



Performance, Efficiency, Achievement, Knowledge

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

June 9-11, 2011  
9th Annual Orthopedic, Spine  
and Pain Management-Driven ASC Conference  
Kenny Hancock

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## Spine Market and Drivers

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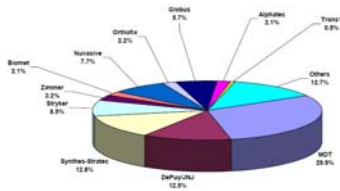
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## 2010 Spine Market

Figure 7: 2010E US spine market

2010 US Spinal Implant Market  
Est. Value of \$4.9B, Growing 1%



Source: Company reports and Canaccord Genuity estimates

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## Spine Driven Ambulatory Surgery Centers

### Market Drivers

- Minimally Invasive “Mindset”
  - ✓ Physicians
  - ✓ Patients -- research on the internet “minimally invasive”
  - ✓ Industry -- less invasive technology
- Technology
  - ✓ Surgical implants
  - ✓ Surgical instruments (tubular retractors --endoscopes - lasers)
  - ✓ 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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## Spine Driven Ambulatory Surgery Centers

### Tangible Patient Benefits

- Smaller incisions -- cosmetically more appealing
- Less trauma to muscles and soft tissue
- Pain control -- less postoperative pain
- Reduction in blood loss
- Faster recovery
- No hospital stay
- Less cost

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## Spine Driven Ambulatory Surgery Centers

### Tangible Physician Benefits

- Take control of their surgical environment
- Increased productivity
- An efficient physical plant
- Comprehensive delivery model (clinic, surgery, imaging, rehab)
- Income opportunity

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Essentials for Success

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Develop a Detailed Business Plan

Detailed Financial Analysis

- Surgical Case Volume
- Reimbursement
- Project Scope
- Construction Cost
- Real Estate Structure
- Financing
- Equipment Planning
- Partnership Formation
- Operations

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Financial Analysis

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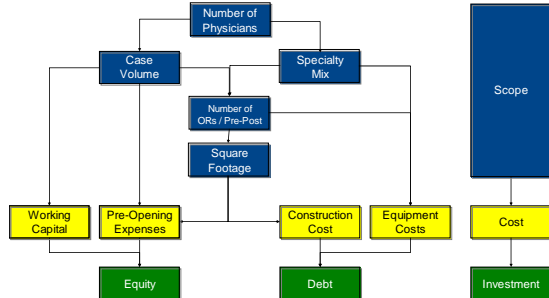
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## Project Scope

1. Determine the **Scope** of the Project
2. The Scope Determines the **Cost**
3. The Cost Determines the **Investment**



## Summary Financial Analysis

### Surgical Case Volume

- We begin with approximately 1,100 cases. We assumed a 15% discount on the actual cases captured at the center. Then applied a 9 month ramp deriving a total case count of 625 cases in year 1.
- Total year one discount applied to the base case volume is nearly 43%.
- Even with a 1.5% growth rate, case volume in year 5 is pegged at 90% of base case volume.

Specialty Build										
Spec.	Count	Cases	Discount	Base	Ramp	Year 1	Year 2	Year 3	Year 4	Year 5
ENT	-	-	-	-	-	-	-	-	-	-
GI	-	-	-	-	-	-	-	-	-	-
GEN	-	-	-	-	-	-	-	-	-	-
GYN	-	-	-	-	-	-	-	-	-	-
OFT	-	-	-	-	-	-	-	-	-	-
OPHD	1	325	-15.0%	276	(92)	184	280	285	289	293
ORT	3	250	-15.0%	213	(49)	144	216	219	222	226
PAINT	1	525	-15.0%	446	(149)	297	453	460	467	474
POD	-	-	-	-	-	-	-	-	-	-
URO	-	-	-	-	-	-	-	-	-	-
Other	-	-	-	-	-	-	-	-	-	-
Total	5	1,100	-15.0%	935	(210)	625	949	963	976	992

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## Summary Financial Analysis

### Case Analysis

- Capture case data on worksheets to determine volume
- Determine discount to case volumes
- Determine reimbursement per case in market and apply to case volume to calculate revenue
- Use historical cost to build financial model

Spine Worksheet					Pain Worksheet				
QTY	Description	Case 2008	Case 2009	Case 2010	QTY	Description	Case 2008	Case 2009	Case 2010
1	Spine Pain Management - Med				1	Spine Pain Management - Med			
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## Financial Model Assumptions

## Financial Model Assumptions

### Global Project Assumptions

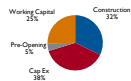
- Construction of 8,500 sq ft facility
- 1 operating room -- capacity for 2<sup>nd</sup> OR
- 1 procedure room
- Lease rate set at \$24.00 per foot
- Equity raise is \$11,000 per 1%
- Design and construction estimated at \$1.2 million
- Capital expenditures of \$1.4 million
- Reimbursement rates:
  - Spine: \$9,706 (spine reimbursement net of implant costs)
  - Orthopedics: \$2,136
  - Pain: \$715
- Medical supplies estimated at 23.5% of net revenue
- Case volume growth estimated at 1.5%
- Reimbursement growth rate estimated at 1.5%

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## Financial Model Assumptions

### Global Project Assumptions

Sources of Capital			Uses of Capital		
Physician Partners	70%	770,000	Design and Construction	1,183,650	
Corporate Partner	30%	330,000	Capital Expenditures	1,414,000	
<b>Total Equity Financing</b>		<b>1,100,000</b>	Pre-Opening Expenses	166,839	
Debt Financing		2,597,650	Working Capital	933,161	
<b>Total Sources</b>		<b>3,697,650</b>	<b>Total Uses</b>	<b>3,697,650</b>	



Investment Terms			Design and Construction		
Available Units		100	Construction Costs	1,042,350	
Price per Unit		11,000	Other Fees and Expenses	121,450	
<b>Total Equity Financing</b>		<b>1,100,000</b>	<b>Total Design &amp; Const.</b>	<b>1,183,650</b>	
<b>Debt Financing</b>			<b>Capital Expenditures</b>		
Design and Construction		1,183,650	Medical Equipment	1,300,000	
Capital Expenditures		1,414,000	Computers & Software	39,000	
<b>Total Debt Financing</b>		<b>2,597,650</b>	Furniture & Fixtures	75,000	
			<b>Total Cap Ex</b>	<b>1,414,000</b>	

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## Summary Financial Analysis

- Free Cash Flow Analysis
- ✓ Construct a free cash flow analysis is to view the opportunity from a realistic, albeit conservative, set of assumptions
- ✓ These assumptions include:
  - Case count
  - Reimbursement
  - Supply cost
  - FTE count
  - Other operating
  - Capital expenditures
  - Working capital and debt service.

Free Cash Flow					
Item/Assumption	Year 1	Year 2	Year 3	Year 4	Year 5
<b>Net Revenue</b>	<b>2,366</b>	<b>3,558</b>	<b>3,856</b>	<b>3,777</b>	<b>3,891</b>
Salaries and Benefits	658	973	1,008	1,043	1,079
Medical Supplies	542	840	870	901	933
Rent Expense	204	210	218	223	230
Insurance	50	51	53	54	55
Management Fee	115	178	183	189	195
Other Operating	124	149	158	164	173
<b>EBITDA</b>	<b>612</b>	<b>1,156</b>	<b>1,186</b>	<b>1,263</b>	<b>1,227</b>
Debt Service	(385)	(474)	(474)	(474)	(474)
Capital Expenditures	(14)	(21)	(28)	(28)	(30)
<b>Change in Working Capital</b>	<b>(56)</b>	<b>(256)</b>	<b>(25)</b>	<b>(25)</b>	<b>(27)</b>
<b>Free Cash Flow</b>	<b>(113)</b>	<b>519</b>	<b>619</b>	<b>675</b>	<b>696</b>
Operating Costs					
Item/Assumption	Year 1	Year 2	Year 3	Year 4	Year 5
Case Volume	625	949	963	978	992
Revenue	3,689	5,750	5,808	5,883	5,921
Salaries and Benefits	1,054	1,626	1,646	1,687	1,688
Medical Supplies	887	886	903	921	940
Percent of Revenue					
Item/Assumption	Year 1	Year 2	Year 3	Year 4	Year 5
Salaries and Benefits	28.6%	27.4%	27.5%	27.6%	27.7%
Medical Supplies	23.9%	23.6%	23.7%	23.9%	24.0%
Rent	5.8%	5.9%	5.9%	5.9%	5.9%
EBITDA	26.5%	32.5%	32.2%	31.9%	31.5%
Distributions Analysis					
Item/Assumption	Year 1	Year 2	Year 3	Year 4	Year 5
Free Cash Flow	(113)	519	619	675	696
Beginning Cash Balance	902	200	100	100	100
Minimum Cash Balance	(200)	(100)	(100)	(100)	(100)
<b>Distributions</b>	<b>449</b>	<b>419</b>	<b>619</b>	<b>675</b>	<b>696</b>
5-Year Investor Return Analysis					
Item/Assumption	Year 1	Year 2	Year 3	Year 4	Year 5
Investor Cashflow	(1,100)	449	419	675	696
Annual Return	40.9%	42.7%	39.9%	61.3%	62.8%
Cumulative Return	-59.1%	-16.5%	43.4%	104.6%	197.8%

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## Real Estate

## Essentials for Success

### Real Estate

- A separate real estate partnership is usually formed
- The real estate partnership captures the land purchase, site, utilities, fees, & permits, shell building and tenant construction allowance
  - ✓ Land cost is variable \$6.50 to \$14.00 sq ft
  - ✓ Shell cost range \$100 - \$110 sq ft
  - ✓ Allowance is \$30 - \$45 sq ft
  - ✓ Real estate partnership seeks a 15 year lease commitment with personal guarantees
- Real estate returns -- 14-20+% cash-on-cash return -- 10 year term

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Real Estate



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Real Estate



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ASC Partnership -- Operating Entity

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## Essentials for Success

### Financing

- Equity – raise the appropriate amount of equity versus making additional capital calls – good idea to raise 100% of the working capital
- 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
- Working Capital
  - ✓ Raise enough cash!!!
  - ✓ 9 – 12 months operating expense
  - ✓ Range \$1.1 mm to \$1.5mm

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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

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## Essentials for Success

### 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

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Operations

Challenges

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

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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 recognize and develop fee schedules for spine in an outpatient setting
- Most times --- this is still a negotiation between the ASC and insurance companies to recognize spine cases may be done safely in an ASC and develop a reasonable fee schedule

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## Operations

### Challenges – Implant Cost

- 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 Cost

- 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
- Surgeons must be comfortable with MIS technique, shorter post-op care and modified discharge criteria
- They need to get that this is not the hospital

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Operations -- Factors for Success

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Operations

Factors for Success

- Patient Selection & Education
- Pre-Op Process
- Pain Control
- Anesthesia

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## Operations

### Factors for Success – Patient Selection & Education

- Thorough pre-operative screening
- A one-on-one pre-operative interview by registered nurse which provides...
  - A comprehensive medical history interview to identify hidden medical issues not covered in the surgeon's office visit.
  - Additional information can be received from the patient including;
    - How they manage their pain
    - Any chronic pain issues
    - Medications that work and don't work for that patient
  - These findings are vital to their post-operative care

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## Operations

### Factors for Success – Pre-Op Process

- RN and Anesthesiologist collaborate closely to ensure successful pre-op screening and post-op care
- Fully understand the health and history of the patient
- The Anesthesiologist reviews and determines with the surgeon whether the patient is a good candidate for outpatient surgery
- Manage patient expectations – procedure, post-op, recovery --- they must be conditioned to go home

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## Operations

### Factors for Success – Pain Control

- Individualized one-on-one care for the first two hours post-operatively
  - ✓ Dramatically improves the success rate of obtaining pain control more quickly
- The ASC provides a calming atmosphere
  - ✓ For patients, as well as family members
  - ✓ Results in less stress and anxiety, which is also a helpful factor in controlling post-operative pain
- Information gathered pre-operatively
  - ✓ Regarding chronic pain issues
  - ✓ Medications that work and don't work for that patient
  - ✓ Identify other coping mechanisms make the post-operative phase a smoother transition

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## Operations

### Factors for Success – Anesthesia

- Anesthesia has progressed allowing spine to be performed in an ASC
  - ✓ Having experience with spine is a big plus
  - ✓ Shorter acting anesthetics
  - ✓ Less nausea post-op
  - ✓ Programmable pain pumps – that patients can take home
  - ✓ Must have good protocols and pathways for dealing with complications, recovery and pain control post-op
  - ✓ Patients should be educated on what's normal and what's not – what to look for if they're experiencing an issue – and who to contact

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## Conclusion

### 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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