

DATA AND PUBLICATIONS UPDATE

HealthCare Appraisers' 2010 ASC Valuation Survey

By Jason Ruchaber, CFA, ASA

Under the Stark Law, also known as the physician self-referral act, physicians are prohibited from having a financial interest in an entity to which they refer clients unless the arrangement meets an applicable Stark exception. Most ancillary services such as imaging and radiation oncology are considered designated health services (DHS) under Stark and therefore preclude most forms of physician ownership.

Ambulatory surgery is different in that it is not considered a DHS under Stark. This permits physicians, typically surgeons, to own an interest in an ambulatory surgery center (ASC) while still referring cases. Though still bound by the various requirements of other applicable healthcare laws (e.g., the Anti-Kickback Statute), the exclusion of ambulatory surgery from Stark has made ASCs one of the most common types of physician-owned entities in the healthcare industry.

With active physician investment, there is frequently a need to determine the value of ASC shares as new physicians buy in and retiring physicians depart. In an effort to augment the available sources of information regarding the appropriate pricing of these shares, HealthCare Appraisers developed its first *ASC Valuation Survey* in 2002. Since that time, we have conducted an annual survey of key management and development companies operating in the ASC industry to identify trends in both the pricing of ASC ownership interests and the management fees charged to ASCs by management companies.

For the 2010 survey, 17 respondents participated in our survey, representing more than 500 surgery centers throughout the country. Though we caution against using the survey as a stand-alone market approach, it does provide high-level guidance regarding the valuation trends observed by the major corporate participants in this industry. These observations serve as a "sanity check" for the valuation multiples that might otherwise be selected for the market approach or implied by the income approach.

Key findings from the 2010 ASC Valuation Survey: When purchasing a *controlling* interest in a *multi-specialty* ASC, 56% of the respondents reported prevailing valuation multiples of 6.0 to 6.9 times EBITDA, while 13% reported valuation multiples of 7.0 to 7.9 times EBITDA and 31% reported multiples of less than 6.0X. For *single-specialty* centers the multiples are lower, with 35% of respondents reporting multiples ranging from 6.0 to 6.9 times EBITDA and 47% reporting multiples of 5.0 to 5.9X. No respondents report multiples above 7.0 for *single-specialty* centers. Some 53% of respondents perceive that valuation multiples have stayed consistent compared to those of the prior year, while 41% perceive that multiples have decreased.

When purchasing a *minority* interest in a *multi-specialty* ASC, 43% of the respondents reported prevailing valuation multiples of greater than 4.0 times EBITDA, and 43% reported valuation multiples of 3.0 to 3.9 times EBITDA. Only 14% reported multiples of 2.5 to 2.9 times EBITDA. For *single-specialty* centers the range of observed multiples is slightly lower, with 46%

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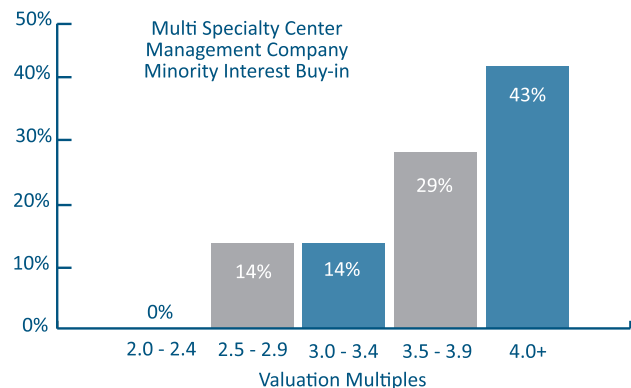
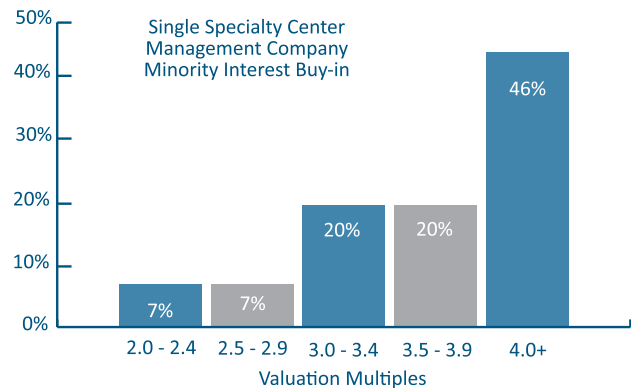
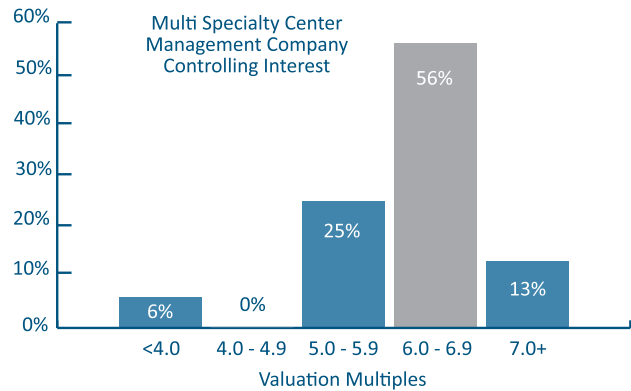
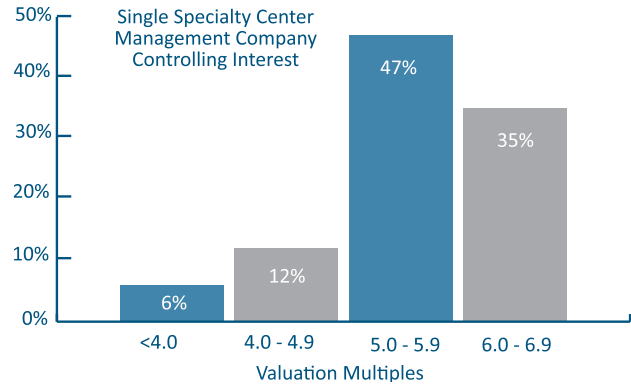
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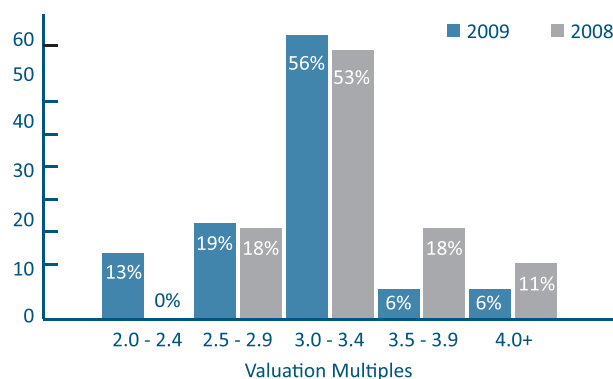
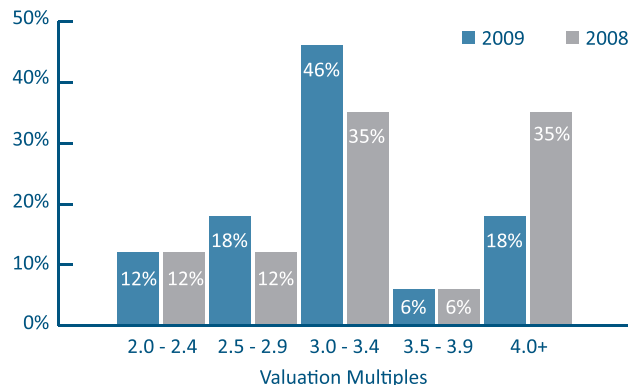


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of respondents reporting multiples greater than 4.0 times EBITDA and 40% reporting multiples of 3.0 to 3.9X. Another 7% of respondents observe multiples of 2.9 to 2.9 times EBITDA, and 7% observed multiples of 2.0-2.5X.

When buying out retiring or underperforming physicians, 46% of respondents pay between 3.0 to 3.4 times EBITDA, and only 18% pay a multiple of 4.0 times or higher (down from 35% in 2009). Pricing for physician buy-ins is similar, with 56% indicating multiples of 3.0 to 3.4 times EBITDA.

When buying out retiring or underperforming physicians, 70% of respondents base the redemption price on a predetermined formula. For new physician investors, 41% of respondents report using a formula to establish the buy-in price; 18% allow the board to determine the purchase price; and 35% obtain an independent fair market value opinion. We note that the percentage of respondents seeking an independent fair market value opinion has doubled from last year's survey.



Insights on transaction activity. Respondents were split regarding the reported levels of acquisition activity in the ASC space, with 35% indicating that the market is declining, 35% indicating no change, and 30% indicating that activity has increased. And 35% of respondents reported that competition for ASC investment opportunities has increased, while 53% reported no change.

During 2009, 82% of respondents were actively searching for potential acquisitions. Forty percent of respondents performed due diligence on one to five ASCs, and 30% of respondents performed due diligence on more than 10 acquisition opportunities.

Despite due diligence efforts, 65% of respondents did not close a deal during 2009. Five of the respondents completed one to six transactions, and only one respondent closed more than seven transactions.

For 2010, 52% of respondents plan to purchase between one to two ASCs, 18% plan to purchase between three and six ASCs, and only one respondent reports plans to close more than seven deals.

Preferred Physician Specialties. The respondents indicated that the majority of surgical specialties for physician-investors were desirable, with strong preferences noted for orthopedics, ophthalmology, ENT, GI, and pain management. Cosmetic surgery was identified as the only undesirable surgical specialty in a surgery center.

Management Fees. Some 56% of respondents also maintain an equity interest in each of the ASCs they manage, and 73% of respondents indicate that management fees do not vary based on the manager's level of equity ownership in the center.

Jason Ruchaber, CFA, ASA is a principal in HealthCare Appraisers' Colorado office where he specializes in business valuation, litigation, and consulting assignments. He is a co-author of a chapter on fair market value in BVR's Guide to Healthcare Valuation, available at www.bvr-sources.com, and frequently writes and speaks on a variety of healthcare valuation topics.

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