



Healthcare Sector Spotlight

Ambulatory Surgery Centers

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Sector Report: Ambulatory Surgery Centers (ASCs) in a time of COVID-19

ASCs have experienced a major disruption to their operations as COVID-related demands on our healthcare system have necessitated a pause in elective procedures. While the immediate-term economic pain is significant for these businesses and their employees, we see a bright future ahead for ASCs as the migration of patients to safer, more cost-effective, and higher performing surgical settings continues.

The Halt on Elective Procedures

On March 18, 2020, at the White House Task Force Press Briefing, the Centers for Medicare & Medicaid Services (CMS) recommended that all elective surgeries and non-essential medical, surgical, and dental procedures be delayed during the novel coronavirus outbreak. This nationwide announcement was made to support the needs of the hospitals and healthcare systems that are caring for coronavirus patients and to enable the reallocation of personal protective equipment (PPE) inventory, healthcare workforce capacity and bed capacity.

For many ASCs across the country, this postponement of elective cases has meant a total suspension of normal operations. The financial impact on individual ASCs and on the sector as a whole is reflected in the recent stock performance of Surgery Partners (NasdaqGS:SGRY) and Tenet Healthcare Corp. (NYSE:THC), for whom ASCs represent a significant portion of their businesses; even after the recent market rebound, SGRY and THC are down 30.3% and 38.3%, respectively, over the last three months, far lower than the S&P as well as other more diversified public healthcare service companies (Figure 1 & 2).

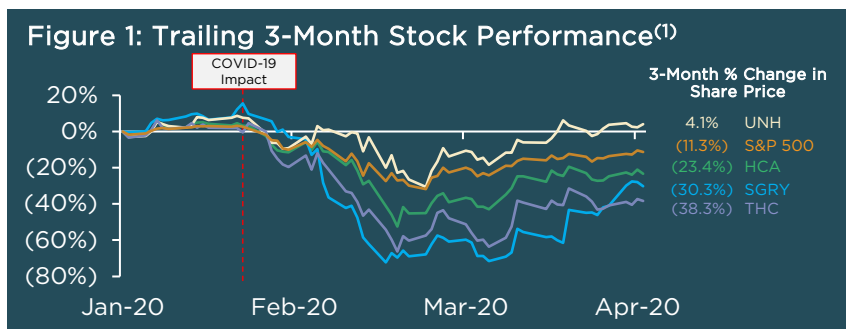








Figure 2: ASC Public Company Metrics⁽²⁾

	Surgery Centers	Market Capitalization ⁽¹⁾	2019 Total Revenue	2019 ASC Revenue	ASC Revenue as % of Total	% Change in Share Price Since Feb 19 ⁽¹⁾
 UNITEDHEALTH GROUP SCA <small>Surgical Care Affiliates</small>	230+	\$277.1B	\$242.2B	\$2.0B+ ⁽³⁾	<1%	(4.2%)
 HCA Healthcare	123	\$37.2B	\$51.3B	n/a	<3%*	(26.8%)
 Tenet Health	260	\$2.1B	\$18.5B	\$2.2B	11.7%	(39.5%)
 SURGERY PARTNERS	112	\$587.0M	\$1.8B	-\$1.0B	54.0% ⁽⁴⁾	(37.9%)

*FocalPoint estimate

The Ongoing Patient Migration to ASCs

With coronavirus-related headlines pervading the news, exposure risk is top of mind for many. Fear of infection now influences even the most routine decisions in our daily lives. Looking ahead, even after restrictions on elective procedures are lifted and business begins returning to normal, these safety concerns are likely to persist. ASCs, with their strong track record for low infection rates, are well-positioned to see a resultant surge in demand. Typically designed as freestanding facilities, separate from hospitals, ASCs have a 6x lower infection rate than Hospital Outpatient Departments (HOPDs), even while performing a higher volume of procedures at a lower cost structure (Figure 3).

Figure 3: ASC Advantages vs. HOPDs

	ASCs	HOPDs
Infection Rate ⁽⁵⁾ :	0.05%	0.31%
Procedures Conducted ⁽⁶⁾ : <i>3-hr span</i>	5-6	2-3
Avg. Procedure Cost ⁽⁷⁾ :	\$2,429	\$4,337

Beyond safety, efficiency and cost, ASCs present numerous advantages across the Quadruple Aim of healthcare, including a superior patient experience, better patient outcomes, and an improved physician experience (Figure 4). These many benefits have resulted in an ongoing migration of surgical procedure volume from HOPDs to ASCs. From 2005 to 2015, the percentage of surgery cases performed in ASCs increased from 41% to 57%, and this trend is expected to

Figure 4: How Leading ASCs Serve the Quadruple Aim

I. Lower Cost of Care

- ✓ Optimized scheduling
- ✓ Lean clinical, technical and administrative teams
- ✓ Volume efficiencies
- ✓ Specialization enables superior case coordination

II. Superior Patient Experience

- ✓ Better safety and cleanliness
- ✓ Specialized care and attention
- ✓ Shorter wait times
- ✓ Reduced post-surgery recovery times

III. Better Patient Outcomes

- ✓ Specialized facility and equipment
- ✓ Higher volume, more reps, greater expertise
- ✓ Low infection rates
- ✓ Fewer readmits

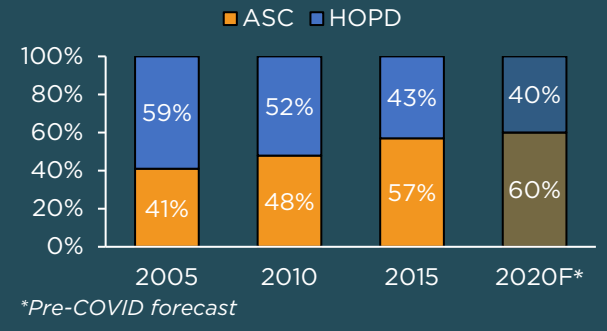
IV. Improved Physician Experience

- ✓ Consistent clinical team and OR setup
- ✓ More flexible scheduling
- ✓ Greater autonomy and control
- ✓ Shared economics

continue (Figure 5). ASC total revenues have also rapidly grown during this time (Figure 6). As life returns to normal in the coming months and patients and physicians look to reschedule the procedures they had postponed, high-quality ASCs may very well see a further acceleration to this migration.



Figure 5: Surgery Cases By Setting⁽⁸⁾ (U.S.)



Strategic Partnerships

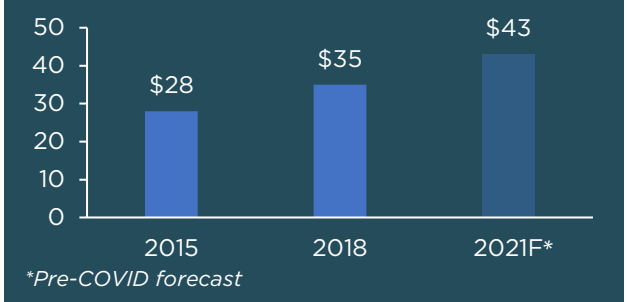
As value-based care and risk-sharing reimbursement models become more prevalent, ASC joint ventures with hospitals and health systems have enabled operational efficiencies, shared resources, centralized management and greater care coordination. These partnerships are especially important as hospitals become risk-bearing entities through Accountable Care Organizations (ACOs), bundled reimbursements and narrow networks. Due to the cost and safety advantages of ASCs, payors are driving cases into the outpatient setting whenever possible and hospital executives want to make sure those cases stay within their multi-pronged ecosystem.

Historically, hospital executives and ASC physician-owners have often had adversarial relationships, but an evolving landscape is inspiring compromise and collaboration. For example, hospital executives are allowing employed physicians to own interest in joint venture ASCs, while free-standing ASCs are embracing a heavier mix of in-network volume by leveraging health system affiliations to access managed care contract rates.

Continued M&A Activity

Despite the current public market turmoil, we see strong interest from national ASC platforms to continue forward with their acquisitive growth strategies, indicating their belief in a near-term return to normal operations as well as an initial surge from the backlog of postponed procedures. Valuations ranges run wide, anywhere from 5x to 9x trailing EBITDA (adjusted for one-time COVID-19 impact), with premium valuations driven by local market leadership, premium surgical center brands and physician reputations,

Figure 6: Total U.S. ASC Procedure Revenue⁽⁹⁾ (\$Bn)



platform synergies and strong payor relationships. In the coming months, we anticipate increased consolidation activity as smaller surgery centers seek the stability and resources of a larger platform. Additional benefits of management services partnerships include: greater purchasing power with payers and vendors; enhanced patient referral networks; corporate-level marketing; physician recruitment capabilities; revenue cycle management best practices; and other operational synergies.

Physician Morale is Paramount

For value-based care models to succeed, physicians must be motivated to lead the charge within their clinical and operations teams to identify cost savings and opportunities for care coordination. Hospitals with sole ownership of ASCs have historically struggled to maintain physician engagement and morale, which can also adversely impact the patient experience. ASCs, on the other hand, have demonstrated the ability to provide a better environment for physicians by offering a number of advantages, including: (i) quicker turnover allowing surgeons to complete more cases; (ii) significantly lower infection rates than hospitals; (iii) fewer complications since patients are generally healthy beyond their need for elective surgery; (iv) less bureaucracy; and (iv) shared economics.

Conclusion

ASCs are currently battling unprecedented business challenges through this global pandemic. However, as we emerge from the crisis and business returns to normal, the strongest ASCs will come out even stronger than before.

Sources: (1) As of April 30, 2020 Market Close; (2) Companies' 10-K Filings and Websites; (3) SCA Revenue Estimate From Company Website; (4) Wall Street Research, March 23, 2020; (5) CASA Benchmarking, Agency for Healthcare Quality and Research, 2017; (6) Ambulatory Surgery Center Association (ASCA), 2018; (7) Becker's ASC Review, 2018; (8) L.E.K Consulting, 2017 Report; (9) Bain & Company, 2019