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Betting on change

Tenet deal with Vanguard shows it's primed to try ACO effort, new payment model

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Vanguard's IPO priced at $18 in June 2011, and its shares closed at $12.37 on the last trading day before the deal announcement. Tenet's operational efficiency is expected to improve cash flow at the smaller chain's hospitals.

Tenet Healthcare Corp.'s $4.3 billion bet on Vanguard Health Systems is about three things: building size and scale, particularly in fast-growing Texas; squeezing additional revenue from Vanguard's hospital and ambulatory-care portfolio; and becoming a bigger and better player in managed care and population health management.

While the first two moves come straight out of any chain's playbook, the third is a riskier wager. Dallas-based Tenet wants to be ready for the likely shift from fee-for-service to payment for outcomes and value under healthcare reform.

Nashville-based Vanguard, the smallest publicly traded hospital operator, has been a leader in the accountable care organization movement among investor-owned systems. Vanguard's Detroit Medical Center is one of the CMS' Pioneer ACOs and was an early participant in the Acute-Care Episode Demonstration Project, a bundled payment initiative for cardiovascular and orthopedic procedures. Vanguard also operates five health plans around the country, covering 237,000 lives.

The deal for Vanguard is not only one of the largest deals among investor-owned chains in recent years, it also comes after several years when Tenet had been relatively quiet on the acquisition front. The chain last year spent just $211 million on acquisitions, according to its annual report, all of it on outpatient-care centers, physician practices and boosting its revenue-cycle management capabilities. It spent $84 million the year before.

“In Tenet, you have a company that has focused on organic growth,” said Joe Lupica, the Phoenix-based chairman of consulting firm Newpoint Healthcare Advisors. “They took themselves out of the acquisition market and then approached it very gingerly.

”While for-profit systems generally have approached the ACO experiment with caution, Tenet's proposed deal for Vanguard is a sign that at least one investor-owned chain is willing to bet on alternative payment models, even though there's no certainty yet that they will deliver cost savings and quality improvements. The other major investor-owned chains, particularly HCA and Community Health Systems, have mostly kept their distance from ACO efforts.

“Hospitals have to become experts at risk management … building networks without holes,” Lupica said. “We can't just focus on dots on a map. I think it's more than geography here—it's about expertise.”

In an analyst call to introduce the deal, Tenet President and CEO Trevor Fetter hailed Vanguard's expertise in health plan operations and population health as key drivers behind the acquisition. The deal not only adds hospitals and new geographic markets, but “we will also have a broader service offering because of Vanguard's health plan operations,” Fetter said. It's expected to close at the end of 2013.

In an interview, Fetter said his company isn't necessarily looking to launch new health plans. But he added that the deal will give Tenet the added expertise to introduce more risk-based contracting, including ACOs.

A number of health systems have announced plans in recent months to re-enter the health insurance market, taking another stab at an experiment they had previously tried but abandoned in the 1980s and '90s. Systems planning to launch their own health plans include Sutter Health, Piedmont Healthcare and WellStar Health System.

Tenet began exploring commercial ACOs early last year, forging relationships with insurers including Blue Shield of California and Cigna Corp. Those moves put it ahead of its for-profit peers, many of whom—including Community Health Systems, Capella Healthcare and Health Management Associates—told Modern Healthcare at the time that they were skeptical that the ACO model would produce the promised benefits.

Observers say the Vanguard deal, on top of those earlier steps, shows Tenet's interest in pursuing the ACO model. “That indicated some interest—this just screams it,” said Bill Melville, an analyst at HealthLeaders-InterStudy.

“Vanguard has really been the only one aggressively participating in the (Center for Medicare and Medicaid Innovation) programs,” said Jeff Goldsmith, president of Health Futures, which forecasts trends on health services and technology.

Goldsmith described Vanguard's early participation in the CMS' Acute-Care Episode Demonstration Project—which it undertook at Baptist Health System in San Antonio—as “tremendously successful,” particularly in building support within the medical community. That project is a bundled-payment initiative for selected cardiovascular and orthopedic procedures. “It's changing Vanguard's image in San Antonio,” he said.Tenet, of course, is buying more than good will. It is also buying covered lives in Vanguard's health plan operations as well as more than three years of experimentation with new payment models.

Tenet Healthcare Corp.

Headquarters: Dallas
CEO: Trevor Fetter
Fiscal 2012 revenue[1]: $9.1 billion
Hospitals: 49
Licensed beds: 13,216
States: 10
Biggest presence in: Florida
Employees: 59,164
Subsidiaries: Conifer Health Solutions (revenue cycle, management services, patient communications)

[1]Tenet's fiscal 2012 ended Dec. 31

Source: Company's annual reports

As of March 31, Vanguard covered 237,000 lives under five managed-care plans, according to the Nashville-based chain's quarterly earnings report. Its health plans for Medicare, Medicaid and dual-eligible beneficiaries operate in Arizona, Illinois and Michigan. It also offers plans for commercial groups in Texas.

Goldsmith, an early critic of ACOs, noted that the move to form them is less about the economic opportunities and more about laying the groundwork for assuming full capitated risk if the market moves in that direction. “I think a lot of people got into ACOs out of defense,” he said.

Yet even among the holdouts, there are signs that investor-owned systems are starting to wade into ACO waters, at least on the commercial side. Last month, HMA said it was forming an ACO with Florida Blue, the state's Blue Cross and Blue Shield company, which would serve patients in Brevard County. And in March, Capella said its hospitals would join the MissionPoint Health Partners ACO, partnering with St. Thomas Health, Nashville, with which it has a separate joint venture.

Still, there are some major exceptions. April Wortham, an analyst at HealthLeaders-InterStudy based in Nashville, said she doesn't expect the same moves from HCA, the largest investor-owned hospital chain, which has been rapidly expanding its number of emergency rooms. “The whole tenet of accountable care is to reduce emergency room use,” she said.

Vanguard Health Systems

Headquarters: Nashville
CEO: Charles Martin Jr.
Fiscal 2012 revenue[1]: $5.9 billion
Hospitals: 28[2]
Licensed beds: 7,064
States: 5
Biggest presence in: Texas
Employees: 40,900
Subsidiaries: Phoenix Health Plan, Abrazo Advantage Health Plan, Valley Baptist Insurance Co.

[1]Vanguard's fiscal 2012 ended June 30
[2]Includes several, such as the five Baptist Health System facilities in San Antonio, that operate under a single Medicare provider number.

Source: Company's annual reports

She also didn't foresee a change in strategy at Community Health Systems. In an interview last year, Community President and CEO Wayne Smith, a veteran of insurance giant Humana, said “there's no empirical evidence that (ACOs) are saving money.”

Wortham said, “It may be that it works in some markets and it doesn't necessarily work in others.”

Melville said Vanguard's participation in the CMS program in San Antonio helps it compete against HCA, the largest player in that market. In Arizona, Vanguard's Phoenix Health Plan had been one of the dominant Medicaid managed-care contractors until it lost its contract in March; a new capped contract will allow it to continue operating in Maricopa County but without being able to add new members.

Tenet's play for Vanguard comes before empirical evidence is available on the performance of the Detroit Medical Center's Pioneer ACO and the other 31 Pioneers around the country, which began their performance period in January 2012. The CMS is expected to release the Pioneer data this year.

Dr. Andrew Ziskind, managing director at Huron Consulting Group, noted that some of the early reports of savings under ACOs have been “much more modest than people anticipated.”

Responding to a question on the analyst call, Keith Pitts, Vanguard's vice chairman, did not disclose numbers for the Pioneer ACO in Detroit, but said, “It looked like we did effect some savings.”

Pitts, who will become Tenet's vice chairman, also said the larger chain's expertise in revenue-cycle management, through its Conifer Health Solutions subsidiary, “can help accelerate some of our activities there.”

Ziskind contended that hospital systems engaged in ACO programs may benefit more from increasing their patient volume through the ACO than from the ACO's shared-savings feature. In addition, the ACO work helps systems build their capacity to manage population health and succeed under new payment-for-value models. “In the long-run, hospitals are trying to position themselves to cover a larger number of covered lives. That's one clear business advantage (of forming an ACO).”

Tenet also has moved aggressively into another key healthcare reform arena. It has entered into contracts with health plans that will be sold through state insurance exchanges. During the company's fourth-quarter earnings call, Fetter said the system had contracts with “three large Blues plan” that will cover 30% of its hospitals. In an interview, Fetter said Tenet currently has more exchange contracts than Vanguard and more than “virtually anyone.”

While Tenet has only recently restarted an acquisition strategy, Vanguard has been on a significant buying spree in recent years. At the end of 2010, the company bought the multihospital Detroit Medical Center and made a significant financial commitment to turn around the financially flagging provider. The following year, it purchased Valley Baptist Health System in Harlingen, Texas. Vanguard has focused primarily on acute-care acquisitions, which allows Tenet to add more ambulatory-care centers in its existing markets, Fetter said.

Increasing revenue from Vanguard's hospitals will be a key part of the “synergies” Tenet hopes to gain from the acquisition. On the analyst call, Fetter said “a large part of Vanguard's revenue comes from hospitals that are relatively new to its system.” He praised Vanguard's turnaround abilities while arguing that Tenet will be able to accelerate those efforts. Vanguard's hospitals will become clients for Conifer after the deal's closing.

Since Vanguard's management and private-equity firm Blackstone Group hold the majority of Vanguard's shares and there are few overlaps among the two companies' markets, analysts are forecasting few obstacles for the deal. As of March 31, Blackstone held almost 38% of Vanguard shares, or roughly 29.4 million.

Tenet plans to pay $1.8 billion, or $21 per share, and will assume $2.5 billion of debt when it buys Vanguard, which launched its initial public offering two years before this deal's announcement.

Vanguard, founded in 1997, operates in Arizona, Illinois, Michigan, Massachusetts and Texas. Tenet, founded in 1967 as National Medical Enterprises before rebranding in 1995, operates in California, Florida, Georgia and Texas.

Fetter boasted that the Vanguard deal will make Tenet “No. 1 or No. 2 in 19 key markets.”

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