Merging Two (Competing) Surgery Centers

A Case Study

Tom Yerden, MHA
President & CEO
TRY Health Care Solutions, LLC
Paris, Chicago, NYC, & Salmon, Idaho

"Challenges for Successful Surgery Centers"

1. Complacency
2. Lack of Strategic Vision (Management)
3. Poor Managed Care Contracts
4. Country Club Membership
5. Operating Agreement Not Up To Date
6. Lack of Exit Strategy for Physicians
7. Divided Loyalty
8. Market Competition: Retaining Market Share

Contemporary ASC Partnership Models

1. Hospital & Independent Physicians
2. Hospital & Independent Physicians & Core Group Practice
3. Hospital & Existing Freestanding ASC
4. ASC_1 Acquiring ASC_2
5. FASC Conversion to HOPD

Why Merge Surgery Centers?

1. CON – May consolidate under one license and gain approval to expand OR capacity
2. Salvage under-performing surgery centers in a competitive market
3. Mirror benefits typically associated with other M&A activity
4. Consolidate leadership resources
5. Potentially create two "centers of excellence" in those cases where both ASCs remain operational
6. Develop a valuable enterprise for potential acquisition

Case Study
Background: Two ASCs in Same Market

ASC-1:
- Multispecialty ASC – 20 years – 4 ORs
- Capacity Issues – "swimming pool expansion"
- Law suit against corporate partner
- Managed by 2 MGP-physicians: solid ROI

ASC-2:
- *Ortho-driven ASC – 2 years – 4 ORs*
- *Out-of-Network Provider strategy*
- *Under-utilization – "divided loyalty"*
- *Poor relationship with corporate (general) partner*
- *Ortho group not functioning as a "Group Practice"*

Conflict?

1. Divided Loyalty: "1/3 Rule?"
2. Ortho Group lacked defined leadership: "Cowboys"
3. Allowed one physician to dictate policy
4. Management Company not trusted
5. Physicians within same practice competing for "status" at the surgery center

Available Solutions?

Increase OR Capacity
- "Fill the pool" – OR expansion ($2m)
- Improve operational efficiency – expand hours
- Relocate facility

Respond to Increased Competition
- Resyndicate: expand physician ownership
- Poach MDs from competing surgery centers
- Enforce 1/3 rule
- Offer new services & programs
- Restructure payor agreements

Available Solutions?

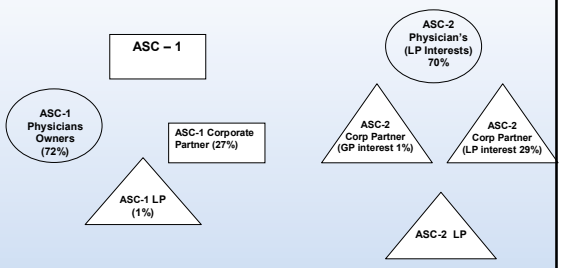
Restructure Legal Entity & Address Divided Loyalty
- Restructure to LLC (from GP)
- Craft Operating Agreement (compliance)
- Resyndicate Newly-Structured ASC
- Remove "Barriers to Entry"
- Non-Compete Provisions
- Educate Physicians re: "costs associated with divided loyalty

*** 1/3 rule doesn't mean you should have ownership in 3 ASCs!*

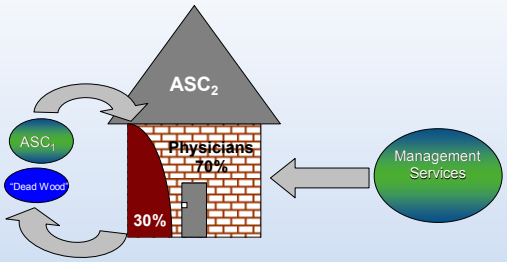
Two ASCs with Shared Challenges

1. Structured as General Partnerships
2. *Capacity* Issues in (ASC-1), *Demand* challenges in (ASC-2)
3. Competition from new Hospital/MD JV'd ASC
4. Divided Loyalty by Physicians
5. Payor Contracting issues
6. Some Physicians had Ownership in Both ASCs
7. **Lack of Trust among physicians (CONFLICT!)**
8. Frustrations with level of cash distributions

"What to do when the swimming pool will not provide sufficient expansion of capacity"



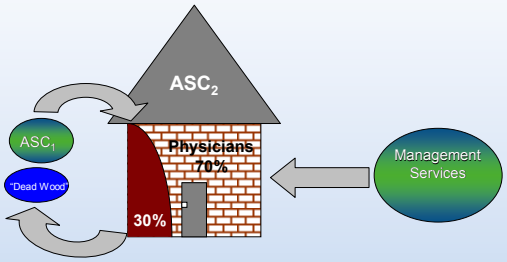
Merging Two Competing ASCs A Phased Approach??



Step 1. ASC 1 purchales 30% interest in ASC 2

Step 2. **ASC 1** assumes management of ASC 2

Merging ASCs "Complete Merger of Assets"



Step 1. ASC 1 purchases 100% interest in ASC 2 -One License!

Step 2. **ASC 2 physicians receive units in newly-formed ASC 1**

Challenging Process !!

- Valuation of both surgery centers
- Post-transaction ownership by physicians: Dilution or Leveraging?
- Restructuring to LLC
- Buying out corporate partner
- Staffing, medical director appointment, management team
- Merger of systems
- Contracting
- Merger of cultures !!

Combined Performance of Surgery Centers

	ASC-1	ASC-2	Combined
Gross Rev	*30,345,465*	*26,379,815*	*56,725,279*
C/A	*20,928,261*	*20,160,601*	*41,088,862*
NPR	9,422,203	6,219,213	15,636,417
Gross Rev/Case	5,800	8,848	6,906
NPR/Case	1,800	2,086	1,904
Salary Exp	3,019,734	2,404,687	12,882,720
Sal/Case	577	807	660
EBITDA	1,939,410	819,339	2,758,749
Volumes	5,232	2,981	8,213

"Value-Added" Performance of Merger

Direct Financial Impact of Merger:

- Improved payor contracts $140,000/yr
- Going in-network (ASC-2) ($590,000) year one
- Reduction in salary expense $740,000/year
- Reduction in supply expense $290,000/year

Indirect Benefits of Merger:

- Combined management team with regional focus
- Eliminated competitive threat
- Restructure from GP to LLC
- provided exit strategy for physicians
- Improve operational (scheduling efficiency)

So, Now What?

- How do we open a dialog with a competitor?
- How do we structure these discussions?
- How do we project financial impact of a merger?
- What other options should we evaluate short of a merger?