Strategic Considerations and Optimizing Opportunities in Alignment with Physicians and Hospitals in ASC JVs

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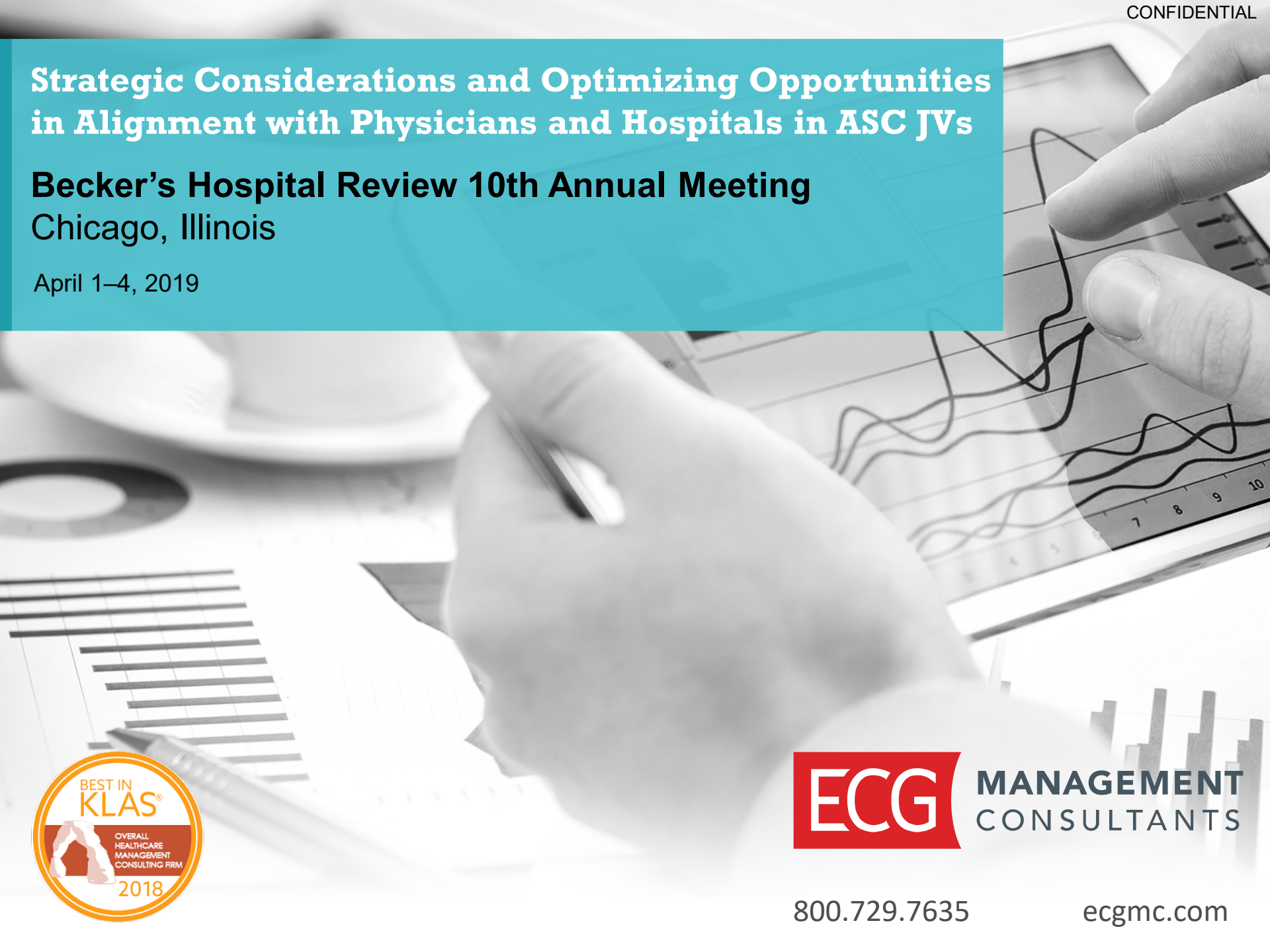

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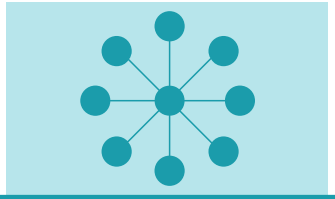
Objectives

During today's presentation, we will discuss several topics related to hospital-physician alignment.

- Review current environment and trends.
- Assess implications on surgery migration.
- Provide an overview of Medicare ASC rule changes.
- Discuss key factors that impact hospital strategy.
- Evaluate trends and opportunities for physician alignment.
- Identify key steps for achieving success.

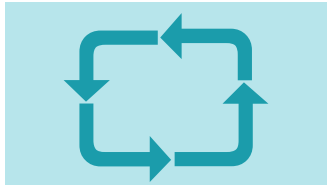
Current Environment and Trends

Key Considerations



Current Environment

- ASC case mix and ownership
- Value of hospital-ASC JVs



Migration of Surgery

- CMS-approved ASC list growth
- Medicare versus commercial payers

Strategic Considerations

- Operations and CMS changes
- Surgery pricing and transparency
- Market dynamics and physician relationships
- Financial considerations and managed care

Current Environment

Consolidation and Market Trends

The current environment and trends are expected to have a meaningful impact on the future of managed care and reimbursement for ASCs and hospitals.

Migration of Surgery from Hospital Inpatient to HOPD to ASC

- Increased technology
- Employer and payer demand
- Physician motivation and alignment

Payer Trends

- Narrow networks
- Alternative payment methods
- Site-of-service direction and policy changes

Retail and Demand for Pricing Transparency

- Patient education
- Increased out-of-pocket responsibility
- Benefit designs

Consolidation

- Payers
- Hospital-physician alignment
- Equity partners
- Mega groups

Migration of Surgery

Inpatient

HOPD

ASC

Key Drivers

- Advancing clinical technologies that allow smaller incisions and shorter stays
- Medicare and commercial payer cost pressures
- Physician motivation—financial and efficiency

Payer Implications for Ambulatory Surgery

Medicare

- » Inpatient-to-HOPD code approval
- » HOPD-to-ASC code approval
- » Outpatient prospective payment system (OPPS) for HOPDs and ASCs
- » Closure of gap on reimbursement methods and rates
- » Device-intensive codes
- » Bundling logic

Commercial Payers

- » CMS approvals to HOPD validate medical director approvals for ASC lists.
- » Expansion of commercial payer ASC-approved lists is growing beyond the CMS-approved list.
- » Inpatient-to-outpatient cost-saving opportunities with outcomes data validate medical director approvals.
- » Commercial payers align with ASCs to move volume.

2019 Medicare OPPS Payment Rule Highlights

Rate Calculation

- ✓ CMS's ASC rule replaced the CPI-U, with the hospital market basket as the annual update for the ASC conversion factor.
- ✓ This sets ASCs and HOPDs on the same update factor, which is expected to have a favorable impact on ASCs.

Device-Intensive Codes

- ✓ The device-intensive code offset percentage has been reduced from 40% to 30% for single-use devices that meet the device offset threshold to be eligible as a device-intensive procedure.
- ✓ Reducing the threshold has a favorable impact on reimbursement for eligible procedures.

Payment for Non-Opioid Pain Management

- ✓ CMS will provide separate payment for non-opioid pain management "drugs that function as a supply" when used in a surgical procedure performed in an ASC.
- ✓ Currently this applies to HCPCS code C2920, the drug EXPAREL®, and is approved for ASCs but not for HOPDs.

Definition of Surgery

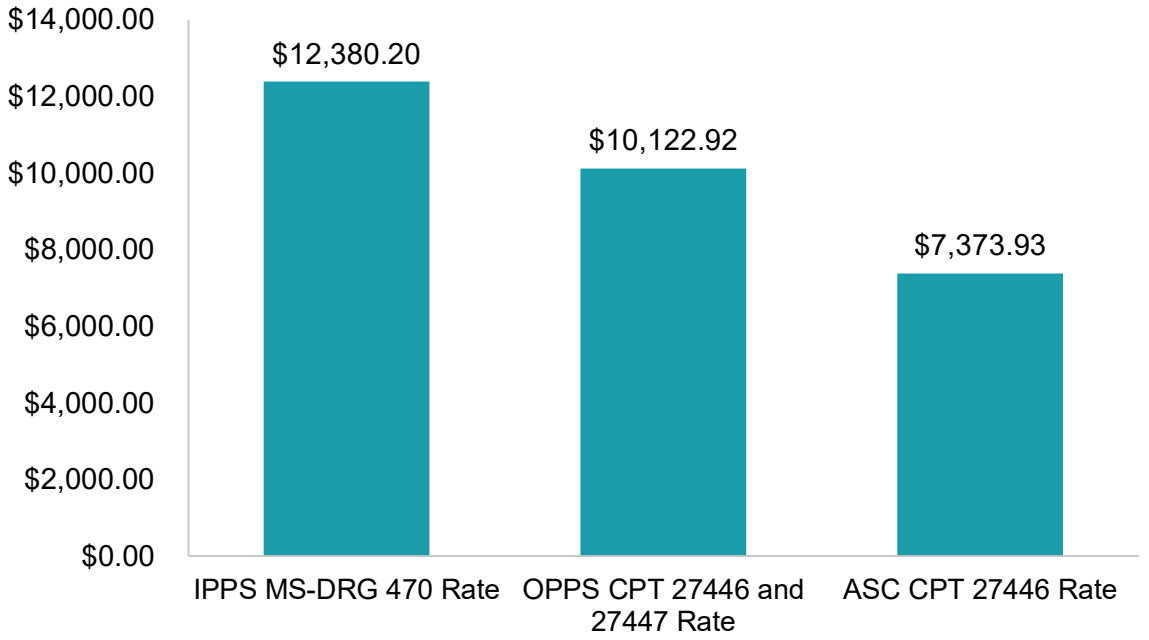
- ✓ CMS modified the definition of surgery, which expanded the ASC-approved list.
- ✓ As a result of the rule change, the majority of cardiac cath lab procedures were added to the ASC-approved list.

Uni-Knee and TKA

TKA CPT code 27447 was removed from the inpatient-only list in 2018 and affects the pace for surgery migration.

- TKA was added to the OPPS in 2018, but it remains excluded from payment in ASCs.
- The OPPS TKA rate represents an 18% discount from the IPPS rate.
- Unicompartmental knee arthroplasty (uni-knee) (CPT code 27446) has the same OPPS rate as TKA in 2018 and is ASC eligible. In 2018, the ASC rate for uni-knee represents a 27% discount from the OPPS rate.

Uni-Knee and TKA Acute Inpatient, Hospital Outpatient, and ASC Rates



Sources: Acute inpatient, hospital outpatient, and ASC payment, 2018, from the following websites:
https://www.cms.gov/Medicare/Medicare-Fee-for-Service-Payment/AcuteInpatientPPS/index.html
https://www.cms.gov/Medicare/Medicare-Fee-for-Service-Payment/HospitalOutpatientPPS/index.html
https://www.cms.gov/Medicare/Medicare-Fee-for-Service-Payment/ASCPayment/index.html

TKA is expected to migrate to the outpatient setting, which will have a significant impact on hospitals; however, it is not included in the 2019 ASC rules.

Medicare Implications
Total Joint ASC Rate Trends Compared to HOPDs

This approved ASC total joint list shows the total joint procedures that are closing the gap in reimbursement from HOPD to ASC.

CPT	2018 Descriptions	ASC 2018 Rate	ASC 2019 Rate	ASC Dollar Change	ASC Percentage of Change	HOPD 2019 Rate	HOPD Rate Premium over ASC Rate
24362	Reconstruct elbow joint	$5,069	$8,179	$3,110	61%	$10,714	31%
24366	Reconstruct head of radius	$7,800	$8,210	$410	5%	$10,714	31%
24370	Revise reconst elbow joint	$7,092	$7,689	$597	8%	$10,714	39%
25441	Reconstruct wrist joint	$8,270	$8,473	$203	2%	$10,714	26%
25444	Reconstruct wrist joint	$8,790	$9,025	$236	3%	$10,714	19%
25445	Reconstruct wrist joint	$2,721	$3,820	$1,099	40%	$5,700	49%
26531	Revise knuckle with implant	$3,812	$3,935	$123	3%	$5,700	45%
27442	Revision of knee joint	$7,344	$7,612	$268	4%	$10,714	41%
27446	Revision of knee joint	$7,374	$7,695	$321	4%	$10,714	39%

Source: https://www.cms.gov/Medicare/Medicare-Fee-for-Service-Payment/ASCPayment/index.html.

The favorable total joint rate trends can provide momentum for expansion of the ASC-approved total joint list and increased opportunities for ASCs.

Alternative Payment Models

Value-Based Pricing: Common Themes

ASCs present opportunities for increased incentives that support alignment between hospitals and physicians via Alternative Payment Models (APMs).

Risk Sharing

- The payer provides incentives for quality outcomes and measured reduced cost.
- Hospitals and physicians share risk for cost.
- ASCs can present an opportunity for shared savings to hospitals and payers.
- What about physician incentives and penalties for volume migration?

Bundled Payment

- Payers are working with ASCs on bundled payment methodologies.
- ASCs are aligning with physicians, hospitals, and payers to provide the continuum of ASC surgical care.
- ASCs in hospital JVs present an opportunity for upside to the hospital on a bundled payment for a surgical episode of care.

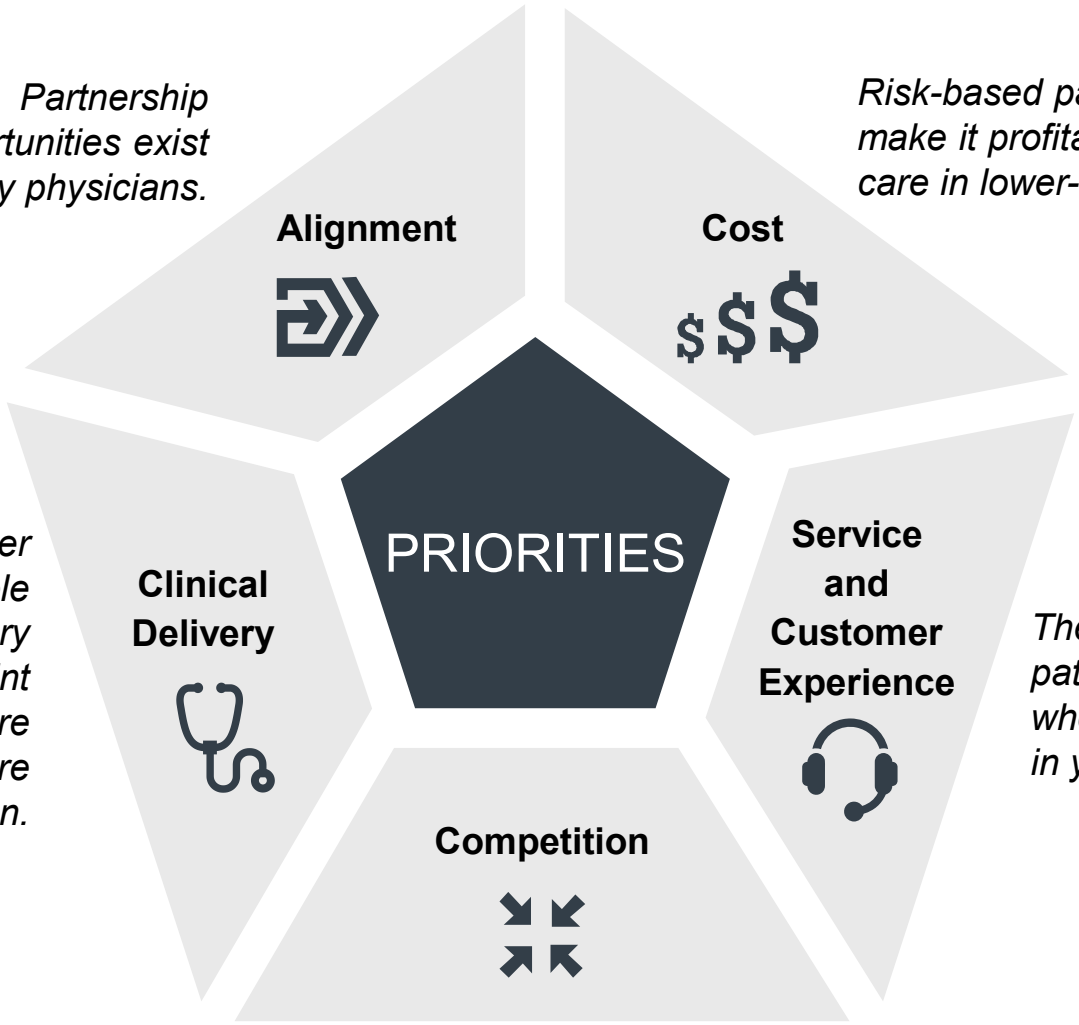
Case Rates

- Case rates incorporate a global payment for surgical experience and include the ASC, surgeon, anesthesiologist, and implant.
- Case rates are often interchanged with bundled payments for ASCs.

Physician Alignment and Value of an ASC Strategy

New Hospital Priorities

Several pressures are changing the way hospitals think about surgery.



Partnership opportunities exist with key physicians.

Risk-based payments will make it profitable to deliver care in lower-cost settings.

There is a longer list of eligible services every year. Total joint replacements are becoming more common.

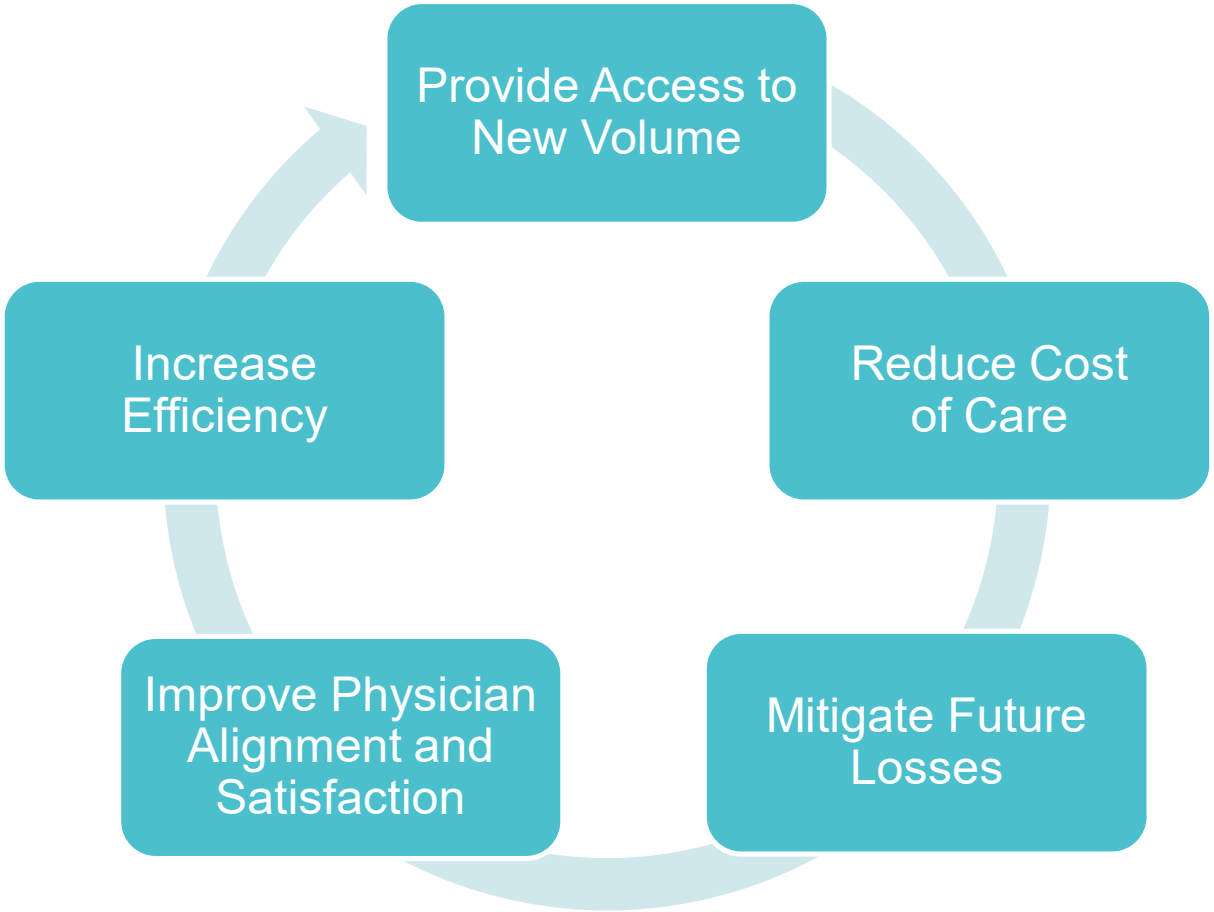
The happiest patient may be one who never sets foot in your hospital.

All of these issues support a greater investment in ASCs by health systems.

If you can't beat 'em…

ASC Value to a Hospital System Network

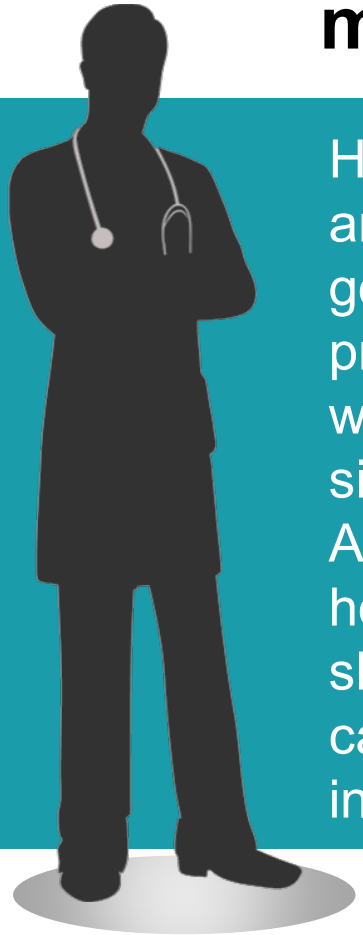
ASCs provide hospitals with a vehicle to reduce the total cost of care.



The Value of Alignment

ASC Implications for Health Systems: Future Considerations

Health system ASC strategies are mandatory and critical to success.



Health systems and hospitals are feeling pressure from payers and their communities to reduce costs. In addition, changes in government regulations and commercial payer strategies reward providers for migrating high-acuity surgery to the ASC setting, which poses a financial threat to health systems due to the significance of surgical revenue. This motivates the demand for ASCs and the need for an ASC strategy. Retention of equity for hospital partners is expected to grow as higher-valued surgery shifts to a lower-cost setting. Health systems are expected to capitalize on their value relative to their equity position and increase alignment with physicians via ASC JVs.

Hospital Ambulatory Surgery Strategy

Hospital surgical case volume can represent 70% to 80% ASC eligibility for migration, posing a significant risk to the financial viability of a hospital.

Why do hospitals need an ASC strategy?

- There is increased pressure to reduce the total cost of care.
- OR care is the most expensive and the highest revenue generator in the hospital.
- Hospitals are analyzing their surgery business.
- Hospitals' freestanding HOPDs that are more than 250 yards from a hospital campus no longer have access to HOPD reimbursement.
- Increased physician alignment and access to lost volume presents accretive value.
- ASCs are capturing high-dollar volume from hospitals.
- Hospitals seek to improve the cost of care and engage in value-based pricing.
- Hospital ORs are full; ASCs offer access and efficiency.

ASC-Eligible Volume Review

Case Study

ECG recently identified that 80% to 95% of the inpatient and outpatient surgical volume within a large, multihospital health system could be performed in an ASC setting.

Specialty	Trailing 12-Month System-Wide Surgical Volume[1]	Percentage of Total on Medicare ASC-Approved Procedure List	Percentage of Total on All-Payer ASC-Approved Procedure List
GI/Colorectal	16,800	99.2%	99.4%
Ophthalmology	11,000	96.3%	100.0%
General Surgery	10,900	72.6%	98.8%
Orthopedics	10,400	94.6%	98.6%
ENT	5,900	95.1%	98.8%
Urology	4,200	81.0%	87.9%
Joint Replacement	3,400	6.8%	99.5%
Spine	3,300	61.7%	100.0%
Gynecology	3,200	85.3%	99.3%
Pain Management	1,400	94.0%	99.9%
Dental	400	1.0%	1.0%
Other Surgery	5,800	46.7%	90.1%
Total	**76,700**	**82.2%**	**97.4%**
Percentage Not on an ASC Approved Procedure List		***17.8%***	***2.6%***

[1] Volumes have been rounded to protect client confidentiality.

This analysis led the system to embark upon a rapid process to develop a greater ambulatory surgery presence with employed and aligned surgeons.

Factors That Affect the Success of a Hospital-ASC JV

Market Dynamics and Physician Alignment

- Physician relationships
  - Hospitals retain physician alignment with ASCs.
  - Hospitals recruit new physicians via ASC partnerships.
- Market competition
  - ASCs
  - Hospitals
  - Payers
- Hospital equity position
- Asset versus stock purchase
- CON implications

Financial Considerations and Managed Care

- Economic implications of moving surgery
  - Excess capacity
  - Demonstrating winners and losers
  - Partnership distributions
- Case mix
- Payer methodologies and cost
- Affiliate language
- Payer contracting considerations
  - HOPD versus ASC rates
    - Historical focus on inpatient rates
    - Shift in SOS
    - Impact on rate negotiations

Contract Consolidation

Case Study

Health system ASC contracts demonstrate the potential for enhancing the overall value of an acquired ASC via favorable affiliate language, enabling access to enhanced reimbursement.

Acquired ASC and New Contract Comparison

Payer	ASC Net Revenue per Case	Health System New ASC Contract Net Revenue per Case	Variance: Health System New ASC Contract Compared to ASC	Percentage Increase	Total Payer Annual Revenue	Potential Increase	Impact from Contract Value
Payer 1							
	$790	$2,955	$2,165	274%	$ 454,250	$1,699,125	$1,244,875
Payer 2							
	$820	$1,976	$1,156	141%	377,200	908,960	531,760
Payer 3							
	$690	$2,143	$1,453	211%	396,750	1,232,225	835,475
Other							
	$810	$1,798	$988	122%	279,450	620,310	340,860
Total					**$1,507,650**	**$4,460,620**	**$2,952,970**

Hospital-ASC JV: Why Does it Make Sense?

Opportunity to Be First Movers

- ASC expansion in the market is inevitable—driven by payers and providers seeking a lower-cost setting.
- Health system can commit to an ASC strategy that mitigates volume losses to competitors.

Synchronicity with the ACO Strategy

- Partnering in an ASC directly supports the cost efficiency goals/objectives of the ACO.
- Partnership presents opportunity for gainsharing and bundled payments.

Independent Physician Access

- Physician alignment and retention is enhanced.
- Independents will be attracted to the efficiency and aesthetics of the ASC.
- Health system captures or retains a portion of this revenue stream.

Financial Feasibility

- Short-term EBITDA reduction in the HOPD is recoverable with a unified ASC strategy.
- CMS and commercial payers redirect volume out of HOPDs.

Patient Access

- Collaboration allows for the most seamless patient access model.
- Health system maintains access to patients.
- Patient satisfaction increases with the ASC option.

The community wins in all scenarios of an ASC partnership between a health system and surgeons.

So What Should You Do?

A Six-Step Program

1 Be Aware of the Payer Market

Be aware of what commercial payers are doing in your market. In most areas, they are more aggressive than Medicare.

2 Understand the Implications

A meaningful portion of your inpatient surgery cases will transition to ASCs in the coming years. Do the math.

3 Create Internal Alignment

How will these trends affect your other plans around value-based care, new payment models, physician alignment, and clinical integration?

4 Develop a Strategy

Can you ride it out? Can you develop your own ASCs or enter into JVs? Explore ways to mitigate the financial hit while positioning for the future.

5 Fill Gaps in Expertise

ASCs are different than hospital ORs. Have a plan.

6 Execute!

Questions & Discussion

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