



Performance, Efficiency, Achievement, Knowledge

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

October 27-29, 2011

18th Annual Ambulatory Surgery Centers Conference:
Improving Profitability and Business and Legal Issues

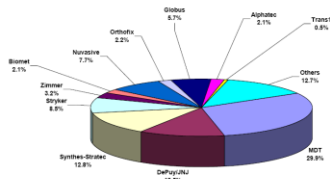
Kenny Hancock

Spine Market and Drivers

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

Imagine making the impossible possible.
Transform your Spine Practice.

Society For Ambulatory Spine Surgery
Inaugural Meeting 11.3.11 - NASS Meeting Chicago

"The ASC is where the future of spine surgery is... This will
literally be a game-changer over the next 10 years."

Robert Bray, Jr., M.D. Neurosurgeon, CA – 11.25.09 (Becker's)

"I would estimate that 80% of all spine cases will be
performed at ASCs in the next five years."

Kenneth Pettine, M.D. – 8.12.09 (Becker's)

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 -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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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

Develop a Detailed Business Plan

Detailed Financial Analysis

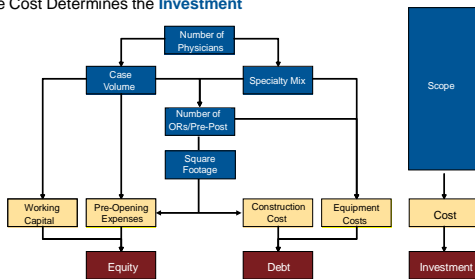
- Surgical Case Volume
- Reimbursement
- Project Scope
- Construction Cost
- Real Estate Structure
- Financing
- Equipment Planning
- Partnership Formation
- Operations

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Financial Analysis

Project Scope

- Determine the **Scope** of the Project
- The Scope Determines the **Cost**
- The Cost Determines the **Investment**



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 deriving 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	Count	Cases	Discount	Base	Ramp	Year 1	Year 2	Year 3	Year 4	Year 5	Case Mix
ENT	-	-	-	-	-	-	-	-	-	-	0%
GI	-	-	-	-	-	-	-	-	-	-	0%
GEN	-	-	-	-	-	-	-	-	-	-	0%
GIN	-	-	-	-	-	-	-	-	-	-	0%
GPT	-	-	-	-	-	-	-	-	-	-	0%
IPNE	2	442	-30.0%	309	(102)	207	312	315	319	322	11%
ORT	-	-	-	-	-	-	-	-	-	-	0%
PAIN	2	2,699	-10.0%	2,420	(813)	1,616	2,453	2,478	2,503	2,528	89%
POD	-	-	-	-	-	-	-	-	-	-	0%
URO	-	-	-	-	-	-	-	-	-	-	0%
Total	4	3,141	-12.8%	2,738	(919)	1,823	2,766	2,793	2,821	2,848	100%

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

[illegible]

Summary Financial Analysis

Net Revenue Determination – NeuroSpine

Neurology - Surgeon 1				
CPT	Description	ReVCase	Cases	Net Revenue
60520	Cervical disc decompression (open)	5,136	0	0
63045	Cervical laminectomy	1,593	22	35,166
22514	Therapeutic lumpectomy	3,380	0	0
22518	Lumbar laminectomy	3,140	2	6,279
63047	Lumbar laminectomy - Micro Discectomy	5,796	10	57,960
63047	Decompressive Lumbar Laminectomy	5,796	14	81,144
22518	ALIF PLIF	10,817	73	7,80,651
22518	PLIF	14,720	12	2,16,640
63042	Laminectomy	4,296	5	21,480
63056	Transpedicular approach with decompression of spinal	4,005	40	1,62,200
22554	ACDF - 2015	22,181	62	4,93,939
22550	3 level hardware removal	4,405	7	31,035
22562	2 or more levels hardware removal	4,285	0	0
22565	Artificial disc replacement	6,417	5	32,085
	Totals		327	\$4,89,054
	Net revenue per case - surgeon 1			\$14,953

Neurology - Surgeon 2				
CPT	Description	ReVCase	Cases	Net Revenue
60520	Cervical disc decompression (open)	5,136	0	0
63045	Cervical laminectomy	1,593	38	60,534
22514	Therapeutic lumpectomy	3,380	0	0
22518	Lumbar laminectomy	3,140	0	0
63047	Lumbar laminectomy - Micro Discectomy	5,796	12	69,552
63047	Decompressive Lumbar Laminectomy	5,796	12	69,552
22518	ALIF PLIF	8,790	0	0
22510	PLIF	7,614	9	68,526
63042	Laminectomy	4,296	12	51,552
63056	Transpedicular approach with decompression of spinal	5,195	67	3,48,385
22554	ACDF - 2015	22,147	10	2,21,470
22550	3 level hardware removal	4,405	0	0
22562	2 or more levels hardware removal	4,285	0	0
22565	Artificial disc replacement	1,917	0	0
	Totals		105	\$9,61,362
	Net revenue per case - surgeon 2			\$91,558
	Net combined net revenue per case			\$12,191

Financial Model Assumptions

Financial Model Assumptions

Global Project Assumptions

- Construction of 9,300 sq ft facility
- 2 operating rooms
- 1 procedure room
- Lease rate set at \$27.00 per foot
- Equity raise is \$15,000 per 1%
- Design and construction estimated at \$1.3 million
- Capital expenditures of \$1.4 million
- Reimbursement rates:
 - Spine: \$12,083 (spine reimbursement 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

Sources of Capital		Uses of Capital	
Physician Partners	70%	Design and Construction	1,314,812
Corporate Partner	30%	Capital Expenditures	1,432,000
Total Equity Financing	1,500,000	Pre-Opening Expenses	280,548
Debt Financing	2,746,812	Working Capital	1,219,453
Total Sources	4,246,812	Total Uses	4,246,812

Investment Terms		Design and Construction	
Buildable Units	100	Construction Costs	1,235,612
Price per Unit	15,000	Other Fees and Expenses	75,000
Total Equity Financing	1,500,000	Total Design & Const.	1,314,812

Debt Financing		Capital Expenditures	
Design and Construction	1,314,812	Medical Equipment	1,272,000
Capital Expenditures	1,432,000	Computers & Software	110,000
Total Debt Financing	2,746,812	Furniture & Fixtures	50,000
		Total Cap Ex	1,432,000



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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						
(in thousands)	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Net Revenue	3,333	3,408	3,579	3,751	3,927	4,107
Salaries and Benefits	786	888	1,023	1,059	1,096	1,133
Medical Supplies	1,030	1,063	1,112	1,145	1,178	1,211
Rent Expense	307	316	328	338	348	358
Insurance	70	72	74	76	77	79
Management Fee	212	328	325	344	353	363
Other Operating	345	431	446	454	467	477
EBITDA	756	1,717	1,763	1,818	1,859	1,896
Debt Service	(355)	(485)	(485)	(485)	(485)	(485)
Capital Expenditures	(146)	(271)	(271)	(271)	(271)	(271)
Change in Working Capital	(565)	(232)	(20)	(21)	(21)	(21)
Free Cash Flow	(140)	859	1,238	1,283	1,283	1,283

Pre-Opening Costs						
(in thousands)	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Case Volume	1,823	2,788	2,783	2,801	2,849	2,849
Revenue	1,558	1,584	1,597	1,611	1,626	1,641
Salaries and Benefits	420	357	366	375	385	395
Medical Supplies	569	571	577	583	589	595

Percent of Revenue						
(in thousands)	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Salaries and Benefits	23.7%	26.2%	28.7%	28.7%	28.7%	28.7%
Medical Supplies	30.9%	31.2%	31.1%	31.1%	31.1%	31.1%
Rent	8.7%	9.2%	9.2%	9.2%	9.2%	9.2%
EBITDA	22.5%	31.6%	31.6%	31.7%	31.7%	31.8%

Debt Service Analysis						
(in thousands)	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Free Cash Flow	(125)	858	1,238	1,283	1,283	1,283
Beginning Cash Balance	1,267	100	100	100	100	100
Maximum Cash Balance	(100)	(100)	(100)	(100)	(100)	(100)
Debt Service	952	859	1,238	1,283	1,283	1,283

S-Value Investment Return Analysis						
(in thousands)	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Investor Cashflow	(1,000)	952	958	1,238	1,283	1,283
Annual Return	88.1%	88.9%	88.4%	88.5%	88.5%	88.5%
Cumulative Return	-33.3%	32.0%	114.4%	199.2%	288.4%	377.6%

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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												
Key Financials	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total
Ownership	0.0%	(75)	50	10	52	54	58	65	68	69	64	705
Annual Return		66.1%	65.0%	62.4%	65.0%	66.0%	66.0%	66.0%	124.7%	124.7%	124.7%	
Cumulative Return		-33.0%	32.0%	114.4%	199.0%	266.4%	376.0%	465.4%	590.0%	714.7%	839.4%	839.4%
Ownership	10.0%	(150)	99	99	124	128	133	133	187	187	187	1,439
Annual Return		66.1%	65.0%	62.4%	65.0%	66.0%	66.0%	66.0%	124.7%	124.7%	124.7%	
Cumulative Return		-33.0%	32.0%	114.4%	199.0%	266.4%	376.0%	465.4%	590.0%	714.7%	839.4%	839.4%
Ownership	15.0%	(225)	149	148	185	192	199	199	281	281	281	2,174
Annual Return		66.1%	65.0%	62.4%	65.0%	66.0%	66.0%	66.0%	124.7%	124.7%	124.7%	
Cumulative Return		-33.0%	32.0%	114.4%	199.0%	266.4%	376.0%	465.4%	590.0%	714.7%	839.4%	839.4%

Notes:

- (1) Debt incurred 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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Real Estate

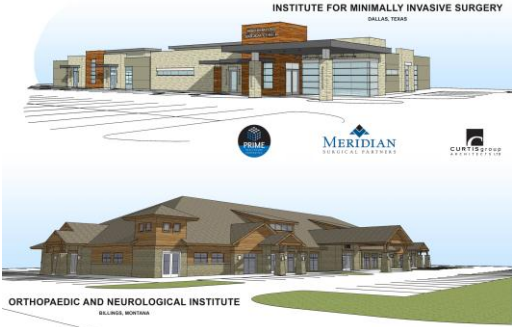
Essentials for Success

Real Estate

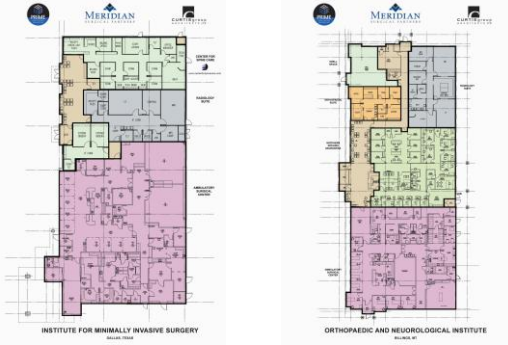
- A separate real estate partnership is usually formed
- The real estate partnership captures the land purchase, site, utilities, fees, & permits, shell building and tenant construction allowance
 - ✓ Land cost is variable \$6.50 to \$14.00 sq ft
 - ✓ Shell cost range \$100 - \$110 sq ft
 - ✓ Allowance is \$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



Real Estate



ASC Partnership -- Operating Entity

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

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

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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