

7 Keys to Successful Physician Hospital Joint Ventures

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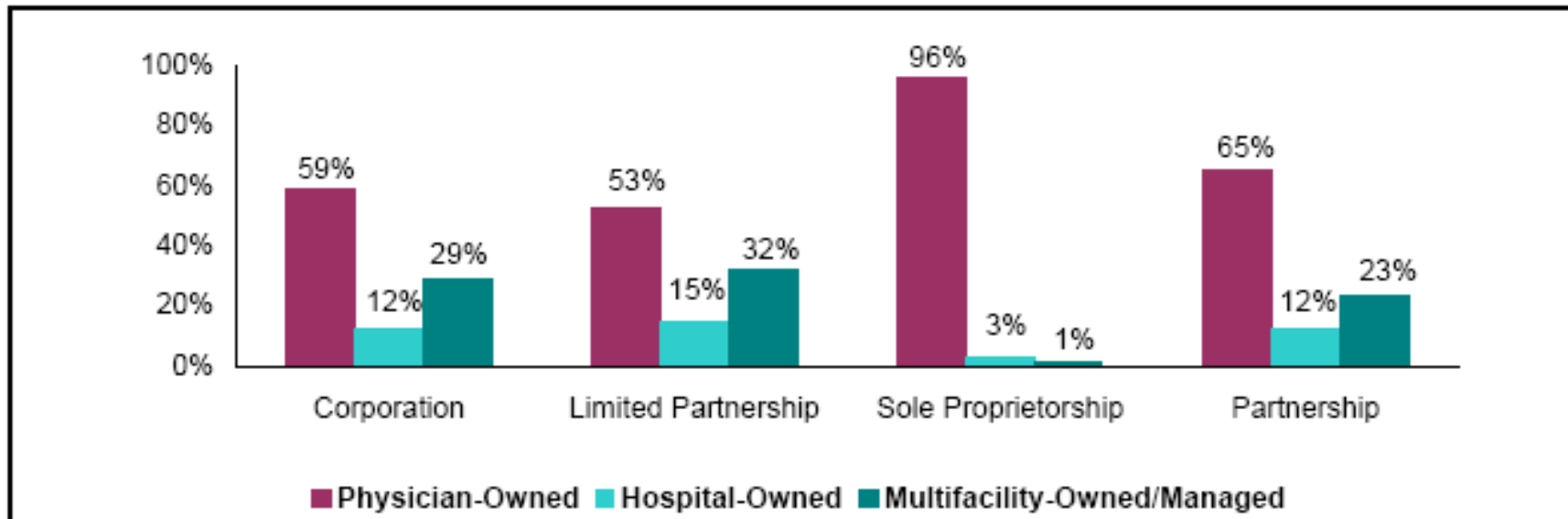
Agenda

- History of physician-hospital joint ventures
- Future of physician-hospital joint ventures
- Stakeholders' motivation for partnering
- Process for putting together a joint venture
- 7 keys to successful physician hospital joint ventures

History

- Physician driven industry
 - Seeking control
 - Operational efficiency
 - Incremental income
- Hospitals have been on the sideline until recently
 - Lost market share
 - Eroding medical staff relations
 - New market competitors

A Physician Driven Industry



Source: InforMed Healthcare Media, LLC 2007

Future

- Hospitals more active seeking ASC partnerships with physicians
 - Usually through acquisition of existing physician owned ASCs
- Physicians more actively seeking out hospitals as partners in ASCs than historically
- Will likely be the most prevalent ownership structure for de novo ASC development going forward

Physician Motivation

De Novo Development

- Certificate of Need (where applicable)
- Share capital cost and risk
- Don't negatively impact hospital (mostly relevant in smaller markets)
- Access to hospital payor contracts
- Avoid competing with the hospital

Sale of Existing ASC

- Liquidate some of their assets while valuations are high and capital gains tax rates are low
- Eliminate a competitor
- Access to hospital payor contracts
- Ability to attract more physician investors over time

Hospital Motivation

De Novo Development

- Increase market share (new physicians, new market, splitters)
- Retain market share
- Share capital cost and risk
- Improve physician relations
- Physician recruitment and retention
- Keep new competitors out of the market

Purchase an Existing ASC

- Eliminate a competitor
- Increase market share
- Regain market share
- Gain needed OR capacity at more reasonable cost
- Improve physician relations
- Physician recruitment and retention
- Keep new competitors out of the market

Motivation for All

Physicians

- More control over day-to-day operations
- Efficient/productive surgical environment
- Recruitment tool
- Incremental Income

Patients

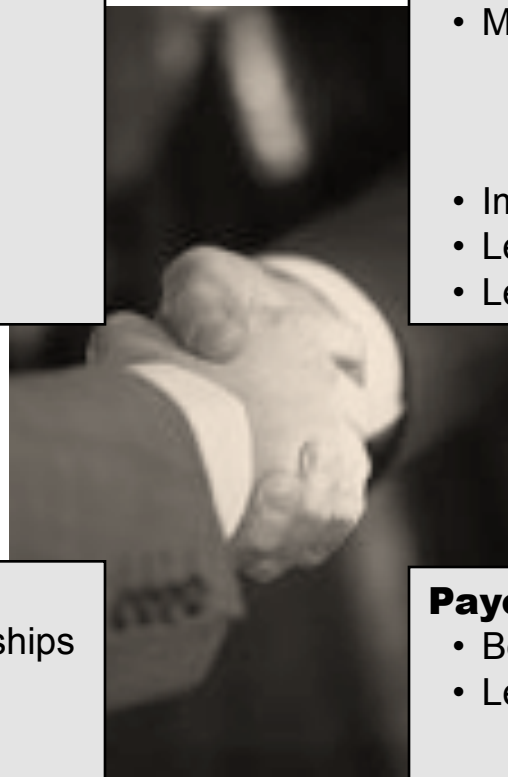
- More convenient
 - ✓ Easier scheduling
 - ✓ Better locations
 - ✓ No “bumped procedures”
- Improved outcomes
- Less institutional environment
- Less expensive than acute care hospitals

Hospital/Health System

- Solidify/improve physician relationships
- Retain/gain market share
- Recruitment tool
- New services delivery component

Payers

- Better patient outcomes
- Less expensive than acute care hospitals



Joint Venture Formation Process

1-2 months

- Determine physician interest level and objectives
- Develop preliminary business plan and financial projections, including hospital impact analysis
- Assess legal, reimbursement regulatory and tax requirements

1-2 months

- Form physician/hospital steering committee to agree on legal structure and business terms
- Prepare and refine term sheet
- Plan for corporate and regulatory approvals
- Obtain necessary valuations of hospital contributed assets
- Finalize projections and financing options

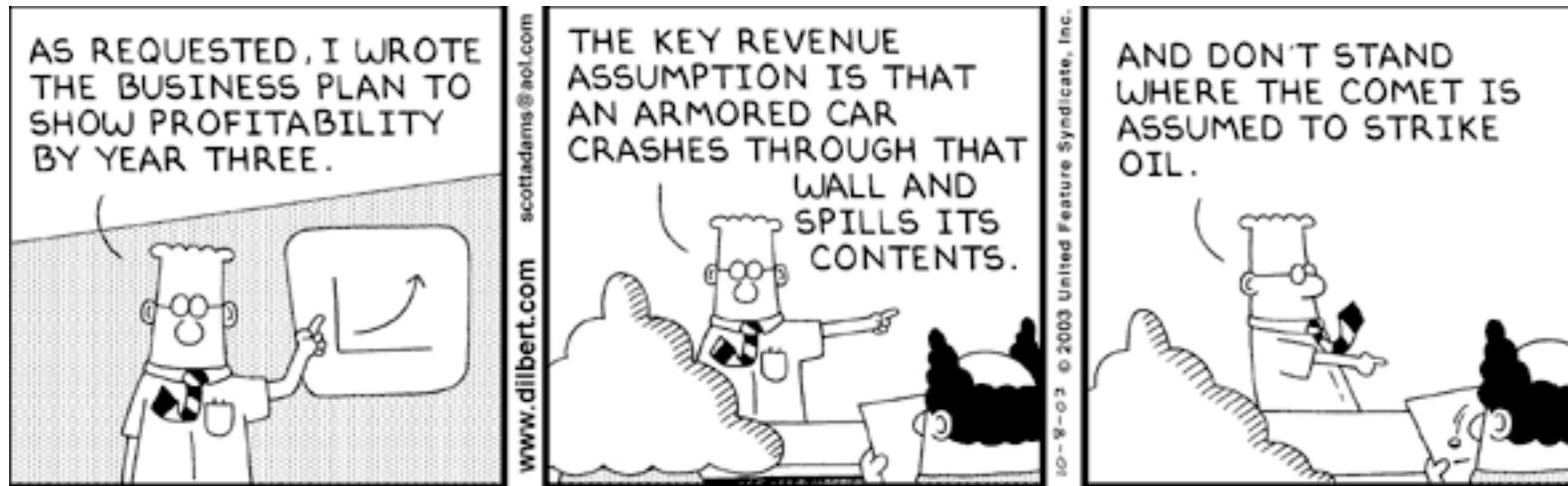
2-3 months

- Draft definitive agreements (Operating Agreement, Lease, Asset Purchase Agreement, Management Agreement)
- Prepare Private Placement Memorandum (PPM) and plan for physician offering
- Complete offering; organize initial owner and board meetings and close on transaction agreements
- Accept physician subscriptions

7 Keys to Success

- Good, thorough, up-front planning
- Work with an experienced outside professionals who have done this before
 - ASC management company
 - Independent legal counsel
 - Valuation firm, where necessary
- Strong physician leadership
- Active, committed hospital partner
- Open and honest communication
- Deal structure that best accommodates stakeholder needs and anticipates future events
- Make decisions for the long-term, not short-term gain

Planning



Planning

- Nothing drives a strong joint venture more than success
- Effective planning significantly enhances the likelihood of future success
- Planning should be led by a steering committee of key physician leaders and hospital executives
- Utilizing an ASC management company will enhance the likelihood that your assumptions are sound
- Your feasibility assessment should address:
 - Physician and hospital objectives
 - Volume and case mix based on local practice patterns, not just “demographics”
 - Right-sized facility for projected volumes and location
 - Organization/ownership options, including legal risk and reimbursement analysis
- Not all ASCs are feasible, don't be afraid to walk away

Planning: Key Considerations

- Choice of partners
 - Attract expanded physician network; do not need to take everyone
 - Secure key constituents to be steering committee members
 - Identify and select the manager of the venture
- Location and services mix; real estate issues
 - Know the market; locate to capture market gain
 - Physician convenience is critical
- Capital requirements and financing options
 - Secure early returns, quick ramp up without excess overhead
- Financial impact to hospital
- Timeline for implementation
 - Create speed to market: secure joint-venture ownership as soon as strategy is developed

Engage Experienced Professionals (Ringmasters)

- Independent, unbiased, leadership for the project
 - What's in the best interest of the new venture?
- Don't recreate the wheel
 - Shorten the project timeline
 - Learn from their positive and negative experiences elsewhere
- Ensure they are a good cultural fit and share your value system

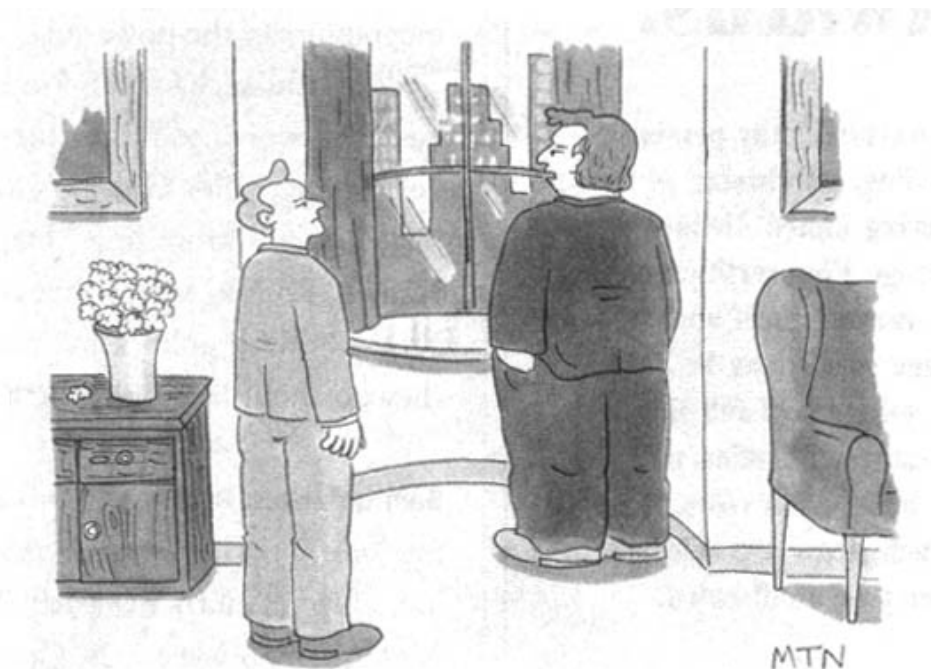
Strong Physician Leadership

- Steering committee should have physicians who are leaders among their peers and can represent the interest of your target physicians
- Physicians have to be committed to this venture
 - Appropriate non-competes have to be in place
 - Meaningful investment requirement
- Vested physicians are the best sales people among their peers
- The entity's operations must be physician led in order to maximize the ASC's performance and meet the physicians' efficiency goals

Committed Hospital Partner

- Hospital should be active in governance but leave the operational management to the management company and physicians
- Hospital should acknowledge physician leadership
- Hospital representatives on the steering committee/Board must be key leaders who are empowered to make decisions for the hospital
 - Shows commitment to the venture by the hospital
 - Best relationship building opportunity with key physicians
- Hospital needs to show commitment to the success of the venture and demonstrate that it is in this for the right reasons
- Hospital needs to do what it can to facilitate the ASC's success
 - Payor contracting support
 - Vendor relationships
 - Marketing
 - Physician recruitment

Open and Honest Communication



"I'm not convinced that's the best strategy. Then again, I wasn't listening."

- Deal with the tough issues up front, working through them creates significant trust among the partners
- Look forward rather than dwelling on the past
- There can never be enough communication
- This is about building successful partnerships

Open and Honest Communication

- Ensure a clear understanding of the expectations of each party and the value each party brings to the table

Hospital

- Community Presence
- Brand Name
- PCP/ Payer network
- Long-term Commitment
- Financial Strength



Management Company

- ASC Operations Experience & Expertise
- ASC Culture
- Joint Venture Experience
- History of Successful Businesses
- Industry Knowledge

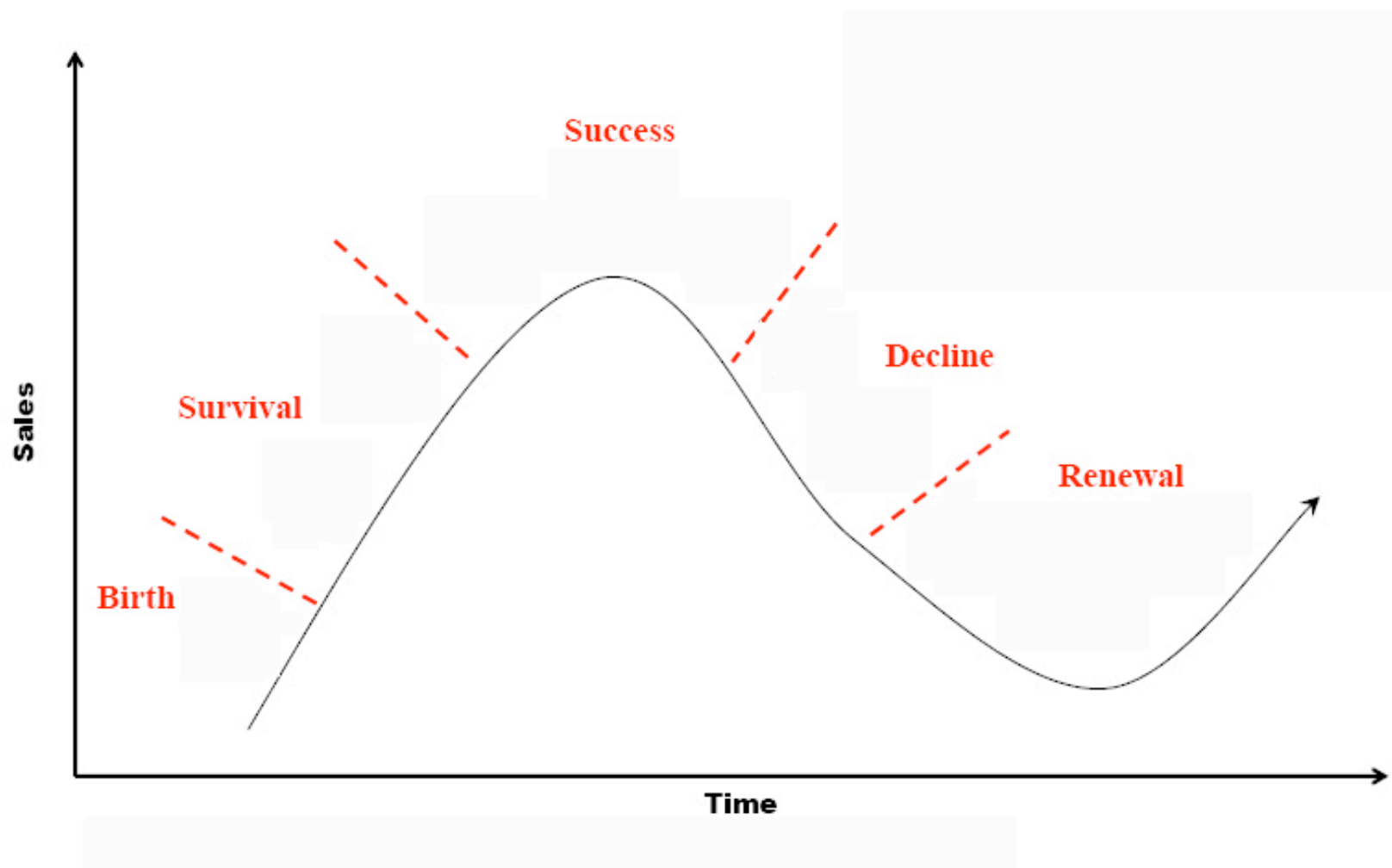
Physicians

- Clinical Skills & Knowledge
- Surgical Volume
- Existing Medical Relationships
- Entrepreneurial Spirit
- Investment

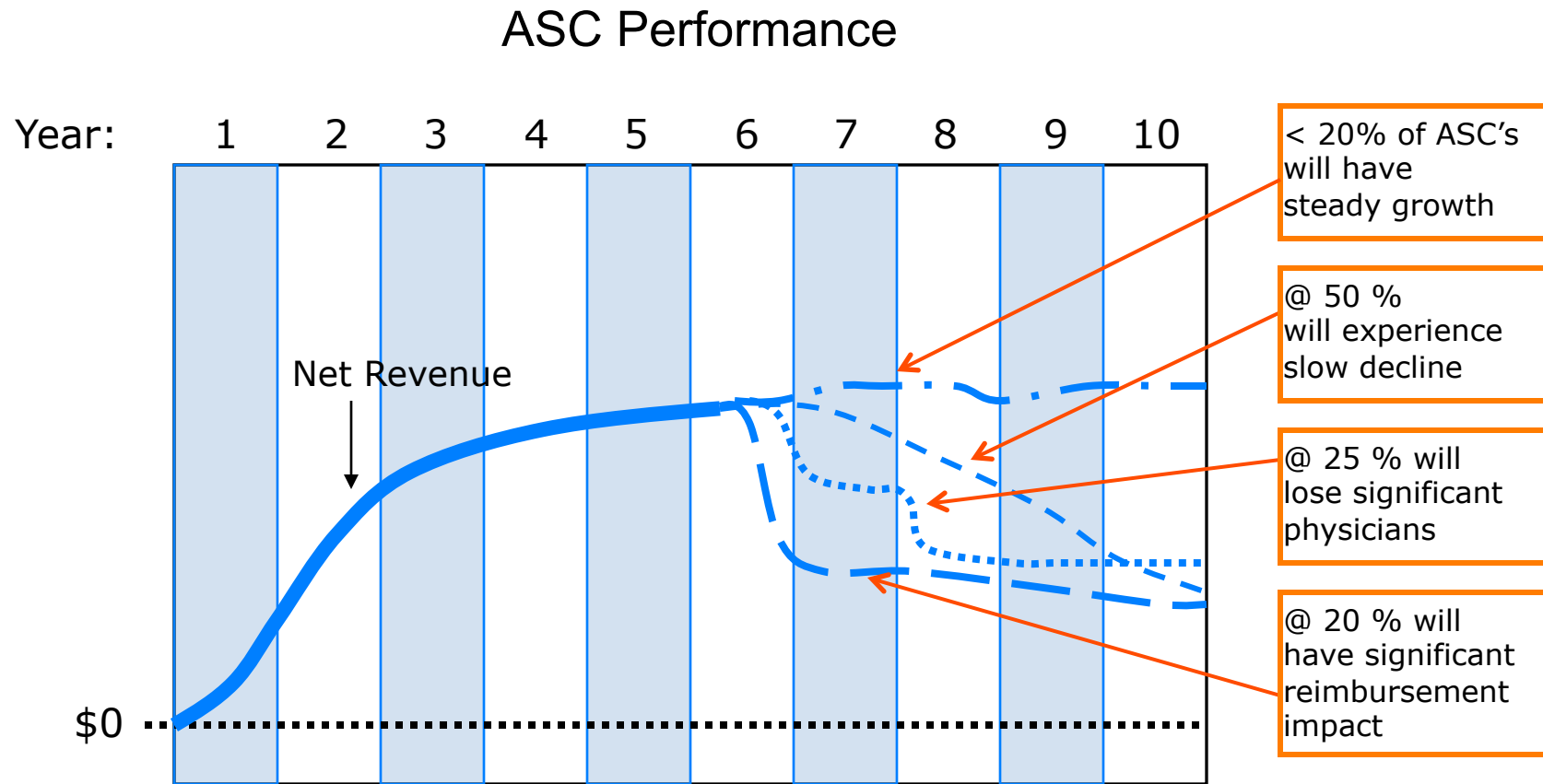
Effective Deal Structure

- Has to accommodate the stakeholders' objectives, work within the legal and regulatory framework, and effectively accommodate future events affecting the partnership
- Document will rarely be referenced if you have a strong partnership created through dealing with the issues through the venture formation process
- Key issues that need to be addressed include:
 - Ownership and control
 - Hospital tax exempt issues
 - Anti-trust related to payor contracting
 - Physician goals/expectations
 - Fraud and Abuse and Stark Law considerations
 - Capital structure
 - Eligible investors
 - Non-compete provisions
 - Unit transfer (buy in/buy out)
 - Redemption terms
 - Capital calls

Managing the Business Lifecycle



ASC Challenges



Source: Value Management Group

Long-term Decision Making

- Decisions have to be made in the best interest of the long-term viability of the business rather than short-term needs of the individual stakeholders
- Challenges will be different throughout the venture's lifecycle and having a community based partnership, such as a physician-hospital joint venture, help to focus the stakeholders on maintaining a viable community asset
- Trust built among stakeholders in the up-front process facilitates constructive decision making throughout the venture's lifecycle

“It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change.”

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Questions?

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