Key Valuation Topics Impacting ASCs

Presented By

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Presentation Outline

- Valuation 101: Approaches and Methods and other 411
  - What are Valuation Multiples?
- Minority vs. Majority Control
- Do's and Don'ts
- Value Enhancers and Value Detractors
- Reported Earnings Multiples
- Recent "Unique" Transaction Observations

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

- **<u>Income Approach</u>** – 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") 2013	2014	2015	2016	2017	Terminal Year
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	
Present Value of Cash Flow	**134,776**	**624,855**	**651,749**	**639,202**	**620,627**	

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

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

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 <u>perpetually recurring</u> earnings stream results in an indication of value"

A multiple is mathematically expressed as follows:

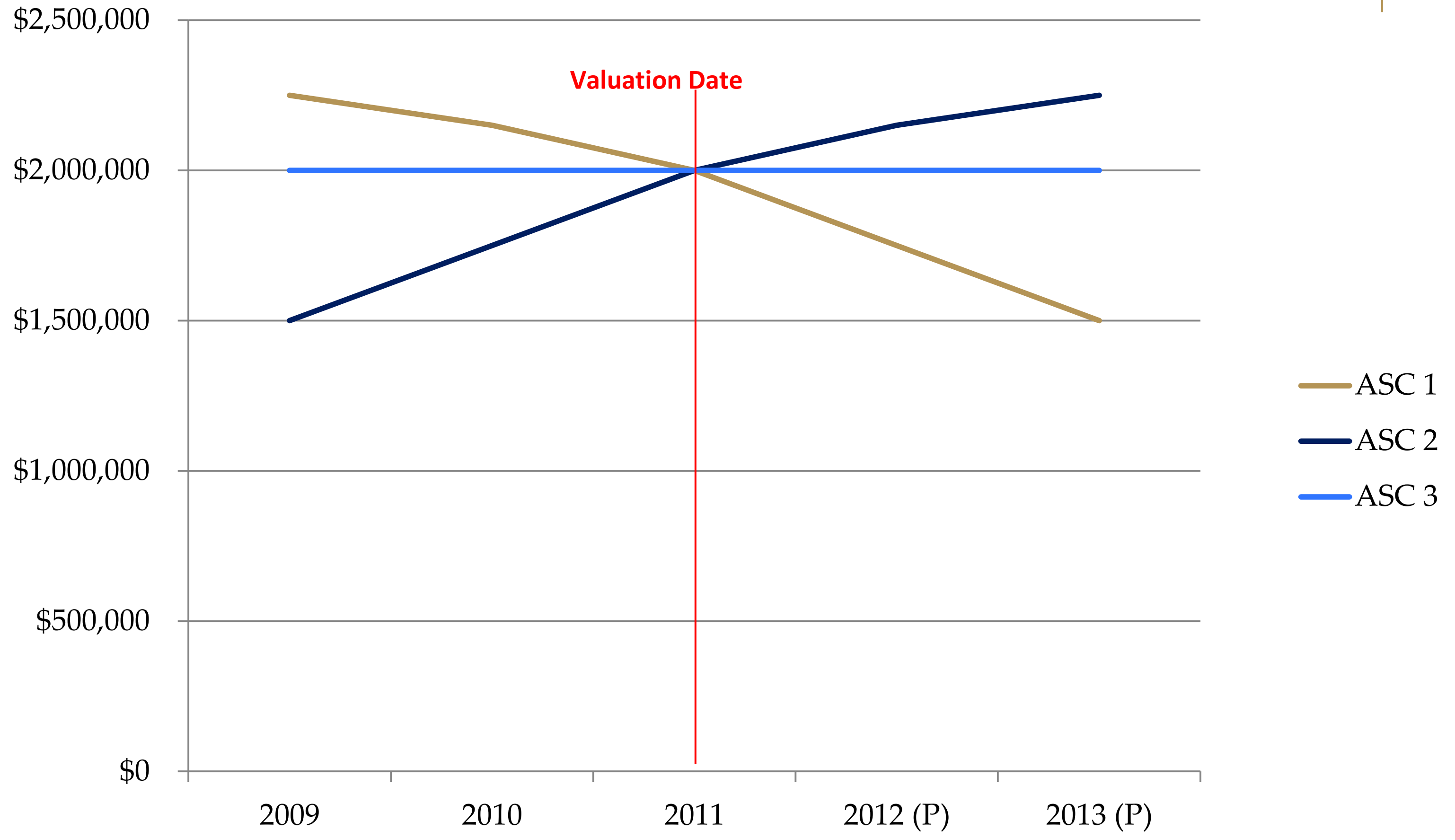
$$\frac{1}{(K-g)}$$

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

What are Valuation Multiples?

	Varying Growth			Varying Risk		
	Scen 1	Scen 2	Scen 3	Scen 1	Scen 2	Scen 3
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%
Multiple	6.67	7.14	7.69	6.67	5.88	5.00

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 but 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?

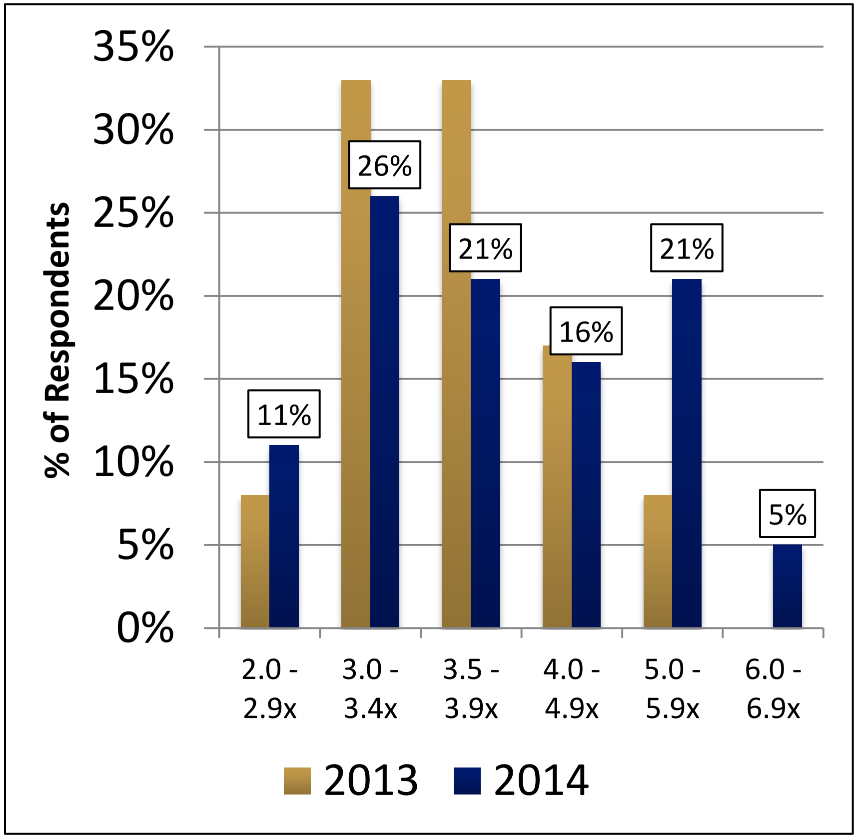
Value Enhancers/Detractors

Detractors (opposite of previous slide)

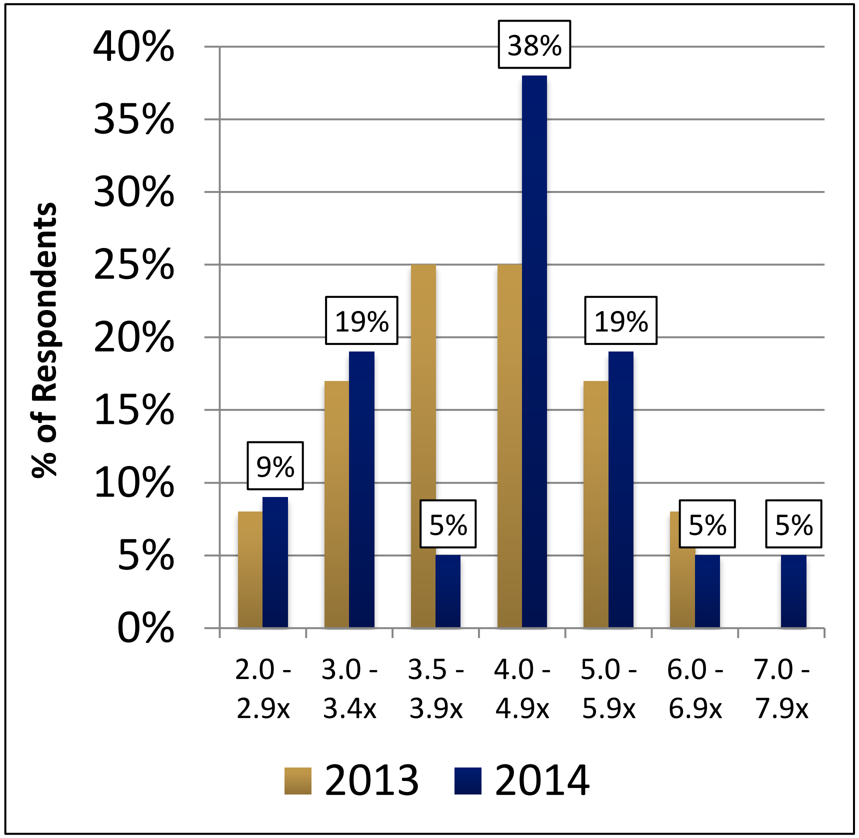
- Reliance on single specialty (not always)
- Lack of diversification of surgeons – majority of cases done by a single surgeon
- High % of cases performed by non-owners
- Little vision on extending center life cycle
- Lack of distributions or lack of consistency in distributing cash flow
- No growth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

Observed Multiples for Minority Interests

Single-Specialty Centers

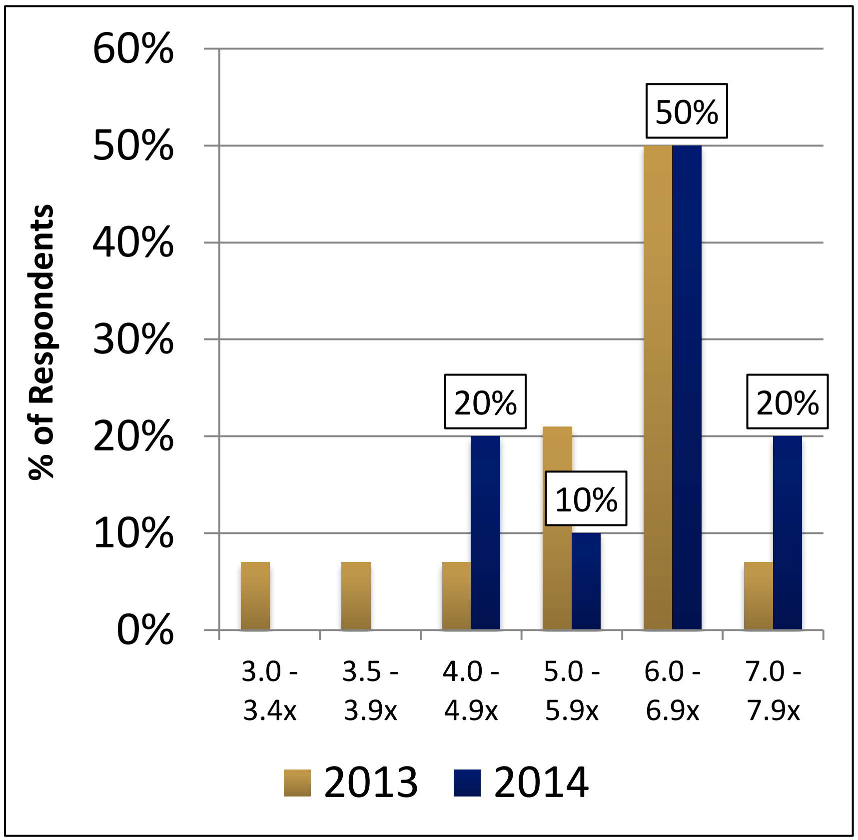


Multi-Specialty Centers

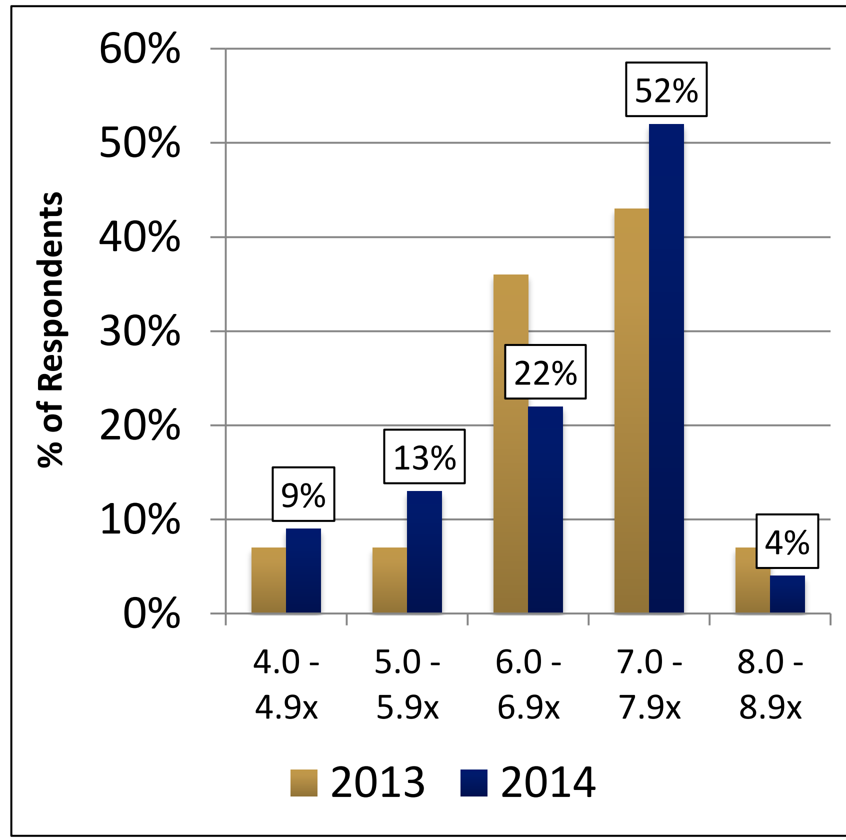


Observed Multiples for Controlling Interests

Single-Specialty Centers



Multi-Specialty Centers



Recent "Unique" Transaction Observations

- ASCs that do not have profits, but still have value?
  - Valuing CONs
  - "Most Favored Nation" clauses in Payor Contracts

- ASCs holding significant Debt
  - How to get to determine what the equity is worth for syndication.

Recent "Unique" Transaction Observations

- HOPDs that are being converted to ASCs
  - What is the correct income stream?
- ASCs operating as In-Office Ancillaries
  - How are these compared to ASCs in a state that has CON protection?

Recent "Unique" Transaction Observations

- ASCs with a complex capital structure
  - Certain physicians/non-physicians receiving preferred shares.

QUESTIONS?

Key Valuation Topics Impacting ASCs

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