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Beaumont merger with Advocate Aurora could lead to Michigan expansion

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- Beaumont's asset merger with Illinois-Wisconsin based system to create \$17 billion company
- Access to capital, economies of scale, growth in Michigan seen as benefits
- Critics say larger company could lead to higher prices for employers, patients



Beaumont Service Center, Southfield

Beaumont Health

Lower cost borrowing, economies of scale, additional working capital and expansion in Michigan are four of the major reasons to merge eight-hospital Beaumont Health with 28-hospital Advocate Aurora Health, say system executives.

Last Thursday, Beaumont Health signed a nonbinding letter of intent to explore an asset merger with Advocate Aurora Health, the ninth largest nonprofit health system in the country.

If completed later this year as executives hope, the combined 36-hospital Beaumont-Advocate Aurora system would create a \$17 billion revenue company with more than 100,000 employees, 2,500 employed doctors, 650 outpatient sites and a medical school partnership. It would become the nation's seventh-largest not-for-profit health system by revenue, behind Livonia-based Trinity Health.

But several critics of the deal say bigger is not necessarily better and the merger could lead to higher prices for employers and patients. On the other hand, they also say financial benefits could accrue to the merging health systems, helping improve quality and patient outcomes.

Alex Calderone, managing director of Calderone Advisory Group in Birmingham, questioned the value of the merger for anyone but the health systems.



Calderone Advisory Group
Alex Calderone

"My gut reaction is: Is bigger really better? This (merger) is a playbook used extensively by a number of health systems around the country. Has it gotten them anywhere?" Calderone said. "I do not believe these mergers and acquisition transactions to create larger entities are the panacea for the problems affecting health care."

Allan Baumgarten, a Minneapolis-based health care consultant who publishes annual Illinois and Michigan market reports, said even though the two health systems operate in different states, combining them would increase their market power.

"If the merger goes through, and many do not, it will result in higher prices for Michigan employers and consumers," Baumgarten said.

Rob Casalou, president of the Trinity Michigan, Florida and Georgia markets, congratulated the health systems on the merger announcement. He said creating an obligated group for bond

financing would improve the credit rating of the two health systems, reduce overall borrowing costs and increase access to capital. He said back office savings would also help reduce expenses.

"Advocate Aurora is very well established, highly reputable in the market," said Casalou, adding: "We're (Trinity) in the same Chicago market, so we know they are a really great organization."



Trinity Health
Rob Casalou

Casalou said operating in different markets wouldn't help the systems contract with state payers such as Blue Cross Blue Shield of Michigan, but it could help negotiate more favorable contracts with national payers like Aetna Inc. and UnitedHealthcare.

"They signed an LOI, so they're going to be figuring out what's the benefit to our organizations to the communities we serve. What's the value besides just being big?" Casalou said. "They will go right down the list and find how to create value. I think it's going to be a powerful merger for both organizations."

The reaction to the potential deal from health insurers, especially the Blues plans that operate in the three states, will be important, as they're key players in the markets the health systems serve, said Rick Zall, a partner at Proskauer and chair of its health care industry practice.

"Because they're in different markets, it's certainly a more viable proposal, I would think, than if they were competitors in similar markets," Zall said.

Cash flow boost

CEO John Fox of Beaumont said the deal with Advocate Aurora would allow the Southfield-based system, which has nearly \$5 billion in annual revenue, to make investments in its clinical programs, facilities and technology that it couldn't do alone.

Fox cited increased investment in its research institute, beefing up its information technology platform, expanding into other Michigan markets and potentially relocating its medical school



Beaumont Health
John Fox

campus as specific examples.

Beaumont has no plans to close any of its eight hospitals, reduce services or cut jobs in Michigan as a result of the deal, Fox said.

"We're going to maintain a strong, growing presence in Michigan and continue to be a major employer here in every respect," he said.

Advocate Aurora CEO Jim Skogsbergh said in a statement that Beaumont "has built a strong reputation for clinical excellence, education and research."

Fox said Beaumont would retain its own CEO, leadership team and headquarters. He speculated that another corporate office could be created through the merger and suggested that location could be in South Bend, Ind., halfway between Chicago and Detroit.



Advocate Aurora Health
Jim Skogsbergh

Advocate Aurora has a single executive leadership team with Skogsbergh as CEO and operations leaders in both states, spokesman Adam Mesirow wrote in an email. The board of the parent company would be composed of 15 people split equally among the three institutions.

"As for future leadership structure, we are at the early stages of our discussions," Mesirow said.

Fox said Advocate Aurora and Beaumont began discussions at the end of 2019. But partnership talks paused to allow both organizations to focus on COVID-19, he said.

Calderone said there are benefits to the merging health systems. However, there are dangers if corporate cultures clash.

"It is hard to see any reason for merger other than to stabilize the organizations' cash flows, generate economies of scale," he said.

"Advocate Aurora would get larger and it would be good for them to access other markets. It would be a continuation of their acquisition strategy," Calderone said. "Pursuing a merger could work out great for them, but those that don't work out, it can be quite damaging."

Calderone, who said he isn't opposed to the merger, but believes doctors and patients in any health system will tell you the main problems with health care delivery have been internal inefficiencies, waste and external regulatory red tape. He said patients want simplicity, lower costs and quality when they see their doctor or are admitted to a hospital.

"(They) should be redesigning their systems from the bottom up" instead of growing larger to create more market share, Calderone said. "What is really needed is more creativity and more innovation. I am not sure pursuing a strategy like this is the path one needs to go down in the present (uncertain) environment."

Future growth?

Advocate Aurora, which has dual headquarters in Milwaukee and Downers Grove, Ill., was formed through a 2018 merger that created a holding company parent.

Besides Beaumont, so far this year the system has signed a letter of intent to develop a partnership with Madison, Wis.-based Quartz Health Solutions Inc., a health insurance company, to develop a Medicare Advantage HMO plan. It also has signed a definitive agreement to sell two of its central Illinois hospitals to Carsle Foundation in Urbana, Ill.

Beaumont Health was formed in the 2014 merger that added Dearborn-based Oakwood Healthcare Inc. and Farmington Hills-based Botsford Hospital. It has since formed joint ventures to build 30 urgent care centers in Southeast Michigan and a 200-bed mental health hospital in Dearborn.

But only in the past 18 months has Beaumont been working to reduce costs and streamline operations by selling non-acute care assets and flattening management layers.

Beaumont, which is one of the largest health systems in Michigan, last month announced that it had scrapped an affiliation deal with four-hospital Summa Health in Akron, Ohio, after the two parties could not agree on contract changes.

Fox said conversations with Summa and Advocate Aurora began around the same time last year but were unrelated. If the Summa merger had gone through, the combined system with Advocate Aurora could have included 40 hospitals, \$18.5 billion in annual revenue and exceeded Trinity in total revenue.

Casalou said he doesn't believe Trinity will respond immediately with business actions to the Beaumont-Advocate Aurora proposed merger in Michigan or Illinois. He said Trinity needs to wait and see what the new system does with its expansion plans.

"I'm confident in the plan we have for our Michigan market. So I don't think we'll be responding with anything specific," he said.

But Casalou said he believes the biggest initial benefit to the merger could be greater access to capital for expansion plans.

"Never underestimate the power of a strong financial foundation that gives you access to capital," said Casalou, adding: "Then the next question will be: 'What are they going to do with that capital?' (Fox) said they want to invest in their facilities and their research and they want to invest in Michigan. I will wait to see what those investments look like and whether they affect us or not."

Mesirow said the COVID-19 pandemic has increased Advocate Aurora's strategic aim that being larger is critical to implement safety and clinical best practices.

"Our access to capital and economies of scale have allowed us to mobilize quickly to maintain and deploy adequate supply of critical resources, including personal protective equipment and expanded COVID-19 testing," Mesirow said in an email.

Advocate Aurora is in a good financial position but is restricted in its ability to make acquisitions of this size, particularly in a competitive market like Chicago, said Ken Marlow, a partner and health care industry chair with the law firm Waller.

"It really does have a lot of the elements we've seen in these megamergers where they're looking for a more fully integrated system that can provide health care across the continuum of care," Marlow said.

While Advocate Aurora doesn't own a health insurance plan, as has been Beaumont's longstanding goal, Mesirow said the system has various collaborations with payers. It also participates in the Wisconsin Collaborative Insurance Co., a joint venture between Anthem Blue Cross and Blue Shield and Aurora Health Care, he said.

The deal with Beaumont would bring Advocate Aurora significantly closer to its goal of doubling its revenue to \$27 billion by 2025.

But both Advocate Aurora and Beaumont have been hit hard by COVID-19 financial losses.

Advocate Aurora reported a \$85.7 million operating loss in the quarter ended March 31 — a 2.7 percent loss margin — compared with \$112.8 million in operating income in the prior-year period, a 3.7 percent operating margin.

Beaumont recorded a \$54.1 million operating loss in the first quarter ending March 31 on operating revenue of \$1.07 billion, down from an operating income of \$37.6 million on operating revenue of \$1.15 billion relative to the prior year.

In March, Fox said Beaumont projected losing \$1 billion to \$2 billion of its approximately \$5 billion in annual revenue as it delayed approximately 80 percent of non-urgent procedures during the COVID-19 pandemic.

However, the projected financial losses do not include more than \$506 million in grant money from the CARES Act, which Beaumont and dozens of other health systems in the U.S. received as part of COVID-19 federal relief aid packages.

Challenging 'disrupters'

Joining forces with Advocate Aurora would also help Beaumont compete with large companies such as Amazon, CVS and Walmart looking to take a chunk of the \$4 trillion health care industry in the U.S., Fox said.

"We're facing extraordinary, if you will, challenges from new players in the market that are much more disruptive," Fox said.

"Hospitals and physicians are the most diffuse, disaggregated part of the health care economy," he said. "The pharmaceutical, device, insurance (sides) have all consolidated way more than the provider side has. And in addition, we have new players coming into the market — Amazon, Walmart, CVS and others — who all want to take a piece of the \$4-trillion health care economy, and either find a profit opportunity in that or become a new gatekeeper in terms of patient flow."

Fox said Beaumont faces many financial challenges ahead. "(We are) really not big enough to play with those kinds of players. And we think that the three of us ... given our concentration (as) the leaders in our respective states, (the merger) gives us an extraordinary opportunity to be more successful."

Baumgarten said he doubts the two systems need to combine to compete with CVS, Amazon and Walmart, companies that have recently announced they are entering the health care outpatient



Allan Baumgarten

market.

"(Fox's) solution is for three large hospital systems that are focused on inpatient care and facilities to join together in a larger organization that can protect or maybe increase the prices it charges for inpatient care?" Baumgarten said.

"CVS or OptumCare or WalMart are not building inpatient hospitals. They are focused on providing care in less costly settings and using technology in innovative ways to let patients manage their care and their data."

Medical school relocation?

The merger could result in relocating the Oakland University William Beaumont School of Medicine to Royal Oak from Rochester. However, since the Royal Oak campus is highly concentrated, at least one or more of the older buildings would have to be demolished, a Beaumont spokesman said.

"It's something we've been talking about for a long time and this transaction we think would enable that to finally happen," Fox said.

In a statement, Ora Hirsch Pescovitz, M.D., president of Oakland University, said the Rochester Hills-based college has talked with Beaumont over the years about moving the jointly owned medical school to the Beaumont Hospital campus in Royal Oak.

"Moving the medical school to the hospital campus could potentially benefit our students and staff in many ways," Pescovitz said. "There are no firm commitments at this time, but we remain interested in exploring the idea with Beaumont."

Regulatory review

The systems said they have notified attorneys general in each of the three states about the potential deal, but experts don't believe there are any antitrust issues.

On its face, the deal appears relatively safe from an antitrust perspective, said Peter Mucchetti, a partner with Clifford Chance and the former chief of the Justice Department's health care and consumer products section. The traditional horizontal overlap challenge, which argues that the systems are trying to serve the same set of patients, would be difficult because Advocate Aurora and Beaumont facilities are so far apart.

In the Federal Trade Commission's challenge of the would-be merger between Advocate Health and NorthShore University HealthSystem, the agency focused on the geographic area between Chicago and the Wisconsin border, Mucchetti noted.

"It's worth noting that Beaumont's Detroit-area hospitals are far outside that market," he said.

— *Tara Bannow at Modern Healthcare contributed to this story.*

Inline Play

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