Not so magic Circle

A Briefing note on Circle Health, researched for UNISON Eastern Region by John Lister

After several delays and in the midst of a cloud of uncertainty, the company which owns the majority of Circle Health was successfully floated on the stock market in mid-June. The flotation raising some £45.3m in additional capital to help pay for its embryonic network of high-cost boutique-style private hospitals, and cover its continuing losses.

The company, now valued at £95.4m, which is the brainchild of a former Goldman Sachs senior executive Ali Parsadoust (known as Ali Parsa), has now been admitted to London's Alternative Investments Market. As part of this process, it published early in June an "Admission Document" setting out more details of the complex structure of the company, 49.9% of which is owned by a "social enterprise", Circle Partnership Ltd. This is the part of the company proudly boasted to be a "John Lewis style" company, owned by Circle's clinicians, employees and other "partners".

The Circle Partnership, itself a private company incorporated in the tax haven of the British Virgin Islands, plays an important role in the business plan of the Circle group, since it incorporates all of the health care and medical expertise in the company. The consultants are also a key factor in the revenue stream for the company:

"Circle's independent business strategy depends on the successful operation and expansion of the Circle Partnership. In particular, Circle's independent business strategy depends on Circle Consultants agreeing (as they have done in CircleBath) to transfer specified percentages of their existing practices to Circle's new hospitals by way of an agreement (each a "Consultant Agreement") in exchange for a role and influence in the design and management of the new hospital and an allocation of an ownership interest in Circle Partnership. Each Circle Consultant has agreed to transfer a specified percentage of his or her private practice to Circle only after their local Circle hospital opens (and thereafter for a minimum of 24 months), and Circle is dependent on the Circle Consultants carrying out such obligations for Circle hospitals to become profitable." (Admission Document, p10)

This makes the company dependent upon attracting and retaining consultants and other staff trained and employed by the NHS to join the partnership and help to build the business: obviously this carries a substantial risk to existing NHS providers which may find themselves losing vital staff. However the company also admits that there is a risk that it cannot secure sufficient staff with the right qualifications to expand its business:

"The decisions to build and open new Circle hospitals in new regions depend on whether Circle can secure a sufficient number of consultants in such regions in order to support the economic viability of the new hospitals. In addition, if Circle experiences delays in its roll out of new independent hospitals Circle Consultants may terminate their contracted commitments. As a result, Circle's ability to generate revenue, become profitable and expand its business will depend substantially on its continuing ability to attract and retain qualified consultants in the Circle

Partnership and its local clinician groups. There is competition for such qualified consultants, and there is no assurance that Circle will be able to attract and retain qualified medical professionals. (…). In addition, the number of consultants that may want to become Circle Consultants may be lower than Circle's strategy requires. Furthermore, Circle may be unable to recruit a sufficient number of suitable local support staff, including nursing and other medical staff …" (page 23).

Within the partnership, consultants and GP members between them have just over 50% of the 36 million issued shares: "Head Office staff" hold another 35%. However another 27 million shares have been authorised and not yet issued, so the balance could change (page 50).

However the Admission Document also admits that although these partners collectively own just 0.2% less of the company than Circle Holdings plc, (49.9:50.1%) the power to take decisions is focused not with the consultants and their "partnership", but in the hands of this for-profit company, which is an investment vehicle for a number of high-powered private equity firms and hedge funds.

Registered in the tax haven of Jersey, although having its head office in London, Circle Holdings brings together a board of executive and non-executive directors from the world of corporate finance: only its Chief Medical Officer, Dr. Massoud Fouladi, a consultant ophthalmologist, has any health background.

Dr Fouladi was director of Nations Healthcare – the company running two Independent Sector Treatment Centres (ISTCs) and in negotiation for a third, bigger contract in Nottingham. Nations was taken over in 2007 by Circle, to give the group its most significant income stream. Like other ISTCs set up under New Labour from 2003, Nations made their money selling uncomplicated elective operations to the NHS at above tariff prices, on centrally-negotiated 5-year contracts which guarantee the number of operations to be paid for regardless of how many patients are actually treated.

These NHS contracts signed years ago with Nations are gradually coming to an end, leaving an increasingly thin and uncertain revenue stream for Circle, which has recently lost two ISTC contracts that were worth £27m last year: the even more important £34m a year ISTC contract in Nottingham has only two more years to run. Without it, the company would have brought in almost no revenue at all, although its relatively new boutique hospital in Bath has just begun to generate a modest trickle of income.

As the Admission Document admits:

"Since its inception in 2004, Circle has incurred losses as it has grown its business and may continue to incur losses in the future as it expands further. For the year ended 31 December 2008 Circle incurred operating losses of £40.07 million, for the year ended 31 December 2009 Circle incurred operating losses of £19.76 million and for the year ended 31 December 2010 Circle incurred operating losses of £34.97 million. If Circle experiences slower than anticipated revenue growth or if its operating expenses exceed budget, its ability to become profitable may be delayed or become unachievable. Even if Circle achieves profitability in the future, given the evolving and competitive nature of the industry in which it operates, it may not be able to sustain or increase profitability." (page 9)

Circle and its subsidiaries are also carrying debts totalling £82m, including £14.1m from the acquisition of Nations Healthcare and £43.5m for financing the Nottingham ISTC, with additional borrowing for the leasing of IT and medical equipment, and from the acquisition of land for more new hospitals that have not yet been built. The company has already been forced into a number of "breaches of financial covenants" although this appears to have been patched over (page 12).

Even is showpiece hospital in Bath appears to be dogged by financial problems: HP (Health Properties) Bath, which owns the hospital that is leased to Circle, is a "non-group joint venture" between the Circle group, a non-group property fund and a company still owned by the collapsed Lehman Brothers: it is in breach of covenant having failed to pay rent, and in negotiations with the senior lender (page 12). If this and other financial problems on the Bath hospital site are not resolved**, "lenders might seek to forfeit the lease or take other enforcement action potentially leading to a loss by Circle of its right to occupy and operate CircleBath which could have an adverse effect on Circle's business, results of operations, financial condition and future prospects and consequently those of the Company".**

There are unresolved financial problems relating to developments in Edinburgh and Manchester which could also set back the company's business Plan (page 13).

Over the last six years existing investors have funnelled in a massive £140m: and many of the high-flying directors from the world of corporate finance will soon become impatient for returns that match the levels they are used to making from their investments elsewhere.

Who are the directors?

Prior to Circle, Chief Executive **Ali Parsa** was an executive director of Goldman Sachs' European technology investment banking team. He also worked at Merrill Lynch and Credit Suisse First Boston. He has a PhD in Engineering Physics from the University of London. Ali won the award for Entrepreneurial Achievement in the 2010 Independent Healthcare Awards, was named in the 100 most influential people in UK healthcare in the Health Service Journal's annual survey in 2010 and has been shortlisted for "outstanding contribution by an individual" in the 2011 Health Investor Awards.

Other directors are:

Michael Kirkwood, Non-Executive Chairman – the former head of Citigroup's British operations and one of the City's most senior investment bankers.

Paolo Pieri, Chief Financial Officer – former Financial Director of two 'boom and bust' companies, lastminute.com and Virgin Megastores.

Lorraine Baldry, Non-Executive Director – Non-Executive Director & Chairman of Technology company Inventa, has over 35 years experience in a wide range of industries including Financial Services, IT and Property and has held senior executive positions in some of the UK's leading companies in these sectors. She is a Board Member of the Olympic Delivery Authority and is Chairman of its Planning Committee. Lorraine is Chairman of Tri-Air Developments Ltd and a Governor of the University of the Arts London. Before that she was Chief Executive of Chesterton International plc having been previously a Senior Advisor at Morgan Stanley, Investment Banking

Division. Prior to that Lorraine was Managing Director and a member of the Executive Committee of Regus, the International Business Centres company. Lorraine joined Regus from Prudential Corporation where she held a number of posts including Managing Director of Prudential Corporate Pensions, Chief Operating Officer of Prudential Portfolio Managers and Managing Director of its property investment division.

Tim Bunting, Non-Executive Director, like Ali Parsa has a background in Goldman Sachs, with 17 years in which he worked as head of the corporate-finance department of in London, and became vice-chairman in 2005. He has now joined Balderton Capital, one of Circle's principal investors, as partner. Bunting was already familiar with Balderton's portfolio, having served as non-executive chairman of Betfair, the person-to-person betting exchange, and as a director of Alphyra, the pan-European electronic payments provider. Balderton is also one of the backers of Wonga.com, the ultra-high interest lenders of "pay day loans" with rates as high as 3,000% for money borrowed using their i-phone app.

Peter Cornell, Non-Executive Director, is the former CEO of Clifford Chance, one of the world's leading international law firms with over 3,500 lawyers in 30 offices. During his 36 years tenure with Clifford Chance, Peter became a trusted adviser to the CEOs of some of the world's largest companies and oversaw Clifford Chance's best ever financial performance in 2005-2006.

Cornell also worked as managing director at private equity firm Terra Firma, and is a partner and head of investor relations at Metric Capital "a pan-European private debt fund providing capital solutions to mid-sized companies." Metric Capital provides debt capital solutions to European Companies with an Enterprise Value of €50 - 500 million. "Our capital solutions include: Financing of buy-outs and acquisitions; Growth capital; Liquidity facilities; Bridge facilities and rescue financing. The members of our management team have run multi-billion euro businesses and corporate divisions across a variety of financial services firms."

None of these senior figures in the company got where they are by sitting passively on the board of a small loss-making company, and it is clear that the current configuration of Circle is seen as a preparatory phase to substantial profits to be generated in the future.

Of the two senior managers described in the Admission document only one has any relevant health or hospital experience, although this is left extremely vague, since he has.

Steve Melton, Head of Mobilisation has over 22 years of experience as a manager – as the supply chain director at Argos, part of Home Retail Group: before that, he was supply chain director at Scottish Courage Ltd., a subsidiary of Scottish & Newcastle, managing over 3,000 staff and a £165 million cost base. Steve began his career on Unilever's management trainee program, and he has held a number of roles at Unilever, Elida Faberge and ASDA.

Martin Wakeley, Head of Operations (age 42) "has worked in health for the past 23 years" – trained originally in clinical biochemistry, he moved into general management working in some of the biggest and most complex acute hospitals in the country.

He joined Pricewaterhouse Coopers as a management consultant for three years working across the UK, prior to leading on the opening of the first ISTC in the country in Trafford, Manchester. "From

2003 until joining Circle, Martin was an executive director and CEO of NHS hospitals, working in some of the most challenging environments in the country."

Dependent on NHS funding

Circle's Admission document makes very clear that the company's focus is on generating the maximum contract income from the NHS:

"Circle is primarily targeting the £82 billion UK secondary acute healthcare market. The Directors believe that a "productivity gap" in the NHS will increase the share of the NHS market available to the non-state sector, allowing Circle to tender for further NHS contracts. The Directors also believe that its modern new build independent hospitals will allow it to attract patients from both the NHS and independent markets." (page 7)

"Circle's NHS business plan is dependent upon factors outside its control, for example, the NHS deciding to tender further NHS Trusts as it did with Hinchingbrooke Health Care NHS Trust ("Hinchingbrooke"), and Circle being awarded a certain number of such tenders, neither of which is guaranteed. Circle's future performance will be adversely affected if such factors do not occur as forecast by Circle." (page 10)

"While Circle has been selected as the "preferred bidder" to operate Hinchingbrooke, the franchise agreement and the Intervention Order necessary to formalise the franchise have not been executed. There is no guarantee that the franchise agreement or the Intervention Order will be signed or that the terms of the franchise that are currently envisaged will not be altered prior to signing.

"If the Hinchingbrooke franchise agreement is not signed, does not reach service commencement or is terminated, this would have an adverse effect on Circle's business, results of operations, financial condition and future prospects and consequently those of the Company." (page 11)

A knockback on Hinchingbrooke would clearly throw major doubts over other aspects of the company's strategy:

"Circle anticipates that the NHS will franchise the running of further NHS Trusts as it is proposing with Hinchingbrooke. Despite other NHS Trusts currently considering this option (for example, Trafford Healthcare NHS Trust), there is no guarantee that further NHS Trusts will be franchised. If such NHS Trusts are franchised, Circle considers itself to be in a strong position to compete in open tenders due to its success in the open tender for Hinchingbrooke. However, such open tenders are expected to be very competitive and as such there is no guarantee that Circle will be successful if further NHS Trusts are franchised." (page 12)

In fact the Admission document admits that there is more uncertainty around the Hinchingbrooke contract, which even when signed could still be terminated ahead of time:

"Once signed, the franchise agreement may be terminated by the SHA prior to service commencement in certain limited circumstances. In such an event, Circle currently expects to be

reimbursed its mobilisation costs up to an agreed capped amount, which may not cover all of the costs Circle has incurred to date. The service commencement date, which is expected to be up to 90 days after contract signing, may be postponed at the discretion of the Secretary of State. In such an event, Circle may only be reimbursed for additional mobilisation costs in certain limited circumstances.

"Once service commencement is reached, the SHA (or the Trust Board) may terminate the agreement if Circle fails to ensure Hinchingbrooke achieves specified levels of financial performance. In such circumstances, Circle will be required to pay the SHA a £2 million termination fee and to adhere to an exit plan.

"It is currently expected that the Trust Board (with consent of the SHA) also will be entitled to unilaterally terminate the agreement for no reason at all, in which case it will be required to compensate Circle for costs incurred and loss of profit (subject to a maximum agreed amount)." (page 11)

The uncertainty over the Hinchingbrooke contract is even greater given the requirement for the hospital to be managed to generate an annual surplus, while the PCT (and later GP commissioners) are pursuing a strategy of reducing the numbers of patients treated and admitted in hospital, and squeezing down tariffs for treatment as part of the NHS-wide drive to make £20 billion of "efficiency savings" by 2014.

"It is envisaged that Circle will only receive payment under the franchise agreement if Hinchingbrooke generates an annual surplus. The ability of Hinchingbrooke to generate surpluses will depend on successful implementation of the Circle Operating System and the ability to engage and empower clinical staff and manage costs." (page 11)

The potential impact of cutbacks in spending and in tariff payments for treatment are specifically addressed by the Admission Document (page 15)

"The opportunities for independent providers to treat NHS-funded patients may be negatively affected by cuts to the NHS commissioning budgets. Such cuts could reduce the amounts of funds to pay for treatment and could force commissioning bodies (PCTs or their successors) to reduce the tariff paid for such treatments or to manage demand by slowing the referral process and increasing waiting times, which would have an adverse effect on Circle's business, results of operations, financial condition and future prospects and consequently those of the Company."

The company's Admission Document also admits to the lack of certainty for private sector providers even if Andrew Lansley's Health and Social Care Bill, which offers more scope for private sector provision, is passed:

"Primary care trusts ("PCTs"), which are the payors of NHS-funded treatments under the current system, are due to be dismantled by 2013 under the pending Health and Social Care Bill 2011 (the "Bill"). The PCTs, or their successor bodies, may elect to ignore, frustrate, or misinterpret government policies seeking to promote patient choice and contestability in the provision of healthcare services to NHS-funded patients. Specifically, they may seek to restrict the scope of services to be offered by independent providers to NHS funded patients, limit the volume of procedures an independent provider can perform, reduce the amount paid for such services, or

make patient referrals to preferred providers, any of which could have an adverse effect on Circle's business, results of operations, financial condition and future prospects and consequently those of the Company." (page 15)

Potential problems with trade unions

The Admission document discusses the possible problems if the company is unable to find a way to work with the unions, most notably at Hinchingbrooke Hospital, where the workforce they will attempt to manage in one hospital is three times or more larger than the grand total of 568 people working for the whole group in five sites and central services at the end of last year (page 65):

"Circle is exposed to the risk of trade union disputes and adverse employee relations which could have an adverse effect on Circle's business, results of operations, financial condition and future prospects and consequently those of the Company.

"A significant number of clinical staff at Circle's Nations facilities and at Hinchingbrooke are members of trade unions. These trade unions may undertake industrial action, either nationally or locally, which could adversely affect the operation of these facilities and have an adverse effect on Circle's business, results of operations, financial condition and future prospects and consequently those of the Company. A significant proportion of NHS staff are unionised and union leaders may elect to frustrate or limit the participation of independent providers in the provision of services to NHS – funded patients or in the management of NHS facilities, which could have an adverse effect on Circle's business, results of operations, financial condition and future prospects and consequently those of the Company." (page 24)

Private sector competitors

The company is also insecure in its position in competition with much larger and established private sector companies and organisations offering a similar or wider range of service to Circle:

"Circle faces competition from independent hospital operators, including General Healthcare Group, Nuffield Health Hospitals, Spire Healthcare and Ramsay Health Care, and independent sector service providers such as Care UK, InterHealth Canada and Serco Group. Circle's ability to compete successfully will vary from location to location depending upon a number of factors, including its ability to attract and retain Circle Consultants, nursing staff and other employees, the number of competitors in the local market, the types of services it provides, its local reputation for quality care of patients, the commitment and expertise of its staff, its local service offerings and the cost of care in each locality." (page 15)

In addition, for Circle's hospitals to treat patients with insurance under agreements with principal private medical insurance companies ("PMIs"), it is necessary for each of Circle's facilities to be recognised by those PMIs. Failure to obtain and/or maintain agreements with these key insurers to treat their patients would result in a decline in Circle's revenue and have an adverse effect on Circle's business, results of operations, financial condition and future prospects. There have been some problems securing this recognition in Bath, and this could affect newer Circle hospitals in Reading and elsewhere which are yet to be completed (page 21).

The company is also in a wider competition with the key established players in the £5.1 billion private health care market, which is dominated by the large independent chains, with the top two, General Healthcare Group and Spire, controlling 38.3 per cent. of the market, and the top five controlling 69.5 per cent. of the market:

"Circle faces competition for patients, consultants, hospital sites and NHS tenders from independent hospital operators such as General Healthcare Group, Nuffield Health Hospitals, Spire Healthcare, HCA and Ramsay Health Care, and independent sector service providers such as Care UK, InterHealth Canada and Serco Group." (page 65)

Potential problems with investors

Some 95% of the company post-flotation is owned by a handful of private equity and other city interests: they will be in a powerful position to shape the future direction of Circle – and any substantial sale of shares by any of these key investors could trigger a downward slide in the privce of share and valuation of the company:

"Immediately following Admission, Health Partners Limited (of which Chief Executive Officer Ali Parsa is a beneficiary) will own 8.2 per cent. of the fully diluted issued ordinary share capital of the Company (…) Balderton will own 17.0 per cent., Lansdowne will own 27.8 per cent., BlackRock will own 12.2 per cent., BlueCrest will own 14.0 per cent. and Odey will own 15.7 per cent. Together these investors will own 94.9 per cent. of the issued ordinary share capital of the Company. (…) As a result, these shareholders will potentially possess sufficient voting power to have a significant influence over all matters requiring shareholder approval, including the election of directors and approval of significant corporate transactions." (page 30)

It seems that for the foreseeable future only these shareholdings are likely to generate any income for those linked in with the Circle group. For the Partnership and its 2500 consultants and GPs there is neither value nor dividend to show for their investment:

"As Circle is still in its growth phase, no dividends have yet been paid to the Circle Partnership and the Circle Partnership Shares do not currently have any value above par (£0.01)." (page 52)

So who are the real investors behind Ali Parsa's so-called social enterprise?

Balderton Capital, formerly Benchmark Europe, is an early-stage venture firm founded by Benchmark Capital in 2000. Balderton became independent, while maintaining close ties with Benchmark, in 2007. Balderton's portfolio includes Betfair, the person-to-person betting exchange, and Alphyra, the pan-European electronic payments provider, as well as Wonga.com, the ultra-high interest lenders of "pay day loans" with rates as high as 3,000% for money borrowed using their i-phone app.

Lansdowne Partners is a hedge fund with $16 billion under management, co-founded by Paul Ruddock, a generous donor to the Conservative Party. It made a £12million killing in days by exploiting the collapse of Barclays shares in 2009. Within hours of the ban on the controversial practice of short-selling being lifted, Lansdowne Partners sold shares in Barclays worth £28.4million.

They were bought back on Wednesday, by which time the bank's value had nose-dived by almost £1 per share, netting a handsome profit for the financiers' investors. The company hit the headlines early in 2010 when it signed up Tony Blair to deliver four speeches on world politics to the company's staff for a fee of £200,000. Ruddock and co-financier David Craigen have donated more than £300,000 to the Tories, most of it since David Cameron became leader.

BlackRock is the giant money-management firm established 23 years ago by Larry Fink, which controls or monitors more than $12 trillion worldwide—including the balance sheets of Fannie Mae and Freddie Mac, and the toxic A.I.G. and Bear Stearns assets taken over by the U.S. government. When Fink's $13.5 billion acquisition of Barclays Global Investors was finalised, BlackRock officially became the largest money-management firm in the world, with $3.3 trillion in assets under its direct management including about $1 trillion of pension and retirement funds for millions of Americans.

BlueCrest Capital Management LLP is Europe's third largest hedge fund or "alternative asset management company" based in Guernsey. It runs $25bn of client assets, managing significant institutional assets across a number of diversified strategies. The two founders of BCM LLP, Michael Platt and William Reeves (now retired), were both Managing Directors and senior proprietary traders at JP Morgan, who left to establish BlueCrest in 2000. BCMLLP is fully owned by its principals. AQccording to its website, "BlueCrest's objective has been to construct a trading infrastructure of investment bank quality, upon which trading teams can be built and new strategies developed. BlueCrest believes in a specialist model. … This specialist structure encourages broader overall portfolios with significantly less concentrated risk and can allow the portfolio managers to focus on smaller, more esoteric anomalies that are often overlooked."

Odey Asset Management is a £3 billion hedge fund, run by Crispin Odey, a donor to the Tories and to the Christian Party, whose slogan is "Proclaiming Christ's Lordship", as well as £18,000 to Libertas EU. The London financier criticised by the Irish government for allegedly intervening in the 2009 Irish referendum, has made a fortune by correctly guessing that banks such as Anglo Irish would collapse without state aid. Harrow and Oxford-educated Mr Odey made a fortune from short-selling British banks in 2008, and then awarded himself a bonus of almost £28m after his investments came right for his clients, an award that beefed up his £300m personal fortune another notch. He threatened to move his firm out of Britain to avoid the 50% income-tax rate on high earners. His wife Nichola Pease is deputy chairman of JO Hambro and as a scion of one of the founding families of Barclays – where her brother in-law John Varley is chief executive – is a City blueblood.

Unanswered questions

With these truly enormous companies behind Circle, the big question is why the company is finding it so hard to pay its bills, and moving so slowly on constructing its planned national chain of small private hospitals across the UK. The private equity bosses who have injected £100m or more into the company will want a return, but are clearly withholding their judgement on the business plan and business acumen of Dr Parsa and his merry band.

None of this does anything to reassure UNISON or the health workers in Hinchingbrooke and elsewhere that their futures would be in any way secure under new management by Circle.

The question would always be who the real management actually is, and where any possible surpluses may wind up.