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AMBULATORY SURGERY CENTERS BUSINESS AND LEGAL UPDATE

Partnering With a Surgery Center Company: What a Buyer is Looking For

By: E. Timothy Geary, Chief Executive Officer; Bryan L. Burgett, Vice President-Development National Surgical Care

If you are a physician partner or an administrator of a surgery center, you should be familiar with how surgery center companies look at partnering. Although you may have never considered it, selling a piece of your center to a surgery center company (such as NSC, USPI, AmSurg or Symbion) may be a good option for you now or at some point in the future. Knowing a buyer's motivations should help you "get down to business" with them, i.e. facilitate an evaluation process, arm you with the right answers, and, perhaps, even help you negotiate successfully. Or it may just tell you corporate partners aren't what you are looking for.

Before getting into the "technical" aspects of what surgery center companies look for in surgery centers, we think it's important to have a clear understanding of what a surgery center acquisition really entails. Beyond the financial analysis, due diligence and legal documents, there is a social component involving the people who will be involved in running the center: the physicians, the center's administrator and employees, and the company's management team. We believe the social component is vital because it serves as the foundation for a long-term partnership. Relationships like this are based on having similar values and a shared vision for the surgery center's future. In fact, if we had to name one thing that was absolutely necessary to move forward in an acquisition, it would be a strong assurance that we can have a productive partnership with the physician partners and key personnel at the surgery center.

How Surgery Center Companies Evaluate Surgery Centers

So, what are we looking for in a surgery center? Put simply, we want to partner with a **good group of physicians** running a **top**

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SAVE THESE DATES FOR 2006 CONFERENCES—

June 22–24, 2006
Chicago Illinois

The 4th Annual Ambulatory Surgery Centers Orthopedics, Neurosurgery and Pain Management Conference.

October 26–28, 2006
Chicago Illinois

The 13th Annual Ambulatory Surgery Centers Business and Legal Issues Conference—Improving, Establishing and Joint Venturing ASCs.

For information, please contact Scott Becker at 312-750-6016, sbecker@mcguirewoods.com; or Ken Freeland at 858-565-9921, ken@pcmisandiego.com.

Twenty-Six (26) Companies To Watch—2006*

The following is a short note on twenty-six companies that are extensively focused on ambulatory surgery centers. Each has strong management and a growth orientation. We have highlighted these companies as companies to watch in 2006. The list is in alphabetical order.

1. **Ambulatory Surgical Centers of America, LLC ("ASCOA").** ASCOA now owns and operates nearly 25 ASCs. Founded by Drs. Brent Lambert, Tom Bombardier and George Violin. ASCOA has an unmatched record of excellence, and an extremely gifted and top flight management team. The management team is led by the very smart Luke Lambert. It executes plans very well. ASCOA operates in a manner whereby physicians own the majority of the interests in the surgery centers it operates.
2. **AmSurg, Inc.** AmSurg remains a leading national publicly-traded operator of single specialty centers. It

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INSIDE

Letter from the Editor

2006 promises to be an exciting year for ambulatory surgery centers ("ASC"). We have articulated nine trends facing the health care environment this coming year. With respect to ASCs, here are a couple of additional thoughts.

ASC Trends and Issues

First, we expect to see increased growth in ASCs. Most of the growth seems to be occurring in smaller types of ASCs rather than large ASCs. Second, parties have learned how to develop ASCs on a very small basis and make them profitable. In fact, in a MGMA study, they found that ASCs that perform a smaller number of procedures are often more profitable per case than surgery centers that perform a larger number of surgical procedures.

Third, we are seeing a great deal of growth in specialties that were not traditionally as involved in ASCs. This includes facilities focusing on spine procedures, ear/nose/throat procedures, general surgery, and several other areas. We are also seeing increased development of hospital physician joint venture surgery centers.

Fourth, there continues to be a growth in the number of management companies involved in the surgery center business. These often run the gamut from high quality substantial management companies to those that are barely able to provide services.

Fifth, we expect there to be an extension and then an expiration on the moratorium of the development of specialty hospitals. This should lead to some substantial development of larger projects and surgical hospitals. This is likely to be good for health care and good for physician entrepreneurs. It is also expected to provide a new set of opportunities for management companies looking to assist physician-driven projects.

Sixth, this year should continue with a lack of clarity on the flexibility as to use of the ambulatory surgical center safe harbors.

Conferences

We have two great conferences planned for 2006. This includes the 4th Annual Orthopedic, Neurosurgical and Pain Management-Driven ASC Conference planned for June 22-24, 2006 and the 13th Annual Ambulatory Surgery Center Business and Legal Issues Conference. This conference will be held October 26–28, 2006. Each conference will be held in Chicago. Call or email Michelle Freeland (michelle@pcmisandiego.com) or Ken Freeland (ken@pcmisandiego.com) at 858.565.9921 for more information.

ASC Review Sponsors

Finally, we welcome back several sponsors to the ASC Review. I am proud to announce that nearly all of our sponsors have signed up for another year. These sponsors include the following:

Gold Sponsors

- Ambulatory surgical Centers of America (contact Brent Lambert, M.D. at 781.258.1533).
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- Advanced Practice (contact Ellen Swan-Taylor at 972.931.9006 x23)
- CIT Healthcare (contact Jeff Fox at 770.592.1859)
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- Healthcare Appraisers (contact Todd Mello at 561.330.3488)
- Medical Facilties Corporation (contact Dr. Larry Teuber at 605.341.2424)
- National Surgical Care (contact Tim Geary at 312.419.1033)
- Regent Surgical Health (contact Tom Mallon at 708.686.1522)
- Surgery Consultants of America and Surgery Center Billing (contact Caryl Serbin at 888.453.1144)
- Value Management Group (contact Greg Koonsman at 214.369.4888)
- Prexus Health Partners (contact AJay Mangal, M.D., MBA at 513.454.1414)

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- Cypress Systems Consulting (contact Michael Berger at 630.271.9000)
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- Physicians Endoscopy, LLC (contact Barry Tanner at 215-589-9005)
- Pinnacle III (contact Ginger Farquhar at 303.550.1132)

Should you have any questions or if we can be of assistance at any time, please contact myself at 312.750.6016 or by email at sbecker@mcguirewoods.com.

Thank you for reading the ASC Review.

Scott Becker
ASC Communications, Inc. ■

The ASC Review is published 6 times per year. It is distributed to approximately 12,000 persons per issue with distribution of 20,000 issues for each the May–June issue and the September–October issue. For information regarding advertising or subscribing, please contact Ken or Michelle Freeland at 858-565-9921 or by email at ken@pcmisandiego.com and michelle@pcmisandiego.com.

Nine Trends To Consider For 2006

In reviewing the current health care landscape, we have put together a list of nine core expectations that we have for 2006. Briefly stated, these are as follows:

1. Ambulatory Surgery Centers.

As of the end of 2005, there are approximately 4,900 to 5,000 surgery centers in the country. Increasingly, a great number of these are simply practice office extension surgery centers. Another set of these are hospital physician joint ventures (over 25%), and another percentage are owned in part by chains and management companies (approximately 25%). We expect 2006 and 2007 to be the last two big years for ambulatory surgery center growth through start-up facilities. This is driven by a number of considerations.

2. Surgical and Specialty Hospitals.

With the conclusion of the moratorium on surgical hospital development, subject to another six-month extension and the tightening of rules by CMS as to reimbursement and certification for surgical hospitals, we expect significant but measured growth in this area. We would expect 50 to 75 surgical-specialty hospitals to open in the next 12 to 15 months. We also expect that several mid-size physician owned hospitals will struggle as they have difficulty developing a specific brand or identity or reason for being.

3. Sales of Hospitals and Surgery Centers.

We expect an increasingly fluid market for hospitals, surgical hospitals and ambulatory surgery centers. There have been an increasing number of strategic and financial buyers that remain interested in this area. The financial buyer portion of the market may shrink as the reimbursement rates for hospitals and surgery centers start to soften a bit in certain markets.

4. Joint Ventures.

We are finally seeing extensive expansion of joint ventures into other areas besides surgery centers. In 2006, notwithstanding significant issues from a regulatory perspective, we see increases in imaging joint ventures, radiation therapy joint ventures, and certain other types of joint ventures between physicians and hospitals.

As nuclear medicine and PET services are slated to become Stark services as of January 1, 2007, we expect less "true" joint venture development in these areas as well and more block leading types of ventures.

5. Health Care Private Equity Investment.

There has been some reduction at the end of 2005 of health care private equity invest-

ment in health care. We expect a substantial amount of investment to take place in health care, both services and life science in 2006. We believe we are still several years away from most of the investors really profiting from their large investments made over the last two years. For a copy of a recent article entitled, "Private Equity Investment in Health Care Companies: Eleven Steps to an Effective Health Care Regulatory Diligence Review", please contact Scott Becker (sbecker@mcguirewoods.com) or Allison Mikula Vratil (amikula@mcguirewoods.com).

6. Health Care Real Estate.

Health care real estate remains an extremely hot commodity. We expect this to peak somewhat in 2006 and start to cool off thereafter. At this time, the investment interest in health care real estate from those parties that have not generally been in this sector remains extremely strong.

7. Dialysis.

There has been great consolidation amongst the leading dialysis chains. We have gone from a Big 5 to a Big 2. Antitrust concerns have lead to some divestiture of facilities. We are also about to see a renewed growth in the development of physician owned dialysis facilities with small chains. Here, because the big companies enjoy such incredible economies at scale, it is critical that someone be in partnership with a great operator.

8. Litigation – Is the cure worse than the disease?

It is often the case, as we witness clients involved in litigation, it reminds me of a patient needing chemotherapy. There are certain instances where the actual cure is worse than the actual threat. Increasingly, we have concern that the cost of litigation may outweigh the benefits to be had to clients from such effort. We are constantly questioning the cost versus benefit ratio for litigation. Wherever possible, we continue to urge settlements of claims in litigation.

9. Payor Consolidation.

It appears as though the most current round of payor consolidation has mostly occurred. At the same time, the actual leveraging of that strength in the marketplace will start to impact results for providers in 2006 and 2007. We expect such payors to have increased strength as we move into the next few years. It will take a bit of time to consolidate their efforts and make use of this market power, but we expect to start seeing results (problems) in 2006. ■

has a deep roster of centers and very disciplined leadership.

3. **Blue Chip Surgical.** Blue Chip was founded by Jeff Leland. Jeff is highly qualified and he has Blue Chip focusing its efforts on spine and ENT driven centers.
4. **Cirrus Health**. Cirrus, based in Texas, has developed centers and surgical hospitals in California and Texas and is expanding rapidly. It has greatly added to its management team this year. Cirrus added two veterans from the Baylor Health System. It is known for developing market research specific to each location.
5. **Health Inventures.** Health Inventures is one of the long-standing leaders in the ASC management and development business. It has great and seasoned leadership in Dick Hanley, Wayne Lee and Paul Davis. It now also invests with its clients in projects. Health Inventures does work across the United States and in Europe.
6. **Healthmark Partners.** Healthmark Partners currently operates nearly ten centers, several with hospital partners. Bill Southwick heads up Healthmark Partners and is the CEO and President.
7. **Health South ("HS").** HS is a national operator and manager of surgical centers. HS has completely revamped its management team and has added several people with terrific reputations such as Jay Grinney as CEO and Joe Clark.
8. **Integrated Medical Delivery ("IMD").** IMD, based in Oklahoma City, provides the back office services needed by ASCs and hospitals. Its model can help hospitals reduce start-up costs. IMD allows its clients to select some or all of the services they desire to use. IMD believes in 100% physician ownership of the hospitals and surgery centers it works with.
9. **Medical Facilities Corporation ("MFC").** MFC, a Toronto Stock Exchange Company, uses a unique model, an income trust, to help owners seek liquidity. The company is led by the brilliant and aggressive Dr. Larry Teuber. The company owns several surgical hospitals. It is seeking acquisitions.
10. **Meridian Surgical Partners.** Founded by Kenny Hancock. Meridian has established a terrific management team and is in the process of acquiring a number of surgery centers.
11. **National Surgical Care ("NSC").** NSC, founded by Tim Geary, has really started to hit its stride. It has a careful and seasoned team and has completed several acquisitions. It is poised for greater growth.
12. **National Specialty Hospitals ("NSH").** NSH is the clear leader in owning and operating surgical hospitals. Founded by John Rexwaller, a Rhodes scholar, it has a top flight management team.
13. **Nueterra Healthcare.** Nueterra is an owner and operator of dozens of centers and some surgical hospitals. It has a tremendous marketing team and continues to assist centers throughout the country. Its CEO, Dan Tassett, is a leading figure in the ASC industry.
14. **NovaMed.** NovaMed has successfully made the transition from practice management to facility ownership and operation. It has grown tremendously and has really hit its stride. It has a new CEO and a long time leadership team, including Bill Kennedy, Michelle Vickery and Tom Chirillo.
15. **Ortmann Healthcare Consultants.** Ortmann is led by Fred Ortmann who is a leading developer of ASCs. The company has particularly great experience with orthopedic and endoscopy centers.
16. **Physicians Endoscopy, LLC ("PE").** PE owns minority interests in and manages nearly a dozen endoscopy centers. Barry Tanner, John Poisson and Karen Sablyak head up a great management team. PE is probably the leading company in the management of single specialty endoscopy facilities.
17. **Pinnacle III.** Pinnacle was established as an orthopedic-driven ASC company. It has had great success with several projects and continues to evolve as a leading company in its niche.
18. **Prexus Health Partners.** Prexus has been founded by Ajay Mangal, M.D., MBA. It focuses on physician-driven centers and other projects. Prexus has several centers operating and several more under construction.
19. **Regent Surgical Health, LLC.** Regent, based in Chicago, Illinois, develops, turns around and manages surgical centers. Founded by industry veteran, Tom Mallon, a Harvard Business School graduate. It has become a leading operating company in the surgery center industry. It has centers in several states. Tom has a leading management team that includes a deep roster of people like Mike Karnes, Steve Hall, Jeff Simmons, Micki Banks, Karen Cox, Mike McKevitt and others. It provides management services and owns minority interests in surgical centers and hospitals. Regent has specialized in helping to stabilize and turn around surgery centers.
20. **Resurge Hospitals** ReSurge Hospitals, led by Rusty Shelton, has made great strides in the business of developing and managing surgical hospitals. The company currently has a wide variety of projects in diverse markets.
21. **Surgery Consultants of America.** This company, founded by Caryl Serbin, provides management and development and billing services to surgery centers. Caryl is one of the finest people in the ASC business. She is honest, fair and bright. Centers really like working with her. The Company's efforts are focused on both physician only ventures and physician hospital ventures. It is a very service-oriented company. Caryl has developed a strong team.
22. **Surgis.** Surgis has fueled its recent growth through the acquisition of individual centers as well as a company that owned a number of ASCs. In one center it bought this year, the physicians have raved about the results Surgis has helped to achieve. It has really improved its efforts over the

last two years and seems to be doing a great job.

23. **Symbion Inc.** This company led by Richard Francis and Billy Webb has done a spectacular job. It has more than hit its stride and is doing a great job in managing and acquiring ambulatory surgical centers. Symbion typically owns a majority interest in centers. It is a leading buyer of ASCs and completed some of the largest industry acquisitions in 2005.
24. **Titan Health Corporation.** Titan manages and develops specialty focused surgery centers nationwide with an emphasis on orthopedics, spine/neurosurgery and pain medicine. Focusing primarily on de novo opportunities, Titan has nine fully operational centers along with several projects under construction and/or development opening in 2006. Titan maximizes physician satisfaction, input and profitability by limiting specialties and physician partners. The company maintains a minority interest position and enjoys its reputation as a knowledgeable and trust-worthy partner.
25. **United Surgical Partners ("USP").** USP has set the gold standard in the operation of three party ownership ventures including a management company-physicians and a hospital. Its leadership from Don Steen to Bill Wilcox to Brett Brodnax is superb in strategy and execution. USP currently has centers and hospitals throughout the United States.
26. **Woodrum/ASD.** Woodrum/ASD, founded by Robert Zasa and ran by Robert Zasa, Joe Zasa and David Woodrum, manages and assists in the development of a wide variety of outpatient services for hospitals and physician. It is one of the very few top firms in managing physician hospital ASC joint ventures. Woodrum/ASD's principal focus is on ambulatory surgery centers. Woodrum/ASD has outstanding leadership and works very hard to help centers excel and keep them running well. ■

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* This list has been compiled by Scott Becker, Co-Chairman of the Health Care Department at McGuireWoods LLP. It is not intended to reflect an endorsement of any such company. Should you have questions regarding any of the companies listed herein, please contact Scott Becker at (312) 750-6016.

Compliance Guidelines Related To Solicitating Physician Investors

This article provides guidance as to certain types of comments and actions that can create regulatory problems. This is based on Federal cases related to the syndication of interests in hospitals, labs, and joint ventures and Office of Inspector General (the "OIG") comments related to ambulatory surgery centers ("ASCs"). In the ASC sector, this can be very challenging.

Sale of Shares to Physician Investors

Actions and Statements to Avoid

1. Do not offer less or more shares or a higher or lower price based on the number, volume or value of referrals a physician can generate.
2. Do not reallocate shares based on the volume or value of referrals.
3. Do not focus on individual distributions being tied to the number of patient referrals. Never make any indications that could lead a potential investor to believe that referrals or performance will determine an individual's "piece of the pie." Focus on overall distributions and profits.
4. Physicians should not be allowed to invest based upon the fact that they can generate referrals for another physician who may use a center.
5. Avoid providing physicians with estimates as to the amount of revenue that will be generated from their referrals or from another physician's referrals.
6. Except as to compliance with the 1/3rd tests, do not develop investor eligibility determinations based on the number of potential referrals. In evaluating physicians, examine compliance with all of the safe harbor criteria.
7. With lists, avoid making notations indicating the potential number of referrals, the growth potential of the physician's practice, that a certain physician is a good target (based on referrals), etc.
8. Subject to non-discrimination rules, consider excluding Medicare and Medicaid referrals from any internal revenue and investment analysis.
9. Do not offer remuneration or special treatment under various disguises, such as directorship contracts or discounted lease arrangements, in order to induce referrals.
10. Do not pressure physician investor to shift referral patterns.
11. Do not make any indications to investors that low-referring physicians will be pressured to withdraw.
12. Units should not be sold at a discount from then fair market value.

Actions That Can be Taken

1. Offer equal amounts of units per investor.
2. Offer units at the same price per unit.
3. Offer units at the then fair market value per unit.
4. Provide investor with the current proformas and not their potential revenues.
5. Offer units to only physicians that will comply with the safe harbors – meet all tests and not just the 1-3rd tests.
6. Review investors against compliance with the requirements of the safe harbors.
7. Ask physicians why they do not choose to use the ASC. ■

SEMINARS AND EVENTS

1. **ASCs – Orthopedic, Neurosurgical and Pain Management Driven ASC Conference.** We have set June 22-24, 2006 as the date for our Orthopedic-Neurosurgical, and Pain Management Driven Ambulatory Surgery Center Conference.
2. **ASCs - Business and Legal Issues: Improving Profitability.** This conference will be held on October 26-28, 2006.

For information regarding these events, please call 858.565.9921 and ask for Michelle Freeland (michelle@pcmisandiego.com) or Ken Freeland (ken@pcmisandiego.com) or feel free to contact myself at 312.750.6016.

Focused Community Hospitals—*A Health care model for the new century*

By Rusty Shelton & Barbara Baccei

Surgical Specialty Hospitals have been a major catalyst in the changing delivery of health care. The opportunity to generate continued revenue growth while keeping clinical outcomes at the core of decision-making, fuelled hospital development across the nation--and ultimately the battle to legislate physician ownership. Now, with a few years of operational history, we find it may not be the most advantageous model for many markets.

The challenge is sustaining market and revenue growth long term. We are finding that, after about 5 years, specialty hospitals experience a maturing or reduction in revenue growth. Even when they successfully capture all the surgeries and procedures possible in their markets and maximize profitability, they're still limited by the narrow book of surgery business. Like an ambulatory surgery center, their singular focus—surgery—only allows them to grow in this primary clinical service.

That realization along with potential legislative changes inspired ReSurge Hospitals to re-evaluate the market dynamics. While we believe there is still tremendous opportunity for surgical specialty hospitals, expanding the market strategy and scope of services will achieve the long-term clinical and business goals that have spurred on so many physicians and hospitals. Our inquiry caused us to define two new hybrids: "focused community hospital" and "regional health network." We believe these innovations have the expansiveness to sustain financial performance—and significantly reduce the impact of potential legislation. They clearly keep our physician partners in the driver's seat and empower them to become key influencers in their health care communities. This article discusses focused community hospitals.

Focused Community Hospital

"Focused Community Hospital" is our term for a licensed, acute care hospital offering surgical services, mixed with a focused range of medical and ICU services and supporting ancillaries determined by the governing board and medical staff. The wider range of services allows you to care for select surgical and medical cases that are optimal for this predictable, clinically focused setting, ICU cases (with limited complications and co-morbidity indicators), urgent care and level 1 emergencies, imaging (including MRI and CT), outpatient women's health services and other services demanded by the local market (such as OB and rehab). Clinical diversification reduces your exposure to potential legislation banning physician ownership in a single specialty hospital, and offers other strategic advantages.

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Focused Community Hospitals—A Health care model for the new century **continued from page 9**

With clinical diversification inherent in the model, the hospital can continue to grow its business through multiple service lines. Surgery may still be the core service, but with clinically appropriate medical and ICU cases, you are not limited by a single revenue stream. You also have continuous growth opportunities to phase value-added programs around core clinical services, such as sports medicine built around orthopedics, occupational health built around urgent care and outpatient women's services built around gynecology and imaging. Selecting the right services and programs for your market and successfully phasing them in, results from a comprehensive, long-term market analysis of the population's current and projected medical utilization.

From a cost standpoint, a focused community hospital still enables you to focus clinically and operationally with optimal administrative infrastructure—benefits gained with the vanguard of ASCs and surgical specialty hospitals. With the increased volume and diversification of cases, you spread your administrative and other fixed costs over a wider revenue base. Efficiency goes up, costs go down and profitability increases at a higher return through the multi-service platform. Your operating margin as a percentage of revenue may be lower, but you will gain an overall, real increase in net revenue and return on investment.

As a catalyst for engaging physicians, there are huge dividends. The medical services line offers an investment opportunity for primary care physicians—a crucial player that few have figured out how to effectively invite to the table. The focused community hospital aligns visions and incentives, motivating primary care physicians and specialists to shift approved medical cases to this less costly setting. The key is shifting cases in line with the hospital's core clinical competencies (as determined by your market and medical staff). With the addition of focused ICU, you are able to treat medical cases and more complex surgeries that could only be performed in the full-scale hospital. You will also experience a volume increase in diagnostic outpatient ancillary services associated with the higher acuity cases.

Expanded clinical capability provides an opportunity to form strategic partnerships with physicians and tertiary level hospitals in outlying markets. Such a partnership can result in mutually beneficial agreements for outpatient ancillaries to be performed at the preferred local level, with physicians bringing their medical and surgical cases to your focused community hospital. For physicians who have been responsible for specialty coverage in areas with limited specialty resources (such as primary care docs saddled with OB), the partnership provides the specialty care enabling them to keep their practice focused. To further connect your hospital to these outlying regions, you can establish satellite medical offices in the region and staff it with specialists from your medical staff on a rotating basis.

You will bring higher value to physician recruitment and investment. The differentiated service model and investment opportunity will benefit your physician's practices when recruiting new doctors and specialists to the community. You can benefit their practices by building medical offices on-site—the convenience factor of officing in close proximity to the hospital will be very appealing. In terms of public relations, the addition of medical offices projects the image in the market that you are a bona fide medical campus, not just a surgery center.

The ability to secure equitable, managed care and insurance contracts continues to be a major issue for many surgical specialty hospitals. With increased physician participation, lower fees based on fixed costs and the wider range of clinical services and programs, you gain a more favorable position for negotiating fees and terms with third party insurers. The playing field is more leveled between you and the larger hospital providers.

You gain greater ability to secure financing and improve your terms for facility development, construction, equipment and working capital. Why? Because lending institutions view multiple use facilities as having a higher success potential and probability of longevity.

What Are the Issues?

As appealing as it all seems, there are many issues to be worked through before diving into a focused community hospital development. Most significant of which is that you will encounter an astronomically higher level of clinical complexity than a surgery center or surgical specialty hospital. The bigger and more diverse you become, the higher your risk of losing the focus of your core competencies. Therefore, it's critically important to phase in medical services around the primary clinical competencies demanded by your market and offered by your medical staff, before introducing value-added specialties and programs. Your lean and mean clinical and administrative leadership structure necessitates that you chose where you prioritize your efforts at all times.

Service mix and introduction should be key components of your overall strategic plan. To be successful, you must have a comprehensive strategic and business plan that includes a thorough analysis of your market, including the growth corridors offering rich opportunities for expanded outreach. The plan must also address the outreach of physician services into those growth corridors, thus providing an integrated business plan that benefits the hospital and its invested physicians. A quick financial model and data search will not do the trick—nor will they provide sufficient details for securing financing or your private placement memorandum.

Outstanding clinical outcomes must be at the heart of the business. Physicians must be invested in the concept because they believe it is the best long-term strategy for being the

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drivers of medical outcomes in their community. If they are attracted strictly as an investment, there will likely be a huge dissatisfaction factor and erosion of goodwill in your medical staff. That is because profitability and distributions will not happen overnight; distributions are typically seen after the first 6 quarters of business.

Physician leadership and participation in the ownership, governance, operations, financial rewards and financial risk are essential. Invested physicians must view themselves as business owners in additional to individual practice owners. For a successful development, you should have at least 3 to 5 physician leaders who are committed to the project and able to dedicate the time needed to see it through from concept to opening.

Selecting the right architect for your facility design is an imperative. You must have an architectural firm that comprehends the complexity of a hospital—and brings an ambulatory care mindset. The firm must understand the unique med-surg operational flow process, that is, the influence of spatial design and positioning on efficiency. The facility master plan must include provisions for phased-in expansion. Service mix with expand and volumes will ramp up, so you must be able to retrofit spaces around changed usage, build out shelled space and construct additions without disruption to operations and business. Expansion phasing must be connected to your strategic plan for outreach into your market growth corridors.

Finally, a successful venture is contingent on having a development partner that shares the vision of the physicians and (if it is a physician-hospital venture) the hospital. The development partner must understand the value that a focused community hospital offers as opposed to an ASC or specialty hospital—and must understand all the complexity of business and clinical operations involved. That is, the developer must have a macro view and micro view. A full-scale hospital may have outstanding leadership, but they probably have too many layers of bureaucracy to function as the developer.

Your development partner must see the value of physician input and be willing to constantly seek it. If you desire to be privately held, the partner must share your long-term strategy, rather than be focused on going public and cashing in on the investment short-term. ■

Rusty Shelton is president and CEO of ReSurge Hospitals, a venture partner and consulting firm, developing physician-centered regional health networks, focused community hospitals, surgical specialty hospitals and ancillary service centers. The firm specializes in physician-hospital joint ventures and consulting services for acute care hospitals. Contact Rusty@resurgehospitals.com or 435.563.4175. **Barbara Baccei** is an affiliate of ReSurge Hospitals responsible for strategic marketing and media. Contact Barbara@resurgehospitals.com or 510.965.0570.

quality surgery center that can **grow in the future**. This is not to disregard the considerable efforts we can make in new development or energizing an under-performing surgery center; but, like any other investor we are looking for surgery centers that have a high likelihood of being successful projects.

Our bolded phrases represent the three (3) key areas a potential partner will want to explore with you as they evaluate your center:

A Good Group of Physicians:

We believe this is the most important category.

- Are the physicians committed to the surgery center? Is the surgery center more than just an investment to them? Beyond doing most of their outpatient cases at the center, this can be demonstrated by participating in the center's governance, promoting the center to colleagues, staying active in quality assurance issues, and exploring new procedures that can be done in an ASC. As everyone in the industry knows, most of the time a surgery center is the product of a group of physicians that founded the center, learned how to cooperate and manage effectively, and then made the facility a success. For a surgery center company, the continued engagement of physicians is the most critical component in an evaluation of a center.
- Do the physicians want to retain a significant percentage of ownership in the center? If so, that may be the best vote of confidence a surgery center can have. The physician's ownership should remain large enough for each physician to continue to receive distributions that are considerable. While an acquisition may lower physicians' distributions in the short run, the shared goal of the company and the partners should be to bring distributions back to a similar or greater level (i.e., doubling the center's throughput from higher volume, better reimbursement, and/or greater efficiency). On the other hand, if partners want 100% of their ownership bought out this may imply a center on a downslide.
- Physicians with established, well-run medical practices. If the physicians practice together in a group, a center's health will be influenced by the health of that group practice. We have seen many centers that have grown and thrived thanks to the participation of a dynamic medical group. On the other hand, the continuity of such a medical group becomes an important issue to a surgery center company. We have seen many surgery centers fall apart because a group practice breaks-up.
- Generally, you want your physician partners to be a good mix of physicians of various ages who have put down some "roots" in the community. Beyond an assurance the cases will keep flowing, an influential group of physicians can help you in payor contracting and relations with the local hospital.

Top Quality Surgery Center (a.k.a., "The Fundamentals"):

There are five (5) issues we refer to as "the fundamentals" of a surgery center, meaning if the center falls short in any of these areas, then it is not the type of center we want to partner with:

- **A history of providing excellent patient care and outcomes.** It is hard to recover from a bad reputation. Great clinical results are a function of having a well-trained and experienced clinical team, meaningful quality improvement and risk management programs, and excellent clinical leadership and cooperation among the physicians, nurses and administration. In addition, a surgery center company likes to see accreditation by AAAHC or JCAHO.
- **The center can demonstrate regulatory compliance throughout its history.** Beyond accreditation and the absence of any regulatory history, a surgery center should be operated conservatively when it comes to matters of billing and ownership arrangements. Pushing the letter of the law is not a positive characteristic for a surgery center. While a surgery center company can protect itself in its agreement to purchase the center, chances are the company will opt not to move forward with an acquisition upon finding a regulatory exposure.
- **The ability for the center to produce clean business records and fairly transparent financial statements.** At the end of the day, the center's financial statements will have to tie back to its outstanding billing, its history of capital expenditures, and its banking activity. Poor record keeping makes buyers uncomfortable.

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- **The willingness of physician partners to sign a non-competition covenant as part of the deal.** We do not believe any of the surgery center companies would do a deal without a reasonable non-compete. Like the physicians' desire to retain substantial ownership, the willingness to sign a non-compete is a vote of confidence for the surgery center.
- **There should not be a lot of things that need to be explained.** This is a catch-all category. We become uncomfortable when there's a long, complicated story in response to every question. If you are selling a center, you should remember that surgery center companies are experienced buyers who are well-aware of the principle of caveat emptor in M&A deals. Why? Because, at some point, everyone has a bad experience that teaches them a lesson. Most surgery center companies follow the old cliché, "If it's too good to be true, it's probably because it is."

Grow in the Future:
This really means two things: not only should a center have ample opportunity to grow and expand, but there should be a high degree of assurance that a center has a sustainable market position. In other words, there should not be any significant risk of a center's performance going backward.

- *Sustainable Market Position:* While the trade protection offered by a CON may help provide this, a presence of a key medical group or hospital among the surgery center owners also shows a center built to last. In addition, a surgery center company will want to test a center's current operational performance to see if it is truly a baseline that can be sustained:

  Cases and Case Mix: Are there concentrations among physicians performing cases? For instance, are there five partners who each represent 20% of the center's net revenue? Or are there four partners who do 10% apiece while one partner is responsible for 60% of the center's top line? High concentrations of cases and/or net revenue production in one or two partners suggest a center may not be sustainable in the long run.

  Reimbursement: Well-negotiated managed care contracts are always a plus. On the other hand, significant out-of-network insurance reimbursement is not a long run sustainable strategy.

- *Opportunities for Expansion:* In partnering with "a good group of physicians" (described above), a surgery center company will count on a degree of organic growth as

their practices mature. Beyond this organic growth, surgery center companies look for external growth opportunities. While not every opportunity may come to pass, there should be a myriad of options that, even if only a few take place, the center will enjoy a span of material growth. Expansion opportunities can relate to new outpatient surgeries (e.g., spine programs), expanded service lines (e.g., overnight stays), improvements to the physical plant (e.g., adding additional O.R. capacity), or new partner recruitment.

Finally, there is always a great deal of industry press and discussion around valuation issues and how much "corporate partners" are willing to pay for surgery centers. In reality, the financial offer you are given for your surgery center reflects what a surgery center company really thinks about your center's group of partners, its fundamentals, and its prospects for growth. With few exceptions, surgery centers are purchased for 5 to 7 times their trailing 12-months EBITDA (earnings before interest, taxes, depreciation, and amortization). In short, the best offers will have most, if not all, of the characteristics we described in this article. As Warren Buffett once said, "It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price." ■

ASC BECKER'S Review
AMBULATORY SURGERY CENTERS BUSINESS AND LEGAL UPDATE

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