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Erlanger's financial situation attracted unsolicited purchase offer

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StoneBridge Healthcare's unsolicited bid to buy Erlanger Health System came as a surprise to Erlanger officials and some community leaders, but not to people who are in the business of buying and selling hospitals.

Scott Phillips, managing director at Healthcare Management Partners — a consulting firm that helps health care organizations navigate financial challenges — is "very familiar with Erlanger and what it does and its role in the community."

He also knows StoneBridge CEO Joshua Nemzoff, who Phillips called "one of the most sophisticated mergers and acquisition guys in the health care space."

"My guess is [StoneBridge] did their homework and looked at all the hospitals — there are lots of databases, which enables you to look at all of the hospitals in the country and identify those that are underperforming but are in otherwise good markets," he said.

One such database, HMP Metrics, is owned and managed by Phillips' company. The program analyzes public data from health systems across the United States and allows users to compare key metrics among hospitals in a particular market as well as against national benchmarks.

Erlanger had its most profitable year in recent history in 2016, when the public health system made a 3.7% operating margin, according to HMP Metrics. [In 2017](#), Erlanger's operating margin fell to 0.9%. It shrank again [in 2018](#) to 0.1%. [In 2019](#), Erlanger ended the fiscal year with a 1.3% operating loss, according to HMP Metrics.

By comparison, Erlanger's competitors Parkridge, CHI Memorial and Tennova Healthcare-Cleveland made 23.7%, 6.8% and 6.7% operating profit margins, respectively, in 2019.

"Erlanger has historically underperformed, and it's historically been under-managed, if you will. Its lack of profitability and its profit margins are well below those of comparable hospitals positioned in other markets," Phillips said.

StoneBridge's \$475 million offer for Erlanger would write Hamilton County a check for \$200 million and put the remaining \$275 million toward capital. After funding Erlanger's remaining pension liability, Nemzoff told the Times Free Press that Hamilton County would end up with around \$70 to \$100 million left over from the deal.

While that may not seem like enough for a more than \$1 billion revenue health system, Phillips said he wouldn't consider StoneBridge's offer a "lowball" based on industry standards. That's because Erlanger's profitability is low, and he said the offer is according to what the health system is worth now, not what it could be worth.

"Erlanger has enjoyed fairly robust top-line growth, but hasn't enjoyed corresponding growth in profitability," Phillips said. "I'm sure that Nemzoff and his partners see this as an opportunity to pay the current value — which is based on the current, poor-to-mediocre profit performance — and bring it up to an industry standard, or maybe even [better]. And I think Erlanger is capable of that."

Nemzoff said the group discovered Erlanger through a federal database of financial performance.

"That's how we found them — there was no other method — that's how we find a lot of our hospitals," he said. "We're in the business of trying to buy hospitals, and the only hospitals that ever sell are distressed hospitals. You don't want to wait until it's too late, because then you run into the situation where it can't be saved."

Erlanger management budgeted a 1.2% operating margin in fiscal year 2021 and plans to put \$20 million toward capital investments.

Garry Gause, a member of the StoneBridge leadership team and former CEO of Tenet Healthcare's Eastern Region, Central Division, said that's not enough to keep up in today's competitive health care climate.

"A lot of those [capital] funds go directly to patient care areas — updating equipment, starting programs, replacing equipment — and that just won't get done with such a small capital budget of \$20 million. Systemwide, that's a very, very small amount," Gause said.

Nemzoff said the company is still prepared to try and buy the public hospital despite [Hamilton County Mayor Jim Copping and the board of trustees saying that Erlanger isn't for sale](#).

StoneBridge will wait and see what happens when Erlanger's 2020 year-end and first quarter of fiscal year 2021 financial reports come out in the fall, he said.

"Everybody is going to see exactly what their financial position is, and then everybody will be able to make their own decision as to whether this is a distressed hospital," Nemzoff said. "We're not going anywhere."