

KEY THOUGHTS ON ASC VALUATIONS

Presented by:

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HealthCare Appraisers
INCORPORATED

David M. Walline, ASA | Director

- Director in the Firm's Nashville office
- Significant financial advisory experience working with large private, publicly traded, international and domestic entities
- Industry experience:
 - working with healthcare organizations, attorneys, administrators, providers, developers, consultants, and investment bankers in connection with transactions involving ambulatory surgery centers, diagnostic imaging centers, dialysis centers, lithotripsy companies, physician practices, hospital systems, hospital departments, patent holding companies, and other healthcare entities.

Mr. Walline earned a Bachelor of Arts degree from Michigan State University, majoring in Finance. He is an Accredited Senior Appraiser (ASA) in Business Valuation through the American Society of Appraisers.

Matthew J. Muller, ASA | Manager

- Experience providing his clients advisory services in business valuation, litigation support, financial and operational analysis, and analysis of healthcare provider compensation relationships since 2010.
- Industry experience includes:
 - working with healthcare organizations, attorneys, administrators, providers, developers, consultants, and investment bankers in connection with transactions involving ambulatory surgery centers, diagnostic imaging centers, physician practices, hospital systems, hospital departments, and other healthcare entities.

Mr. Muller earned a Bachelor of Business Administration degree from the Seidman College of Business at Grand Valley State University, majoring in Finance. He is an Accredited Senior Appraiser (ASA) in Business Valuation through the American Society of Appraisers.

Outline of Presentation

Key Thoughts on ASC Valuations

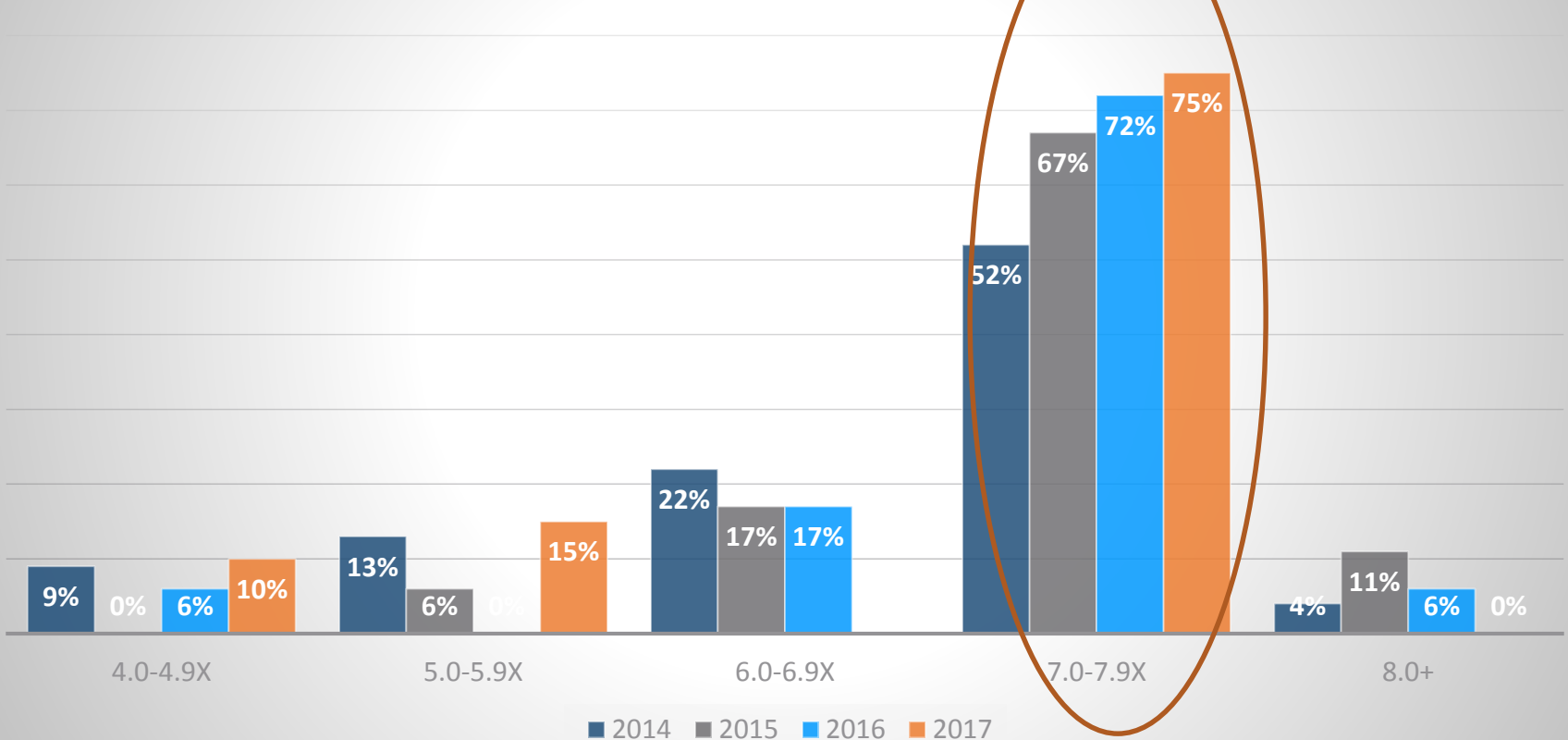
- FMV Considerations – Comparable Transactions
- Public Companies - Transactions and Industry Outlook
- Forms/Structures of Recent M&A Activity
- Regulatory Environment Update
- Common Errors/Pitfalls in Valuation Analyses



FMV Considerations

Comparable Transactions - HAI's Annual ASC Valuation Survey

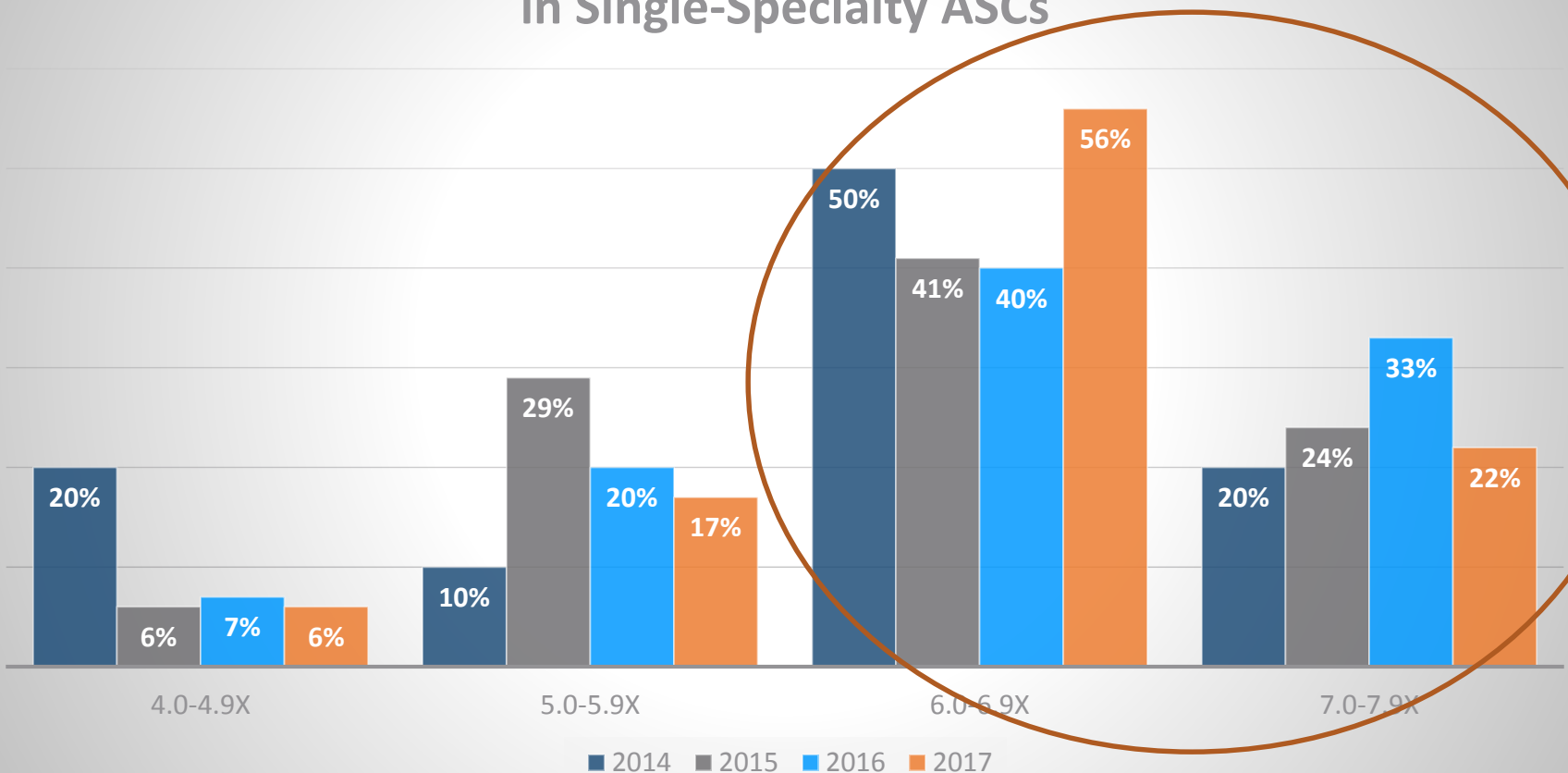
EBITDA Multiple Trend for Controlling Interests
in Multi-Specialty ASCs



FMV Considerations

Comparable Transactions - HAI's Annual ASC Valuation Survey

EBITDA Multiple Trend for Controlling Interests
in Single-Specialty ASCs



FMV Considerations

Comparable Transactions - HAI's Annual ASC Valuation Survey

- Factors Contributing to *Higher* Multiples

- Multispecialty (diversification of case types)
- Diversification of surgeons – majority of cases not done by a single surgeon
- High % of cases performed by owners
- An established history of continually seeking new owners
- History and expectation of continued distributions
- Growth in cases and earnings
- Little debt over time
- Barriers to entry (*e.g.*, CON)
- Predominantly in network with Commercial payors

FMV Considerations

Comparable Transactions - HAI's Annual ASC Valuation Survey

- Factors Contributing to *Lower* Multiples

- Reliance on single specialty
- Lack of diversification of surgeons – majority of cases 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
- High Medicaid patient population

FMV Considerations

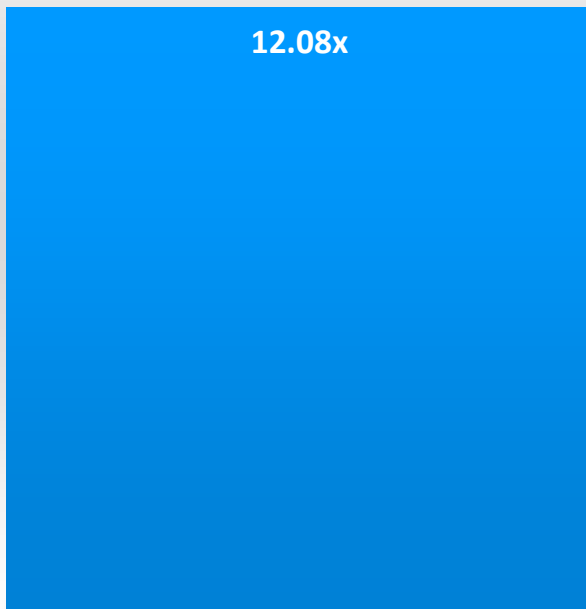
Comparable Transactions - HAI's Annual ASC Valuation Survey

- Factors Affecting Transaction Multiples

- The average *discount* for a non-controlling interest in an ASC as compared to a controlling interest is 30% to 35%
- The average multiple *premium* paid for a surgery center with a CON ranges from 0.25x to 0.50x
- The average *decrease* in multiple paid for a surgery center that is out of network is 2.0x

FMV Considerations Guideline Public Companies

Trailing Twelve Month Valuation Multiples
Enterprise Value / EBITDA



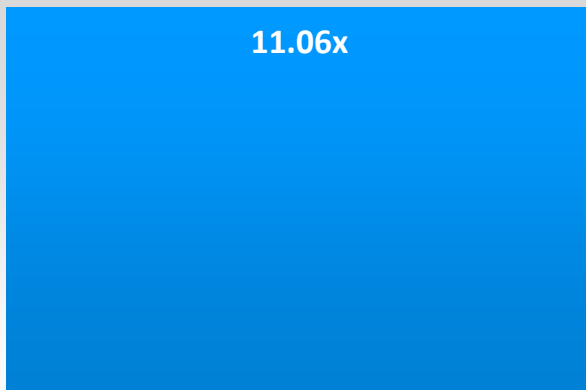
Envision Healthcare



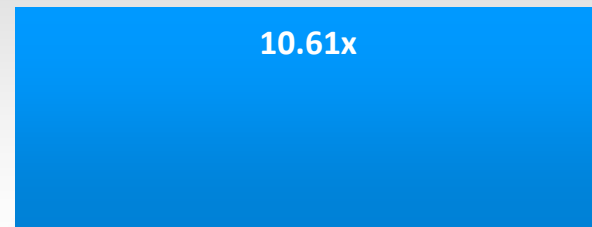
Surgery Partners

FMV Considerations Guideline Public Companies

Forward Twelve Month Valuation Multiples
Enterprise Value / EBITDA



Envision Healthcare



Surgery Partners

FMV Considerations

Envision Healthcare Corporation

- Envision Healthcare Holdings, Inc. merged with AmSurg Corp (Closed December 2016)
- Ambulatory Services Segment Outlook
- Ambulatory Services Segment Operating Strategies

FMV Considerations – Surgery Partners

Acquisition Activity and Financial Performance

- Purchase of 54.19% interest in Surgery Partners by Bain Capital from H.I.G. Capital (Closed August 2017)
 - Implied 11.1x LTM MVIC/EBITDA multiple
 - Transaction in conjunction with Surgery Partners purchase of National Surgical Healthcare

FMV Considerations – Surgery Partners

Acquisition Activity and Financial Performance

- Surgery Partners hit a 52-week low in August 2017
 - Key takeaways from 2Q2017 Earnings Call
 - Slower industry-wide utilization
 - Unfavorable payor dynamics
 - Physician practice integration issues
 - Positive CMS actions

FMV Considerations

Optum, Inc. Acquires Surgical Care Affiliates, Inc.

- **Highlights of Acquisition**
 - Complex deal structure
 - Closed March 24, 2017
 - LTM EBITDA multiple of 12.3x
- **Expected Impact from Acquisition**

Forms/Structures of Recent M&A Activity

- De Novos
- Existing Surgery Centers
 - HOPD
 - Freestanding
- Existing Surgery Centers as part of larger JOA
- Single + Multispecialty Surgery Centers
- Involvement of multiple types of market participants
- Other driving factors (*e.g.*, capital, contracts)

Less Traditional Transaction Structures

- Joint ventures and strategic partnerships have become a common alternative to traditional M&A
 - Allow participants to retain independence while expanding their service line
 - Allow for more nuance in contracts and terms of affiliation
 - Expect multi-entity joint ventures / affiliations to proliferate going-forward



Less Traditional Transaction Structures

- Remaining Independent Can Present Long-Term Challenges
 - Competing against larger, more diverse ASC peers and HOPDs
 - Face weaker position in payor negotiations

Less Traditional Transaction Structures

- More Complex Deal Structures

- Multi-entity ownership structures
 - Management Companies
 - Physicians
 - Health Systems / Hospitals
- Drive for enhanced collaboration between healthcare providers



Strategic Advantages of Hospital Joint Ventures

- **Physician Alignment**
 - Support hospital recruitment and retention of top-tier physicians
 - Increased economic upside for physicians
 - Increased quality of care

Strategic Advantages of Hospital Joint Ventures

- **Strategic Market Position**
 - Maximize patient access and capture increased market share through alignment
 - Expand a hospital's presence and patient base in the community



Strategic Advantages of Hospital Joint Ventures

- **Management and Operational Expertise**
 - Enhanced administrative support / increased resources
 - Additional capital, operational expertise and experience

Strategic Advantages of Hospital Joint Ventures

- **Increased Surgical Specialization**
 - Larger multi-specialty ASCs targeted
 - Improved efficiency and coordination of patient care

Fair Market Value of JV Contributions

- Participants must consider the value of each contribution “as-is”
- Value of Contributions Different than Value of NewCo
- Strategic valuations often performed by participants separate from FMV

Fair Market Value of JV Contributions

- Standard of Value

- Must be careful with Investment/Strategic Value

- Contracts
 - Expenses
 - Synergies

- Ask yourself:

- What is being given-up by seller on an *as-is* basis?
 - Are there market adjustments that would be applicable to any hypothetical ASC?



Example of Complex Deal Structure

- Proposed Joint Venture
- Large Multi-Specialty ASC (“ASC”)
 - Multi-Entity Ownership
 - Declining due-to local competition
- Off-Campus HOPD of Hospital
 - Hospital already has an interest in ASC
 - Additional affiliation opportunity
 - Consolidate surgical services

Shift Towards Site-Neutral Payments

- **Bipartisan Budget Act of 2015 – Section 603**
 - Effective Jan. 1, 2017
 - Revisions to Act in late 2016
- **21st Century Cures Act**
 - Revised Site-Neutral Payment Policy in Section 603
 - Addresses newly built off-campus outpatient departments that were poised to accept patients before Dec. 2, 2015; and submitted proper attestation to CMS
 - Provides some clarification to questions surrounding Section 603
- **Excepted Off-Campus Provider Based Departments**
 - Service expansion
 - Relocation
 - Changes in ownership

Impact of Site-Neutral Payments

- Reimbursement
- Impact may be payor mix-dependent
 - Government vs. Commercial payors
- Transaction Impact
 - Hospitals shift from 100% acquisition to partnerships and JVs
 - Increase in HOPD transactions

Future Payment Landscape

- CMS continues to explore alternative payment structures
- Anthem's New Imaging Site-of-Care Policy
 - No longer reimbursing some hospital outpatient imaging services
 - Could ultimately affect 4.5 million Anthem members
- What Does This Mean for ASCs?

Errors Encountered in Recent Appraisal Reviews

- Unsupportable Growth Assumptions
- Incorrect Standard of Value
 - Investment Value vs. Fair Market Value
 - HOPD Pricing
- Use of Unsubstantiated Figures
 - One size fits all approach
 - *“Well, this is the same assumption we have used on the last few hundred appraisals we have completed.”*
- Math and Valuation Theory Errors in Appraisal
 - One size fits all approach
 - Discounted cash flow application error by internationally renowned accounting firm

Thank You!

Key Thoughts on ASC Valuations

Please contact us if you have questions regarding this presentation.

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