The Financial World’s View of ASCs

Craig D. Frances, M.D.
Agenda

► What is private equity and its utility?

► Why consider a private equity partner?

► What is the state of ASC investing?

► Where are we headed?
What is Private Equity and its Utility?

- Long-term equity investment in private companies by professional investors

- Limited partners include private and public pension funds, endowment funds, foundations, corporations, and wealthy individuals

- The primary use of private equity is to fund long-term growth and provide shareholder liquidity

- Private equity firms offer highly tailored financing which meets a company’s unique needs

- Firms look to add value beyond the financing
Global Pool of Investable Capital

1969
$2.3 Trillion

- All Other Equities 12.8%
- Dollar Bonds 22.3%
- Cash Equiv. 6.9%
- U.S. Real Estate 11.6%
- Private Equity 0.1%
- U.S. Equity 30.7%

2006
$103.0 Trillion

- All Other Equities 22.3%
- All Other Bonds 20.1%
- Dollar Bonds 23.2%
- US Equity 17.8%
- Emerging Mkt Equities 2.1%
- US Real Estate 6.3%
- High Yield Bonds 1.0%
- Private Equity 0.4%
- Cash Equiv. 3.8%
- Emerging Mkt Debt 2.9%

Private Equity

180x

1969 vs 2006:
- Total Capital: 45x
- Private Equity: 180x

Sources: UBS Global Asset Management
## Relative Returns
Short and long-term alpha vs. public equities

<table>
<thead>
<tr>
<th>Investment Type</th>
<th>1-Year</th>
<th>5-Year</th>
<th>10-Year</th>
<th>20-Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Venture Funds*</td>
<td>16.4%</td>
<td>1.0%</td>
<td>20.3%</td>
<td>16.6%</td>
</tr>
<tr>
<td>U.S. Buyout Funds*</td>
<td>24.5%</td>
<td>10.4%</td>
<td>8.5%</td>
<td>12.9%</td>
</tr>
<tr>
<td>All U.S. Private Equity*</td>
<td>23.3%</td>
<td>7.5%</td>
<td>11.0%</td>
<td>13.9%</td>
</tr>
<tr>
<td>European Venture Funds**</td>
<td>2.1%</td>
<td>0.5%</td>
<td>5.5%</td>
<td>6.6%</td>
</tr>
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<td>23.4%</td>
<td>6.8%</td>
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</tr>
<tr>
<td>All European Private Equity**</td>
<td>20.0%</td>
<td>4.0%</td>
<td>10.1%</td>
<td>10.4%</td>
</tr>
<tr>
<td>MSCI World*</td>
<td>20.1%</td>
<td>10.0%</td>
<td>7.6%</td>
<td>9.1%</td>
</tr>
<tr>
<td>S&amp;P 500*</td>
<td>15.8%</td>
<td>6.2%</td>
<td>8.4%</td>
<td>11.8%</td>
</tr>
</tbody>
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* In USD  
** In Euros  

Sources: Thomson Financial and NVCA; Investment Horizon Performance through 12/31/06 for US; 12/31/2006 for Europe
## Relative Returns

Industry returns driven by top quartile funds

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<th>10-Year</th>
<th>20-Year</th>
</tr>
</thead>
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<tr>
<td>Top Quartile U.S. Venture Funds*</td>
<td>29.2%</td>
<td>10.4%</td>
<td>82.7%</td>
<td>30.0%</td>
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<tr>
<td>Top Quartile U.S. Buyout &amp; Mezzanine Funds*</td>
<td>32.8%</td>
<td>22.1%</td>
<td>22.9%</td>
<td>37.5%</td>
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<tr>
<td>Top Quartile European Venture Funds**</td>
<td>53.0%</td>
<td>7.4%</td>
<td>26.7%</td>
<td>21.0%</td>
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<td>Top Quartile European Buyout &amp; Mezzanine Funds**</td>
<td>45.3%</td>
<td>18.5%</td>
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Sources: Venture Economics; Thomson Financial; NVCA; Through 12/31/06
Outperformance by Top Quartile

Top Quartile Private Equity Firms Outperform Public Markets by a Wide Margin

Return on $1,000 investment in 1980 through 2005

$18,200
12% per annum

$3.8 Million
39% per annum

Total Value in 2005 created by investment indexed to S&P 500

Total Value in 2005 created by investments of top-quartile PE firms

Sources: Venture Economics; Bloomberg; Private Equity Council
Sources of Value in Private Equity
Three fundamental drivers of equity value creation

**Financial Leverage**
- Purchase price financed partially with debt
- Equity value grows with debt repayment
- Reduced cost of capital for acquisitions, investments, etc.

**Multiple Expansion**
- Buy low/sell high
- Faster growth = higher multiple
- Attention to cycles: industry, capital markets

**Earnings Growth**
- Acceleration of revenue/earnings trend: organic and via acquisition
- Improve incentives/alignment
- Improved execution

Attention to cycles: industry, capital markets
Financial Leverage
Effect of recent credit market volatility

PE investors cannot rely on leverage alone for returns
- No more “cheap debt”
- Equity contributions increase

Sources: Goldman Sachs; Morgan Stanley
Multiple Expansion
“Pre-deal alpha” tougher to find

Average Trailing S&P 500 EV/EBITDA Multiples

<table>
<thead>
<tr>
<th>Year</th>
<th>Multiple</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>12.9x</td>
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<tr>
<td>2001</td>
<td>11.0x</td>
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<tr>
<td>2002</td>
<td>11.5x</td>
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<tr>
<td>2003</td>
<td>11.2x</td>
</tr>
<tr>
<td>2004</td>
<td>11.2x</td>
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<tr>
<td>2005</td>
<td>10.3x</td>
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<tr>
<td>2006</td>
<td>9.7x</td>
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<tr>
<td>2007</td>
<td>9.6x</td>
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<tr>
<td>2008</td>
<td>8.5x</td>
</tr>
<tr>
<td>2009</td>
<td>8.9x</td>
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Average Buyout Purchase Price / LTM EBITDA Multiples

<table>
<thead>
<tr>
<th>Year</th>
<th>Multiple</th>
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<tbody>
<tr>
<td>2000</td>
<td>6.3x</td>
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<tr>
<td>2001</td>
<td>6.1x</td>
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<tr>
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Sources: Adams Street Partners; MorganMarkets; FactSet; Capital IQ
Multiple Contraction
Influence of credit market on valuations

Availability of Leverage has Dramatically Decreased in Last 18 Months...

...Driving Down Average Purchase Multiples

Sources: Goldman Sachs; Standard & Poor's; Mergerstat
Pay for Value

“Price is what you pay. Value is what you get.”

“It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price.”

- Warren Buffett
70% of value created in transactions generating 60%+ IRR was from improving company performance (“post-deal alpha”)

Conversely, private equity firms’ inability to fundamentally improve companies was blamed for majority of underperforming investments.

An analysis of more than 60 transactions from primary data collected from 11 PE firms

Sources: Private Equity Council
Primary Focus of Private Equity Value Creation

1980s

1990s

2000s

Financial Leverage

Multiple Expansion

Earnings Growth

Estimated Sources of Private Equity Investment Return

Sources: Asset Alternatives; LEK Consulting
Private Equity Investment Strategy
Investors rely on multiple value drivers

<table>
<thead>
<tr>
<th>Earnings Growth</th>
<th>Least commoditized: effort/skill rewarded</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>PE firms add value (best practices, acquisitions)</td>
</tr>
<tr>
<td></td>
<td>Improve incentives/alignment</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Multiple Expansion</th>
<th>Hardest to predict</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Ex-post multiple expansion more likely than ex-ante</td>
</tr>
<tr>
<td></td>
<td>Understanding industry cycles</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Financial Leverage</th>
<th>Easiest to predict</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Most commoditized</td>
</tr>
<tr>
<td></td>
<td>Currently MIA</td>
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Outsized returns generated by combining all three sources of value
Why Consider a PE partner?

Most companies eventually reach a crossroads

- Entrepreneur wants to take “two bites from the apple”
- Company’s management wants to run (and own) the firm
- Company wants to finance internal growth
- Company wants to finance an acquisition
- Entrepreneur wants to professionalize organization

Private equity investors can help entrepreneurs take their companies to the next level
What is a Recapitalization?

A recapitalization (recap) is a partial sale of equity to finance liquidity for existing shareholders.
What is a Recapitalization?

Choice 1:
Sell Today
100% for 100

Choice 2:
Sell Today
50% for 50

3 Years Later
Sell Other
50% for 150

Total is
200
Benefits of a Recapitalization

- Wealth diversification (mitigates risks of concentrated wealth)
- Two bites of the apple
  - Partner helps accelerate growth (organic and/or acquisitions)
  - Experience maximizing value at exit
  - Overall more proceeds than selling 100% at once (assuming things go well)
- Cash out inactive shareholders
- Increase management’s ownership
- Tax advantages (capital gain vs. dividends)
- Remain independent
- Strong assistance from private equity firm
Benefits of PE Partnership: 
Board Level Advice

Great companies are built by management teams, not investors

- Good PE firms treat management teams as clients
- Focus on corporate and growth strategy
- Best practices from other leadership companies
- Recruitment of management and board candidates
- Sponsorship with the financial community
  - Laying the groundwork for successful acquisitions, IPOs, or mergers
- Corporate governance
  - Devising appropriate stock option, compensation, and incentive programs
  - Building and enhancing the functionality of your board
**Benefits of PE Partnership:**
**Executing on an Acquisition Strategy**

**Investors can assist management in pursuing an acquisition strategy**

<table>
<thead>
<tr>
<th>Capital Support</th>
<th>Provide equity and subordinated debt financing to help fund future operations or acquisitions, as needed.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategy</td>
<td>Provide advice on the types of acquisitions to seek.</td>
</tr>
</tbody>
</table>
| Tools for management | Serve as an additional corporate development team for management  
|-identifying, analyzing, and negotiating an acquisition  
|-help management focus on running the day-to-day operations of the company. |
Case Study: HealthCare Partners

HealthCare Partners is one of the nation’s leading integrated healthcare delivery systems servicing 600,000 members in California, Florida, and Nevada.

- Operates under global capitation and seeks to produce highest quality, most cost effective care through coordinating delivery (multispecialty model, tiers of care)

- Run by Dr. Bob Margolis, Chair of NCQA. HCP has won extensive awards for quality of care.

- Physician owners were looking to bring on a partner to help set and execute strategic acquisition strategy for diversification and growth

- Sourced 4 possible acquisitions, closed on JSA (Florida)

- Built relationship with JSA team, introduced the parties, worked on deal structuring

- Deal diversified the Company into two more markets
Investors can help entrepreneurs create a successful exit

- Deep relationships: Regular and highest-level access to investment banks

- Running private companies like public ones

- Help with type of transaction and timing

- Attention to long-term performance
Private Equity in Healthcare Services:
Some Successful Attributes

Company Specific:
- Positioned well in reimbursement environment
- Value to all constituents
- Platform for acquisition growth
- Attention to culture and service levels

Management Specific:
- Aligned in wanting to build company value
- Data driven, open to new ideas
- Aggressive and lofty goals
HealthCare Services Sectors

- Providers/Practice Management
- Insurance/Benefits
- Outsourcing
- HCIT/Information
- Life Sciences
- American Dental Partners
- EBP
- LogistiCare
- IMPAC
- Cetero Research
- Anesthetix
- The Galtney Group
- NightHawk Radiology Services
- mecon
- Clontech
- HealthCare Partners
- TPA
- Prompt Associates
- MEDITECH
- Diagnostic Hybrids
- MDVIP
- Home Health
- Distribution/Supply
- Labs/Diagnostics
- Facilities
- NVA
- HH
- HRA
- AmeriPath
- LASIK Vision Institute
- Pediatrix
- Lincare
- Suburban Ostomy
- AURORA Diagnostics
- OnCare
- Senior Home Care, Inc.
- cpl
- RTC
- RENAL TREATMENT CENTERS, INC.
ASC Reimbursement Changes/Outlook

The introduction of a new payment system has given the industry clarity on reimbursement for the next two years.

- Four-year transition to the new system is expected to be fully-implemented by the end of 2011.

- CPI updates will be re-introduced into the payment system beginning in 2010 after being absent from fee schedules for several years. CMS projects that the CPI increase would update the ASC conversion factor to 0.6% in 2010.

- Specialties that benefited from the changes were general surgery and orthopedics. Gastroenterology suffered the largest decline in reimbursement under the new system

- Industry players that are well-diversified in their specialty mix and mostly handle “in-network” cases are best positioned

Source: Centers for Medicare & Medicaid Services (CMS)
The outpatient surgery industry has experienced significant growth over the past few years, reaching more than 5,800 outpatient surgery centers in 2008, while the number of hospitals has remained relatively flat.

Source: Verispan Outpatient Surgery Center Market Report
Both the number of multi-facility surgery center chains and the corresponding number of centers within those have increased substantially since 2000.

Note: A surgery center “chain” is defined as a corporation that owns, manages or leases more than one outpatient center.

Source: Verispan Outpatient Surgery Center Market Report
ASC Investments: Does the math work?

- Purchase a $60mm revenue / $10mm EBITDA-MI ASC platform
- Acquire 3 centers with $3mm revenue each annually

| Past Case: 6.0x leverage; 10% organic growth; make acquisitions at 5.0x |
|--------------------------|----------------|----------------|----------------|----------------|----------------|
|                         | 2009    | 2010    | 2011    | 2012    | 2013    |
| Revenue                 | $60.0   | $75.9   | $93.4   | $112.6  | $133.8  |
| Growth                  | 26.5%   | 23.0%   | 20.6%   | 18.8%   |
| Same Store Growth       | 10.0%   | 10.0%   | 10.0%   | 10.0%   |
| EBITDA-MI               | $10.0   | $12.7   | $15.6   | $18.8   | $22.3   |
| Margin                  | 16.7%   | 16.7%   | 16.7%   | 16.7%   |
| Debt to PF EBITDA-MI    | 6.0x    | 5.5x    | 5.1x    | 4.6x    | 4.2x    |
| Entry Multiple          | 9.0x    |
| Returns at Exit in Four Years |
| IRR                      | 32.5%   | 38.8%   |
| MoM                      | 3.1x    | 3.7x    |
### Present Case 1: 4.0x leverage; 10% organic growth; make acquisitions at 5.0x

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue</th>
<th>Growth</th>
<th>Same Store Growth</th>
<th>EBITDA-MI</th>
<th>Margin</th>
<th>Debt to PF EBITDA-MI</th>
<th>Entry Multiple</th>
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<th>IRR</th>
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<td>10.0%</td>
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<td>16.7%</td>
<td>4.0x</td>
<td>6.5x</td>
<td>7.0x, 8.0x</td>
<td>31.7%, 39.2%</td>
<td>3.0x, 3.8x</td>
</tr>
<tr>
<td>2010</td>
<td>$75.9</td>
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<td>2011</td>
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<td>10.0%</td>
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</table>
## ASC Investments: Does the math work?

| Present Case 2: 4.0x leverage; 0% organic growth; make acquisitions at 4.0x |
|-----------------|-----|-----|-----|-----|-----|
|                 | 2009 | 2010 | 2011 | 2012 | 2013 |
| Revenue         | $60.0| $69.0| $78.0| $87.0| $96.0|
| Growth          | 15.0%| 13.0%| 11.5%| 10.3%| 0.0% |
| Same Store Growth| 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| EBITDA-MI       | $10.0| $11.5| $13.0| $14.5| $16.0|
| Margin          | 16.7%| 16.7%| 16.7%| 16.7%| 16.7%|
| Debt to PF EBITDA-MI | 4.0x | 4.0x | 4.0x | 4.0x | 4.0x |
| Entry Multiple  |      | 5.5x |      |      |      |
| Returns at Exit in Four Years |      |      |      |      |      |
| IRR             | 27.0%| 36.6%| 7.0x | 8.0x |
| MoM             | 2.5x | 3.4x | 2.5x | 3.4x |
While Growth has Slowed, ASCs Remain Well Positioned

- ASC growth has slowed
  - Same-facility case volumes are expected to be flat or negative in 2009

- Trend towards outpatient surgery centers
  - Over 70% of all surgeries can now be safely performed on an outpatient basis
  - Number of surgery centers in the US has grown significantly in recent years

- Opportunity to consolidate fragmented industry
  - Top 10 surgery center operators control <20% of the market
  - Few “national” operators capable of being “platform” companies

- Reimbursement changes
  - Clarity on reimbursement through 2011

- ASCs provide value to all constituents
  - Payors: Higher levels of efficiency and, in turn, lower costs than hospitals
  - Physicians: More attractive economic incentives; effective use of time
  - Patients: More personal patient care; convenient and less stressful environment
Where are we going?

“In the business world, the rearview mirror is always clearer than the windshield.”

- Warren Buffett
Present and Future Considerations

- Leverage levels will be lower
- Valuations will be lower
- Good time to consider minority transactions (recap versus full sale)
- Large sources of capital can be advantageous for acquisitions
- Capital sources under one roof can be advantageous (e.g., equity/subordinated debt)
- A good partner can help you maximize the value of your business
“Never, never, never give up.”

“Kites rise highest against the wind - not with it.”

“We make a living by what we get, but we make a life by what we give.”

-Winston Churchill