The Business of Total Joints in Surgery Centers

NADER SAMII
CHIEF EXECUTIVE OFFICER
JULY 31, 2019
As CEO (since 2010), Nader has guided National Medical into its position as the largest and most reputable revenue cycle management company in the ASC market

Nader leads the strategic direction with a strong emphasis on exceptional client services, lean and efficient processes, cutting edge technologies and insightful analytics

Co-Founder and President, Ajuba International, a leading healthcare revenue cycle management company that grew to + 2,500 employees in six years before successfully exiting

Investment Banker, UBS (NY) and Merrill Lynch (San Francisco)

Corporate finance attorney, Dykema Gossett PLLC

Served on the board of MedPlans Partners before its sale to FirstSource Solutions and also served on the board of ResourcePro before its sale to the private equity firm of DFW Capital Partners

Currently a member of the Public Affairs Committee for the Ambulatory Surgery Center Association as well as an active member of the Healthcare Financial Management Association

Named the #14 best CEO in the nation by Glassdoor

University of Notre Dame, BA/BBA in Finance; University of Wisconsin-Madison, JD/MBA
Agenda

• Evolution of Total Joints in the Outpatient Setting
• Reimbursement Trends for Total Joints in ASCs
• Medicare’s Stance on Total Joints in an ASC
• Bundled Payments for Total Joints in ASCs
• Reimbursement Pitfalls
  • Contracting
  • Front Desk
  • Coding
  • Claims, Payment Posting and A/R
• Financial Impact of Moving Total Joints to your ASC
• Orthopedics – The New Darling of Private Equity
Evolution of Total Joints in the Outpatient Setting
Trends Impacting Total Joints (TJs)
Moving to ASCs

• Economics and convenience
  • Patient
  • Surgeon
  • Payers
  • Bundled payments/lower cost setting
• Aging patient population
• Technological advancements
• Safety and outcomes
  • Decreasing length of post-operative stay
• CMS proposal ruling
Projected Growth

- Estimated growth in hip and knee joint replacements to increase from approximately 900,000 today to 1.8+ million by 2026
- SG2 Research projects by 2026, approximately 50% of primary hip and knee joint replacements will be performed in an outpatient setting, up from approximately 15% today
- Outpatient cases will increase from 200,000 today to 900,000 in 2026
- ASCs offering outpatient total joint replacements has jumped from 25 in 2014 to more than 200 in 2017
- ASCA study indicates movement to ASCs equal $38 billion in commercial payer savings and $2.5 billion in Medicare savings
Reimbursement Trends for Total Joints in ASCs
## Reimbursement Trends

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Total Hip</td>
<td>$8,000</td>
<td>$27,000</td>
<td>$11,500</td>
<td>$20,000</td>
<td>$17,500</td>
<td>$23,000</td>
</tr>
<tr>
<td>Total Knee</td>
<td>$7,300</td>
<td>$26,000</td>
<td>$11,500</td>
<td>$22,000</td>
<td>$16,500</td>
<td>$21,500</td>
</tr>
<tr>
<td>Total Shoulder</td>
<td>$8,000</td>
<td>$26,000</td>
<td>$11,500</td>
<td>$20,000</td>
<td>$16,500</td>
<td>$21,500</td>
</tr>
<tr>
<td>Total Ankle</td>
<td>$9,500</td>
<td>$27,000</td>
<td>$1,250</td>
<td>$16,500</td>
<td>$20,000</td>
<td>$26,000</td>
</tr>
</tbody>
</table>
Medicare’s Stance on Total Joints in an ASC
Medicare and Total Joints

- CMS removed total knee and shoulder procedures from the inpatient only list in 2018
  - However, the CPT codes were not added to the ASC approved list
- CMS has now proposed to move total knee replacements to the ASC payable list, and to move total hip replacements off the inpatient only list in 2020
  - Fear that CMS could set price too low, which would cause most total joints to stay in an HOPD setting
  - Also concern that commercial payers will use the CMS rate as a baseline and reduce its reimbursement significantly from today
- On the other hand, volume of total joints in ASCs would spike
  - 48% of Medicare’s total knees occurred without complications on patients 80 or younger
## Will TKA be Financially Viable in the ASC?

<table>
<thead>
<tr>
<th>Procedure</th>
<th>DRG</th>
<th>HOPD 2019</th>
<th>ASC 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Wrist</td>
<td>$14,877</td>
<td>$15,371¹</td>
<td>$12,501¹ (19%↓)</td>
</tr>
<tr>
<td>Total Elbow</td>
<td>$14,877</td>
<td>$15,371¹</td>
<td>$11,852¹ (23%↓)</td>
</tr>
<tr>
<td>UKA (27446)</td>
<td>$12,680</td>
<td>$10,123¹</td>
<td>$7,374¹ (27%↓)</td>
</tr>
<tr>
<td>TKA (27447)</td>
<td>$12,680</td>
<td>$10,123¹</td>
<td>???</td>
</tr>
<tr>
<td>THA (27130)</td>
<td>$12,680</td>
<td>XXXXX</td>
<td>XXXXX</td>
</tr>
</tbody>
</table>

¹ Medicare.gov, facility fees, 2019
Trends in 2019: Bundled Payments

• Fastest growing payment type ("value-based care")

• Estimated to be 17% of all medical payment types by 2022\(^1\)

• Who is ready for bundled payments (2016)?
  • 50% of payers\(^1\)
  • 40% of providers\(^1\)

• Will become increasingly important for viability of ASCs

• Quadruple aim (quality, cost, patient and provider satisfaction)

\(^1\)The State of Value Based Reimbursement in 2016, ORC Int'l
It is critical to establish an efficient and effective total joint business program to maximize reimbursement.

**MANAGED CARE CONTRACTING**

- Negotiate contracts to include healthy reimbursement for total joints
  - Understand inpatient costs in the local market
  - Understand detailed costs to build and operate a total joint program at your ASC
  - Use this data, along with background track record of your orthopedic surgeon, to negotiate strong rates
  - Ensure clinical policy is in line with payer requirements
  - Focus on implant reimbursement methodology, global period language, and ancillary service requirements

**FRONT DESK PROCESS**

- Ensure patient meets pre-surgery requirements
  - Safety, prior conservative treatment, medical necessity
  - Obtain prior authorization (including a range of codes)
  - Identify correct insurance product and/or employer
  - Understand payer’s medical policies
  - Have a comprehensive registration packet (including AOB)
  - Have financial counselors
Coding

• Select the proper CPT codes

• Set the correct chargemaster

• Have specific invoices for each implant

• Understand implant coding/billing methodology per payer
  • Payer products
  • Shipping included? Tax included?
  • Required revenue codes (274, 276, 278, 279)

• Third-party implant vendors
Claims, Payments and Follow-up

• If the payer requires a copy of the invoice
  • Upload the invoice through the payer portal
  • Submit the whole claim electronically and submit the invoice on the back-end
  • Drop the whole claim to paper
• Flag underpayments by understanding specific payer reimbursement
• Payer’s “lump” payments into one line on the EOB – must post by line item
• Establish a denial management process
  • Zero-paid implant reports
  • Total joint procedure reports
    • Manually audit accounts: charges and payments
Financial Impact of Moving Total Joints to an ASC
Financial Impact

Multi Specialty ASC

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Monthly Cases</td>
<td>300 cases</td>
</tr>
<tr>
<td>Avg. Cash/Case</td>
<td>$2,000</td>
</tr>
<tr>
<td>Total Monthly Collections</td>
<td>$600,000</td>
</tr>
<tr>
<td>Total Monthly EBITDA (20%)</td>
<td>$120,000</td>
</tr>
<tr>
<td>Annualized Revenue</td>
<td>$7,200,000</td>
</tr>
<tr>
<td>Annualized EBITDA</td>
<td>$1,440,000</td>
</tr>
<tr>
<td>Equity Value @8x</td>
<td>$11,520,000</td>
</tr>
<tr>
<td>Add 15 T.J./Month</td>
<td>15 cases</td>
</tr>
<tr>
<td>Cash/Case of TJs</td>
<td>$18,000</td>
</tr>
<tr>
<td>Additional Monthly Revenue</td>
<td>$270,000</td>
</tr>
<tr>
<td>Additional Monthly EBITDA (at 50% margin)</td>
<td>$135,000</td>
</tr>
<tr>
<td>Increased Annual Cash Flow</td>
<td>$1,620,000</td>
</tr>
<tr>
<td>Increased Equity Value @8x</td>
<td>$12,960,000</td>
</tr>
<tr>
<td>Total Equity Value</td>
<td>$24,480,000</td>
</tr>
</tbody>
</table>

Total joints, with average reimbursement being approximately $18,000, and being highly profitable (35-60% margins), will significantly increase the top line, bottom line, and equity value of a surgery center.
## Case Cost of Total Joint Procedures: Example Surgery Center

<table>
<thead>
<tr>
<th>Device / Implant Costs Per Case</th>
<th>Cost</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$5,000</td>
<td>Market Range is typically $4,000-$6,000</td>
</tr>
<tr>
<td>Drug Costs Per Case</td>
<td>$455</td>
<td>Includes Exarel</td>
</tr>
<tr>
<td>Basic Supply Costs Per Case</td>
<td>$900</td>
<td>Excludes Capital Equipment</td>
</tr>
<tr>
<td>Staffing</td>
<td>$427</td>
<td>Assumes 12 hrs of nurse/tech staff</td>
</tr>
</tbody>
</table>

**Total Case Cost** **$6,782**  

**Includes revenue for implant with contracts where payers reimburse implant separately**

- This example does not include home health or potential financing costs for equipment
- Facility may also incur additional costs related to patient safety and monitoring programs
- Typically, the implant and overall case costs for a hip or knee procedure are similar
- We have seen some physicians willing to use generic implants, with pricing below $4,000
## Total Joint Case Reimbursement

<table>
<thead>
<tr>
<th>Procedure</th>
<th>Reimbursement Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Hip Rev per case</td>
<td>$14,700 - $20,600</td>
</tr>
<tr>
<td>Total Knee Rev per case</td>
<td>$14,838 - $22,600</td>
</tr>
</tbody>
</table>

**Includes revenue for implant with contracts where payers reimburse implant separately

- Rates for total joints in an ASC are heavily dependent on local hospital rates
  - Rates can be well above and well below this range
- CMS listed total knees (CPT 27447) on the 2019 OPPS fee schedule with National allowed amount of $10,714
  - This rate is set to be 10-20% lower once it’s added to ASC fee schedule
  - In addition, rates would be further adjusted by the local wage index
## Total Joint Program Revenues and Gross Profit

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hips (CPT 27130)</td>
<td>43</td>
</tr>
<tr>
<td>Knees (CPT 27447)</td>
<td>80</td>
</tr>
<tr>
<td>Total Cases</td>
<td>123</td>
</tr>
<tr>
<td>Total Revenues</td>
<td>$2,326,280</td>
</tr>
<tr>
<td>Total expenses (before facility's  fixed costs)</td>
<td>$834,186</td>
</tr>
<tr>
<td>Contribution Margin</td>
<td>$1,492,094</td>
</tr>
</tbody>
</table>

### Per case Metrics:

<table>
<thead>
<tr>
<th>Metric</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue per case</td>
<td>$18,913</td>
</tr>
<tr>
<td>Total Cost per case</td>
<td>$6,782</td>
</tr>
<tr>
<td>Contribution Margin per case (before facility's fixed costs)</td>
<td>$12,131</td>
</tr>
</tbody>
</table>
Orthopedics – The New Darling of Private Equity
Private Equity

- Historically, private equity has focused on investing in specialties such as pain management, ophthalmology, dermatology and hospital-based specialties
  - Orthopedic groups have preferred independence and have had the cash flow to do it
  - Interest in orthopedic groups is on the rise

- Drivers of private equity interest
  - Aging population: increase in orthopedic procedures such as knee and hip implants, shoulder, back and neck surgeries – significantly increasing revenue and profitability
  - Alternative payment initiatives such as bundled payments
  - Movement of orthopedic cases to ASCs means reimbursement shifting from hospital to physician owned ASC
  - Leverage, and cash flow, created through ancillary services such as ASCs, imaging, PT and DME
Private Equity cont.

• Orthopedic surgeons now open to investment due to high EBITDA multiples, capital for rapid expansion, and “second bite at the apple” after taking some chips off the table
  • Scale provides leverage with payers

• A flurry of PE investment into private equity in the next five (5) years
  • Strategy to consolidate local or regional markets by acquiring practices
Private Equity cont.

- Benefits of taking private equity investment
  - Opportunity for older physicians to cash out at very high multiple, or for active surgeons to take some chips off the table today, with additional equity upside
  - Capital for rapid expansion, which is helpful for total joints
  - Capital for acquisition to increase footprint and leverage with Payers
  - Gain significant business and financial expertise
  - PE typically is hands off regarding the practice of medicine
- Downside to taking private equity investment
  - Potential loss of control of business side
  - Giving up of ownership
  - Dilution to shareholders – costly if deal doesn’t help increase growth and profitability
Private Equity cont.

- Recent Relevant Transactions

  - **Rothman Orthopaedic Institute, NueHealth** and **Muve Health JV**

  - **Frazier Healthcare Partners** and **Princeton Ventures** invested in **CORE Institute**, a group of 67 musculoskeletal and neurological physicians in Arizona and Michigan

  - **Varsity Healthcare Partners** invested in **The Orthopedic Institute**, an integrated orthopedic surgical care and ancillary patient treatment provider in Florida

  - **Candescent Partners** acquired the majority of **Southeastern Spine Institute**, a practice of 16 physicians and 31 total providers

  - **Lorient Capital** acquired Atlantic **Neurosurgical Specialists**, located in New Jersey

  - **Atlantic Street Capital** invested in **OrthoBethesda**, based in Washington DC