



Valuing ASCs for Sale and For Syndication ASC and Hospital Compensation Issues

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Presentation Outline

- Valuation Framework
- Factors Affecting Value
- Valuation Approaches & Selection of Appropriate Approach
- Valuing Minority Interests – (sale to management company vs. sale of interest in connection with syndication)
- Valuation of Contractual and Service Arrangements
 - Commonly Observed Assignments/Engagements
 - Techniques
 - Importance of FMV Standard and Common Challenges

Valuation Framework

- What is the ownership interest being valued (e.g. controlling or non-controlling/minority)?
- What is the purpose of the valuation?
- What is the standard of value (typically Fair Market Value)?
- What is the premise of value?
 - Going concern
 - Liquidation
- Scope Limitations

Definition of FMV

- Per AICPA Statement on Standards for Valuation Services (SSVS No. 1):
 - “The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.”
- Stark II (CMS) definition:
 - “...the price that an asset would bring, as the result of *bona fide* bargaining between well-informed buyers and sellers who are not otherwise in a position to generate business for the other party...”

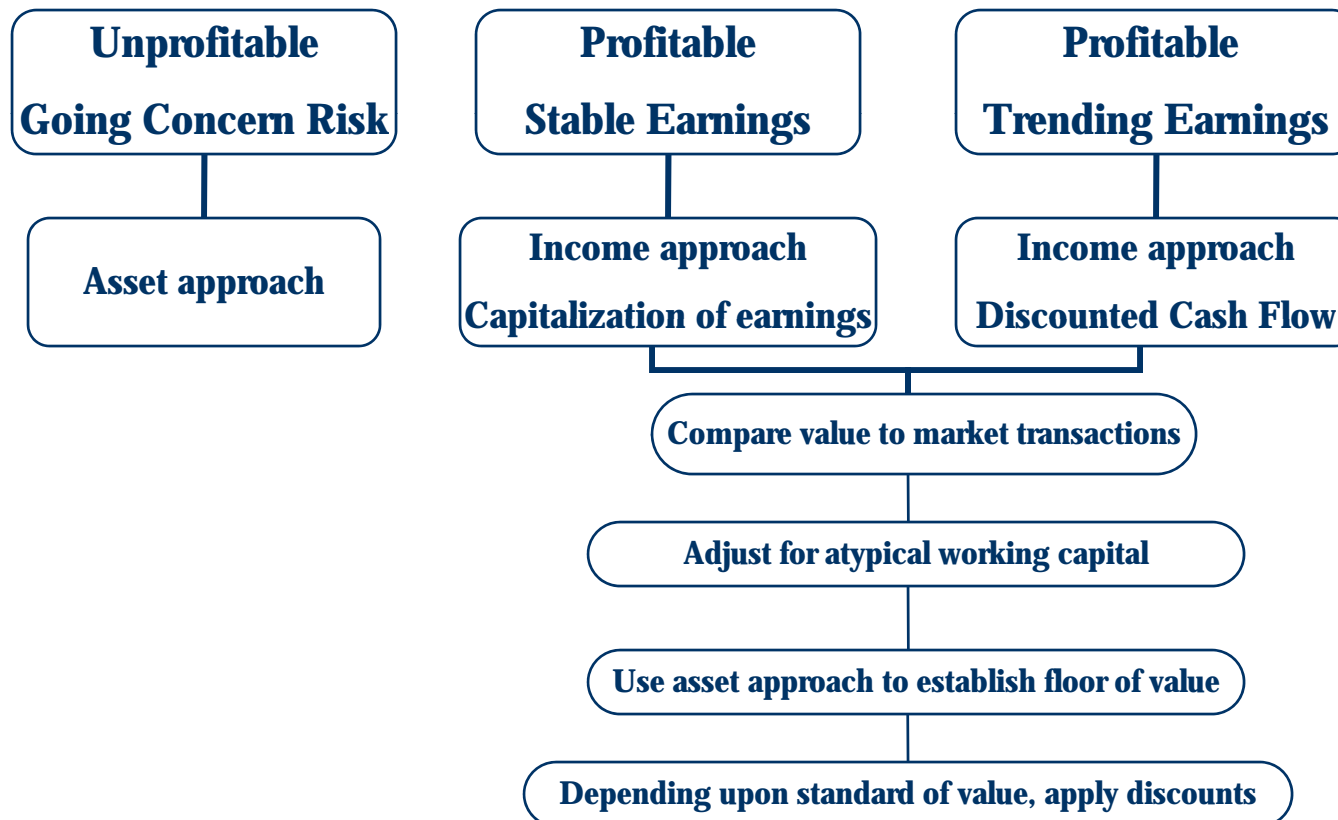
Primary Factors Affecting Value

- Case volume, mix, and reimbursement
- *Expected* changes in volume and reimbursement
- Diversification (e.g., # surgeons, specialties, payors)
- Size of MD ownership, appropriate non-competes, and ability to attract new investors
- Nature of payor contracts (or is there a substantial portion of “out of network” volume)
- Ability to generate sustainable cash flow from operations to fund on-going distributions (ASCs are dividend paying companies)
- Financial leverage, working capital, and on-going capital expenditure needs
- Opportunities for expansion (rooms and surgeons)
- Barriers to entry
- Competent management

Valuation Approaches

- **Asset Approach** – Restate book value of assets and liabilities to Fair Market Value; consider intangibles not otherwise recorded (e.g. work force, CON, etc.); establishes a “floor” of value; not typically relevant for profitable, going-concern entities
- **Market Approach** – Determine value of subject business based upon comparable public company multiples and/or sales of private businesses; while most “intuitive”, comparable data often difficult to identify. Use of market multiples (e.g. multiples of EBITDA) is typically difficult to utilize as primary valuation approach.
- **Income Approach** – Determine value of subject business based upon present value of a future economic benefit stream; one methodology, Discounted Cash Flow, is commonly utilized in BV

Selecting the Appropriate Approach



Valuing Minority Interests

- **Simply stated:** Interests providing absolute control (*e.g.*, greater than a 50% interest whereby key aspects of control are not diminished by governing documents or otherwise) are worth more than interests which do not have the same control rights
- Control granted by the governing documents. Examples include:
 - Capital calls
 - Admission of new investors
 - Borrowings greater than a certain amount
 - Entering into material contracts
 - Selling, merging, or liquidating the company
- Concept of “effective” control – physicians control with their feet → typical ASC ownership agreements are very friendly to the minority shareholder

Valuation of Contractual and Service Arrangements

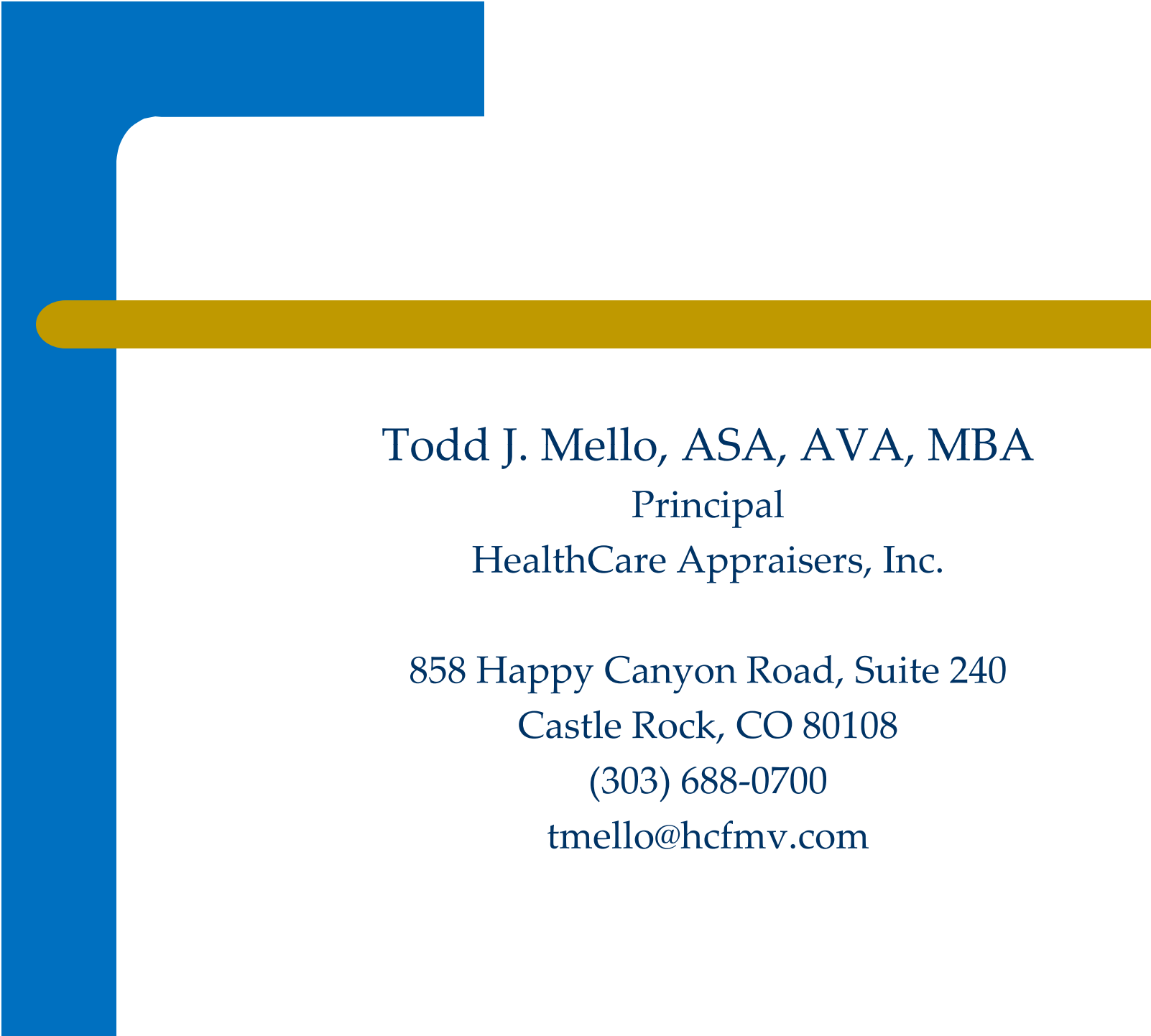
- Commonly observed engagements involving ASCs or Hospital Outpatient Surgery Departments (yes, FMV still applies)
 - Medical Directorships
 - Under Arrangements Transactions
 - Management and Service Arrangements
 - “Per Use” Equipment Leasing – have we seen the last of these?
 - Clinical Co-Management Arrangements: Managing the inpatient and outpatient surgical service line
 - Complexity of assignments has increased substantially over the years, as parties continue to explore ways to work together

Valuation of Contractual and Service Arrangements – Valuation Techniques

- **Cost Approach** – Cost plus margin; more conservative than “top down” approach, yet not without its own challenges and limitations (e.g. could be perceived to encourage inefficiency); involves application of profit margin which compensates management company for risks and responsibilities assumed; applications include under arrangements transaction and service agreements
- **Market Approach** – Similar to BV, involves identification of “comparable” transactions in the marketplace to determine FMV of the subject arrangement; limitations include wide variation in service scope, inability to glean sufficient details to proposed comparables and limitations on the use of market data for transactions which involve MD ownership (e.g. lithotripsy prior to recent pronouncements)
- **Income Approach** - Limited application, as Income Approach considers value of a future economic benefit stream

Valuation of Contractual and Service Arrangements

- Importance of FMV Standard and Common Challenges
 - Same definition as BV, though language specific to service arrangements
 - Most challenges arise from inappropriate reliance upon market data, inappropriate valuation techniques, and a misunderstanding of the applicable valuation standard
 - “Top Down” approaches in management, service, and under arrangement transaction (e.g. initial opinion based upon top down approach by another valuation firm)



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