Why Less Is More:

Embracing the Niche Network Model for Joint-Venture ASCs

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Today's Presenters

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About Blue Chip Surgical

- Develops, manages and optimizes ASC businesses
- Nationwide network of 15+ ASCs
  - ✓ Clinically distinguished, highly profitable
  - ✓ 4 hospital/health system partners
  - ✓ Experts in spine-focused ASCs
- Annual ROI of each project is typically 50-200%
- Focus on financial, payor, legal and operational matters
- Enables our surgeon partners to focus on patient care
- Build trust-based JVs built on aligned incentives, shared risk-reward and creative business models

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About Sentara Healthcare

- 124-year not-for-profit mission
- 10 hospitals; 2,349 beds; 3,700 physicians on staff
- 10 long term care/assisted living centers
- Extended stay hospital
- 3 Medical Groups (600+ Providers)
- 432,600-member health plan
- Sentara College of Health Sciences
- $4.0B total operating revenues
- $5.0B total assets
- 24,000 members of the team
- Mission: We improve health every day

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Sentara-Blue Chip Partnership

- Sentara Lake Ridge; Lake Ridge, VA
- CON required
- JV Structure
  - ✓ Physician-led; 9 partners
    - ✓ Orthopedic & spine surgeons; pain specialists
    - ✓ All partners are board members – attend monthly, one-hour meetings
    - ✓ Each partner adds unique value
  - ✓ Sentara & Blue Chip hold minority stakes
  - ✓ Real estate owned in part by Ortho MD partners
- Small, focused ASC: 1 OR + 1 PR with expansion options
- Capture market share: spine/ortho + other specialties in time

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Sentara Objectives

- Stable medical community & engage with top talent
- Proactive succession planning
- Facility coverage
- Total clinical, strategic and economic integration
- Ensure long-term viability of critical programs
- Manage CON process briskly
  - ✓ Decommission hospital OR & Transition to ASC
- Position for evolving reimbursement model
  - ✓ Hospital ORs & beds may become a cost center, not a revenue generator
- Improve level of care via specialty service centers
  - ✓ Musculoskeletal COE, MD office, imaging, ASC under one roof

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ASC Investments: What Surgeons Want

- Control
  - ✓ Professional satisfaction
  - ✓ Personal – work/life balance
- Patient Focus
  - ✓ Excellent outcomes
  - ✓ Comfortable patient experience
  - ✓ A place to do their best work
- Productivity/Efficiency
- Financial Benefits
  - ✓ Economic stability
  - ✓ Ancillary income
  - ✓ Wealth-building

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ASC Investments: What Hospitals Want

- Stronger Surgeon Relationships
  - ✓ Better communication
  - ✓ Sense of alignment
  - ✓ Loyalty – capture greater share from “splitters”
  - ✓ Capture surgeons aligned with hospital rivals
- Clinical Excellence
- Return on Investment
- Market Share
  - ✓ Brand awareness
  - ✓ Competitive advantage
- Control – typically 51% ownership
- Pricing Flexibility – ASCs allow for lower price points than hospital

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Getting to Alignment with Surgeons

- Identify the best business model to achieve alignment
- Began with review of what both want to accomplish
  - ✓ Review of history
  - ✓ Competitive market dynamics
  - ✓ Why affiliation is being considered – MD & hospital perspectives
  - ✓ Affiliation options
- Present facts to address important questions
  - ✓ What is the motivation?
  - ✓ Why now?
  - ✓ What are the concerns of physician membership?
  - ✓ What can the health system offer versus not offering?
  - ✓ Benefits to both organizations compared to staying status quo?

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The Problem with Traditional Multi-Specialty Model

- Too many specialties
  - ✓ Drives up capital costs
  - ✓ Risk of overbuilding
- Too many owners and/or wrong owners
- Generalist staffing – not truly "expert"
- Diluted financial results
  - ✓ Limited returns – can only make "restaurant money"
  - ✓ On small investments, 50+% ROI may only = $6,500 annually
  - ✓ Same $ profit distributions to each surgeon for different specialties (e.g., neurosurgery vs. dentistry)

The Problem with Traditional Multi-Specialty Model (cont’d)

- Minimal cross-referral opportunities
- Non-committed owners
  - ✓ Misaligned incentives
  - ✓ Lack of shared vision
- Governance issues & complexity
  - ✓ Limited board participation by surgeon-owners
  - ✓ Lack of physician engagement due to minimal “skin in the game”

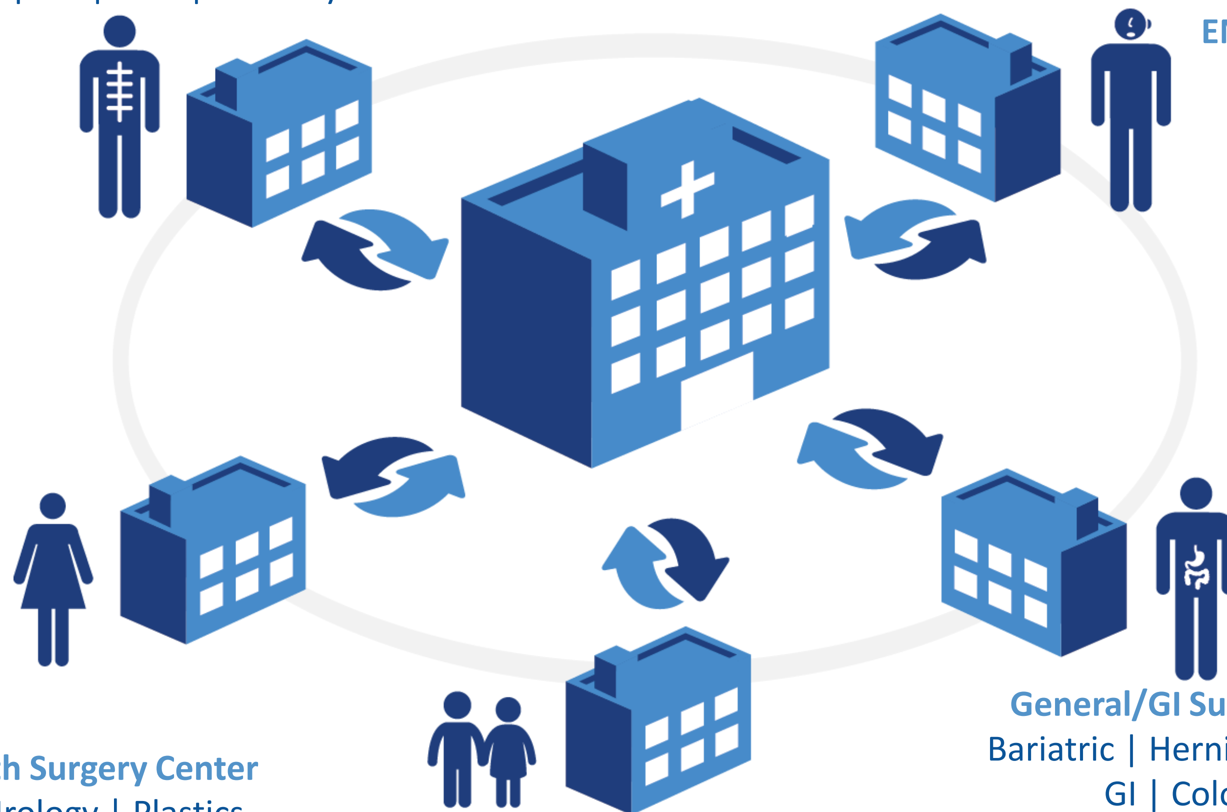
New Approach: "Niche Network"

- Network of single-specialty, "boutique" ASCs
  - ✓ Spine/Ortho
  - ✓ Women's Surgery Center
  - ✓ Bariatric & Hernia
  - ✓ Pediatric
  - ✓ ENT
- Focus on clinical excellence & great patient experience

“Niche Network” Model

Musculoskeletal Surgery Center
Ortho | Spine | Pain | Podiatry

ENT Surgery Center



Women's Health Surgery Center
GYN’s | GynoUrology | Plastics

Pediatric Surgery Center
ENT | GI | Ortho

General/GI Surgery Center
Bariatric | Hernias/Lap Choles
GI | Colorectal

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“Niche Network” Business Model

- Creatively-structured joint venture models:
  - ✓ Physician-led: surgeons are majority owners
  - ✓ Hospital and managing partner equal minority stakes
  - ✓ Nimble, responsive management structure
  - ✓ Shared risk & reward
  - ✓ Facilities configured to market niche
  - ✓ All surgeon-owners assume leadership responsibility

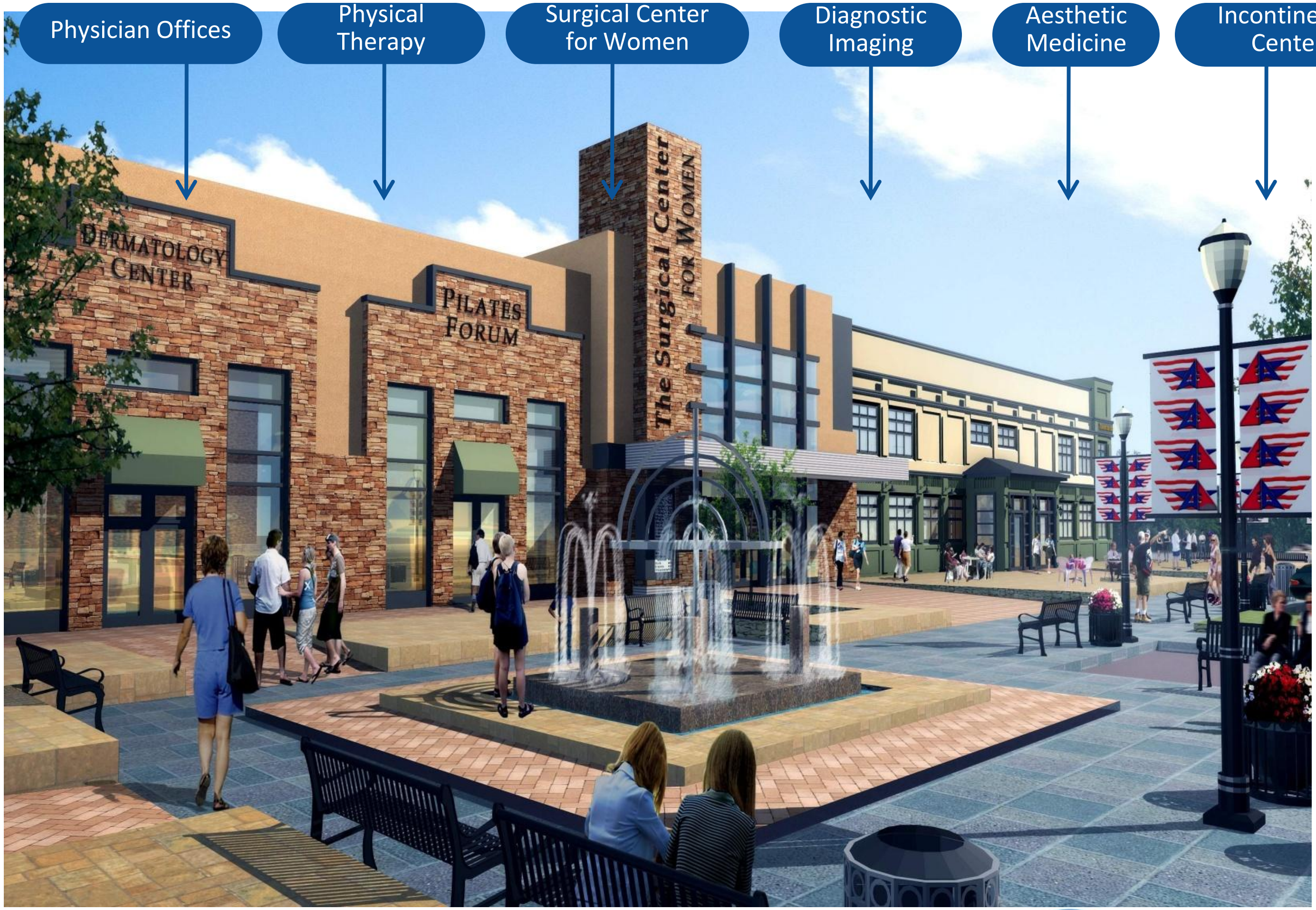
“Niche Network” Business Model

- Hospital Equity Stakes – Why 51%?
  - ✓ Not-for-profits expect 51% equity to preserve Not-for-Profit status
  - ✓ For-profit hospitals & publicly-traded ASC management companies want to consolidate financials
- Surgeon Equity Stakes – Why 51%?
  - ✓ Commitment & engagement – MDs “own” the center
  - ✓ Well-informed, engaged surgeons make excellent business decisions

If hospitals must own 51%, future equity purchase options should be agreed at the outset.

Niche ASCs: Surgery Center for Women

Hospital creates opportunity for surgeons to own a portion of the real estate



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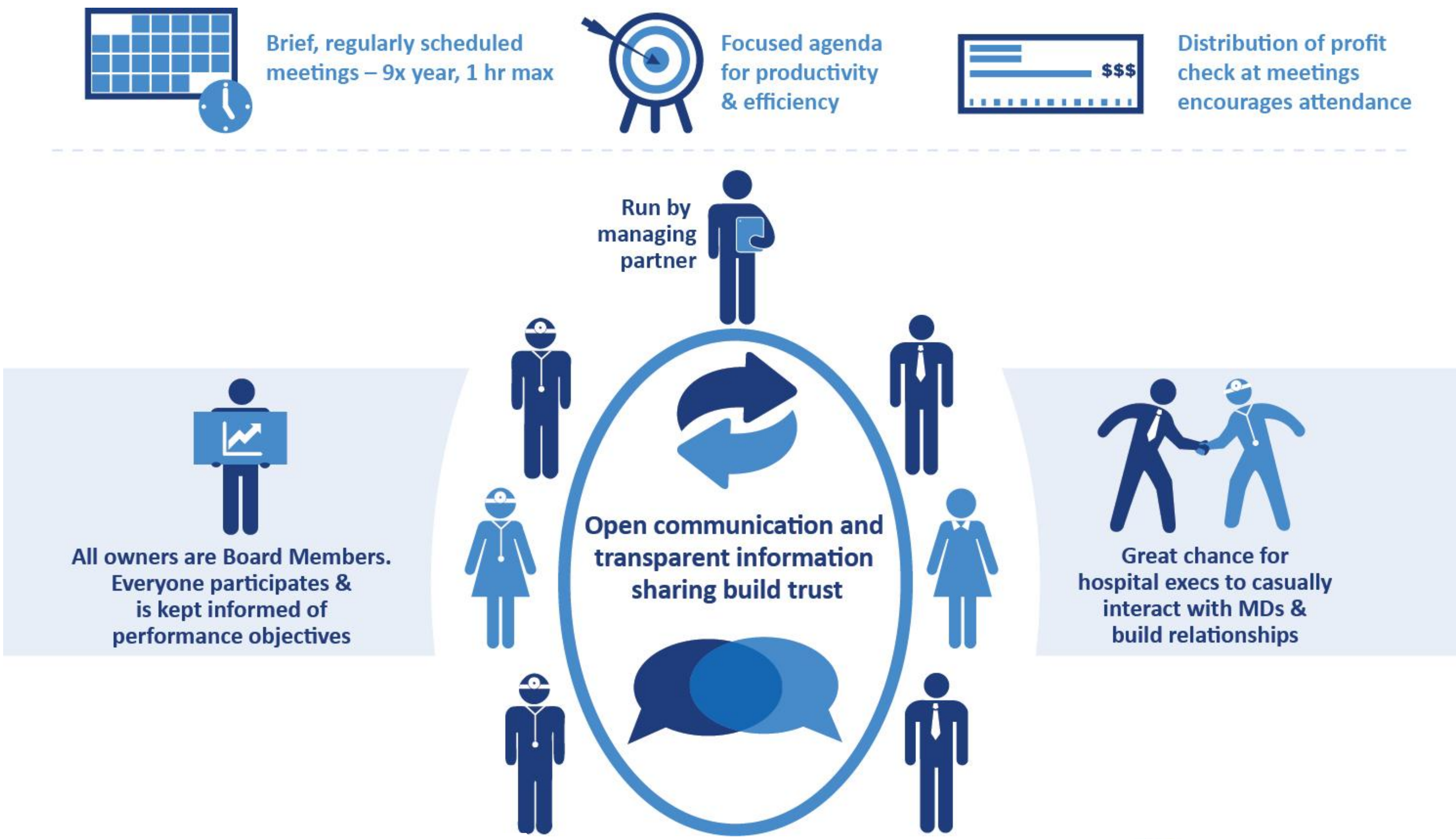
Why "Boutique" ASCs

- Quality experience for both surgeon & patient
- The location factor:
  - ✓ Surgeons will travel crosstown 2-3x/month for quality, productivity, compressed schedules, control, etc.
  - ✓ Patients will travel crosstown for specialized experience, surgeon focus, easy parking, etc.
- Improved outcomes through "best practices"
- True expert staffing
- Full surgeon commitment – no "dead wood"
- Attractive financial benefits
- The "Board Meeting" advantage

The Board Meeting Advantage



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Why “Boutique” ASCs (cont’d)

- Address hospital strategic agenda:
  - ✓ Recruit “splitters” and surgeons from competitors
  - ✓ Grow inpatient volumes through MD alignment
  - ✓ Target hospital line development by specialty
- Improved “word of mouth” referrals
- New marketing opportunities:
  - ✓ Direct-to-consumer
  - ✓ Co-marketing with local teams, local celebs
  - ✓ Smaller, nimble, agile – responsive to needs of marketplace

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Boutique ASCs & ACOs

- Positioning for ACO and bundled payments:
  - ✓ Governance - engaged, informed surgeons
  - ✓ Ownership of the bundle
- Prepare for shift from revenue-based to cost-based models
  - ✓ New hospital metric: not how many beds filled, but how few

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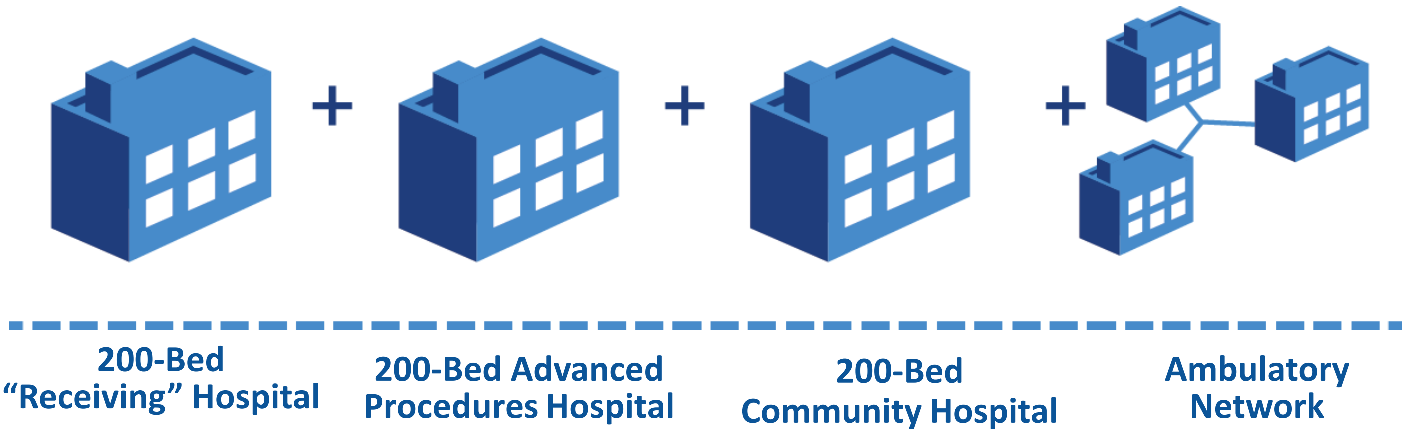
Tomorrow's Hospital Networks



If niche hospitals represent the future, why not niche ASCs?

Niche Hospitals

- Receiving Hospital
- Frail Elderly Hospital
- Community Hospital
- Scheduled Hospital
- Pediatric

Niche ASCs

- Ortho/Spine
- ENT & Eye
- Surgery Center for Women
- General Surgery/Bariatric
- Pediatric

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Niche vs. Multi-Specialty

	Hospital			Average Physician			
Niche Centers	Invest	Annual ROI $	Annual ROI %	# Phys	Invest	Annual ROI $	Annual ROI%
- Spine/Ortho	$147,000	$211,000	144%	10	$31,000	$44,000	142%
- Women's	$147,000	$54,000	37%	15	$20,400	$7,500	37%
- ENT	$147,000	$125,000	85%	10	$31,000	$26,000	84%
- General Surgery / Bariatric	$147,000	$138,000	94%	7	$44,000	$41,000	93%
TOTAL	$588,000	$528,000	90%	42			
Multispecialty	$510,000	$273,000	54%	40	$12,250	$6,600	54%

For hospitals, niche investments offer bigger payoff – both financially and with stronger MD bonds.

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Parkway Surgery Center: Impact to Hospital

- Hospital viewed ASC as threat
- Per Hospital's CFO: *five years later "no threat, data indicates the spine ASC was helpful to hospital"*
- Hospital inpatient neuro revenue increased as a result of the spine-focused ASC
  - ✓ Expanded Hospital OR capacity as a result of ASC – capacity for more complex cases
  - ✓ Surgeons attracted patients from larger regional area
  - ✓ Much less leakage from community

Spine & Musculoskeletal ASCs

Greenspring Surgery Center - Baltimore, MD

Crane Creek Surgery Center - Melbourne, FL

GNS Surgery Center - Athens, GA

Mayfield Clinic - Cincinnati, OH

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Questions and Discussion

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Appendix

Financials:

Multi-specialty: Capital and Expenses

Multi-Specialty ROI

Spine / Ortho ASC: Capital and Expenses

Spine Ortho ROI

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Multi-Specialty: Capital & Expenses

4 ORs, 2 PRs – 18,000 square feet 40 Surgeon-Owners – ENT, Eye, GI, General, GYN, Ortho, Ophthalmology, Pain, Plastic, Urology		
Capital Requirements	$7,450,000	*Architecture, construction, legal, equipment, furnishings, working capital*
Partner Contributions	$1,000,000	
Bank Loan	$6,450,000	*7 years*
Revenue	$5,340,000	*5,600 total cases at $954 average reimbursement*
Expenses	$4,803,840	*Staffing, suppliers, rent, services, interest & principal repayment*
Free cash flow	$536,160	

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Multi-Specialty: ROI

Partner	% Stake	Initial Investment	Year 2 Return	Year 7 Return
Hospital	51%	$510,000	$262,718	$451,553
Surgeon Owners (40 @ 1.225%)	49%	$490,000	$273,442	$469,983
Return on Cash Invested			*54%*	*92%*

	Initial Investment	Annual Return	Annual Distribution
Individual Surgeons	$12,250	54%	$6,600

50+% ROI on small investments equals $6,600 annual distributions per surgeon – "restaurant money"

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Spine/Ortho ASC: Capital & Expenses

2 ORs, 1 PR – 6,500 square feet **10 Surgeon-Owners – Spine, Orthopedic, Pain**		
Capital Requirements	$3,340,000	*Architecture, construction, legal, equipment, furnishings, working capital*
Partner Contributions	$600,000	
Bank Loan	$2,7400,000	*7 years*
Revenue	$4,050,000	*2,600 total cases (300 spine, 800 ortho, 1,500 pain)* *$1,558 average reimbursement*
Expenses	$3,185,240	*Staffing, suppliers, rent, services, interest & principal repayment*
Free cash flow	$864,760	

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Spine Ortho: ROI

Partner	% Stake	Initial Investment	Year 2 Return	Year 7 Return
Surgeon Owners (10 @ 5.1%)	51%	$306,000	$441,030	$615,523
Hospital	24.5%	$147,000	$211,866	$295,693
Management Partner	24.5%	$147,000	$211,866	$295,693
Return on Cash Invested			*144%*	*201%*

	Initial Investment	Annual Return	Annual Distribution
Individual Surgeons	$30,600	144%	$44,103

140+% ROI on larger investments equals $44,000 annual distributions per surgeon – "Yale money"

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