



Performance, Efficiency, Achievement, Knowledge

## Developing a Spine-Driven Ambulatory Surgery Center: The Essentials for Success

June 15, 2012

10th Annual Orthopedic, Spine, and Pain Management-Driven ASC  
Conference

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Meridian Surgical Partners

## Market Drivers – Spine Driven ASCs

### Minimally Invasive "Mindset"

- Physicians
- Patients – Research on the internet "Minimally Invasive"
- Industry – Less invasive technology

### Technology

- Surgical implants
- Surgical instruments // Tubular Retractors – Endoscopes – Lasers – Imaging
- Surgical techniques

### Anesthesia

- Portable pain pumps

### Insurance Company Acceptance

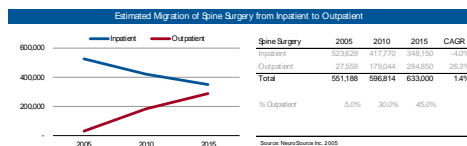
- Safe
- Better, faster & less expensive than the hospital alternative
- High quality patient outcomes

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## Migration of Spine to ASC

### Spine Surgery Shift to Outpatient

- 2015 Shift of Spine to ASCs – 45%
- Driven by Technology, Anesthesia, Physician Mindset and Insurance Acceptance
- Society Ambulatory Spine Surgery – NASS launch 2011 – Goal 50% to ASC
- Insight from Spine Investments – MSP



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## Essentials for Success

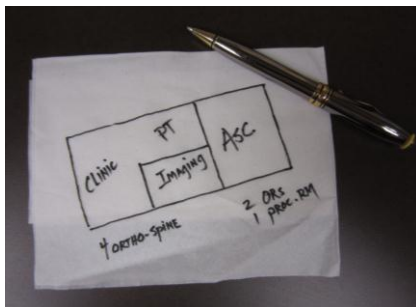
## Develop a Detailed Business Plan

### Detailed Financial Analysis

- Project Scope
- Surgical Case Volume
- Reimbursement
- Partnership Structure
- Construction Cost
- Financing
- Equipment Planning
- Operations - Challenges

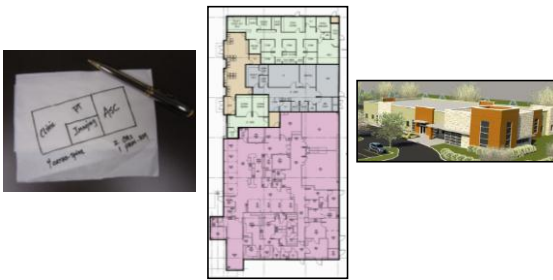
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## The BIG Idea...where do you go from here?



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## How do you get from concept to delivery?



## Planning - Schematics



## Completed Project



Completed Project



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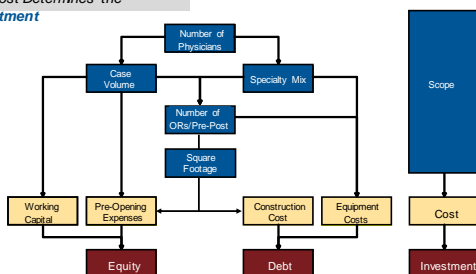
## Project Scope

Determine the **Scope** of the Project

The Scope Determines the **Cost**

The Cost Determines the **Investment**

### The Cost Determines the Investment



## Summary Financial Analysis

### Surgical Case Analysis

- Determine **Volume**
  - Complete case data worksheets
  - Discount case volumes
- Determine **Reimbursement** per case
  - Market Specific
- Determine **Revenue**
  - Volume times Reimbursement
- Use historical cost to build financial model

Spine Worksheet					
CFI	Description	Cases 2008	Cases 2009	Cases 2010	Cases 2011 YTD
00000	Service User Representative Panel				
00004	Service Leadership				
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Pain Worksheet					
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## Summary Financial Analysis

### Net Revenue Determination – Spine Surgery

NeuroSpine - Surgeon 1				
CPT	Description	Rev/Case	Cases	Net Revenue
63030	Cervical Disc Foraminotomy Post	\$4,996	0	\$0
63045	Cervical Laminectomy	5,993	22	131,835
22523	Thoracic Kyphoplasty	3,380	0	0
22534	Lumbar Kyphoplasty	3,380	2	6,759
63030	Lumbar Laminectomy / Micro Discectomy	4,796	11	52,315
63047	Decompressive Lumbar Laminectomy	5,195	100	521,477
22558	ALIF/PLIF	18,937	71	1,413,035
22630	PLIF	18,755	12	218,808
63042	Laminotomy	4,296	5	21,480
63056	Transpedicular approach with decompression of spinal	5,195	40	205,419
22554	ACDF - 22551	28,221	62	1,758,109
22850	1 level hardware removal	4,805	7	33,634
22852	2 or more levels hardware removal	4,288	0	0
22856	Artificial Disc replacement	6,437	5	32,183
Totals			337	\$4,386,654
Net revenue per case - surgeon 1				\$13,056

NeuroSpine - Surgeon 2				
CPT	Description	Rev/Case	Cases	Net Revenue
Net revenue per case - surgeon 2				\$8,963
Total blended net revenue per case				\$12,081

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## Summary Financial Analysis

### Surgical Case Volume

- We begin with 3,141 cases.
- We assumed a combined 12.8% discount on the actual cases captured at the center.
- Then applied a 9 month ramp to derive a total case count of 1,823 cases in year 1.
- Total year one discount applied to the base case volume is about 42%.
- Even with a 1.0% growth rate, case volume in year 5 is pegged at 90% of base case volume

Specialty Build											Case Mix
Spec	Count	Cases	Discount	Base	Ramp	Year 1	Year 2	Year 3	Year 4	Year 5	
BNT	-	-	-	-	-	-	-	-	-	-	0%
GI	-	-	-	-	-	-	-	-	-	-	0%
GEN	-	-	-	-	-	-	-	-	-	-	0%
GYN	-	-	-	-	-	-	-	-	-	-	0%
OPT	-	-	-	-	-	-	-	-	-	-	0%
PRIV	2	442	-30.0%	309	(100)	207	312	315	319	322	11%
QRT	-	-	-	-	-	-	-	-	-	-	0%
RAIN	2	2,899	-10.0%	2,429	(813)	1,616	2,453	2,478	2,503	2,528	89%
POD	-	-	-	-	-	-	-	-	-	-	0%
URD	-	-	-	-	-	-	-	-	-	-	0%
Total	4	3,141	-12.8%	2,738	(915)	1,823	2,766	2,793	2,821	2,849	100%

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## Partnership Structure

## Partnership Structure



### Real Estate Partnership

- Separate real estate partnership is usually formed
- The partnership captures land purchase, site, utilities, fees & permits, shell building and tenant construction allowance
- Includes physicians from the ASC partnership
- Investment:
  - Land (\$6.50 to \$14.00/sf.) – 1.54 acres (\$436-\$939k)
  - Site Improvements/AE/soft costs - (\$30/sf.)
  - Building Shell (\$100 to \$110/sf.)
  - TI construction cost allowance (\$45/sf.)
- Investment Thesis:
  - 15 year lease term with personal guarantees
  - Total investment: \$3.95mm - \$236 sf. (MOB w/ASC)
    - Equity: 30% (\$1.05mm)
    - Debt: 70% (\$2.9mm)
    - Guarantees pro-rata

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## Partnership Structure



### Surgery Center Partnership

- Separate partnership
- Physician owners and management partner
- Investment includes:
  - 9300 sf.
  - Interior construction cost
    - \$1.35mm (\$145 sf)
    - TI allowance - \$45 sf - (\$419k)
  - Equipment (\$1.4mm)
  - Working capital (\$1.5mm)
- Investment Thesis:
  - Total investment: \$4.25mm
  - Equity: \$1.5mm – 1% pro-rata \$19K
  - Debt: \$2.75mm
  - Guarantees -1% pro-rata - \$27.5k
  - 15 year lease term
  - Cash-on-cash returns 50% +

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## Real Estate – MOB & ASC



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## Financial Model Assumptions

## Financial Model Assumptions

### Global Project Assumptions

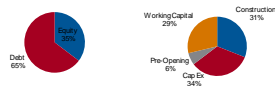
- ASC Construction
  - 9,300 sq ft facility
  - 2 operating rooms
  - 1 procedure room
- Lease rate – \$27.00 per foot
- Equity raise – \$15,000 per 1%
- Design and construction – \$1.3 million
- Capital expenditures – \$1.4 million
- Reimbursement rates:
  - Spine: \$12,083 (*net of implant costs*)
  - Pain: \$638
- Medical supplies estimated at approximately 30.0% of net revenue
- Case volume growth estimated at 1.5%
- Reimbursement growth rate estimated at approximately 1.5%

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## Financial Model Assumptions

### Global Project Assumptions - ASC

Sources of Capital		Uses of Capital	
Physician Partners	70%	Design and Construction	1,314,612
Corporate Partner	30%	Capital Expenditures	1,432,000
<b>Total Equity Financing</b>	<b>1,500,000</b>	Pre-Opening Expenses	280,548
Debt Financing	2,746,612	Working Capital	1,219,453
<b>Total Sources</b>	<b>4,246,612</b>	<b>Total Uses</b>	<b>4,246,612</b>



Investment Terms		Design and Construction	
Available Units	100	Construction Costs	1,239,612
Price per Unit	15,000	Other Fees and Expenses	75,000
<b>Total Equity Financing</b>	<b>1,500,000</b>	<b>Total Design &amp; Const.</b>	<b>1,314,612</b>
<b>Debt Financing</b>		<b>Capital Expenditures</b>	
Design and Construction	1,314,612	Medical Equipment	1,272,000
Capital Expenditures	1,432,000	Computers & Software	110,000
<b>Total Debt Financing</b>	<b>2,746,612</b>	Furniture & Fixtures	50,000
		<b>Total Cap Ex</b>	<b>1,432,000</b>

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## Summary Financial Analysis

Construct a free cash flow analysis is to view the opportunity from a realistic, albeit conservative, set of assumptions

### Free Cash Flow Analysis

- These assumptions include:
  - Case count
  - Reimbursement
  - Supply cost
  - FTE count
  - Other operating
  - Capital expenditures
  - Working capital and debt service.

Free Cash Flow					
(In Thousands)	Year 1	Year 2	Year 3	Year 4	Year 5
Net Revenue	3,333	5,438	5,379	5,731	5,887
Salaries and Benefits	765	585	1,023	1,020	1,096
Medical Supplies	1,028	1,580	1,612	1,645	1,676
Rent Expense	307	316	326	336	346
Insurance	70	72	74	75	77
Management Fee	272	326	335	344	353
Other Operating	345	431	448	454	457
EBITDA	168	1,177	1,763	1,818	1,879
Debt Service	(385)	(488)	(488)	(488)	(488)
Capital Expenditures	(146)	(146)	(171)	(200)	(200)
Changes in Working Capital	(568)	(279)	(120)	(121)	(121)
Free Cash Flow	(1,021)	658	1,058	1,029	1,070

Pay-Per-Visit					
(In Thousands)	Year 1	Year 2	Year 3	Year 4	Year 5
Case Volume	1,423	2,386	2,703	2,821	2,849
Revenue	1,328	1,364	1,397	1,431	1,466
Salaries and Benefits	420	357	365	375	385
Medical Supplies	589	571	577	583	589

Percent of Revenue					
	Year 1	Year 2	Year 3	Year 4	Year 5
Salaries and Benefits	21.7%	19.2%	19.3%	19.5%	19.5%
Medical Supplies	29.3%	29.1%	28.9%	28.7%	28.5%
Rent	8.7%	5.8%	5.8%	5.9%	5.9%
EBITDA	22.5%	31.8%	31.8%	31.7%	31.8%

Distribution Analysis					
(In Thousands)	Year 1	Year 2	Year 3	Year 4	Year 5
Free Cash Flow	1,121	819	1,215	1,253	1,257
Beginning Cash Balance	1,287	150	100	100	100
Market/Cash Balance	1,033	1,029	1,029	1,029	1,029
Debt Service	362	368	1,254	1,263	1,307

5-Year Investor Returns Analysis						
(In Thousands)	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Investor Capital	(1,000)	862	868	1,036	1,043	1,047
Annual Return		88.1%	88.3%	89.4%	89.5%	89.5%
Cumulative Return		-33.8%	32.0%	114.4%	199.9%	288.4%

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## Summary Financial Analysis

### Investor Returns

Based on the preliminary and conservative analysis, investors can anticipate an attractive return on investment.

- Incremental cash.
- No change in what you do just where you do it.
- State of the art facility with maximum convenience and efficiency.

10-Year Investor Returns Analysis													
(In Millions)	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total	
Ownership	5.0%	(7%)	50	49	62	64	66	66	94	94	94	709	
Annual Return	66.1%	65.9%	82.4%	85.5%	86.5%	86.5%	86.5%	86.5%	124.7%	124.7%	124.7%	1	
Cumulative Return	-33.9%	32.0%	114.4%	199.9%	288.4%	376.9%	465.4%	550.0%	714.7%	839.4%	939.4%	230.4%	

#### Notes:

- (1) Debt assumed fully amortized at the end of the 7th year.
- (2) In years 8, 9, and 10, distributions are based on Year 5 EBITDA and held constant.

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## ASC Partnership – Operating Entity



## Essentials for Success – Financing

### Equity

- Raise enough cash!!!
  - Raise the appropriate amount of equity versus making additional capital calls
- Good idea to raise 100% of the working capital
  - 9 to 12 months operating expense
- Range \$1.2 mm to \$1.5mm

### Debt

- Obtain a commitment for financing prior to starting the project
- Non-recourse is not available
- Contingent upon the financial strength of the business
  - Committed partners and surgical cases
  - Business plan and management plan
- Expect personal guarantees for tenant construction cost & equipment

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## Essentials for Success

### Equipment Planning

- It is well worth the expense to seek an experienced equipment planner
- Plan to spend up to \$1+mm per operating room for equipment
- Count on needing a microscope, c-arm, lumbar table, drill systems and instrument sets

### Partnership Formation

- Seek appropriate legal counsel to determine the best legal structure for your project
- A contribution agreement or private placement memorandum describes the project in detail
- Investment opportunity and risk associated with the transaction are identified
- Escrow account is established and capital committed

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## Operations – Challenges

- Reimbursement
- Implant Cost
- Equipment Cost
- Staffing
- Physician Mindset

## Operations – Challenges

### Reimbursement

- Getting paid is a critical step in the business plan
- Most spine procedures are not currently approved by Medicare
- Must convince the insurance company these procedures are safe in an ASC
- Some insurance companies are beginning to develop ASC fee schedules for spine
- This is still a negotiation between the ASC and insurance companies

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## Operations – Challenges

### Implant Costs

- Addressing implant cost is essential
- Negotiate carve-outs
- Having solid cost data is important when negotiating with the payors
- Off-load implant cost to a third party company

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## Operations – Challenges

### Equipment Costs

- Hire an experienced equipment planner to assist
- Expense – up to \$1.0 + mm per operating room
  - Microscope - \$80-120k
  - C-arm - \$150k
  - Drill set - \$30,000
  - OR-ARM & navigation - \$600-800k
  - Spine instrument trays – cervical and lumbar \$50k+
  - Lumbar table \$35k
  - Cautery unit - \$50k

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## Operations – Challenges

### Staffing

- Hire a staff that has spine experience
- Hire a staff that has worked with your surgeons
- Understanding the challenges and needs of the patients pre and post-operatively will make a significant difference in success out of the gate

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## Operations – Challenges

### Physician Mindset

- Build a program with surgeons that are comfortable in the ASC arena
  - MIS technique
  - Shorter post-op care
  - Modified discharge criteria
- They need to get that this is not the hospital

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## Summary

### **Spine surgeons are evaluating opportunities to develop ASCs**

- Driven by desire to control their surgical environment
- Increase productivity, simplify their lives and increase income

### **Advancements in technology drive spine into an outpatient setting**

- MIS product and instrument design
- Improvements in anesthesia
- Evolution of surgeon acceptance and comfort in an outpatient setting

### **Planning is essential for a successful outcome**

- Careful business plan development is critical
- Seek assistant from professionals with specific experience

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Thank You!

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