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Trinity Health President and CEO Joseph Swedish and Catholic Health East President and CEO Judith Persichilli

HOLY ALLIANCE

Trinity Health and Catholic Health East mega-merger hopes to help 'both ministries to build upon our common mission' / Page 6

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Cover Story » Ashok Selvam

Major merger

Catholic Health East, Trinity deal stands out as hospitals, systems react to changes in healthcare

he drive to get big and get integrated is the defining dynamic in healthcare as providers and payers adjust to their fast-changing world.

Two large Catholic hospital systems. Trigity Health and Catholic Health Fact.

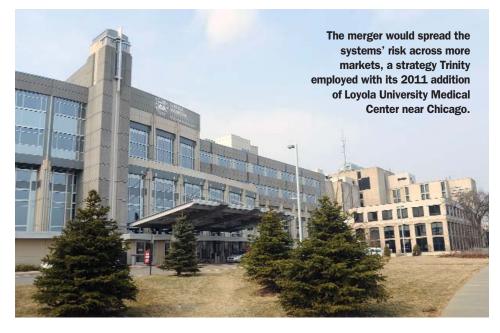
are moving toward a deal that does so in a way that's big and unusual, even judged against a parade of large and surprising matchups.

A proposed merger of Novi, Mich.-based Trinity Health and Newtown Square, Pa.-based Catholic Health East would create a massive Catholic system with combined assets exceeding \$19 billion. Together they would generate annual operating revenue of more than \$13 billion, their executives estimate. The merged system would be the third-largest not-for-profit health system in the U.S. by net patient revenue, according to recent financial statements.

And the system's combined 79 hospitals (including several Trinity manages under contract and Catholic Health East counts under joint-operating agreements) span 19 states from coast to coast. Trinity and Catholic Health East don't overlap in any of those states.

"In the world we live in, because of reform, we know scale matters, and we do believe that the opportunity that we see translates to synergy that will occur because of the combination of these two organizations," Trinity President and CEO Joseph Swedish said.

Other recent mergers and acquisitions involving hospital systems—consistently characterized by



the participants as necessary under the demands of reform and declining reimbursement from Medicare and Medicaid—have more often involved small systems and standalone hospitals joining larger organizations with deeper pockets; pairings that consolidate market share and create opportunities for integration; and expansions into new service lines that allow systems to provide a broader continuum of care.

Systems adjusting to new payment and delivery models under the Patient Protection and Affordable Care Act will look internally to reduce their cost structures, and when they exhaust those, even large ones will look for partners, said Lisa Goldstein, an analyst who covers Catholic Health East for Moody's Investors Service.

"This is one of the first that we've seen in the second wave of M&As with two sizable systems considering consolidation," Goldstein said.

The merged Catholic system could better manage its supply chain and gain leverage in purchasing, Goldstein and other observers said, and its member hospitals could more easily weather volatile times with more access to capital and with risk spread across so many markets.

Catholic Health East President and CEO Judith

Persichilli and Swedish initially spoke about their preparation for new delivery models, including accountable care organizations. They soon realized that to have the proper competencies to prosper in the future they needed to work together.

"We needed to harvest the intellectual capital in both organizations to meet those challenges in a better, faster way," Persichilli said.

The increased scale also gives the new Catholic organization a bigger say in Catholic and other healthcare matters of national significance, said Swedish, who also serves as the chairman of the Catholic Health Association's board of trustees: "We will now have a unified voice that I think is substantial."

The past few years have been active ones for Catholic hospitals and systems. Boston-based Caritas Christi Health Care sold to private-equity firm Cerberus Capital Management, yielding Steward Health Care System.

Trinity and Catholic Health East's news came a month after Ascension Health announced an agreement to take ownership of Marian Health System's 27 hospitals in Oklahoma, Wisconsin, Kansas and Minnesota. Ascension Health last week said it planned to sell its two Carondelet Health

hospitals in the Kansas City, Mo.-area to HCA (See story, p. 7).

In January, Ascension Health created an umbrella company, Ascension Health Alliance, over its hospital system and stable of subsidiaries—to which the company recently added a group purchasing organization. Not long before that, Ascension Health formed a joint venture with a private-equity firm in 2011 that intends to buy Catholic hospitals in order to make sure they stay Catholic.

Another large Catholic player, then called Catholic Healthcare West, last year severed its formal ties to the Catholic church and moved forward under the name Dignity Health, with a commitment to continue its Catholic mission while expanding eastward by acquiring hospitals, Catholic or not.

Dignity Health in August paid \$455 million to acquire U.S. HealthWorks, a network of 172 occupational health and urgent-care centers, deals that significantly increased the system's geographic footprint as well as its reach in outpatient care.

Trinity Health's hospitals are primarily in the Midwest, although the system owns 436-bed St. Agnes Medical Center in Fresno, Calif., and sponsors two small hospitals in rural Oregon. Its sole presence on the East Coast is 425-bed Holy Cross Hospital, Silver Spring, Md.

Catholic Health East operates hospitals from Fort Lauderdale, Fla., to Portland, Maine, although the system intends to sell its Mercy Hospital there to Steward Health Care.

An April ratings report by Moody's observed that a challenge for Trinity Health—though the system's operating income and cash-to-debt-service ratio have been solid—is that 41% of its cash flow in fiscal 2011 was generated in the economically strapped state of Michigan. Moody's noted the system had since made the significant addition of Loyola University Health System in Maywood, Ill., just outside Chicago, a deal completed at the start of its fiscal 2012.

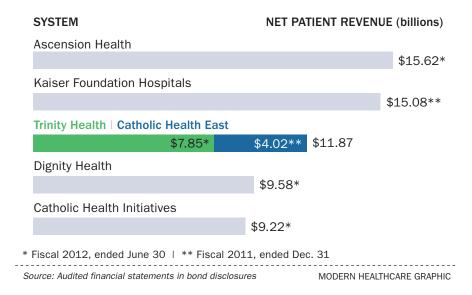
"Both of our organizations are financially strong, we have good ratings," Swedish said. "I would not anticipate there being a change, but obviously that's subject to review."

Kay Sifferman, a Moody's analyst who follows Trinity, said Catholic Health East would benefit most from the diversification of cash flow and market risk. Catholic Health East has suffered from persistent operating losses at facilities in New Jersey, according to a Moody's June ratings report that also noted steady improvement in the system's operating margins and cash flow.

"It does appear that these organizations, to me, are trying to build scale and scope to position themselves for the next fairly significant transformation in payment reform, whether it's local, state or a federal move from encounter-based to payment systems really more oriented toward population management," said Lawrence Garcia, an attorney at the

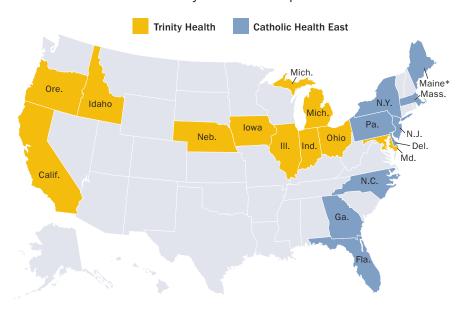
NEW ORDER

The union of Trinity Health and Catholic Health East would put the combined organization among the top five not-for-profit systems in the U.S.



COAST TO COAST

A proposed union of Trinity Health and Catholic Health East would create a system with hospitals in 19 states



* Catholic Health East has a deal pending to sell its one Maine hospital.

Sources: Trinity Health, Catholic Health East

MODERN HEALTHCARE GRAPHIC

Sacramento, Calif.-based office of Gordon & Rees, who worked for Catholic Healthcare West when it formed as a four-hospital system in 1986. He said a shared vision would best serve Trinity Health and Catholic Health East.

The organizations' boards met for the first time July 2. Persichilli said the meeting showed the two groups' cultures were a good fit: "It was like they had been meeting for years," she said.

Swedish said synergy is rooted in the systems'

similar histories, which date to a previous wave of hospital mergers and acquisitions.

Catholic Health East formed in 1998 when Allegany Health System, Eastern Mercy Health System and Sisters of Providence Health System merged. Two years later, Holy Cross Health System and Mercy Health Services formed Trinity. Swedish looked back at the groups' origins and called the merger a "natural progression."

"Exceptional care is really a significant focus of ours as we come together so we can better serve people much more efficiently based on our Catholic tradition," Swedish said.

The shared Catholic heritage helps, but it's not the only reason the pairing makes sense, said Neal Hogan, a managing director in the Boston office of BDC Advisors, a healthcare consulting firm.

The systems also have similar strategic philosophies, Hogan said. "For example, both of them

have been very interested in working closely with physicians for a long time."

Catholic Health East stands to benefit more from the deal, he said. It will have access to more capital and Trinity's resources, such as a better information technology infrastructure. Hogan said he didn't think Catholic Health East is "sized enough" to leverage their own resources.

He also foresees more Catholic organizations pursuing deals. "If you're a smaller Catholic provider, I think every organization right now is thinking 'How big do we need to be?'" he said. "If we're going to shift to value-based operations, size matters."

The systems over the past few years have made similar efforts to operate more efficiently, Swedish said, including implementing electronic health records.

The parties did not disclose financial terms or the

mechanics of how the companies would combine their assets and governance. The news release issued and filed with bond investors does indicate that there would be a "new organization"—rather than Trinity absorbing its smaller partner—and that Swedish would take the helm as CEO, with Persichilli serving as executive vice president. The companies hope to reach a definitive agreement by spring 2013, according to the release.

"Obviously, we have a lot of work ahead of us," Swedish said. "But I think that's true for us and any large-scale health organization."

Asked whether the deal would position the merged system to become even larger, Persichilli said: "Growth is on our radar."

"We're open, especially with other Catholic organizations," she said, adding, "and to other organizations who share our vision and values and commitment to excellence." «

