

The Epiphany of Free Standing ER's and Micro Hospitals for Health Systems

Today, April 4, 2017 Adeptus (ADPT) stock traded at \$1.10, a massive drop from its peak of 121.00 in 2015. Plenty of finger pointing at this stage along with the expected shareholder lawsuits. But why all the surprise? Why can't healthcare remember the similar meltdown of publicly-traded physician practice management companies in the mid 1990's when finally, a sell side analyst announced, "Where are the fundamentals?" Likewise, experts in the healthcare industry know all too well that ERs lose money for hospitals, but they are operated nonetheless because of licensure and community mission. So why would a free-standing ER or a micro hospital generate positive cash flow as an individual business? It wouldn't normally unless it was a unique market anomaly.; such an anomaly, however, would immediately attract competitors and dilute the profitability overnight. In the same light, why would a jointly owned FSE between a private company and a health system produce positive cash flow? It wouldn't. The negative underlying economics are the same whether jointly or solely owned.

So, where do we go from here? Is there a future for Free Standing Emergency Departments and Micro Hospitals in spite of the Adeptus experience? Absolutely, but only if operated by health systems as part of a broader ambulatory strategy . The inherent purposes of the traditional hospital-based ER remain to support the mission of community health, to function as a major primary care center, and to channel acute patients to the health system. As reimbursement compresses into pre-acute, acute, and post acute bundles, health systems need FSEDs and micro-hospitals to both expand market reach and control the healthcare dollar. Listed below are basic fundamentals for FSEDs and micro-hospitals for hospitals and health systems to consider:

Ownership and Control: The venture should support the health system organizational mission and reputation. The health system needs to be the majority owner and control the enterprise in order to ensure quality outcomes, keep patients in the system and include it in managed care networks.

Operations: The venture will lose money in the short and long run on a per unit basis, but can contribute significantly to the health system enterprise. Maintain both accountability and responsibility of operations; but carefully monitor and track the contribution to the enterprise. Connect and attach the IT system, Revenue Cycle Management, employees, and Physician Staffing to the health system to assimilate operations and strengthen enterprise value.

Location: Using empirical, unbiased external health planning and commercial real estate market analysis, identify the location with the best demographics and growth for the next ten years. Steer away from hunches and cheap land deals including existing hospital owned property in undesirable locations.

Flexible Design and Capital Risk: These are not your traditional hospital structures, so carefully select and chose to partner with seasoned architects and developers who have direct, relevant experience with FSED and micro-hospital projects. The partners will help you adapt to new clinical techniques and designs in the ambulatory setting - including the ability to entirely repurpose a project should markets shift.

Conserve Capital: A health system should conserve cash for primary campus project expansions/improvements and needed equipment and technology. Preserve cash and available credit by negotiating build-to-suit lease arrangements with qualified, financially strong development partners.

The Future: Micro Hospitals and Free Standing Emergency Departments have appeared on the healthcare landscape as a direct result of consumer demand, so don't hope they will eventually disappear. Instead, identify external resources experienced in consumer driven healthcare, ambulatory design, and alternative financing to implement your strategy.