

## AMBULATORY SURGERY CENTERS

June 2018

### Overview of the ASC Sector

Growth in the ambulatory surgery market is continuing at a rapid pace in 2018, with outpatient surgery volumes projected to grow 11 percent nationally between 2017 and 2022, compared to a 4 percent decline in inpatient surgeries, according to data gathered by *Becker's ASC Review*. With surgery comprising more than half of all inpatient spending in 2016, providers and payers are turning to ambulatory surgery centers (ASCs) to help bend the cost curve, maintain high quality, and enhance the overall patient experience.

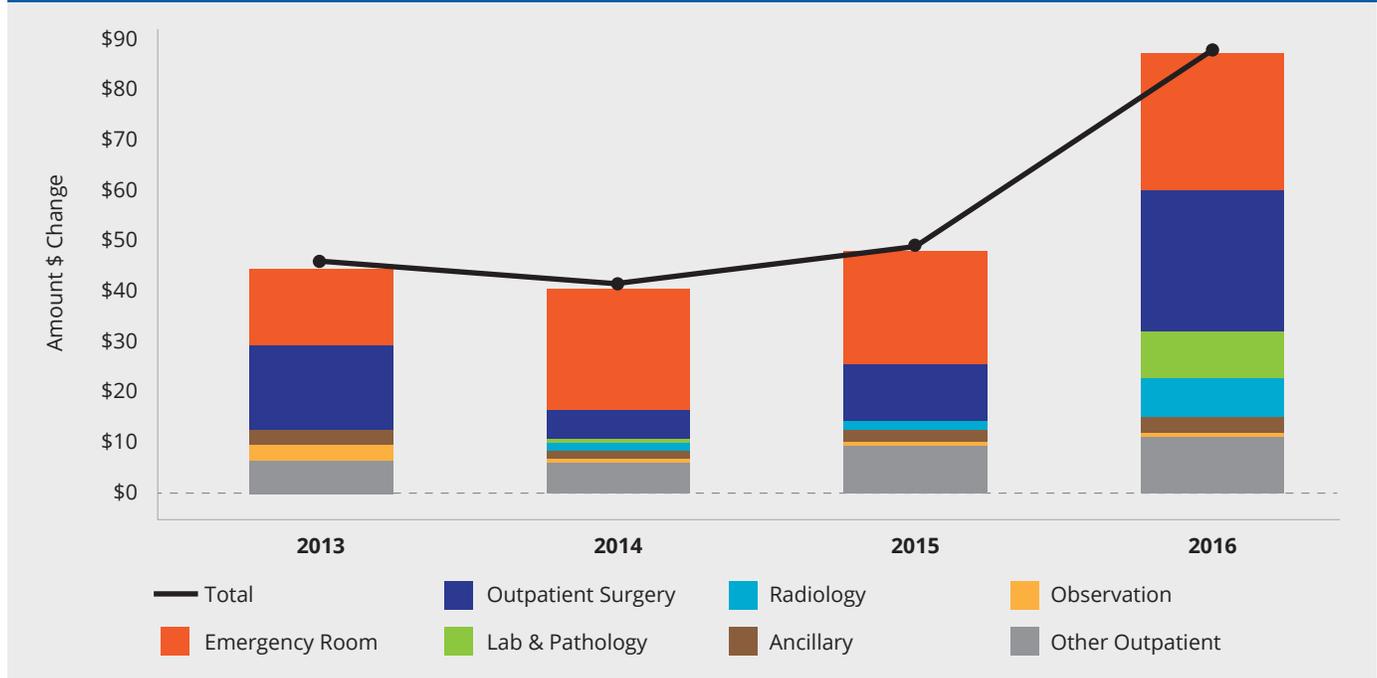
The U.S. ASC sector generates more than \$25 billion in combined revenue annually. Of the approximately 5,500 Medicare-certified ASCs across the U.S., slightly more than half are independent/physician-owned compared to approximately 65 percent in 2011, according to *Becker's ASC Review*. That dynamic may be changing, however,

as hospitals and health systems continue to employ specialists, and new market entrants—such as insurance companies and private equity firms—demonstrate growing interest in the ASC sector.

In addition to payer pressures, rising consumerism likely will contribute to greater use of ASCs as patients increasingly recognize the benefits of having surgery in an ASC versus the hospital setting. While a national data set on ASC patient satisfaction is not yet available, feedback obtained from individual facilities demonstrates high satisfaction rates for convenience and quality of care.

Factors that could temper ASC growth include low-acuity procedures moving to physician offices, escalating out-of-pocket costs, a high percentage of ASC procedures that are considered elective, changing payer dynamics, reform initiatives, and regulatory requirements.

### Annual Change in Outpatient Spending per Person



Source: Health Care Cost Institute, 2016 Health Care Cost and Utilization Report

For more information, please contact Rich Oakford or Forrest Sylvester at 847.441.8780

## Comparable Public Company-Specific Statistics

Financial Metrics	LTM Revenue (MMs)	LTM EBITDA (MMs)	LTM EBITDA Margin	TEV / Revenue	TEV / EBITDA
Envision (including AMSURG)	\$7,819.30	\$1,047.40	13%	1.4x	10.8x
Surgery Partners	\$1,312.47	\$229.58	17%	3.1x	17.9x
Nobilis Health Corp.	\$297.32	\$34.21	12%	1.0x	8.8x

Note: The highlighted public companies together with the largest private ASC operators, USPI and SCA, comprise approximately 16 percent of the total market based on the number of ASCs.

Source: CapitalIQ

### Service Lines to Watch: Orthopedics and Cardiology

The variety and volume of orthopedic procedures performed in ASCs continue to expand, and are only exceeded in volume by outpatient ophthalmology and GI procedures, according to a 2017 *National Health Statistics Report*. In terms of net revenue per case, orthopedics far outpaces other specialties. The 2017 *Multi-Specialty ASC Study Intellimarker* ranked orthopedics as generating the highest net revenue per case among 11 specialties, coming in at \$3,133 per case, compared to ophthalmology at \$1,434 and GI at \$1,004.

The cost implications for orthopedic surgeries performed in ASCs are substantial. A recent study, detailed in the *Orthopaedic Journal of Sports Medicine*, concluded that cost savings of 50 percent or more can be achieved when unicompartmental knee arthroplasty is performed at an outpatient surgical facility. The main cost savings were attributed to the outpatient surgical facility fee, which averaged \$3,800 per patient versus the inpatient facility charge, which averaged \$13,200 per patient.

While cardiovascular care continues to decline in the inpatient setting, the movement to ambulatory care settings has been limited due to patient populations that often are older and have co-morbidities that require additional

support, as well as reimbursement and credentialing challenges. Kaufman Hall forecasts that cardiology, similar to orthopedics, will rise in prominence at ASCs over the next five years. Interventional cardiology, electrophysiology procedures, and other tests and procedures will increasingly move to outpatient settings, assuming that payer incentives and technology continue to support this transition, and credentialing standards are not too onerous.

### The ASC Transaction Market

Given the positive ASC market outlook, hospitals and health systems, physicians, and insurers are continuing to pursue ASC investments, leading to an increasingly consolidated and competitive market in some regions. Gaining a deep understanding of the nuances and unique features of individual markets and the physician landscape is imperative when evaluating ASC opportunities. In markets in which a health system employs a significant portion of the physicians, 100 percent hospital/health system ownership of an ASC may be the best option, particularly if the market and organization are early adopters of value-based care. In markets in which a health system employs few physicians, a joint venture with physicians may be the best path forward, acknowledging that ASC joint ventures are one of the most successful physician alignment strategies available to hospitals and health systems.

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## Progressive Transaction – Bellwether for the Future?

When Optum, the healthcare arm of the largest U.S. insurer, UnitedHealth Group, purchased Surgical Care Affiliates (SCA) in January 2017, ASC market disruption moved from a possibility to a certainty in multiple markets. The only unknown has been how quickly and broadly these changes will be enacted. SCA is the nation's largest outpatient surgery operator with approximately 200 surgical centers and hospitals. The \$2.3 billion deal combines SCA's contracts with large and small payers across the country with Optum's data and contracting expertise and OptumCare's roughly 20,000 physicians

and extensive network of facilities to influence the delivery and reimbursement of outpatient surgery. Optum currently represents one of the most formidable competitors to hospitals and health systems, according to Kaufman Hall market assessments.

During Optum's Q1 2018 conference call, OptumHealth CEO Andrew Hayek said the corporation has set its sights on covering 75 U.S. markets, adopting a more consumer-centric care model using evidence-based medicine, and partnering with medical groups through OptumCare. Kaufman Hall anticipates that more commercial payers may explore opportunities for ASC partnerships on a market by market basis, using this recent transaction as a blueprint.

## Implications for U.S. Hospitals and Health Systems

Hospitals and health systems have known for decades that their core inpatient services were susceptible to erosion from physician offices and ASCs. Physicians have been the traditional primary investors in ASCs, which made the threat level seem less extreme. As more nimble and well-capitalized investors and developers have moved into many markets, the pace of change and degree of risk have increased. Hospitals and health systems are concerned that their medical groups will be purchased by a national powerhouse, and that their surgery volume—often up to one-third of their revenue—is potentially at risk.

With so much at stake, hospitals and health systems must have an ASC strategy in place to pre-empt these threats. That strategy may include letting some volume go to physician partners in order to lower the risk of losing additional volume in the future.

These considerations should be top of mind as hospital and health system leaders craft their ASC strategies:

- **Seek partners not rivals.** Hospitals should avoid purchasing ASCs to eliminate the competition, and instead partner with strong independent medical groups to create opportunities that are mutually beneficial and prevent duplication of assets. In some instances, a third-party ASC management company may be beneficial to the business.
- **Be willing to structure the venture as a true partnership.** Optimal governance structures typically have approximately 50 percent representation from both the hospital and physician base, with physicians in some cases having more operational control.
- **Be open to new facility concepts.** Kaufman Hall has evaluated varying approaches to creating, advancing, and restructuring ambulatory footprints in numerous markets. Ambulatory sites of care are becoming more customized. Depending on projected surgery volume, a facility will typically total 60,000-80,000 square feet with one-third for operating rooms, one-third for office space, and the remaining space allocated to ancillary services and lobbies or a cafe.

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