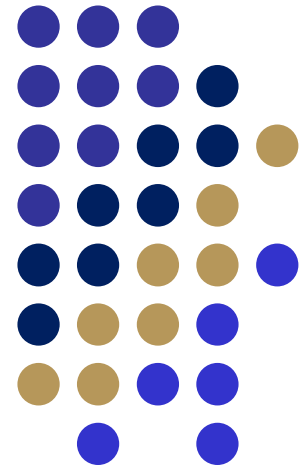
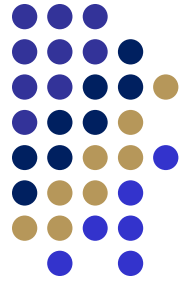


Current Valuation Trends: Physician-Owned Hospitals

Nicholas J. Janiga, Manager
David M. Walline, Senior Associate



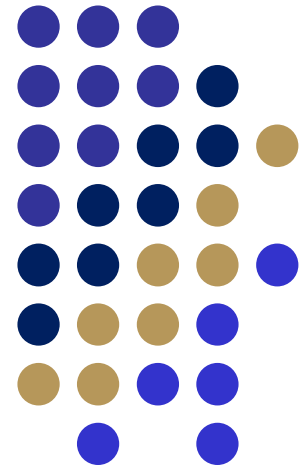
Financial Disclosure



Other than being an employee of HealthCare Appraisers, Inc., we have no financial relationships to disclose relating to this presentation or conference.

1

Valuation Overview



Valuation Overview

Standard of Value

Fair Market Value

Investment Value

Premise of Value

Going-concern

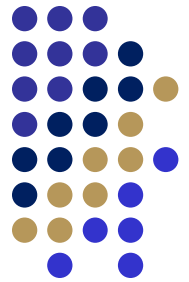
Assemblage of Assets

Valuation Approaches

Income

Market

Cost



Income Approach



Discounting future benefit(s) back to present value

Single Period (Capitalization of Earnings Method)

VS.

Multi Period (Discounted Cash Flow Method)

Market Approach

Guideline Public Company Method (“GPCM”)



Value per relative unit of revenue, profitability, cash flow

Comparability and Standard of Value

Price-to-Earnings

Invested Capital-to-Revenue

Invested Capital-to-EBITDA

Market Approach Continued...



Comparable Transaction Method (“CTM”)

Value per relative unit of revenue, profitability, cash flow

Comparability, Standard of Value & Data limitations

Invested Capital-to-Revenue

Invested Capital-to-EBITDA

Cost Approach



Net Asset Method

Value through direct examination of the underlying assets of a business; economic principal of substitution

De Novo

Holding Companies

Distressed Companies

Asset Intensive Companies with Marginal Profitability

Secondary Discounts



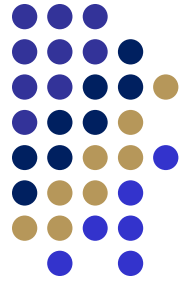
Discount for Lack of Control (DLOC)

Discount for Lack of Marketability (DLOM)

Discount for Lack of Liquidity (DLOL)

Discount for Lack of Voting Rights

Transaction Structure



Stock vs. Asset

Levels of Value (Example on next slide)

Equity vs. Market Value of Invested Capital
(Example on following slide)

Transaction Structure



Levels of Value

Synergistic, Strategic, or Investment Value

Premium for Synergies



Value of Marketable, Control Shares

Control Premium



Discount for Lack of Control



"Publicly Traded Equivalent Value" or "Stock Market Value" of Minority Shares if Freely Traded

Discount for Lack of Liquidity



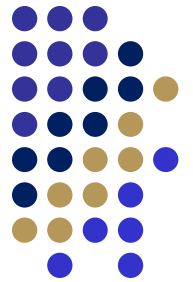
Value of Restricted Stock of Public Company

Discount for Lack of Marketability



Value of Non-Marketable, Minority Shares

Transaction Structure



Equity Vs. Market Value of Invested Capital	
Assets	Liabilities and Equity
Net Working Capital	Interest Bearing Debt
Fixed Assets	
Other Assets	Stockholders' Equity
Intangible Assets	

Invested Capital

FMV Pitfalls



Misapplied and Unreliable FMV Analyses:

Valid over a specified range of outcomes, conditional, governing assumptions, etc.

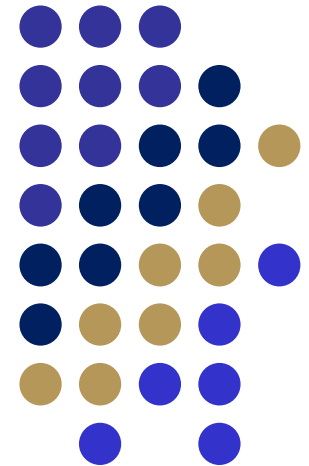
Assumed terms and provisions do not match the agreement

Lack of sufficient knowledge of certain subject matters

“Shelf Life” of the appraisal and whether any post-closing obligations (such as a true-up) are necessary

What Impacts Value of Physician-Owned Hospitals

Recent White Paper on Valuation of Physician-Owned Hospitals



Growth



Limited Growth through Expansion (§6001 of PPACA)

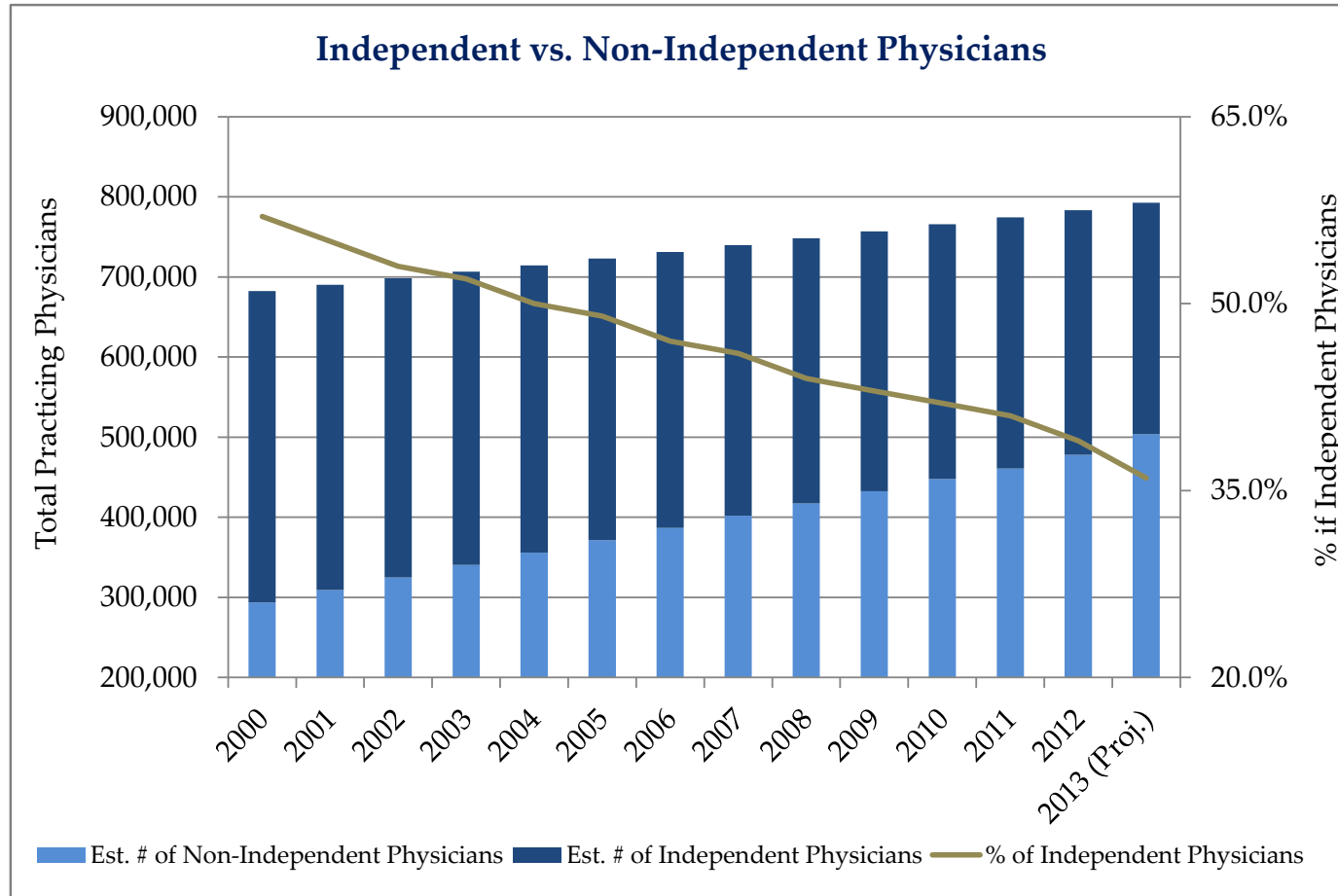
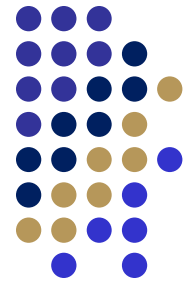
Select Service Line Expansion

Physician/Specialty Syndication

Physician Availability (Illustrated on following slide)

Higher growth leads to higher valuation multiples, *ceteris paribus*

Growth Continued...



Growth Continued...



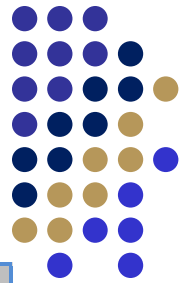
Sequestration – Budget Control Act of 2011

Recent MedPAC Recommendation (example on next slide)

Specialties / Investments Going Forward

Declining Reimbursement and Profitability lead to Lower Valuation Multiples, *ceteris paribus*

MedPAC "Site" Neutral Example



Difference in Payments for Level II Nerve Injections

Current Payment Rates	<u>Payment</u> <u>Amount</u>
Service in Free Standing ASC - CPT Code 64633 Payment	\$317
Service in Hospital Outpatient Department - APC 0207 Payment	\$566
<i>Premium Over Free Standing ASC</i>	78%

"Site-Neutral" Policy	<u>Payment</u> <u>Amount</u>
Service in Hospital Outpatient Department - APC 0207 Payment	\$317
<i>Implied Discount From Current Payment Rates</i>	-44%

Source: ASCA 2013 Medicare Rate Calculator and CMS' 2013 HOPD Final Payment Rates

Efficient Operations



OR Turnover

Additional Staff

Additional Hours

Increased Return on Assets (“ROA”) and Profitability leads to Higher Valuation Multiples, *ceteris paribus*

Corporate Partners



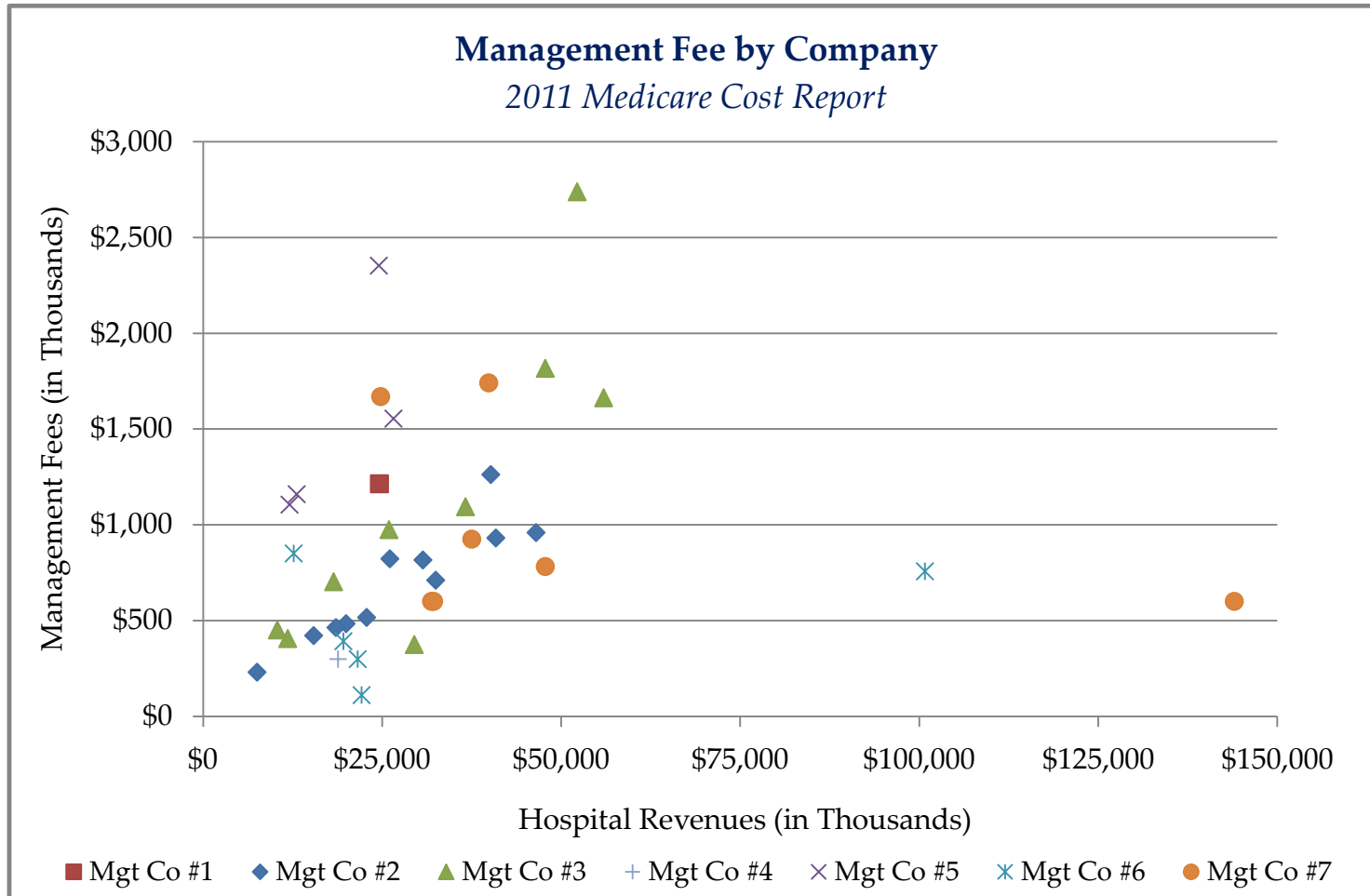
Management Fee

In-house Billing, Collecting, etc.

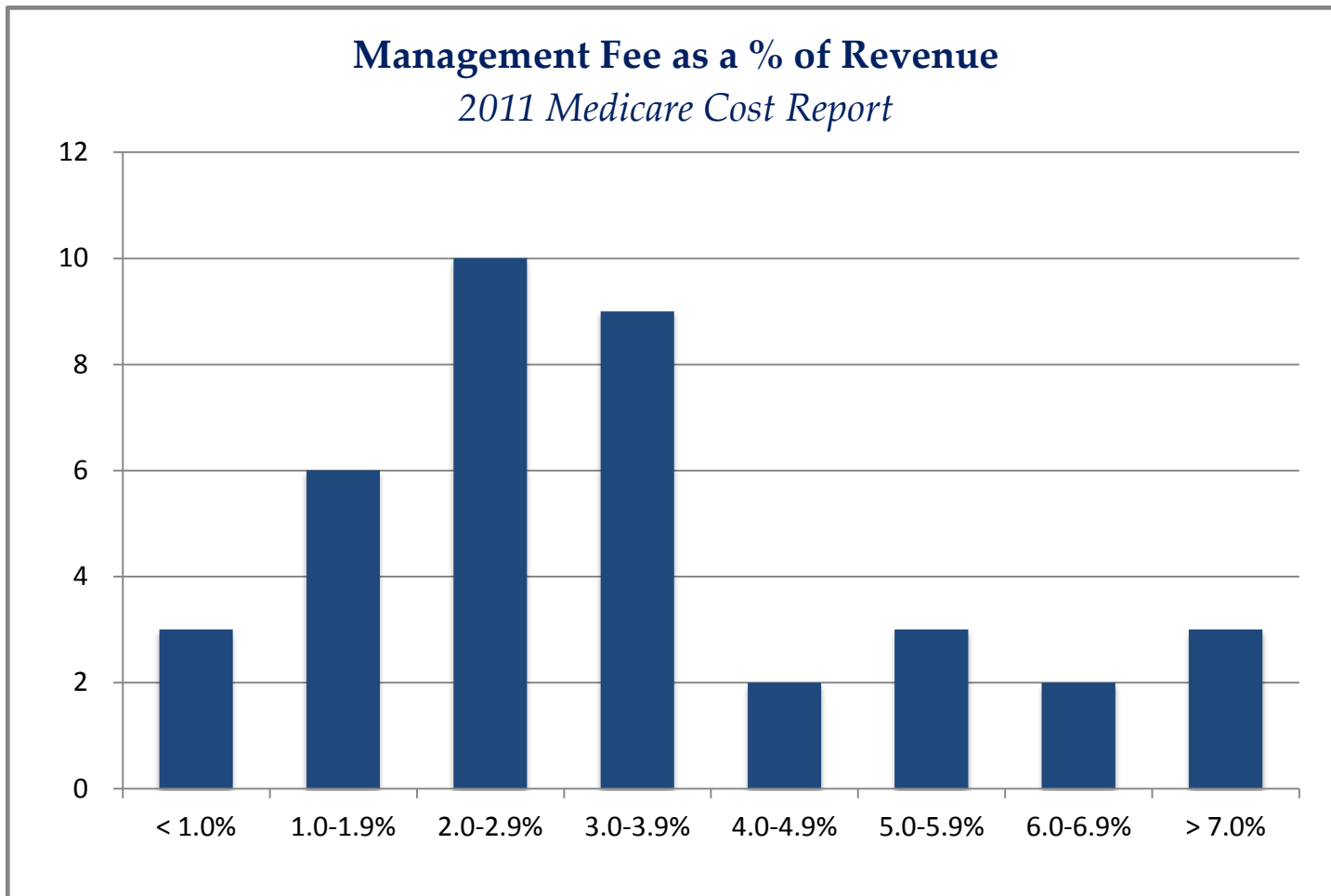
Buyout of Management Agreement

New Corporate Partners

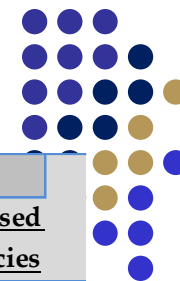
Management Fee



Management Fee Continued...



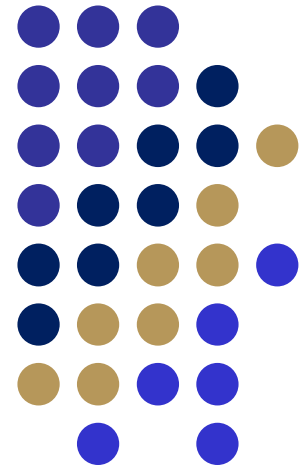
Valuation Impact Example



Summary Income Statement	Base Year	Scenarios			
		Syndication	Payor Contracts	Mgt. Svcs In-House	Increased Efficiencies
Case Volume	20,000	21,000	20,000	20,000	20,000
Reimbursement per Case	\$ 1,700	\$ 1,700	\$ 1,750	\$ 1,700	\$ 1,700
Net Revenue	\$34,000,000	\$35,700,000	\$35,000,000	\$34,000,000	\$34,000,000
Management Fee	1,360,000	1,428,000	1,400,000	-	1,360,000
Internal Contracting, Billing, and Collecting	0	0	0	680,000	0
Other Operating Expenses	24,480,000	24,888,000	24,480,000	24,480,000	23,460,000
Total Operating Costs	25,840,000	26,316,000	25,880,000	25,160,000	24,820,000
EBITDA	8,160,000	9,384,000	9,120,000	8,840,000	9,180,000
Depreciation and Amortization	1,360,000	1,360,000	1,360,000	1,360,000	1,360,000
EBIT	6,800,000	8,024,000	7,760,000	7,480,000	7,820,000
Income Taxes @ 40.0%	2,720,000	3,209,600	3,104,000	2,992,000	3,128,000
Net Operating Income After Tax	4,080,000	4,814,400	4,656,000	4,488,000	4,692,000
Adjustments to Determine Cash Flow					
Plus: Depreciation and Amortization	500,000	500,000	500,000	500,000	500,000
Less: Capital Expenditures	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)
(Increases)/Decreases in Working Capital	(51,000)	(54,000)	(53,000)	(51,000)	(51,000)
Free Cash Flow	4,029,000	4,760,400	4,603,000	4,437,000	4,641,000
Divided by Capitalization Rate [(wacc-g) / (1+g)	12.0%	12.0%	12.0%	12.0%	12.0%
Indicated Market Value of Total Capital	\$33,575,000	\$39,670,000	\$38,358,333	\$36,975,000	\$38,675,000
<i>Change in Value Relative to Base Year</i>	<i>N/A</i>	<i>18.2%</i>	<i>14.2%</i>	<i>10.1%</i>	<i>15.2%</i>

3

Alternatives



Alternatives



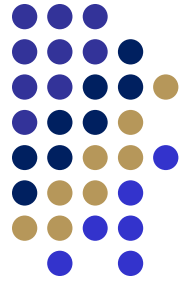
Expanding Patients' Access to Quality Care Act of 2013
Bi-partisan, but limited

Physician-Owned Hospital, not accepting Government Payors
Inherent weaknesses given PPACA

Public Company

Alternative Structure

Alternative Structure



Unsecured Debt, Paid-In-Kind Interest, Convertible (§6001 PPACA)

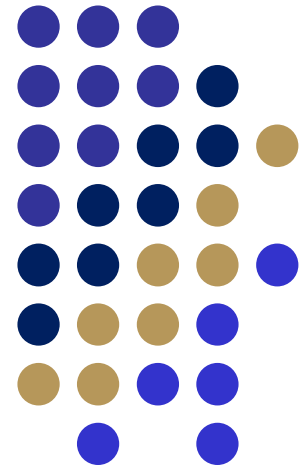
Management Agreement

Real Estate and/or Equipment Holding Company

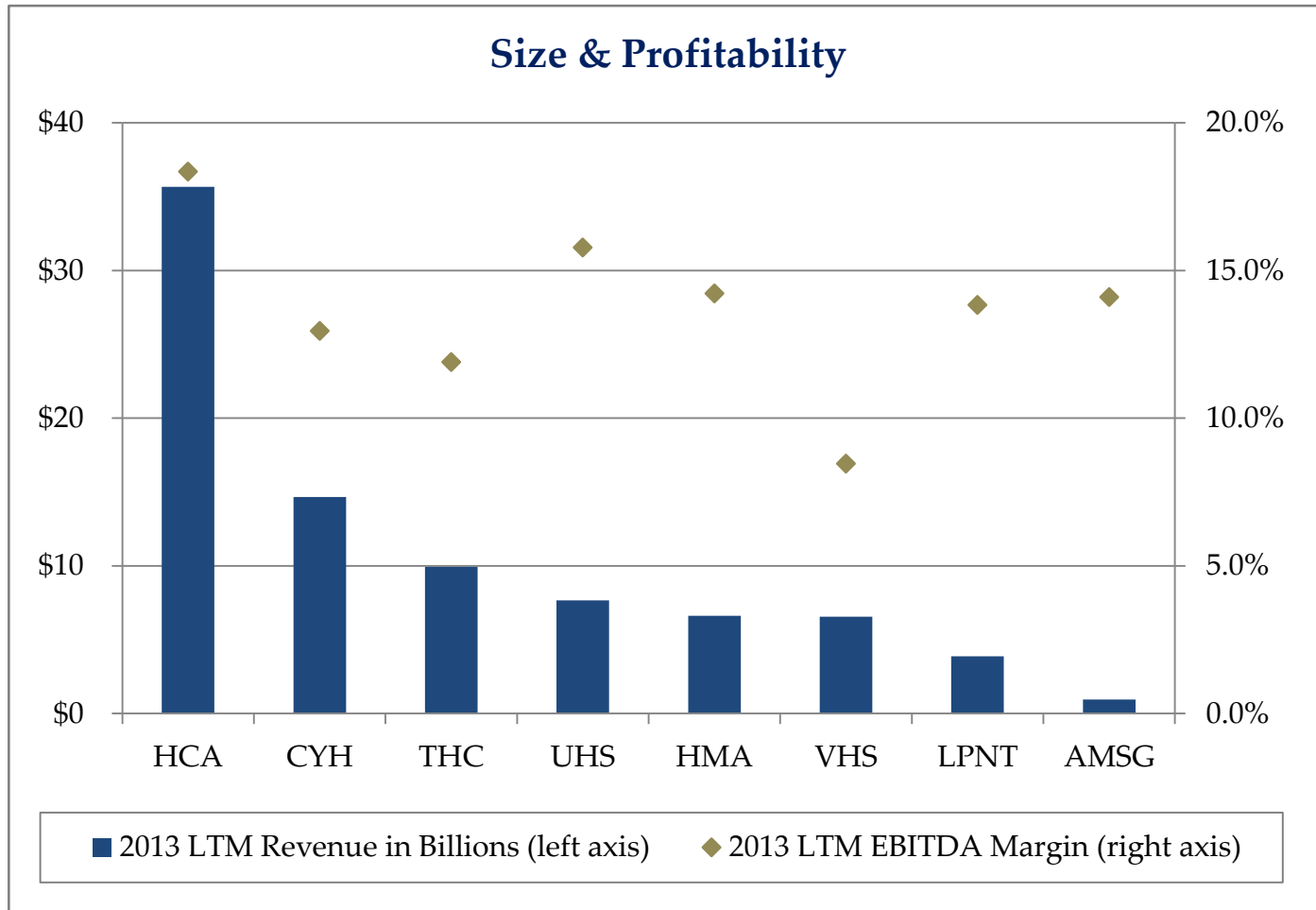
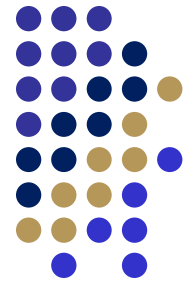
[White Paper Further Describing Alternative Structures](#)

4

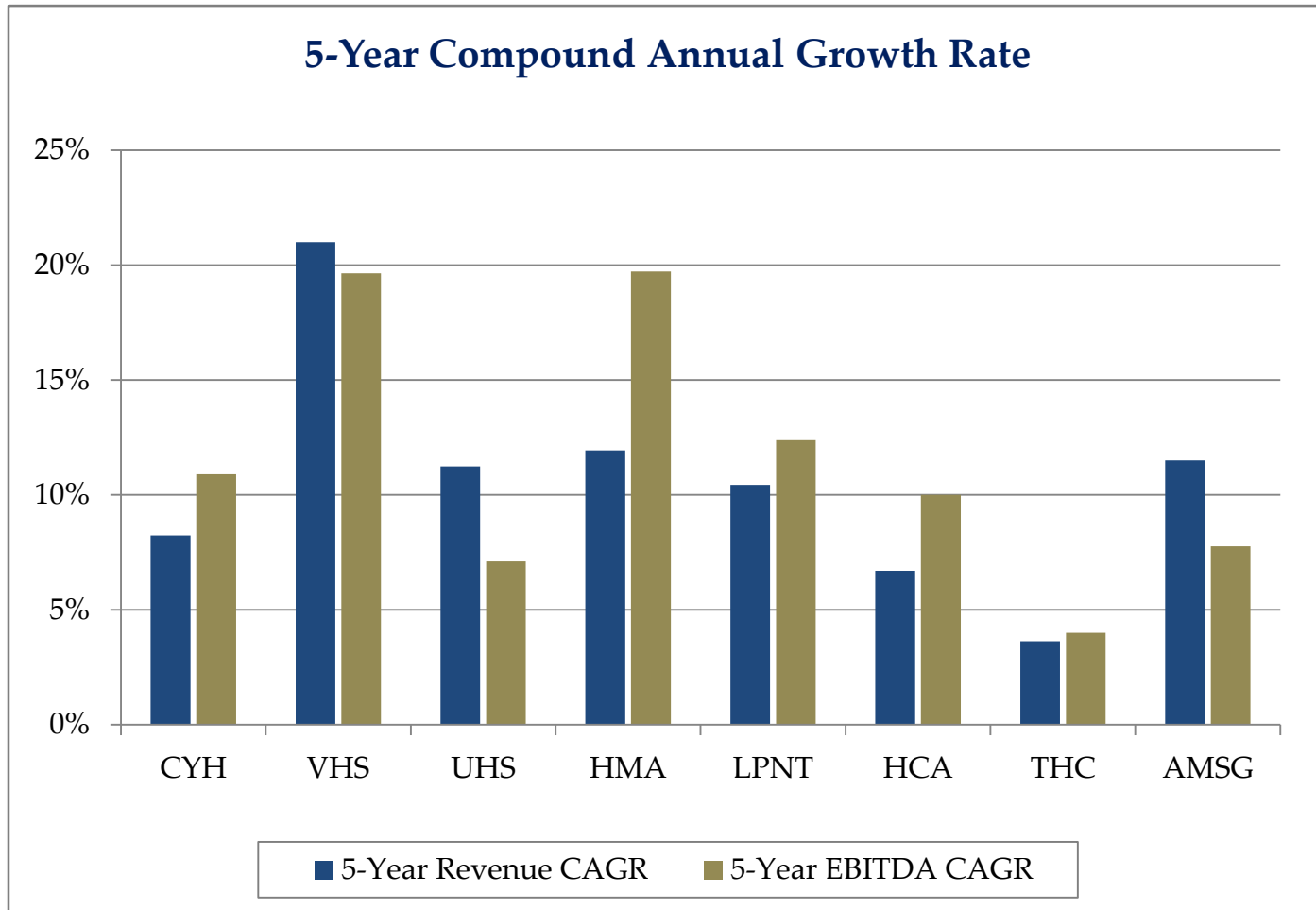
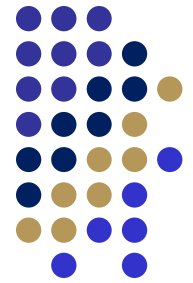
*Guideline Public Company Valuation
Multiples*



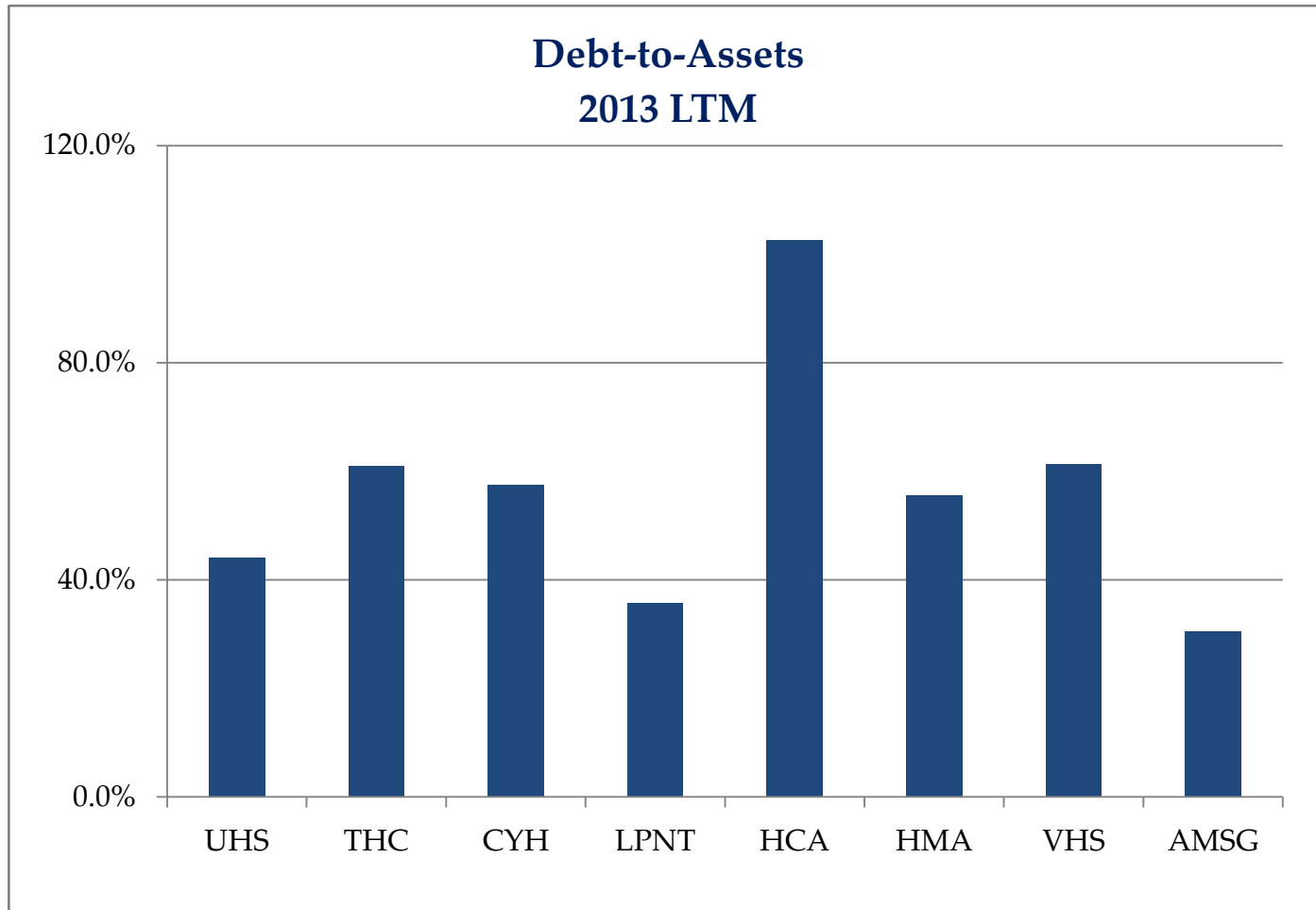
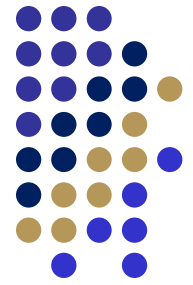
Public Company Multiples



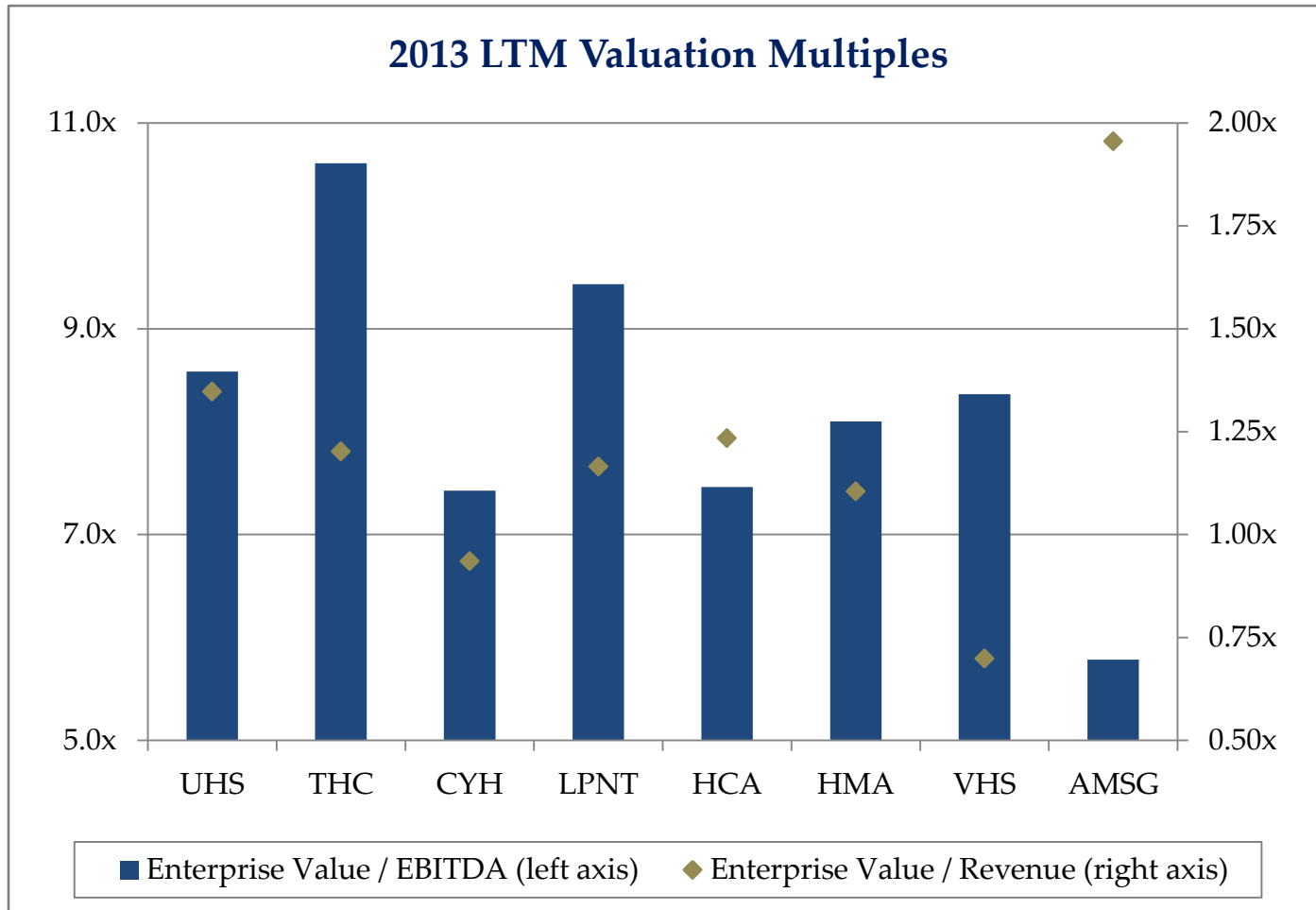
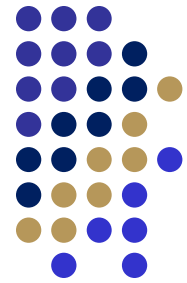
Public Company Multiples



Public Company Multiples

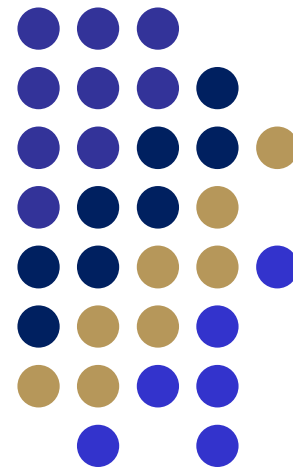


Public Company Multiples



5

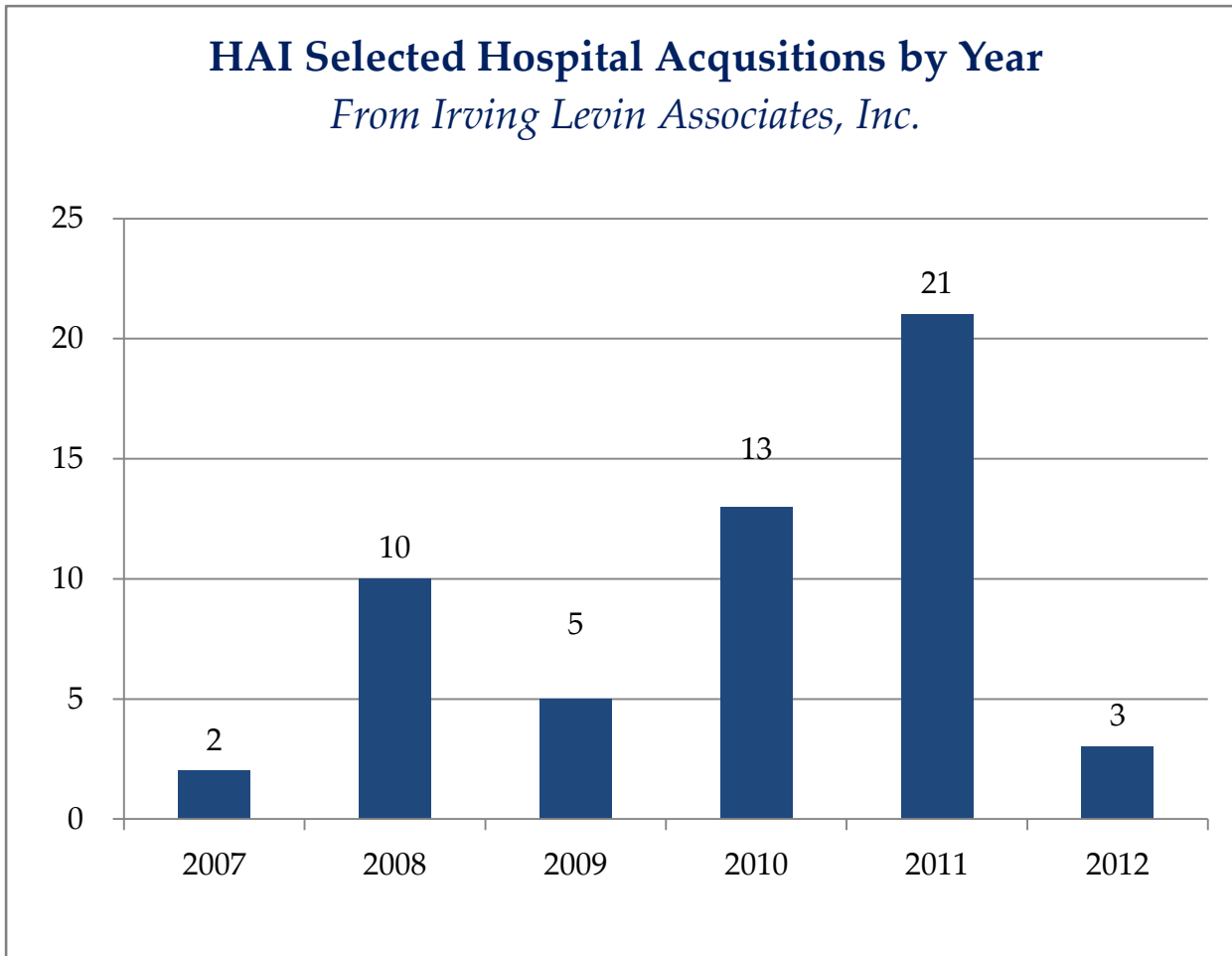
*Comparable Transaction Valuation
Multiples*



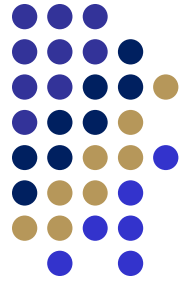
Comparable Transactions



HAI Selected Hospital Acquisitions by Year
From Irving Levin Associates, Inc.

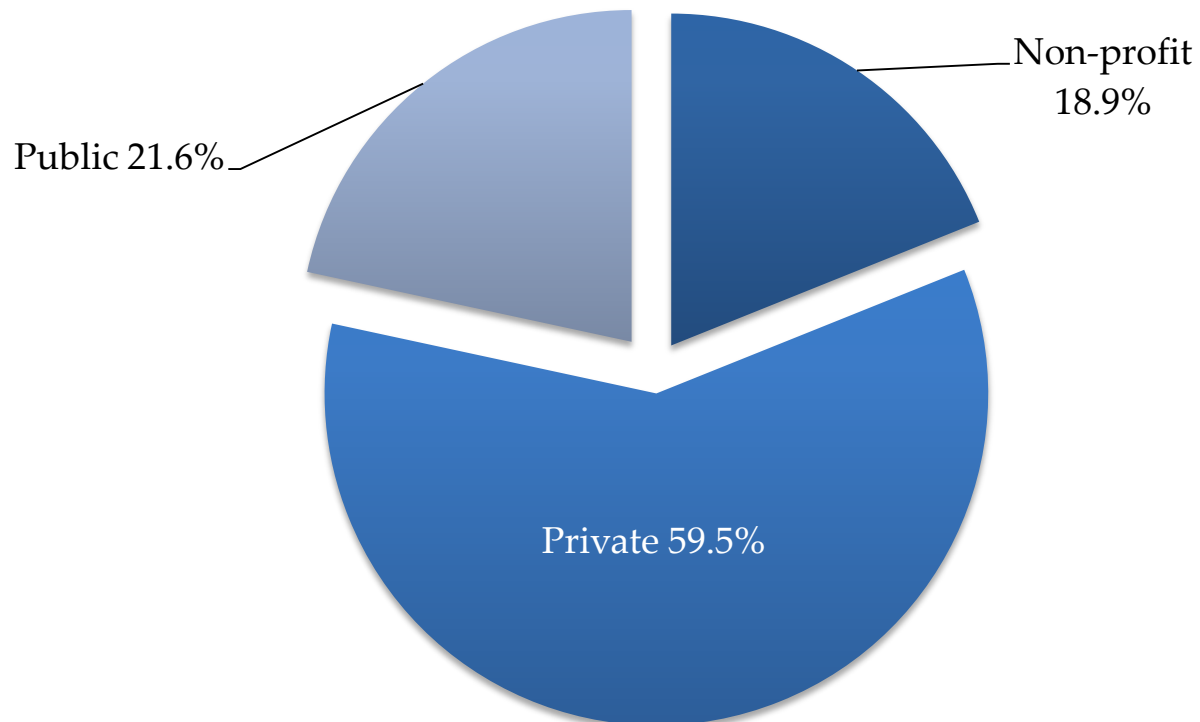


Comparable Transactions



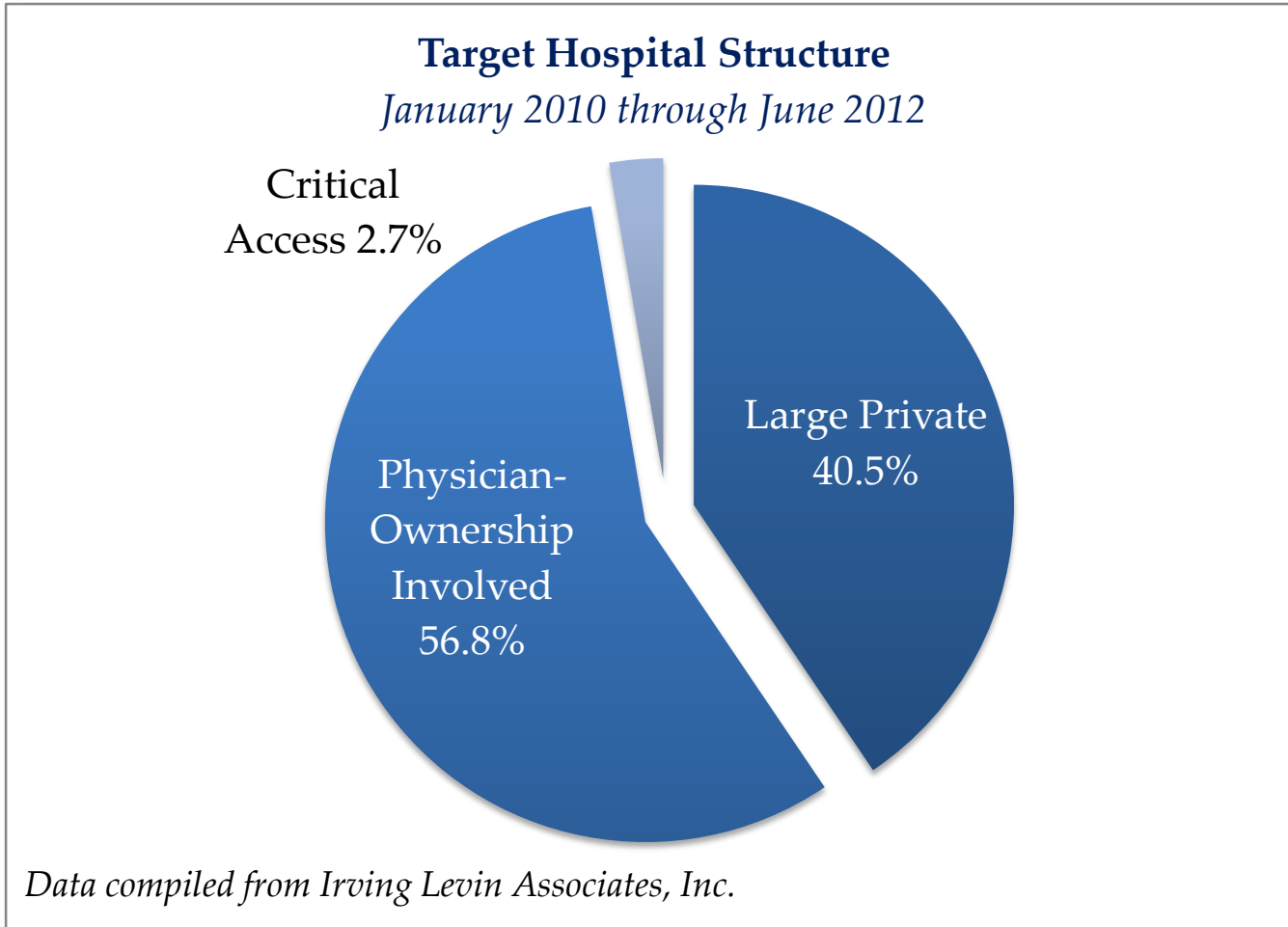
Target Hospital Legal Structure

January 2010 through June 2012



Data compiled from Irving Levin Associates, Inc.

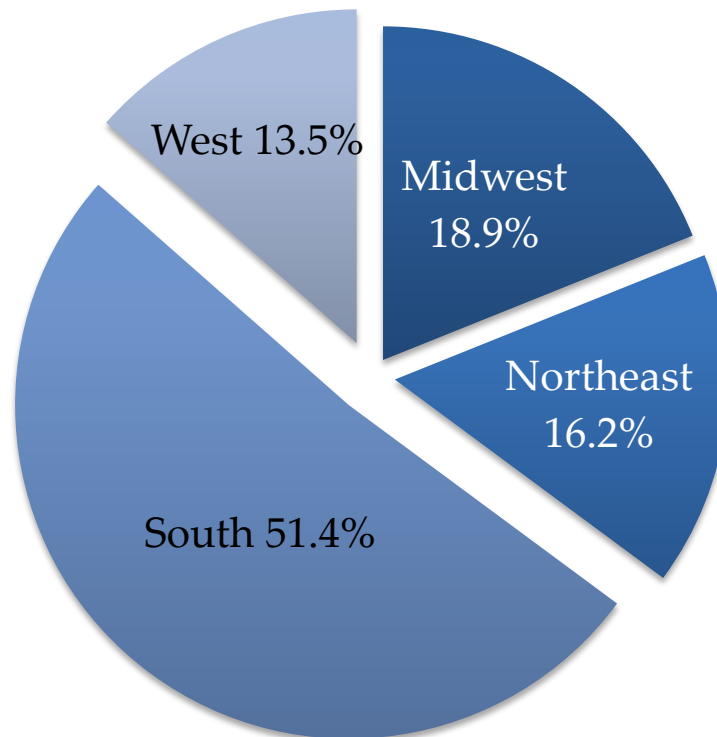
Comparable Transactions



Comparable Transactions

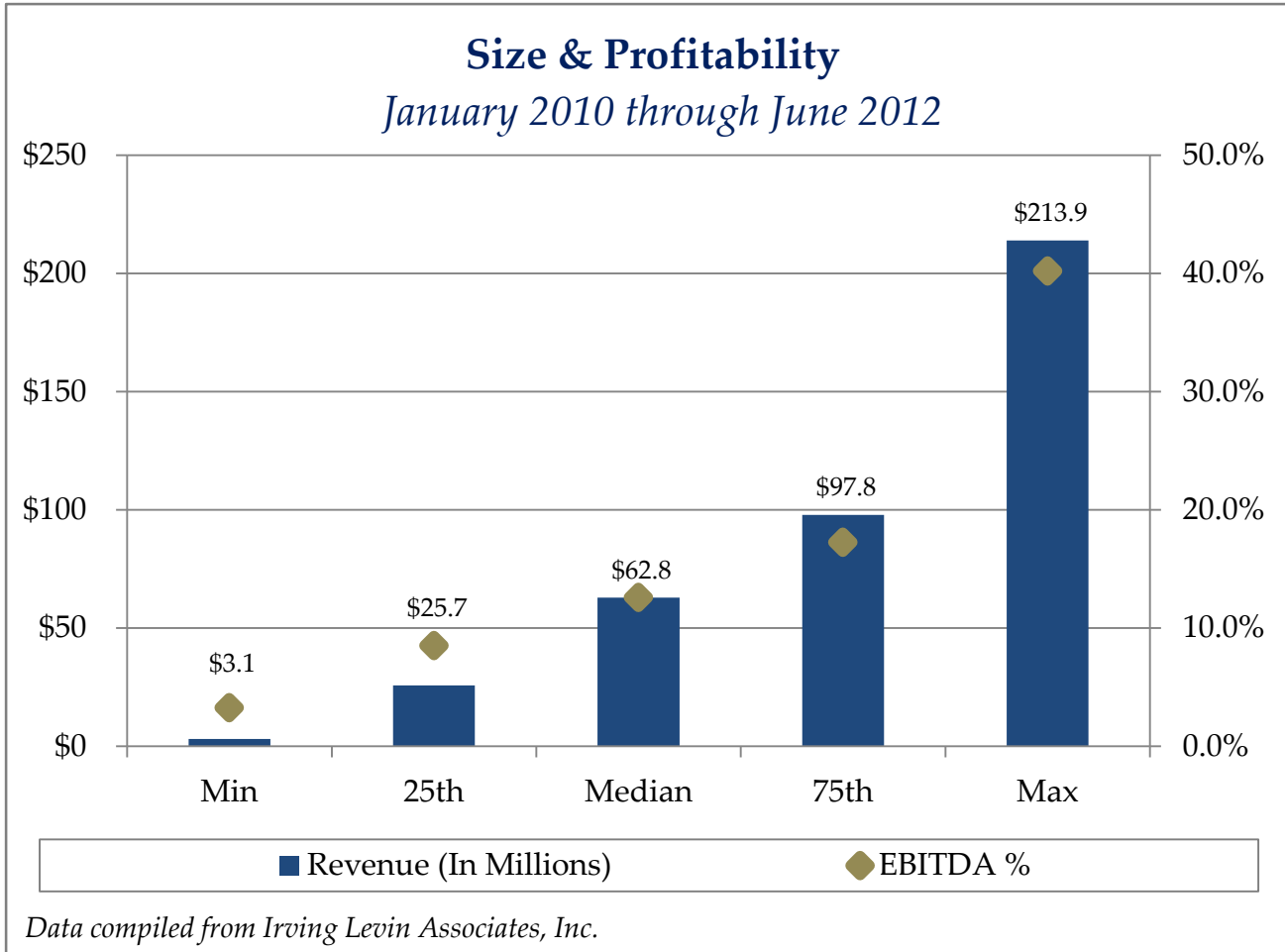


Transactions by Region
January 2010 through June 2012

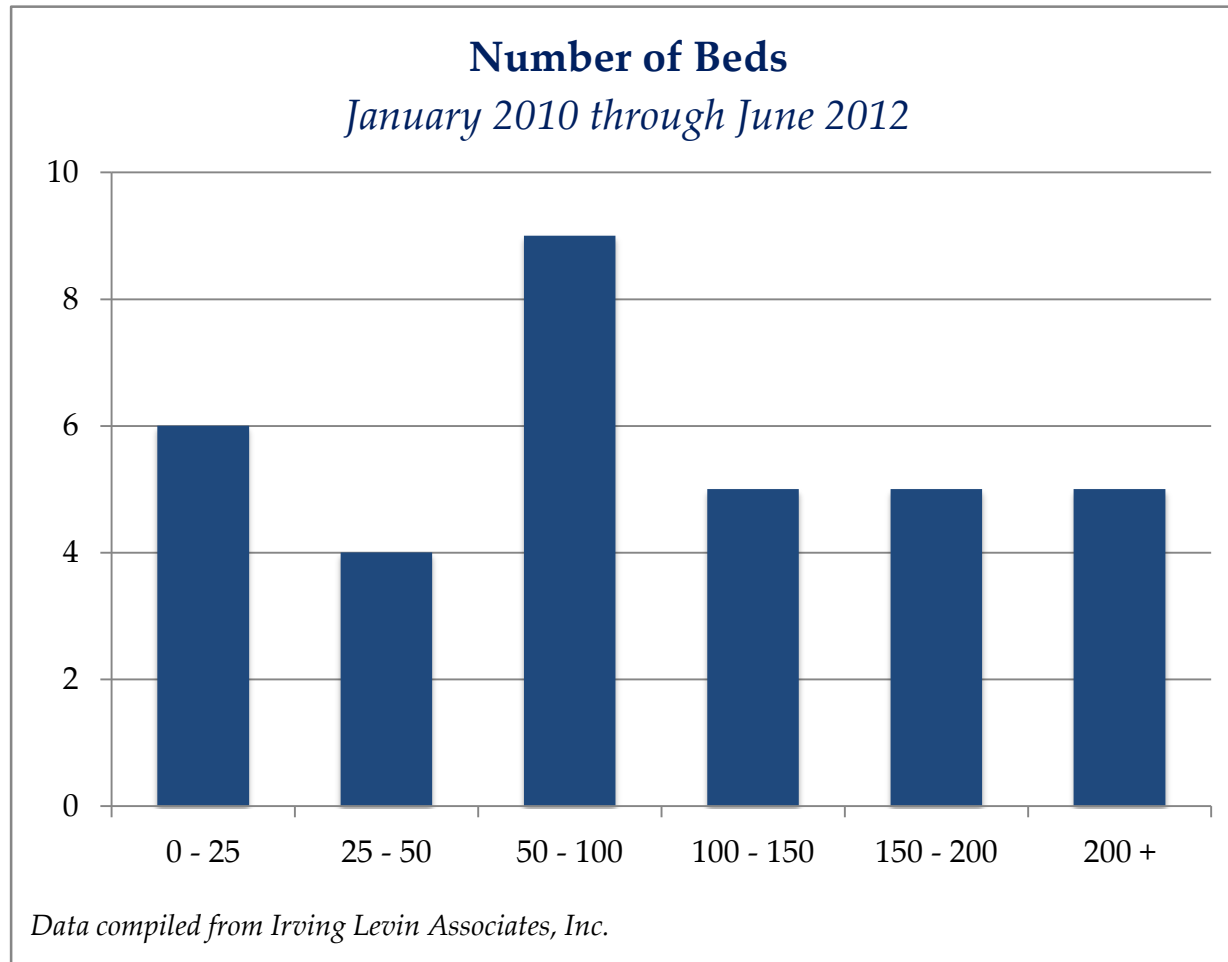


Data compiled from Irving Levin Associates, Inc.

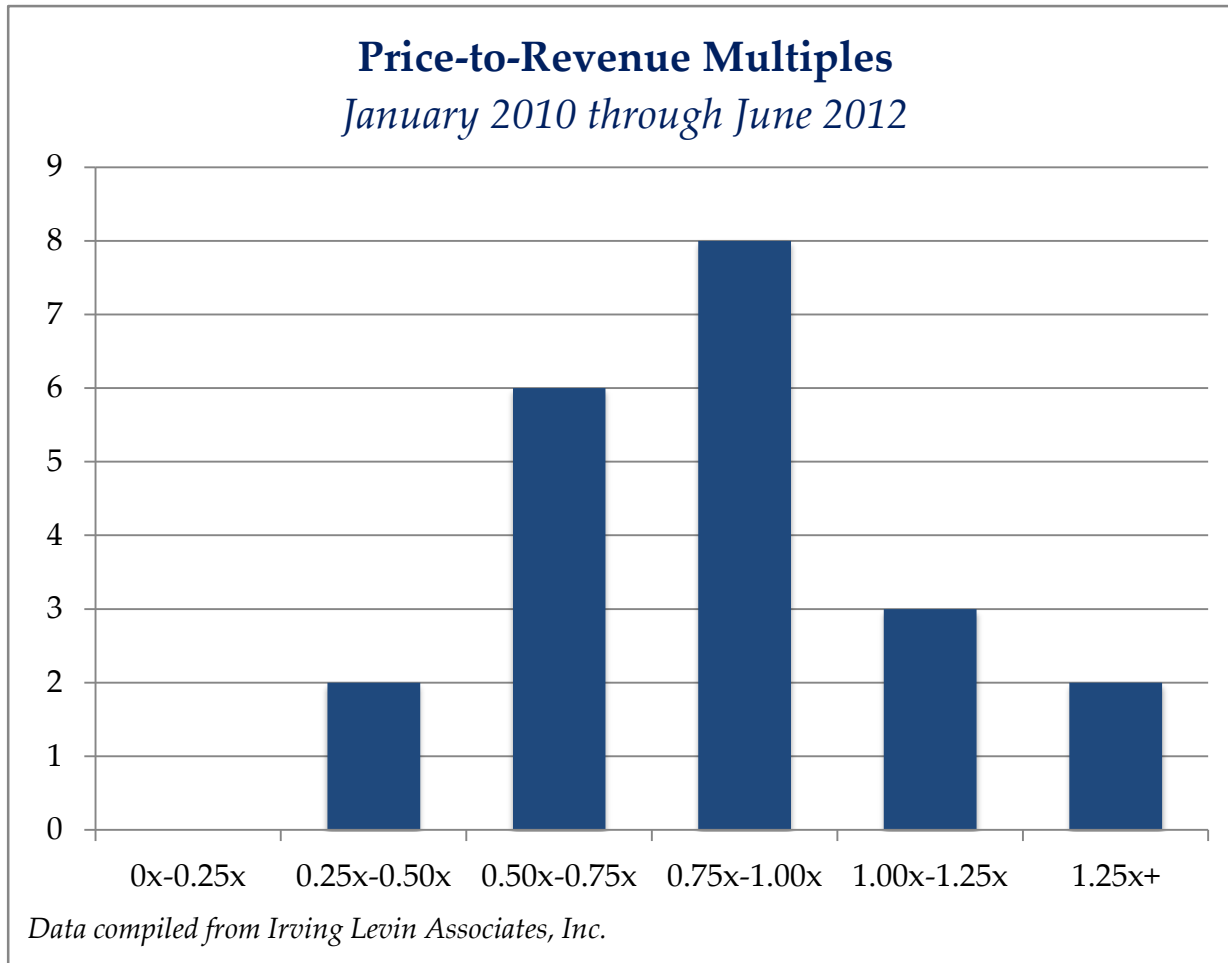
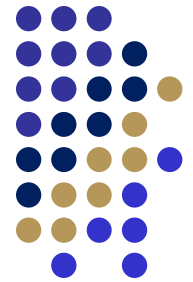
Comparable Transactions



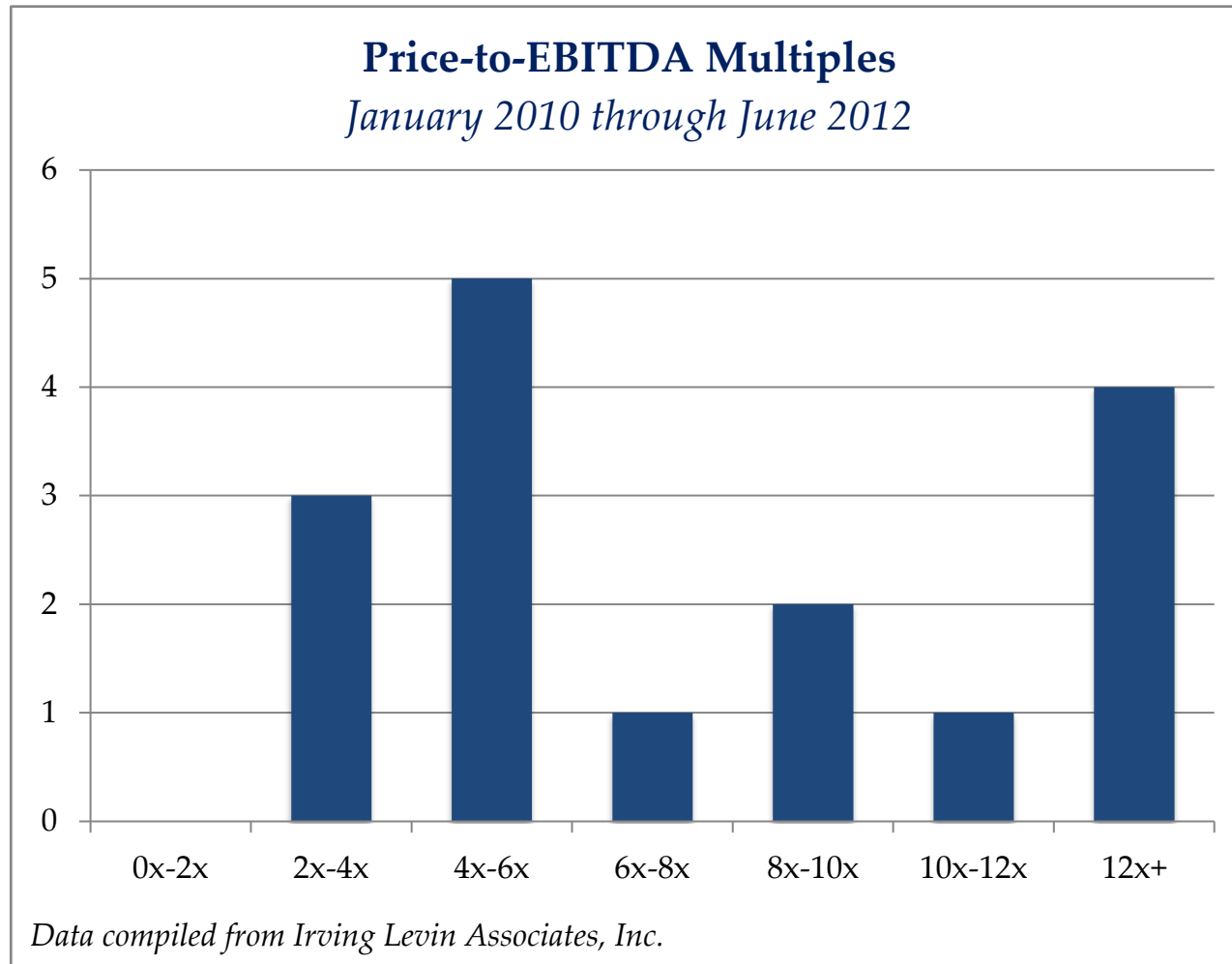
Comparable Transactions



Comparable Transactions



Comparable Transactions



Recent Transactions of Public Companies



Terms of CHS and HMA Purchase/Merger

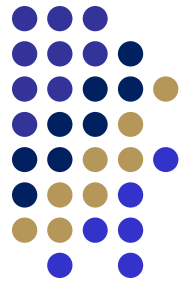
Combination of stock and cash; complicated

Once complete, CHS will own and operate approximately 206 hospitals in 29 states with a total bed count of over 31,000

Take Under vs. Premium

Expected to close by the end of the first quarter of 2014

Recent Transactions of Public Companies



Terms of Tenet's Acquisition of Vanguard

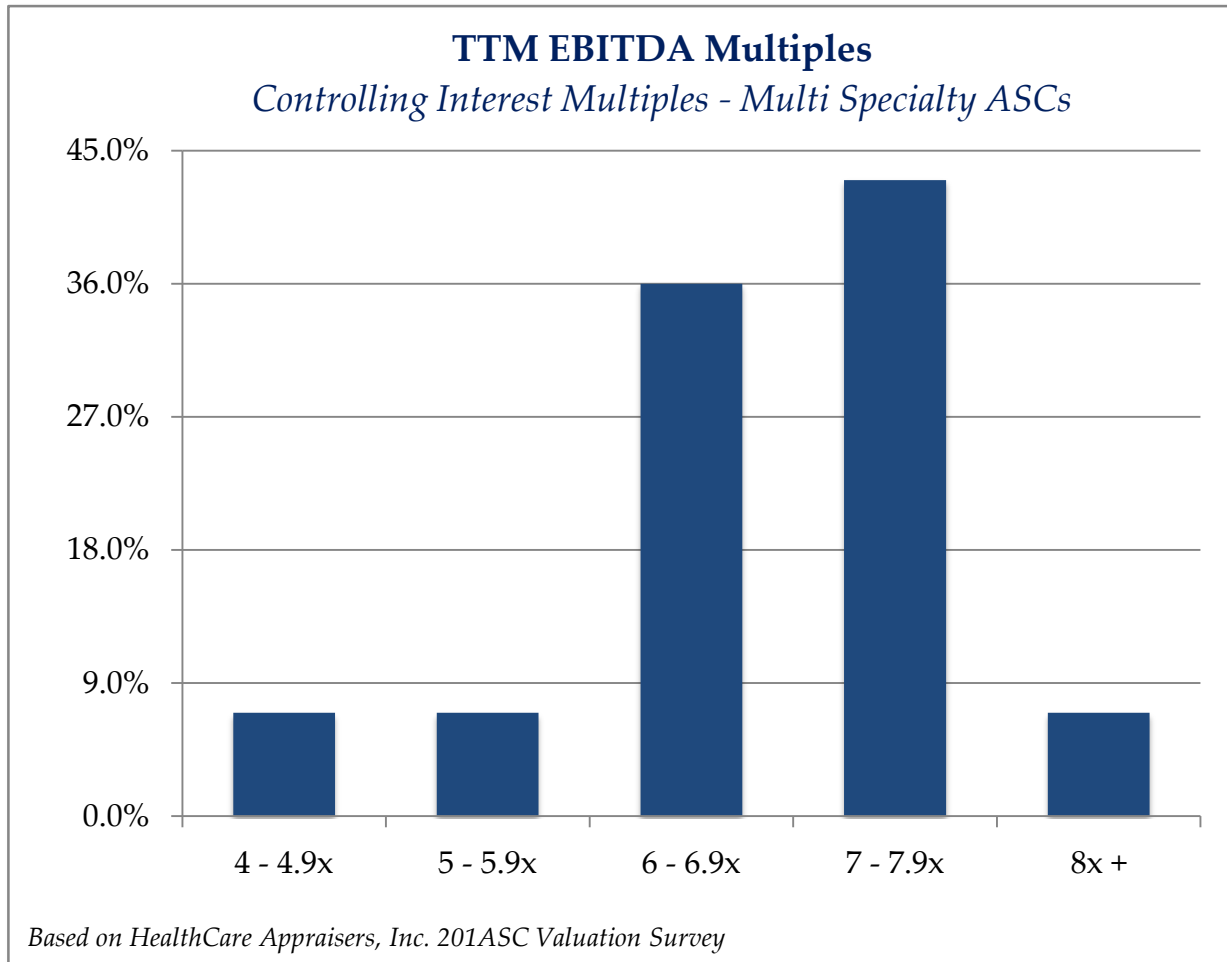
\$4.3 billion purchase price, includes \$2.5 billion in debt

Tenet to pay a 70% premium over Vanguard's prior closing price

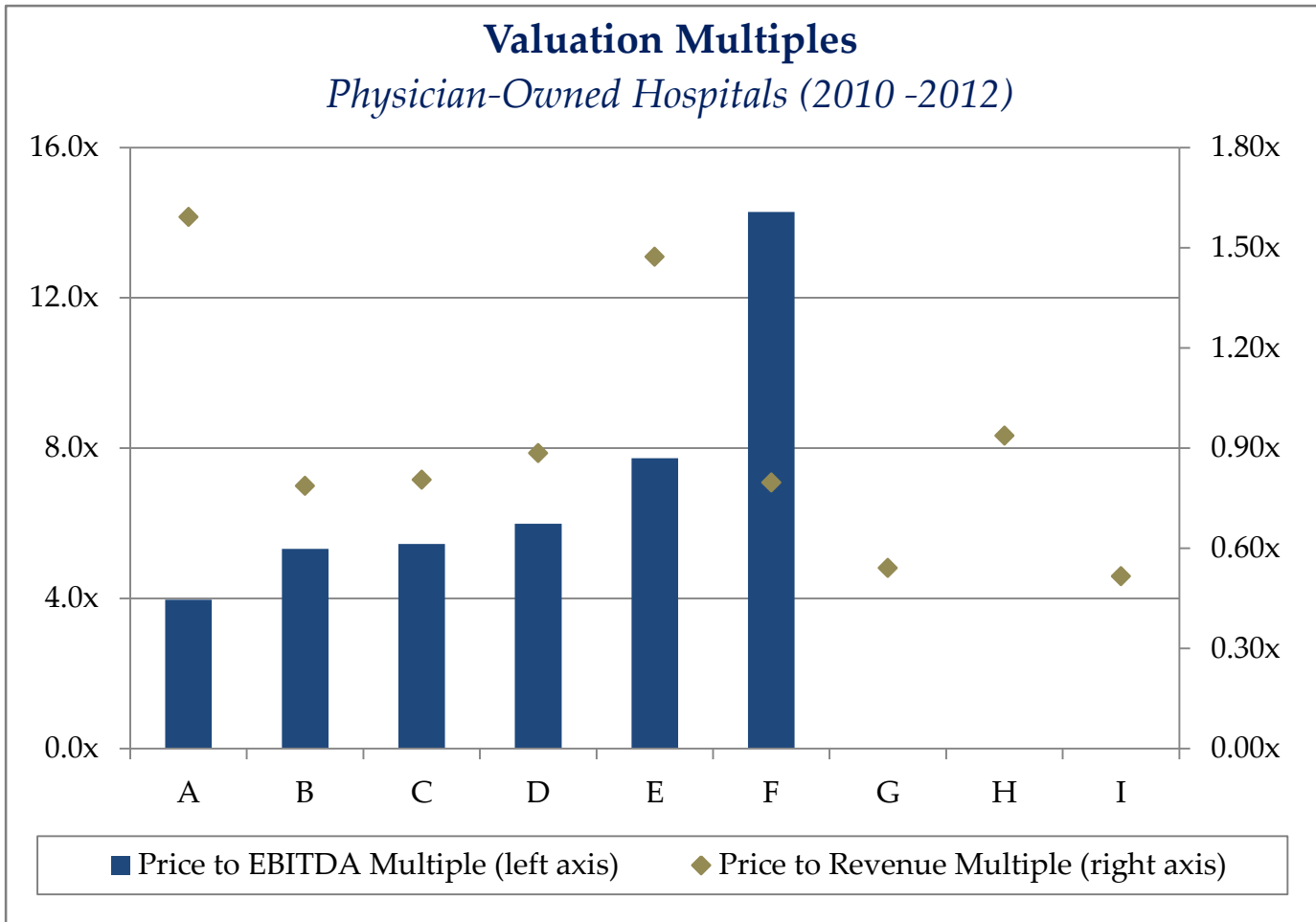
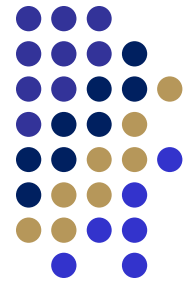
Tenet will own 79 hospitals and 157 outpatient facilities

Expected to close by the end of 2013

HAI's 2013 ASC Survey

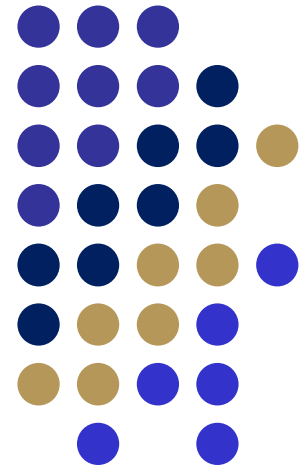


Physician-Owned Valuation Multiples

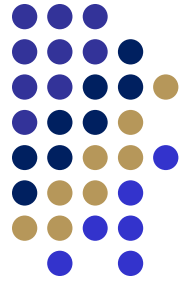


6

Benchmarking



Medicare Cost Reports



Includes comparable physician-owned / specialty hospitals

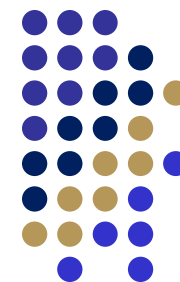
Presents key financial and operational metrics

Gross inpatient and outpatient charges, net revenue, total operating expense, net income

Cash, inventory, gross and net accounts receivables, accounts payable, total assets, total liabilities

All beds (including long-term care), total bed days, discharges, FTE employees

Physician Hospitals of America Quarterly Benchmarking Reports



PHA Benchmarking Data	Q3 2012 PHA Reported Data				
	# of Respondents	Percentile			
		<u>25th</u>	<u>Median</u>	<u>75th</u>	<u>90th</u>
Operating Expense as a % of Net Revenue	42	92.93%	84.85%	68.13%	62.22%
Personnel Expense as a % of Net Revenue	42	37.49%	28.36%	22.11%	19.27%
Bad Debt as a % of Net Revenue	42	11.51%	2.69%	1.21%	0.00%
Supply Cost as a % of Net Revenue	42	31.31%	24.40%	20.01%	14.30%
Days in Accounts Receivable	41	58.7	42.5	29.8	29.8
Days Cash on Hand	42	0.5	0.5	30.7	58.0
Cost of Benefits as a % of Personnel Expense	42	15.77%	13.80%	14.24%	10.84%
Average Length of Stay (In Days)	42	3.76	2.75	2.22	1.10

HAI's 2009 Physician Hospital Valuation Survey



Conducted in Cooperation with Physician Hospitals of America

Includes 30 participants

Out-Dated but Comprehensive

Presents Valuation Multiples and Methodologies

Presents Management Fee Guidance and Other Helpful Metrics

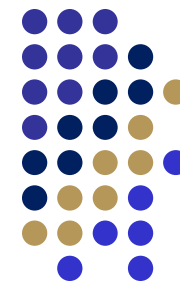
Guideline Public Companies



Key operational data often disclosed within public filings

Key financial metrics are disclosed within public filings

Publicly traded company data is often used as a basis for the industry as a whole



QUESTIONS?

Current Valuation Trends: Physician-Owned Hospitals

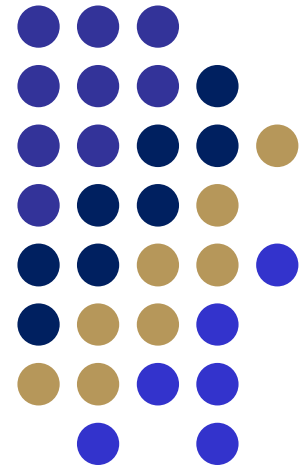
Presented By

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