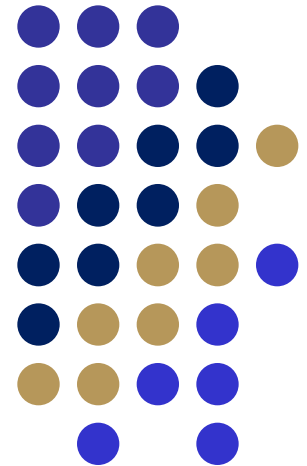


# Valuing ASCs and Recent Trends in ASC Transactions

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*Presented By*

*Todd J. Mello, ASA, CVA, MBA, Founding Partner*

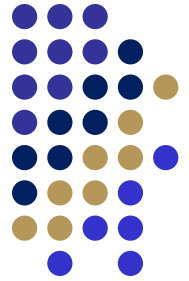


# Presentation Outline



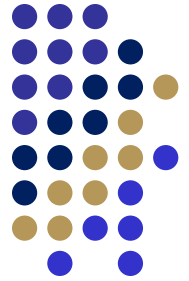
- Valuation 101: Approaches and Methods and other 411
- Do's and Don'ts
- Value Enhancers and Value Detractors
- Minority vs. Majority/Control
- History, Purpose and Limitations of the Survey
- What are Valuation Multiples?
- Reported Earnings Multiples
- Other Survey Observations (time permitting)

# Valuation 101



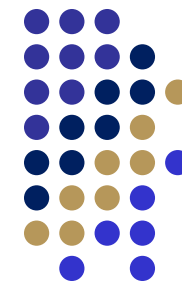
- Valuation is *forward* looking
- Why get a valuation?
- Standard of value in most healthcare transactions is *Fair Market Value*. The definition of **fair market value** in healthcare is slightly different than the standard valuation definition.
  - the price at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell ... *between well informed parties who are not otherwise in a position to generate business for the other party...*
  - *Implications of "hypothetical"*

# Valuation 101



- **Income Approach** – A general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that convert anticipated future economic benefits into a single present amount.
- Most common methods: Discounted Cash Flow Method and Capitalization of Earnings Method
- When and why?
- Example: next slide

# Valuation 101

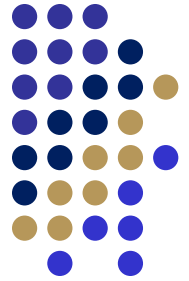


	Low Weighted Average Cost of Capital ("WACC")					Terminal Year
	2013	2014	2015	2016	2017	
Free Cash Flow	\$716,731	\$689,381	\$819,707	\$916,550	\$1,014,428	\$1,076,696
Partial Period Factor	0.25					
Discounting Periods (mid-point)	0.13	0.75	1.75	2.75	3.75	
Present Value Factor @ 14.0%	0.9838	0.9064	0.7951	0.6974	0.6118	
<b>Present Value of Cash Flow</b>	<b>134,776</b>	<b>624,855</b>	<b>651,749</b>	<b>639,202</b>	<b>620,627</b>	

Present Value of Projected Cash Flows	2,671,209	
Present Value of Terminal Value Calculation	<u>5,489,355</u>	
<b>Indicated Market Value of Total Capital</b>	<b><u>\$8,160,564</u></b>	
Less: Debt	(1,529,861)	Exhibit B.2
Plus: Surplus Cash	<u>601,000</u>	Exhibit C.5
<b>Indicated Market Value of Equity (Rounded)</b>	<b><u>\$7,232,000</u></b>	
(control, marketable)		

<b>Terminal Value Calculation</b>	
Free Cash Flow in Terminal Year	1,076,696
Divided by Capitalization Rate (WACC - LTGR of 2.00%)	<u>12.00%</u>
Equals Terminal Value in 2017	8,972,466
Present Value Factor for 2017	<u>0.6118</u>
Present Value of Terminal Value	<u>\$5,489,355</u>

# Valuation 101



- **Market Approach** – A general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.
- Most common methods: Guideline Publicly Traded Method and Comparative Transactions Method
- When and why?

# What are Valuation Multiples?



## The Meaning Behind the Numbers

### The Finance Definition (a.k.a. Appraiser speak)

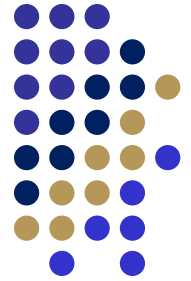
*“A mathematical expression of risk and growth, which when applied to a perpetually recurring earnings stream results in an indication of value”*

A multiple is mathematically expressed as follows:

$$\frac{1}{(K - g)}$$

- Where, (K) represents the rate of return (risk), and
- (G) represents the growth rate of the earnings stream

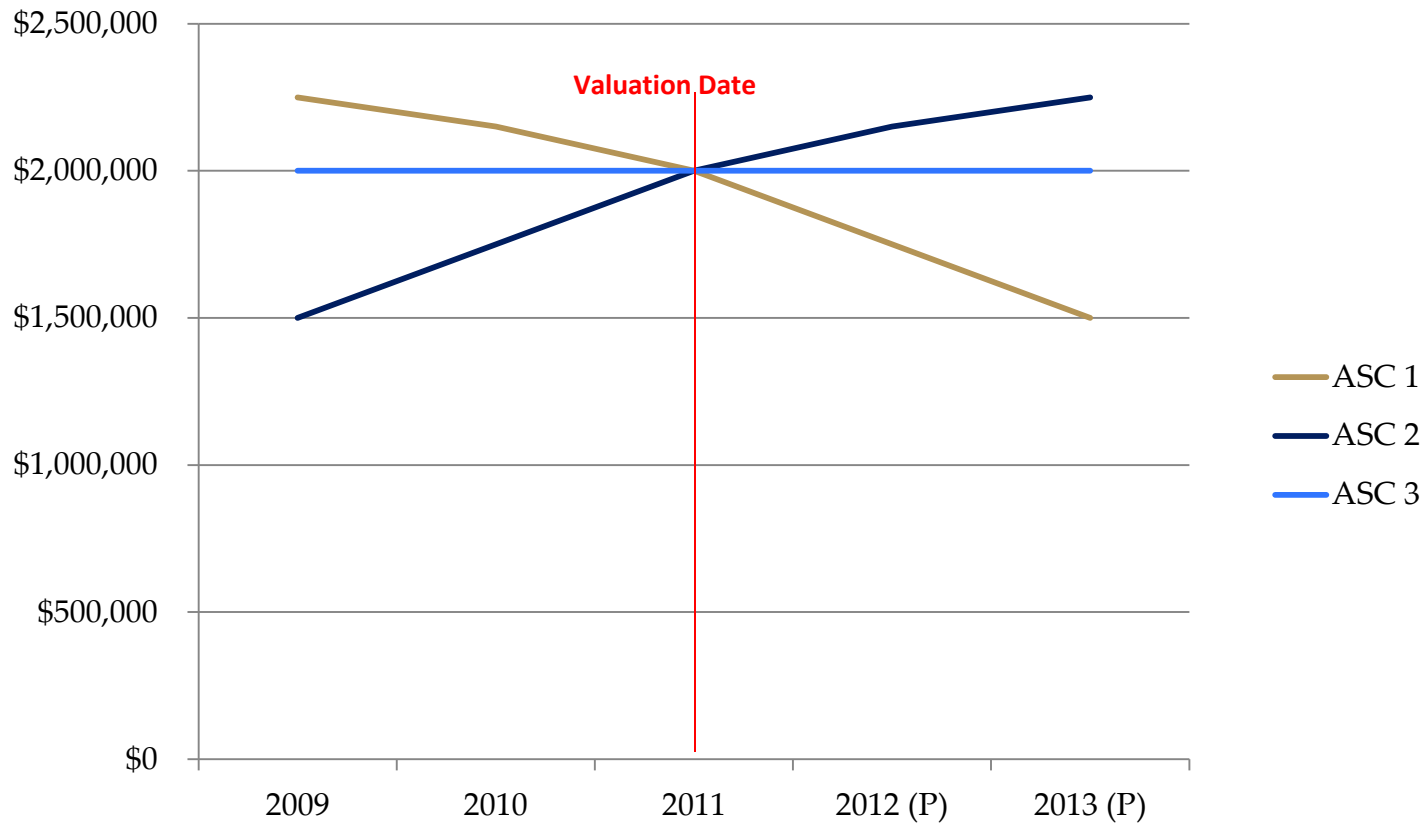
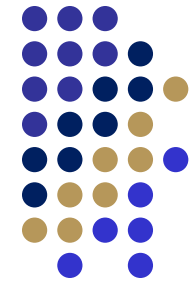
# What are Valuation Multiples?



	<u>Varying Growth</u>			<u>Varying Risk</u>		
	<u>Scen 1</u>	<u>Scen 2</u>	<u>Scen 3</u>	<u>Scen 1</u>	<u>Scen 2</u>	<u>Scen 3</u>
k	17.0%	17.0%	17.0%	17.0%	19.0%	22.0%
g	2.0%	3.0%	4.0%	2.0%	2.0%	2.0%
<b>Multiple</b>	<b>6.67</b>	<b>7.14</b>	<b>7.69</b>	<b>6.67</b>	<b>5.88</b>	<b>5.00</b>



# Three ASC's with \$2.0M EBITDA



# Valuation 101



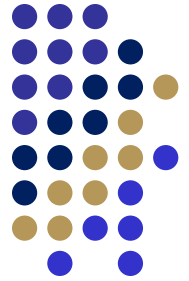
- **Asset or Cost Approach** – A general way of determining a value indication of a business, business ownership interest, or security using one or more methods based on the value of the assets net of liabilities.
- When and why?

# Minority vs. Majority Control



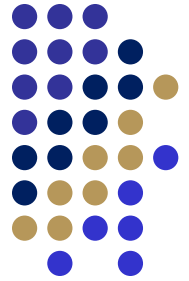
- Interests providing absolute control (*e.g.*, greater than a 50% interest) are worth more than interests which do not have the same control rights.
- Control granted by the governing documents. Examples include:
  - Major equipment purchases and investments
  - Debt signing authority
  - Admitting new owners
  - Granting physician privileges

# Do's and Don'ts



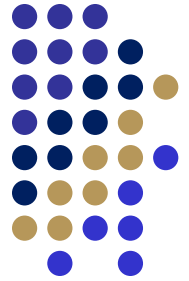
- In connection with a hospital's 100% acquisition of an ASC, can we consider overlaying hospital's fee structure onto valuation?
- If a new surgeon who has not done any (or a material amount) of cases is looking to buy in, should you include his/her cases in connection with valuing the interest?
- An ASC has done a poor job on collecting from Medicare; can we factor billing improvements into our valuation?
- An ASC experienced a one-time material adverse event in the most recently completed year. Can we ignore for purposes of valuation?
- An ASC is looking to buy out one investor at \$X and sell an interest to a new investor at 75% of \$X.
- Assume a hospital want to buy an ASC for purposes of shutting it down. Impact to value?
- Others?

# Value Enhancers/Detractors



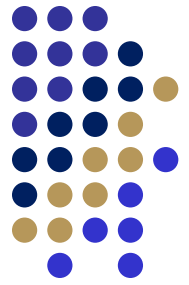
- Enhancers
  - Multispecialty (diversification of case types)
  - Diversification of surgeons – majority of cases not done by a single surgeon
  - High % of cases performed by owners who are “motivated” to continue working
  - An established history of continually seeking new owners
  - History and expectation of continued distributions
  - Growth in cases and earnings; reimbursement growth less certain
  - Little debt over time
  - Barriers to entry (e.g. CON)
  - Predominantly in network with Commercial payors
  - Others?

# Value Enhancers/Detractors



- Detractors (opposite of previous slide)
  - Reliance on single specialty (not always)
  - Lack of diversification of surgeons – majority of cases done by a single surgeon
  - High % of cases performed by non-owners
  - Little vision on extending center life cycle
  - Lack of distributions or lack of consistency in distributing cash flow
  - No growth or loss in volume, revenue
  - Excessive debt
  - Predominantly out-of-network with Commercial payors
  - Others?

# History, Purpose & Limitations of the Survey

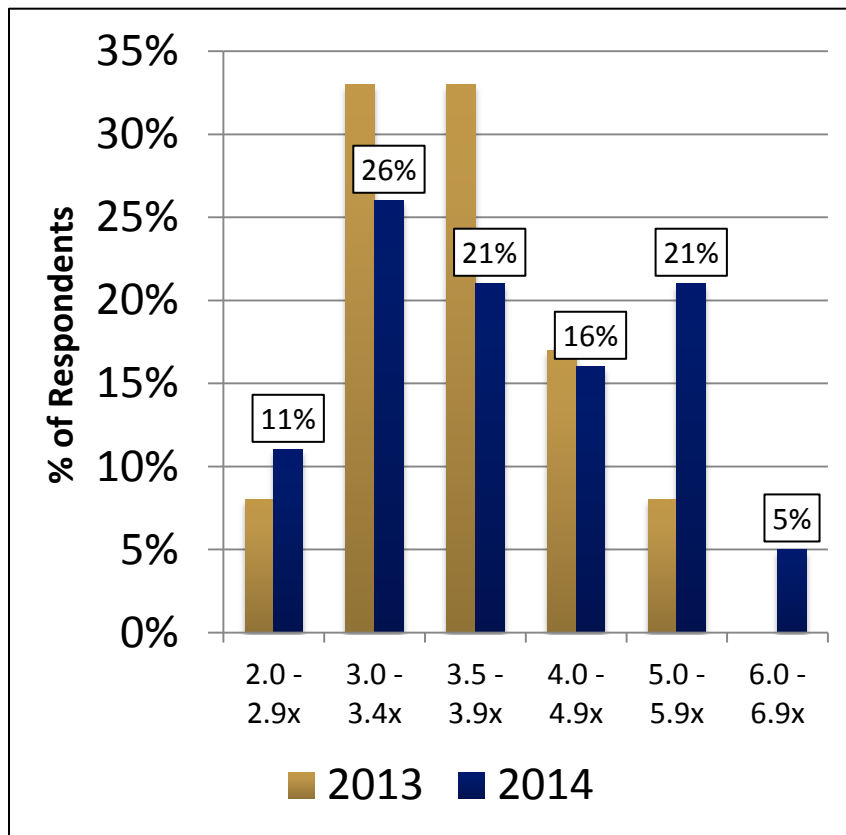


- Since 2003, HAI has published ten annual ASC surveys
- Why? To provide a centralized source of market intelligence on valuation trends within the ASC industry.
- 2014 was largest to date with 25 companies respondents
- *Disclaimer: Survey should not be used in lieu of a formal valuation.*

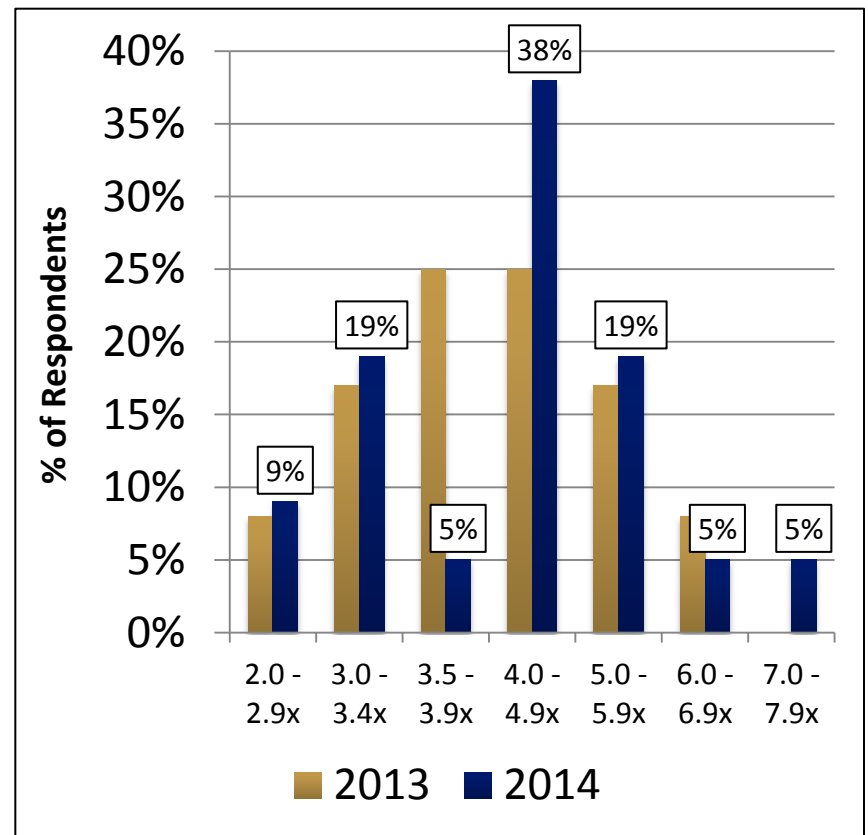
# Observed Multiples for Minority Interests



## Single-Specialty Centers

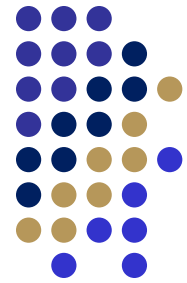


## Multi-Specialty Centers

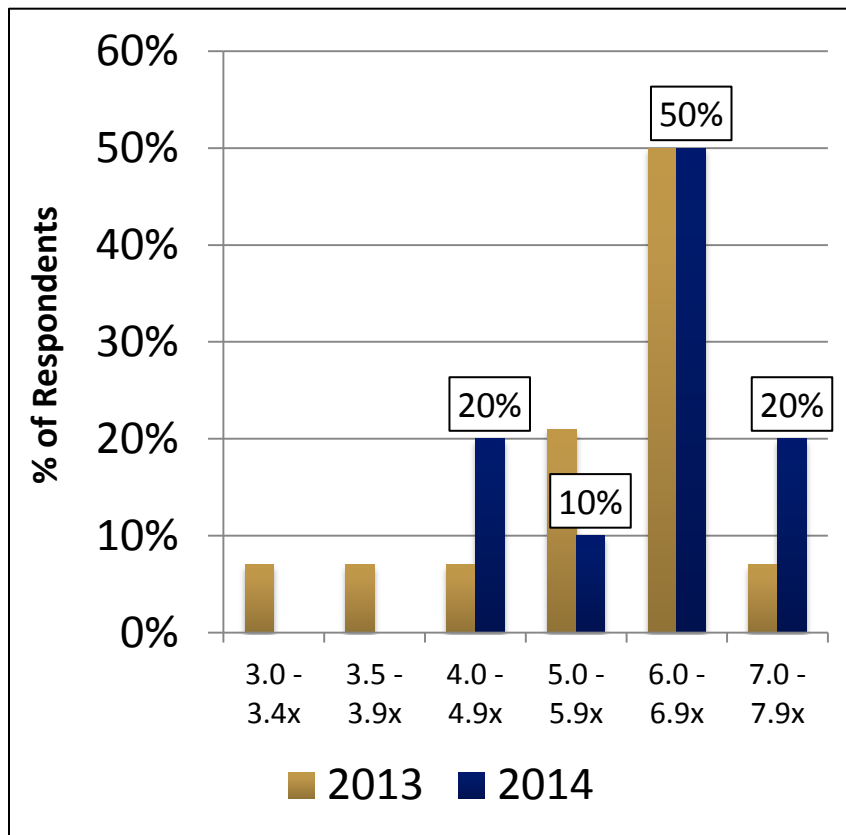




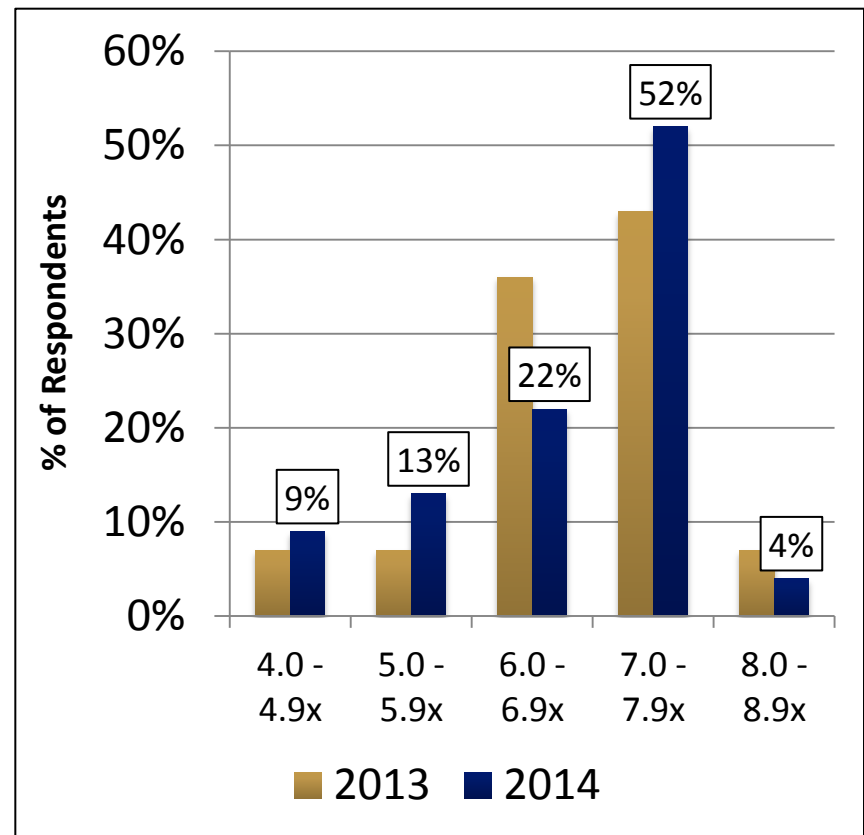
# Observed Multiples for Controlling Interests



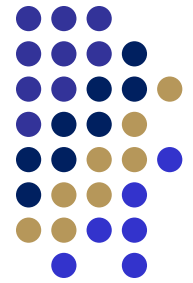
## Single-Specialty Centers



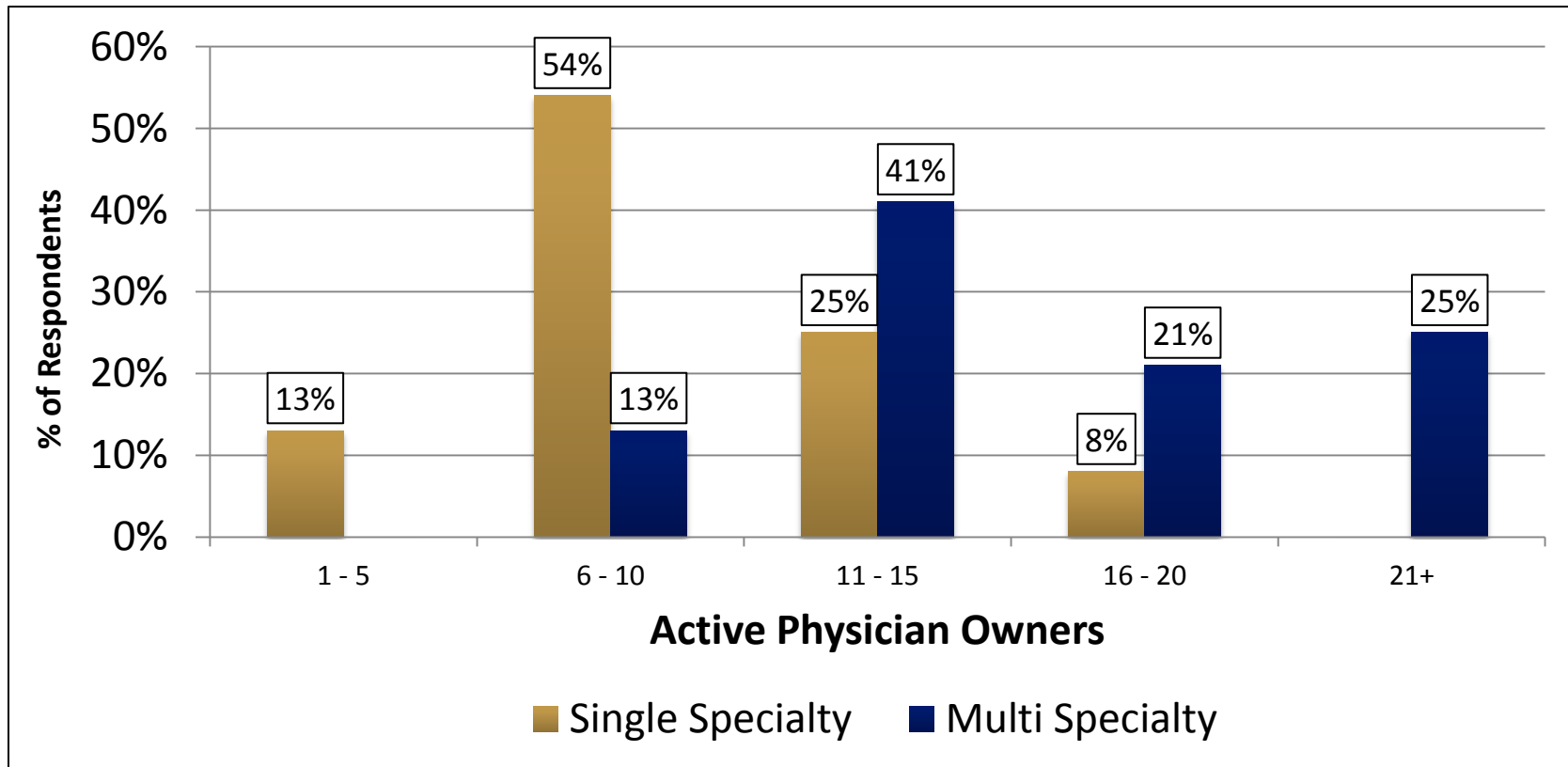
## Multi-Specialty Centers



# Buyer Expectations



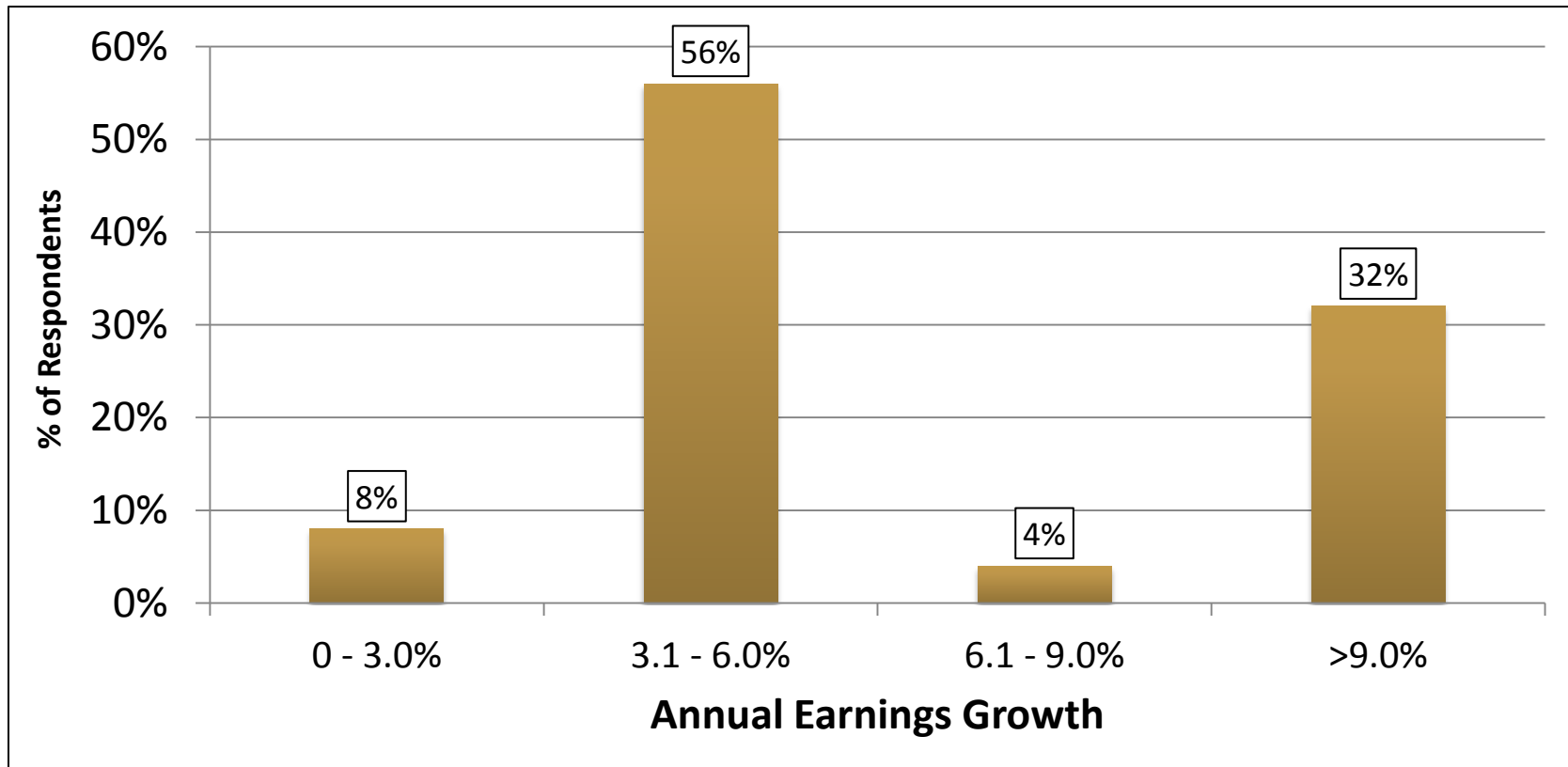
## Preferred Number of Active Physician Owners



# Buyer Expectations



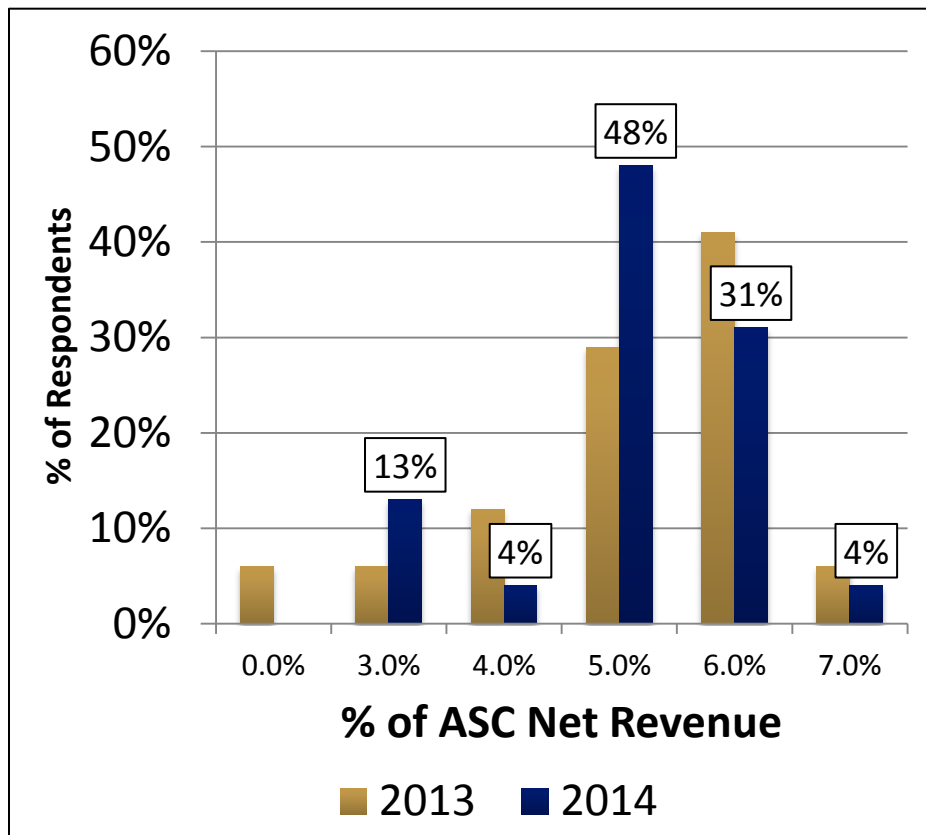
## Initial Earnings Growth Expectations Post-Transaction



# ASC Management Services

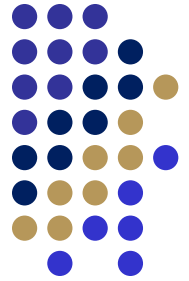


## ASC Management Fee Rates



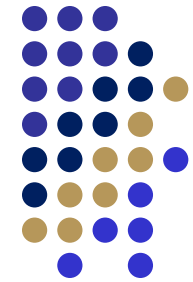
- Competitive trends
- 36% have *minimum* management fees
  - 60% of those report minimum fee of \$100K to \$200K
- 48% have sliding scale management fees whereby fees decline after a predetermined threshold
  - 58% of those report declining management fee rates between \$5.0M and \$9.9M in ASC net revenues

# ASC Management Services

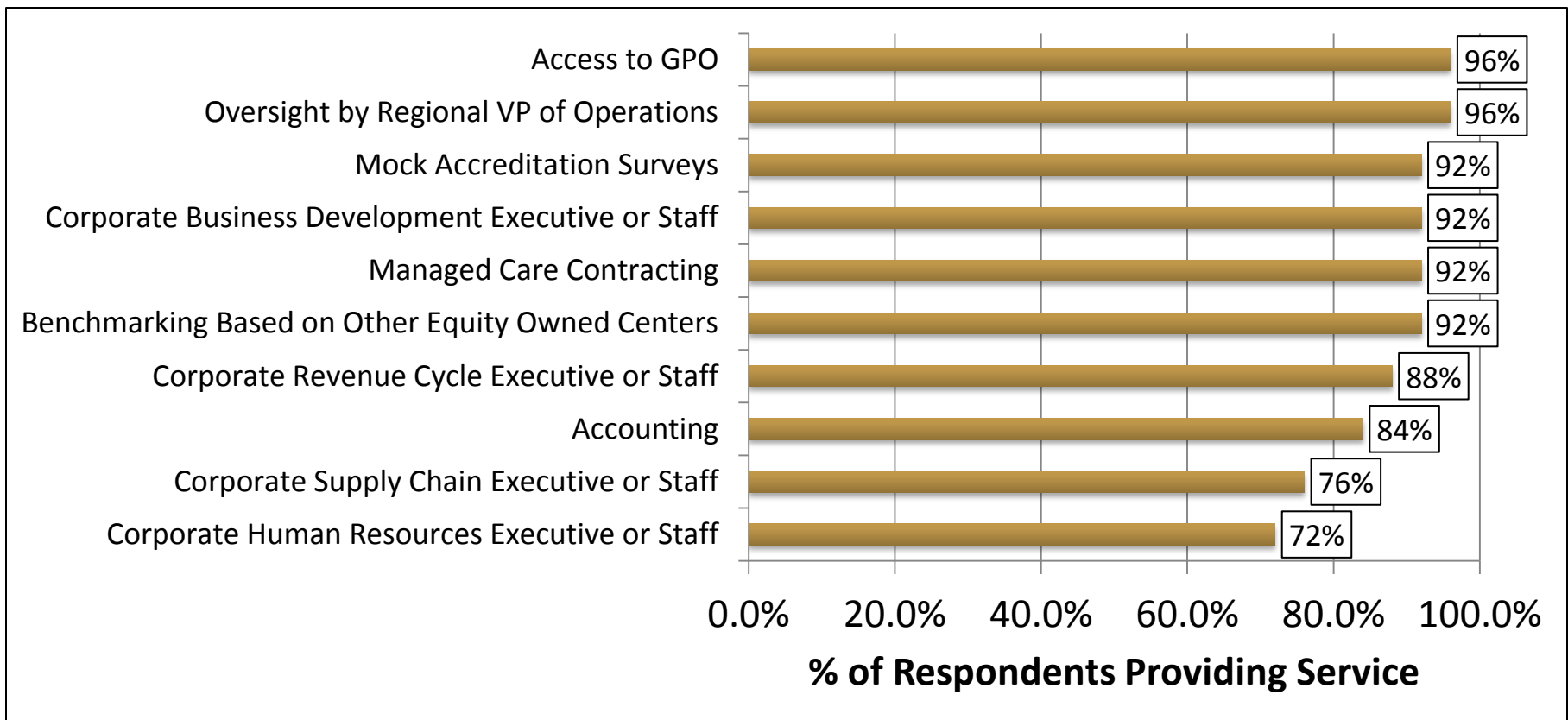


- 80% report no management arrangements with fees at risk for performance
  - 76% reported no at risk arrangements in 2013
- 64% report holding ownership in all managed ASCs
  - Over half of those who manage, or plan to manage, non-owned ASCs indicate increasing management fees 1% to 3% or more for service-only ASCs

# ASC Management Services



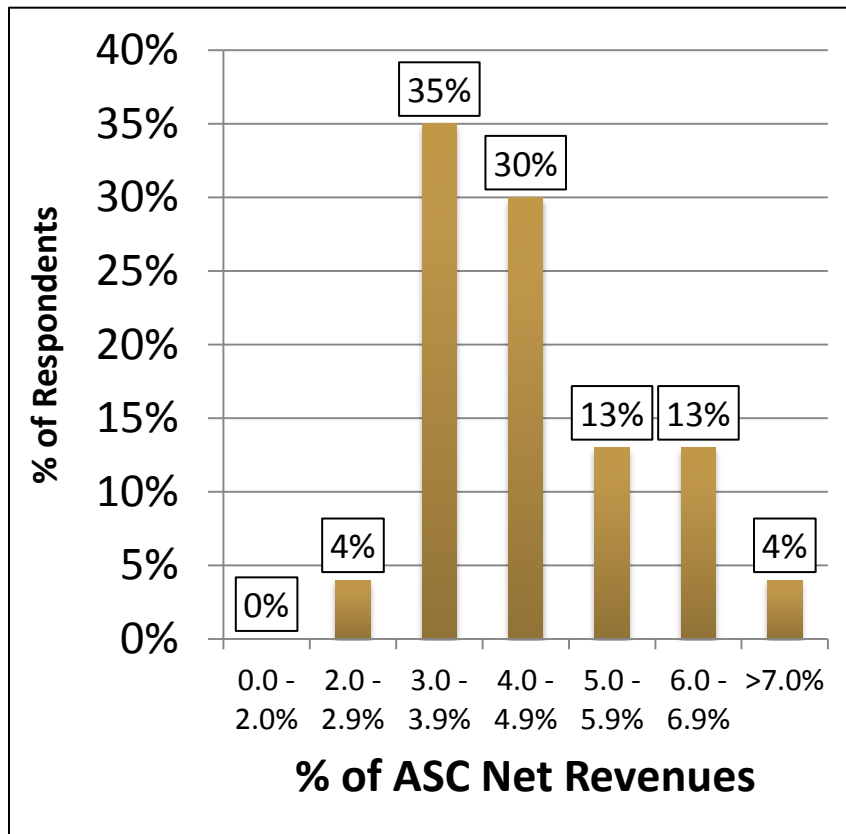
## Services Often or Always Provided as Part of ASC Management Fee

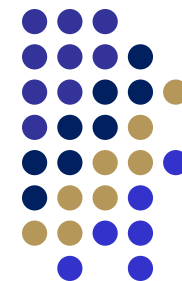


# ASC Billing



## ASC Billing Fees





# QUESTIONS?



# Valuing ASCs and Recent Trends in ASC Transactions

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