

# ASC and Healthcare Transactions The Year in Review

Presented By

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9<sup>th</sup> Annual Orthopedic Spine & Pain Management Driven ASC Conference  
June 9, 2011

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## Overview – ASC Valuations



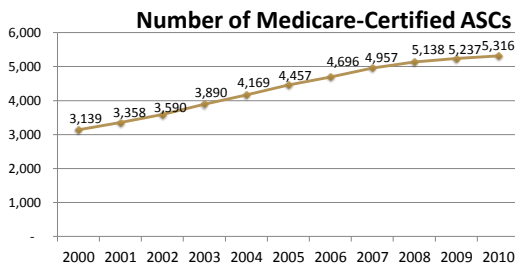
- During 2010 we observed a significant increase in acquisition activity in the Ambulatory Surgery Center market.
- During 2010 we have seen multiples paid for controlling interests shift slightly upward, and we anticipate stronger pricing for controlling interests in the coming year.
- Valuation multiples for controlling interests, expressed as a multiple of EBITDA, were generally in the range of 6.0x to 7.0x less debt during the last year (*i.e.*, for centers which were predominantly or exclusively in network with Commercial payors).
- The pricing of minority shares in ASCs has remained relatively stable, with the majority of transactions occurring between 3.0x to 3.5x EBITDA less pro rata debt.

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## Overview – ASC Valuations (cont.)



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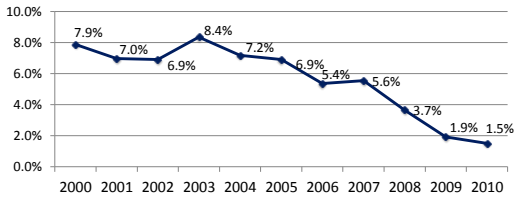
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## Overview – ASC Valuations (cont.)



### Annual Growth Rate of Medicare-Certified ASCs



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## Physician Employment: Hospitals & Groups



- Single biggest threat to ASCs in coming years. Limits patient referrals and supply of physician investors and users.
- Over half of the physicians in the U.S. are employees of groups owned by hospitals, other physicians, or foundations. Less than half of U.S. physicians own their own independent practice.<sup>1</sup>
- Employed surgeons may be subject to restrictive investment covenants.
  - Standard hospital employment contract prohibits ownership in ASCs.
  - Many large physician groups also have “all or nobody” investment prohibitions.

<sup>1</sup><http://www.nytimes.com/2010/03/26/health/policy/26docs.html>

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## Physician Employment: Hospitals & Groups (cont.)



- Vast majority of primary care physicians will be employed by health systems, thus limiting the referrals to surgical specialists outside of the system.
  - ACOs will create substantial financial incentives for many primary care physicians to join a health system.
- According to MGMA 2010 survey, sixty-five percent (65%) of established physicians who changed positions in 2009 became hospital employees and nearly half (49%) of new physicians coming out of training chose hospital employment over private practice.<sup>2</sup>
- Medicare physician payment cuts have been delayed for over 7 years in a row. Physician pay will be a key target of Medicare reform. This will (and has) lead more physicians to seek hospital employment out of fear.

<sup>2</sup><http://www.mgma.com/press/default.aspx?id=33777>

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## Out-of-Network



- Over 60% of ASCs are small (2 operating rooms or less), and many have relied on OON billing to maintain viability.
- OON strategy is becoming less and less of a viable option.
- Pricing multiples for OON centers is significantly lower than their in-network peers due to the risk of sustaining the cash flow.
  - Based on discussions with prominent surgery center chains, we observe multiples of 1.0x to 3.0x EBITDA for controlling interests in OON ASCs. These lower OON equivalent valuation multiples are calculated based on future cash flow projections using “normalized” revenue, which may be significantly reduced.

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## Out-of-Network (cont.)



- Commercial payors are now using many direct and covert tactics to try and force these centers to stop OON billing. Tactics include:
  - Significant delays or denials of charges, including remission of “reasonable and customary” payment for services conducted at OON centers.
  - Threats and direct action to remove physician’s professional practice from the payor network.
  - Legal action against ASCs to recover prior payments based on a variety of allegations of impropriety. Regardless of merit, such litigation can disrupt business and delay payment of legitimate charges indefinitely.

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## Out-of-Network (cont.)



- All respondents to HCA’s 2011 ASC survey thus far have indicated that they view ASCs with significant out-of-network revenue “very negatively” or “slightly negatively”.
- Small OON ASCs are ideal targets for Hospital acquisition, with the goal of converting the freestanding ASCs into a hospital outpatient department (“HOPD”). Hospitals can potentially buy these “at risk” ASCs at attractive prices and then covert to a HOPD to restore profitability.

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## Healthcare Reform



- Major Payor Mix Shift expected in 2014
  - 24.4 million uninsured to get insurance covered in 2014
    - 22 million uninsured to enroll in Medicaid under expanded eligibility
      - Primary benefactors are hospitals which currently see most charity cases; ASCs don't see many charity care patients.
    - Another 15.8 million (uninsured and insured) are expected to enroll in individual health insurance plans subsidized by insurance exchanges.<sup>3</sup>
      - It is believed that some people in group health plans will leave to join subsidized individual health plans.

<sup>3</sup><http://www1.cms.gov/NationalHealthExpendData/Downloads/NHEProjections2009to2019.pdf>

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## Healthcare Reform (cont.)



- Major Payor Mix Shift in 2014 (cont.)
  - Anticipate high-deductibles for individual health insurance plans.
  - Effect on ASCs: Medical providers won't "cost-shift" as much charity care to commercial insurance companies. Commercial insurers will argue that they don't need to inflate payment as much because unpaid charity care will be less.

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## Healthcare Reform (cont.)



- Inclusion in ACO
  - ACOs must own or contract with surgery providers for service. Depending on the popularity of ACOs, surgery patient referrals could be redirected in two ways.
    - ACO patients treated by ACO- or hospital-employed surgeons would be performed at the Hospital or hospital-owned ASC.
    - Independent surgeons contracted with the ACO could have a contractual requirement to perform surgery on ACO patients at an ACO-designated surgical site.
  - Low-cost (reimbursement) providers should get contracts. However, hospitals that view their surgery departments as idle, fixed costs may try to absorb surgery patients and forego paying an outside contractor.

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