

Slow and Steady...

by Molly Cate

During a feeding frenzy, Essent Healthcare dines slowly and selectively.

In July 1998, industry trade magazine *Healthcare Business* chronicled Nashville's evolution as a health care power in a cover article entitled "The Nashville Story: How Music City became health care central." Author William Poole portrayed the pervasive and prolific nature of the business when he

wrote: "Doing the deal. That's the ever-present mantra around here."

That statement, now more than ever, captures the nature of the hospital business. Powered by strong financials and clean balance sheets, publicly held hospital companies have displayed a hearty appetite for acquisitions over the past year. Community Health Systems and Province Healthcare gobbled up five facilities apiece in 2001. The growing number of acquisition opportunities also attracted new industry players during the past several years, including Vanguard Health Systems and Ardent Health Services. Both of these privately held newcomers wasted no time in building critical mass by absorbing beleaguered hospitals starved for capital.

Not all locally based hospital companies have been quite so aggressive in their growth strategies. Essent Healthcare is the most notable exception. The three-year-old startup, led by former HealthTrust executive and Arcon founder Hud Connery, had completed just two hospital purchases as of February this year. And although Essent expects to finally wrap up a two-year deal in late March (after this story was filed for publication) that would mark its third purchase, the company's un-hurried growth stands out among its counterparts.

"Recently I was asked if I'd buy 10 hospitals to get three good ones, and I said I wouldn't do it," says Connery, who after overseeing 110 hospitals as chief operating officer at HealthTrust, concluded that "not all hospitals are created equal."



Quality control: Essent's Hud Connery sees more chaff than wheat in the current health care market. "There are many hospitals for sale, but most of them are in markets that aren't that good or in markets where the hospital for sale is strategically impaired."



In the works: Essent Healthcare spent two years negotiating the purchase of the 78-bed Sharon Hospital in Sharon, Conn. It expects to close the deal this spring.

“There are many hospitals for sale, but most of them are in markets that aren’t that good or in markets where the hospital for sale is strategically impaired, relative to the competition. [At Essent], I’m not saddled with facilities that I don’t want to have,” he says.

Connery says his three facilities—94-bed Crossroads Regional Hospital in Wentzville, Mo., 129-bed Merrimack Valley Hospital in Haverhill, Mass., and the 78-bed Sharon Hospital in Sharon, Conn. (yet to be completed when this story went to press)—produce \$90 million in revenues. That number could conceivably grow to \$120 million over the course of two to three years.

“None of them require full facility replacements, so our capital expenditures are very reasonable over the next couple of years relative to the growth of revenue. The opportunities to better margins from operational improvements are very

significant as well. We therefore will have significant earnings per share as a private company and significant cash flow,” he says.

Connery’s partner and main investor in Essent is Chicago-based Thoma Cressey Equity Partners. While Essent board member and Thoma Cressey partner David Mayer concedes that the

company’s acquisition pace has been slow, he says that the tedious legwork behind their structuring has paid off.

“In the long term, the discipline and decision-making of the management team are what’s going to ensure the company’s success and the value creation for ourselves,” Mayer says. He adds that some companies “run hard and do a lot of things under the assumption that getting bigger faster will somehow end up translating into value. That just hasn’t proven to be the case with most sectors and certainly not hospitals.”

Whether it’s exhaustive due diligence on Essent’s part or dire financial straits on the selling hospital’s end, one thing is certain about each purchase—the bargain-basement price Essent paid for its properties is enough to turn heads in the hospital industry. The company acquired Crossroad Regional, a 14-year-old facility situated on roughly 50 acres, for a mere \$6 million. In its Merrimack Valley Hospital, Essent dodged absorbing \$30 million worth of debt, bought the hospital’s working capital and committed to \$5 million in capital expenditures over five years.



Cost control: Essent acquired the 129-bed Merrimack Valley Hospital in Haverhill, Mass., for the actual purchase price of \$4 million, avoiding the absorption of \$30 million worth of debt.

The actual purchase price for the 15-year-old, 129-bed facility was \$4 million. If completed, the Connecticut deal will cost Essent \$16.4 million, all of which will be used to pay off the hospital's existing debt. Essent committed \$8 million in capital expenditures for the hospital.

"On one hand, things have been slow to take off. On the other, only a fraction of the money we've committed has been called down," Mayer ob-

"Anybody can pay \$40 million more than the next guy for a hospital—that's not the hard part. The question is, will there be true returns for shareholders?"

*Hud Connery
President and CEO, Essent Healthcare*

serves. "So, we may not have bought many hospitals, but we haven't invested or put much at risk, either."

Thoma Cressey has \$50 million in Essent and is committed to more for acquisitions if needed. But don't count on Essent picking up the pace anytime soon. Both parties—Essent and Thoma Cressey—are fond of the company's strategy of mitigating risks on the front end of a deal, no matter how long it takes, through tasks such as forming relationships with managed care organizations in the markets and working through the maze of local politics. That way, Mayer says, the company can immediately focus on the hospital once it is purchased.

"They spend time pursuing other initiatives that will bear fruit a little bit

later—but they will bear fruit," Mayer says. As an example, Connery points to the Massachusetts deal. One of the conditions on the acquisition was establishing a 25% rate increase from three major health plans in the market.

Essent's slow, deliberate approach may be just what it takes to pull off deals in the Northeast, a place where antipathy against for-profit health care runs deep. Nonetheless, the area is swarming with financially distressed hospitals, most of which are locally owned. Although Mayer and Connery say Essent will not solely focus on that part of the country, both say the efforts and patience exerted in the Connecticut and Massachusetts deals should open more doors in the region—if Essent sticks to its words.

"I know that for the next two years we're going to be under a microscope with people asking if we are performing and if we have done what we've said we were going to do. Out of that will come opportunities, but we have to perform first. We haven't done anything yet in Sharon. All we've shown is that we're persistent," Connery says with a chuckle.

Going forward, Essent plans to continue to pick its markets very selectively, a good idea in the hospital industry, where the mantra "you can fix a bad hospital, but you can't fix a bad market" sometimes, but not always, takes precedent over "doing the deal."

In a town like Nashville, where the talent to operate hospitals effectively is abundant, market selection is critical.

"If I pay 25% or 30% more than the next guy to get a property, then I either think the market potential is there or that I'm a better operator," Connery says. "I don't believe I'm any better of an operator than the rest of the people in this town. Anybody can pay \$40 million more than the next guy for a hospital—that's not the hard part. The question is, will there be true returns for shareholders?" **NP**

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