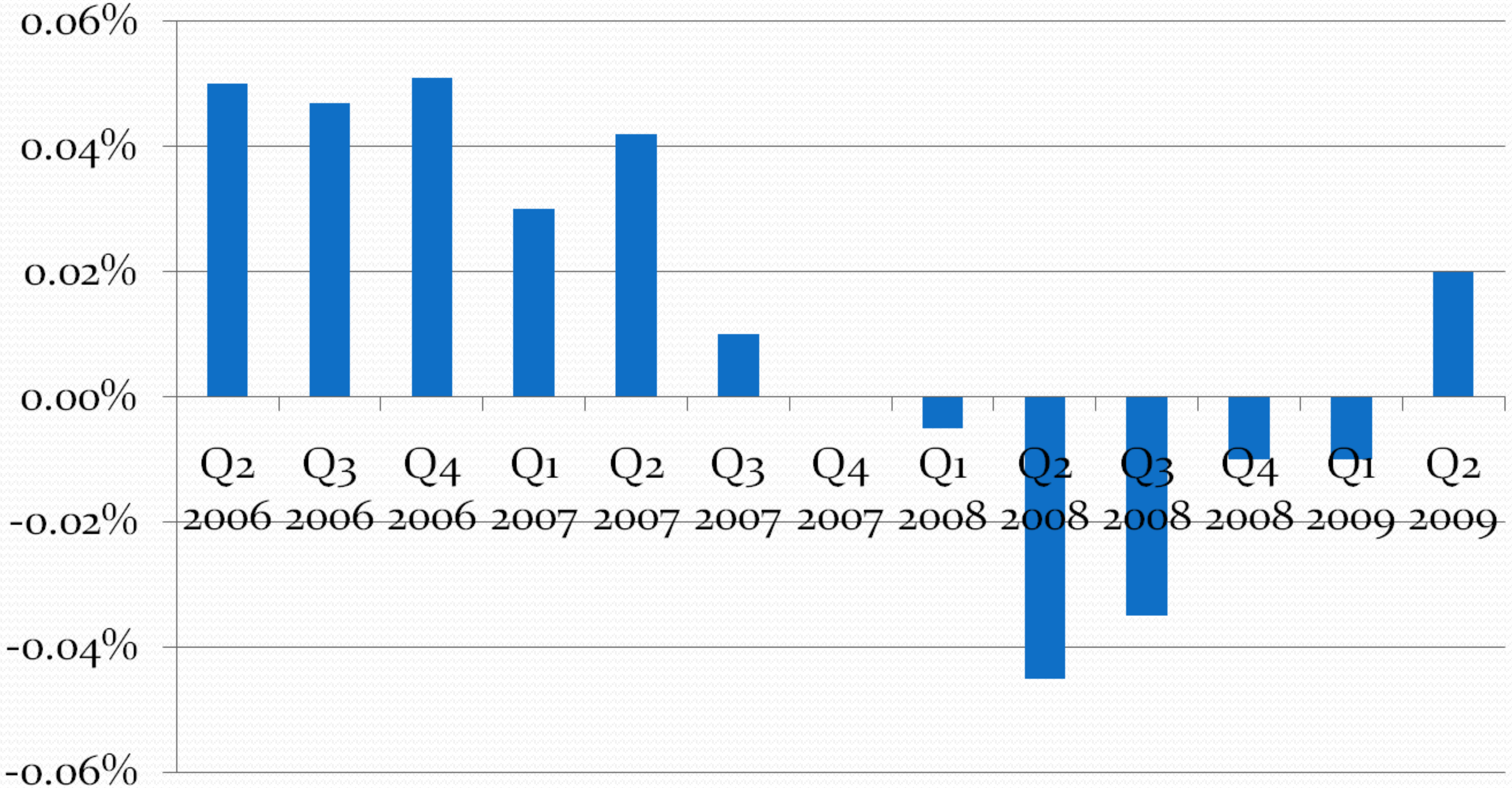
Annual Change in Discharges

All Hospitals, Q2 2006 – Q2 2009



Source: Thomson Reuters, September 2009

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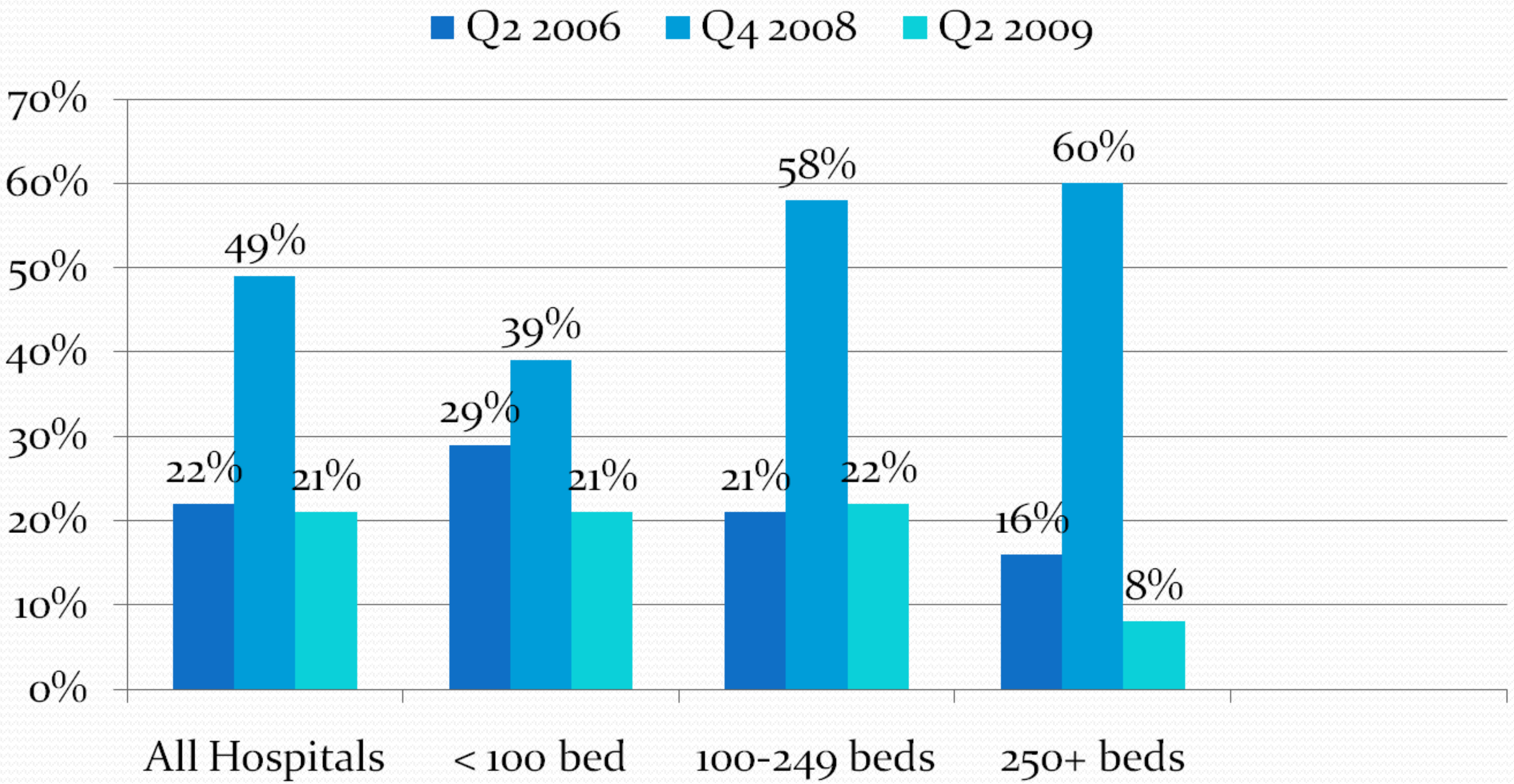
Hospitals: Have They Returned to Pre-Recession Status?

% of Hospitals with Negative Total Margins



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The Employer War : Push Cost to Employees (or drop coverage)

- "**<u>Never waste a good crisis</u>**"
- Growing % of high deductible products
- Growing % of consumer directed health plans : high deductible + HSA

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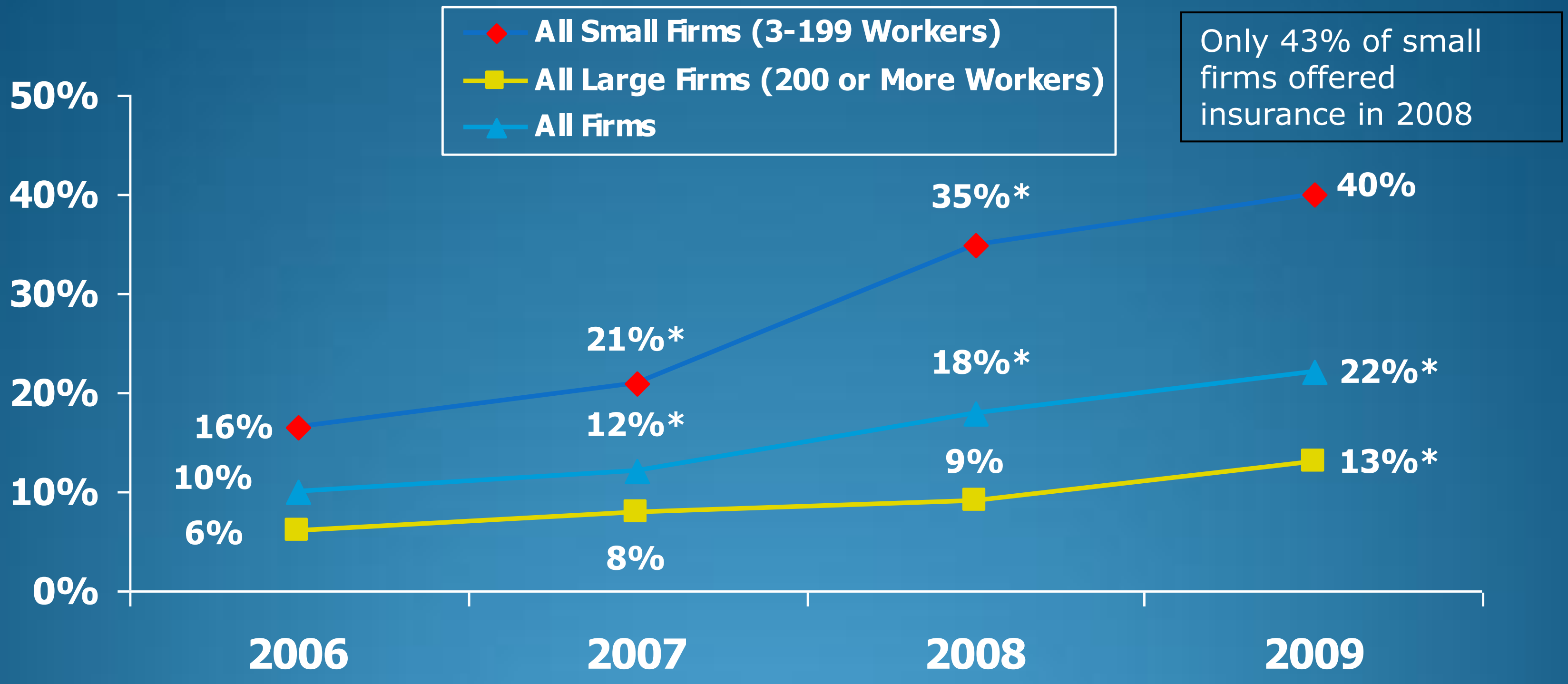
Percentage of Covered Workers Enrolled in a Plan with a General Annual Deductible of $1,000 or More for Single Coverage, By Firm Size, 2006-2009



*Estimate is statistically different from estimate for the previous year shown (p<.05).

Note: These estimates include workers enrolled in HDHP/SO and other plan types. Because we do not collect information on the attributes of conventional plans, to be conservative, we assumed that workers in conventional plans do not have a deductible of $1,000 or more. Because of the low enrollment in conventional plans, the impact of this assumption is minimal. Average general annual health plan deductibles for PPOs, POS plans, and HDHP/SOs are for in-network services.

Source: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 2006-2009.

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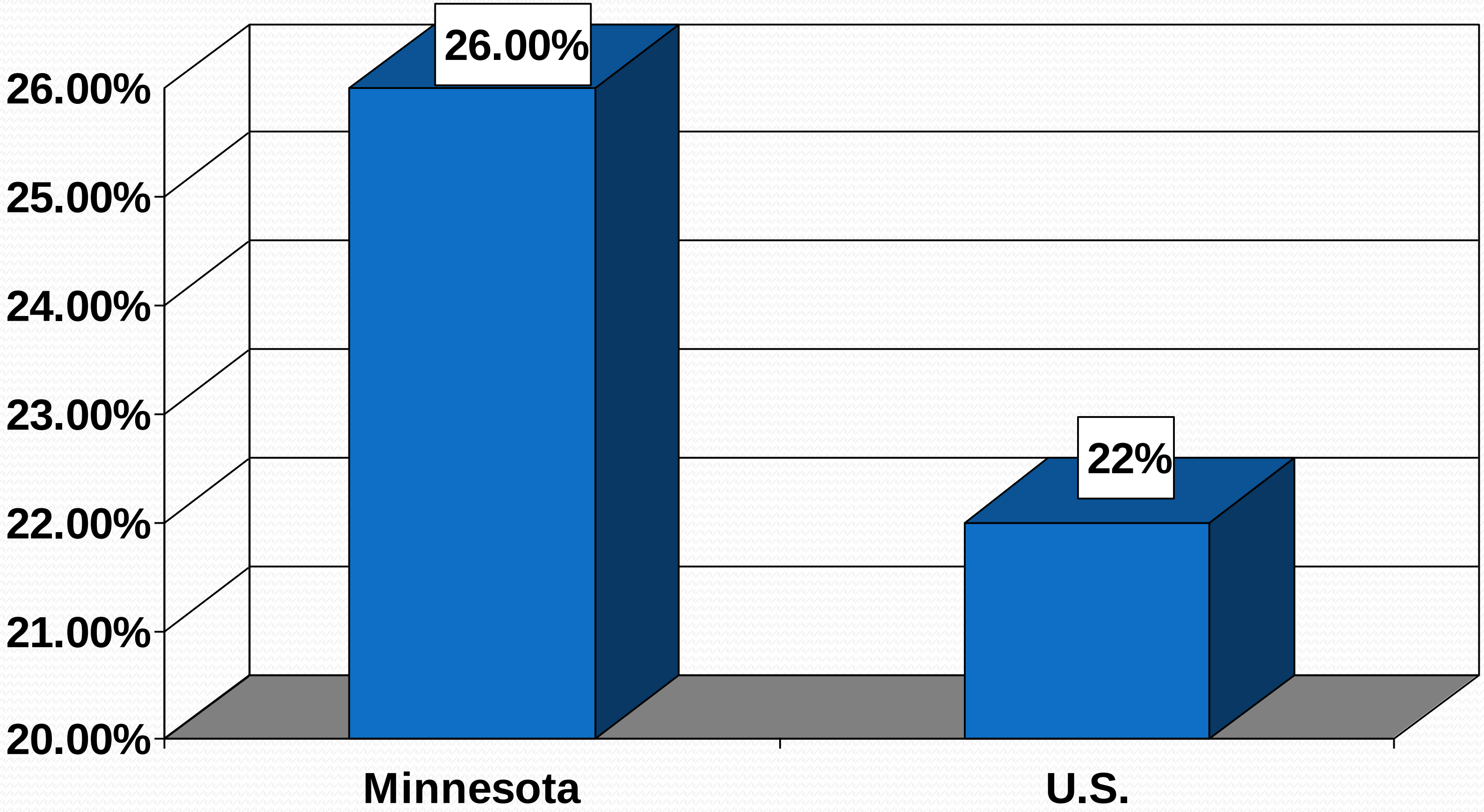
HSA Penetration 2009

Minnesota Leading the Way…50% by 2010?



Medtrend Analysis

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Minnesota HSA: Plan Deductibles

- New higher deductibles
  - BCBS:
    - Single deductibles up to $8,000
    - Family deductibles up to $12,000
  - Medica:
    - Single deductibles up to $5800
    - Family deductibles up to $9800

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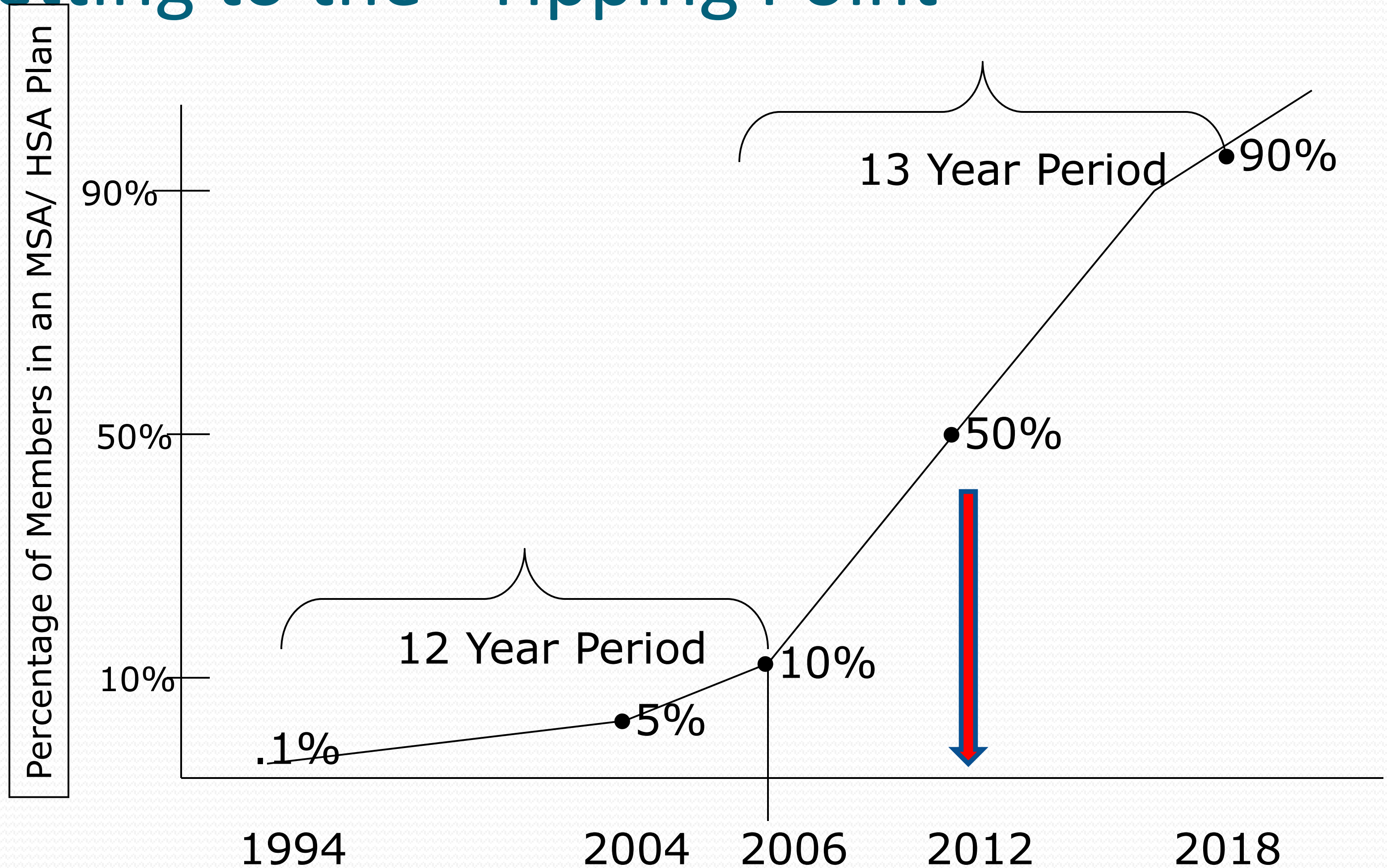
HSA's:
Getting to the "Tipping Point"



Following the standard "S" curve adoption rate

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HSA's = Hospital Volumes Drop

- United Health Group:
  - 12% reduction in utilization rates under the deductible
- Minnesota HSA enrollees – 15% reduction in care

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How much does an MRI cost?

a) $750.00

b) $850.00

c) $3000.00

d) Depends on where you go

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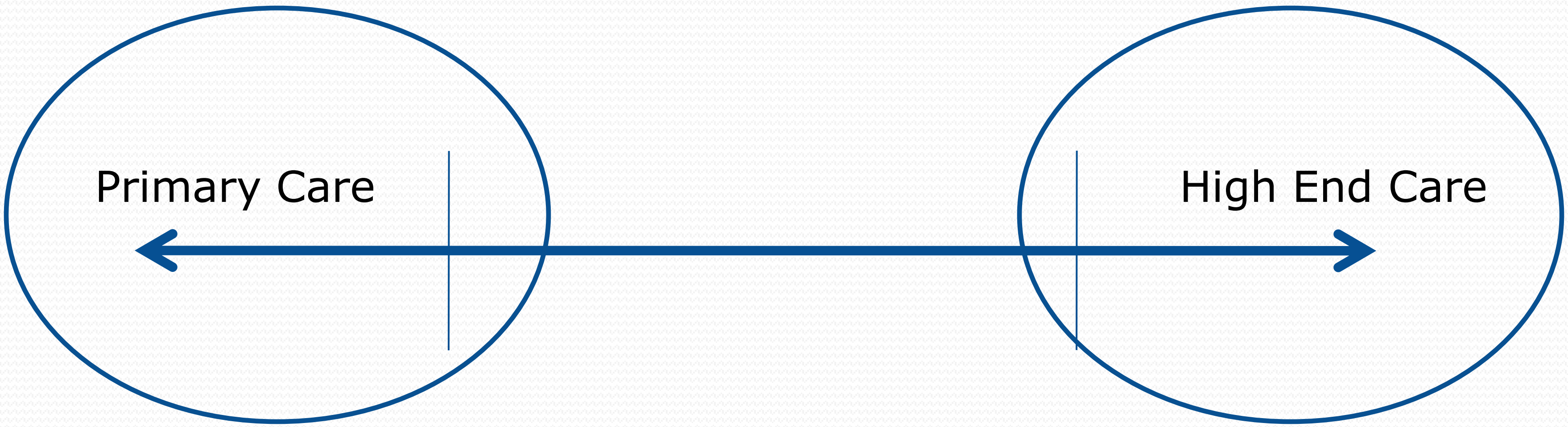
Value Innovation: Not From Us



High Volume

Low Margin

High Margin

Low Volume

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Primary Care

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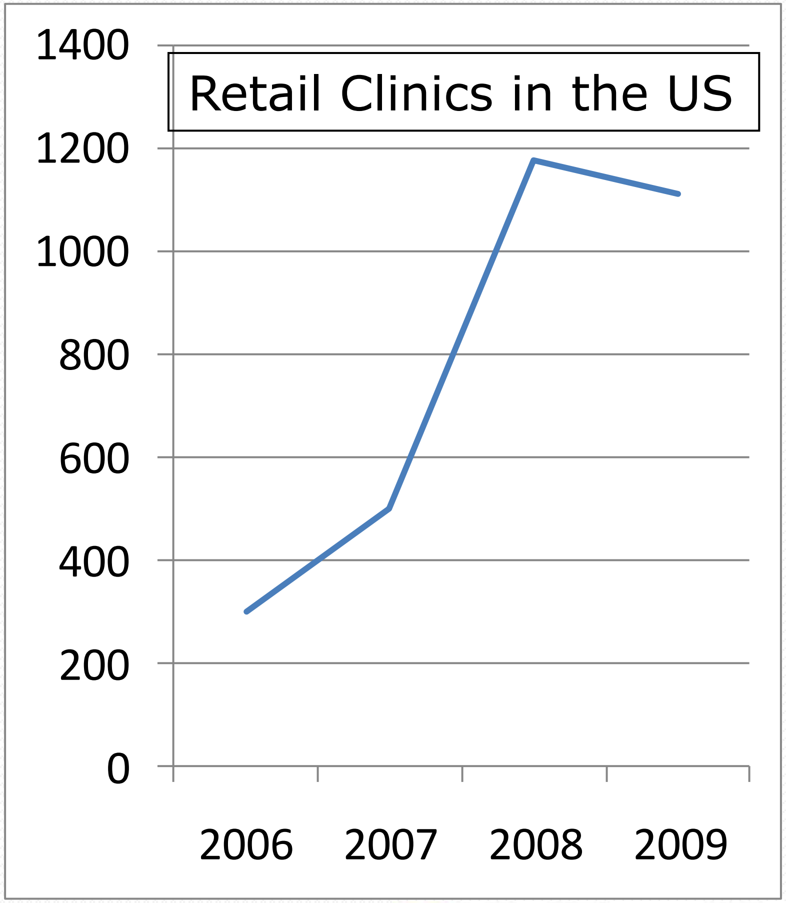
Retail Grows…

And In 3 Years Hospitals Go From "No Way" to Having a Retail Clinic

- Large potential market
  - 10% of physician visits non-urgent, low acuity; 14% of ER visits
- Largely owned by Pharmacy/ PBM companies
- Adding asthma, diabetes services
- Forecast
  - MinuteClinic (CVS) 500+ by 2010
  - Take Care (Walgreens) 1400 by 2010
  - RediClinic (Walmart, Walgreens) 500 by 2010
  - SmartCare (Kerr, Walmart, Kroger) 1050 by 2012



Source: Deloitte and Forrester

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High End Care: Go to India

High End Care

And In 2009 Hospitals Say "No Way"

- 2010 Estimate: 6 Million Americans will go Abroad
- 39% of consumers say they would consider going overseas for a surgical procedure if they could save 50% or more on costs and be assured the quality was equal to or better than US care (Deloitte, 2008)
- **Only 12.5% of US hospital leaders believe global medical travel will have a negative impact on their business (HealthLeaders Survey, 2009)**

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Will We Be The Next GM?

- " This has the potential of doing to the U.S. health care system what the Japanese auto industry did to American carmakers."
    - Uwe Reinhardt, Princeton Healthcare Economist
- GM
    - Built an unsustainable model
    - Out-competed by better value global companies
    - Bailout then bankruptcy
    - Wage/ benefit concessions

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Savings Are Enormous

Savings for Typical OffShore Elective Procedures

Procedure	US Inpatient Price ($)	US Outpatient Price ($)	Average 3 Lowest Foreign Price + Travel ($)
Knee Surgery	$11,692	$4,686	$1,398
Shoulder Angioplasty	$6,720	$8,972	$2,493
Hysterectomy	$6,542	$6,132	$2,114
Weighted Price of a Procedure	$10,629		$1410

Source: Deloitte, "Medical Tourism", 2008

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Savings Are Enormous

Savings for High End Procedures

Procedure	USA	India	Thailand	Singapore
Heart Bypass	$130,000	$9,300	$11,000	$16,500
Heart Valve Replacement	$160,000	$9,000	$10,000	$12,500
Angioplasty	$57,000	$7,500	$13,000	$11,200
Hip Replacement	$43,000	$7,100	$12,000	$9,200

Source: Medical Tourism Association, 2009

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US Health Plans and Employers add Global Hospitals to the Network

- BCBS North Carolina
  - Singapore Hospitals in the network
- BCBS South Carolina
  - After visiting Thailand's Bumrungrad Hospital, began new division called Companion Global Healthcare
  - Contracts with manufacturers competing globally- global travel is already the norm for them
- Anthem – Serigraph, West Bend Wisconsin
- WellPoint (BCBS)
  - Pilot to include India Hospitals in the network
- Aetna
  - Launched a pilot partnership with Singaporean Hospitals
  - Procedures > $20K
  - Better value, better IT, better care
- United Health Group working on it

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WHERE?

- India:
  - 450,000 in 2007
  - Cost 20% of US
  - 10 JCI Accreditations
- Thailand
  - 1,200,000 in 2006
  - Cost 30% of US
  - 4 JCI Accreditations
- Malaysia
  - 300,000 in 2006
  - Cost 25% of US
  - 1 JCI Accreditation
- Brazil
  - Cost 40-50% of US
  - 12 JCI Accreditations
- Singapore
  - 410,000 in 2006
  - Cost 35% of US
  - 13 JCI Accreditations
- Mexico....growing

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Bumrungrad Hospital- Thailand

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India Hospitals

- Apollo Hospital – India
  - 1000 beds
  - Performed over 27,000 open heart surgeries with 99.6% success rate
  - 70% success rate in BMT
  - Performing multi-organ, liver, and cord blood transplants
- AIIMS Hospital – India
  - 1000 bed with attached medical college
  - 900,000 square feet, 80 acres of land
  - 750 inpatients daily
  - 22 modern ORs
  - 135 fully equipped ICU beds
  - Fully computerized, networked EMR/ HIS
  - Fully digital radiology
  - 24/7 telemedicine
  - Over 17,000 operations annually

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How Do They Do It?

- Costs are lower:
  - **<u>Higher out of pocket drives very competitive pricing</u>**

  - Labor 18% versus US 55%
    - Physicians make 40% of US rates; nurses 10%
  - Malpractice costs 1/10th
  - Medical supplies/ drugs much less
    - Why don't we push for more equal supply prices?
    - Does GM pay more for steel than Toyota??
  - IT more advanced
    - 2% of US hospital have EMR
    - Microsoft Healthcare located in Bangkok

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Global Comes To America – Importing Competition

- North American Surgery
  - Canadian company formed August 2007

- Signed up hospitals in Kansas, Michigan, New York, Oklahoma, and Washington
  - Galichia Heart Hospital in Witchita
    - "We're making money at this rate. We're challenging our colleagues to really square off against rising health care costs." Steve Harris, CEO
  - $10,000 by-pass surgery

- New England Hospitals: Match pricing

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Global Comes to the Cayman Islands

- 2000 bed general hospital being built by Indian Cardiac Surgeon Dr Devi Shetty/ family owned Narayana Hrudayalaya Group
- One hour plane ride from Miami,FL
- Have a 1000 bed hospital in India, 42 cardiac surgeons, 3174 bypass surgeries in 2008 (Cleveland Clinic did 1367) at a cost of $2000 each

- Source: WSJ, November 2009

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USA "Tourism"

- Employee financial incentives to go out of town for care
  - Taking the "transplant network" model to lower levels of care

- Lowe's waives the $500 deductible and $4500 out of pocket if employees go to Cleveland Clinic

- Handford Grocery (New England): Go to 2 specific centers and the employee saves $2500-$3500 on knee and hip replacement

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Health Plans Experimenting with Payment Change

- Typically follow changes in Medicare payment
- From Fee for Service (Per Click) to Global/ Episode Based Payment
- Same issues for providers:
  - Integration to handle bundled payment
  - Models to take on and manage risk
  - Enhanced efforts and focus on cost reduction
  - Incentives to engage doctors to help

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Delta… Now Healthcare

- Airlines
  - Consumers wouldn’t pay more
  - Fits and starts of cost reduction efforts
  - IT investments
  - Consolidation
  - <u>Pilots took 40% reduction in pay over five years</u>
  - Major concessions by labor to keep their jobs- wages and benefits

- “Having lived through the cost destruction in airlines, I am convinced healthcare is next.”
  - Health System COO/ CFO

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The Winners (and there will be winners)

- From “More Bricks” to “More Value”
  - Total revenue to Total cost/ discharge
  - Market share to Total cost/procedure
  - More procedures to Cost/total care
- From Cranes to Creative Destruction
  - Build more to Innovate more

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Short Run (3 Years) You'll See More…

- Doctor Fights to Get Income Stability
- Consolidation/ Integration
- Re-design: LEAN +
- EMR – largely doctor driven decisions
- Supply Chain/ Inventory Control Focus
- Evaluate Core Mission and Eliminate Product Lines
- Labor: Job Cuts, Salary Freeze, Hiring Freeze, eliminate 403(b) match

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Strategic Questions for Hospitals

- PRESERVE AND GROW REVENUE:
  - How will we capture local growth and keep patients in town?
  - What is the long term growth strategy? What product lines can we compete best in?
  - Where do we have critical mass we can leverage?
  - How do we maximize reimbursement in the new world?
- ENSURE VALUE/ EFFICIENCY:
  - Are we adequately focused on value creation and cost savings to meet employer/ consumer needs?
  - Can we coordinate care and get good results efficiently?

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Strategic Questions for Hospitals

- ALIGN WITH DOCTORS:
  - How do get doctors what they need and preserve some level of independence/ control?
  - What physician strategies and partnerships will best serve the community?
- PRICING:
  - How do we price to be competitive in both Medicare and commercial worlds?
- GOVERNANCE:
  - Is our governance structured to meet the strategic demands of the next five years?

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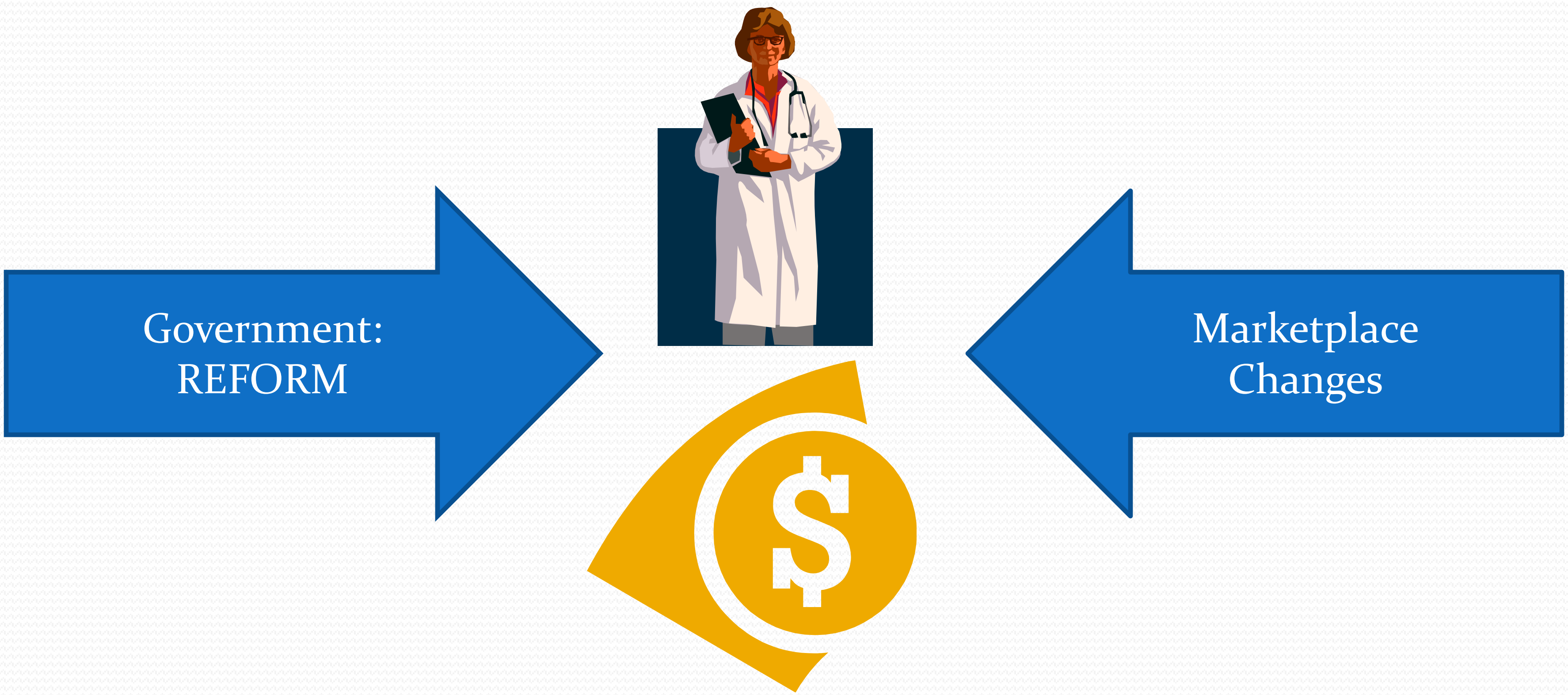
Pressures to Re-design Delivery Costs



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