Valuation Considerations in ASC Joint Ventures

Presented by:
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Mr. Janiga is a Partner with HealthCare Appraisers and for the past 10 years has been providing his clients consultation in business valuation, litigation support, intellectual property, healthcare provider compensation relationships, and other types of financial analyses. Mr. Janiga’s extensive industry experience includes working with healthcare organizations, attorneys, administrators, providers, developers, consultants, investment bankers, and private equity groups in connection with transactions involving ambulatory surgery centers, cancer centers, diagnostic imaging centers, dialysis centers, lithotripsy companies, physical therapy centers, pathology laboratories, urgent care centers, physician practices, hospitals, hospital departments, medical device manufacturers, durable medical equipment suppliers, patent holding companies, accountable care organizations, and other healthcare entities. Many of the transactions Mr. Janiga analyzes involve Stark, Anti-Kickback, IRC 501(c)(3), and/or other regulatory implications, which necessitates analyses of fair market value and/or commercial reasonableness.

Mr. Janiga earned a Bachelor of Business Administration degree in 2007 from the Seidman College of Business at Grand Valley State University, dual majoring in finance and economics, and minoring in accounting. He is an Accredited Senior Appraiser (ASA) in Business Valuation through the American Society of Appraisers.
Outline of Presentation

Valuation Considerations in ASC Joint Ventures

Supply + Demand Factors Driving Joint Ventures
- Macro
- Micro

Forms/Structures of Recent Joint Venture Activity

Valuation Overview and FMV Considerations

Common Errors/Pitfalls in FMV Analyses
Where have we been the past decade

2005  Deficit Reduction Act
2006  End of Temporary Moratorium on Construction of New Physician-Owned Hospitals
2010  Patient Protection & Affordable Care Act
2011  Budget Control Act (Sequestration in 2013)
Where have we been the past decade continued...

2012 American Taxpayer Relief Act
(2014 equipment utilization rate)

2013 Medicare Payment Advisory Commission
June 2013 Report to Congress – Chapter 2:
Medicare Payment Differences Across
Ambulatory Settings

2015 Bipartisan Budget Act (Section 603 – Site
Neutrality)
Where have we been the past decade continued...

2018  Department of HHS anticipates shifting 50% of Medicare fee-for-service payments to alternative payment mechanisms (i.e., value instead of volume payment mechanisms)
Population Health Management

- Value/Risk-based contracting with payors
- Medicare Shared Savings Program (ACOs)
- Other ACOs
Macro Supply + Demand Factors
Achieving Lower Costs

HOPD Medicare Rates as % of ASC Medicare Rates, By Year

<table>
<thead>
<tr>
<th>Year</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>158%</td>
</tr>
<tr>
<td>2009</td>
<td>169%</td>
</tr>
<tr>
<td>2010</td>
<td>161%</td>
</tr>
<tr>
<td>2011</td>
<td>164%</td>
</tr>
<tr>
<td>2012</td>
<td>174%</td>
</tr>
<tr>
<td>2013</td>
<td>178%</td>
</tr>
<tr>
<td>2014</td>
<td>181%</td>
</tr>
<tr>
<td>2015</td>
<td>182%</td>
</tr>
<tr>
<td>2016</td>
<td>179%</td>
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</tbody>
</table>
Macro Supply + Demand Factors
Hospital Employment – Orthopedic Surgeons

% of Orthopedic Surgeons Employed by Integrated Delivery Systems

Macro Supply + Demand Factors
Hospital Employment - Gastroenterologists

% of Gastroenterologists Employed by Integrated Delivery Systems

Macro Supply + Demand Factors
Hospital Employment - Pain Mgt Physicians

% of Pain Mgt Physicians Employed by Integrated Delivery Systems

- 2005: 4%
- 2010: 21%
- 2015: 47%

Macro Supply + Demand Factors
Hospital Employment - Urologists

% of Urologists Employed by Integrated Delivery Systems

Macro Supply + Demand Factors
Hospital Employment - Ophthalmologists

% of Ophthalmologists Employed by Integrated Delivery Systems

Macro Supply + Demand Factors
Hospital Employment - ENTs

% of ENTs Employed by Integrated Delivery Systems

- 2005: 13%
- 2010: 24%
- 2015: 45%

Macro Supply + Demand Factors
Hospital Employment - Family Medicine

% of PCPs Employed by Integrated Delivery Systems

Macro Supply + Demand Factors
Maturing Market

Number of Medicare-Certified ASCs by Year

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of ASCs</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>3,028</td>
</tr>
<tr>
<td>2001</td>
<td>3,358</td>
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<tr>
<td>2002</td>
<td>3,597</td>
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<td>2003</td>
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<tr>
<td>2013</td>
<td>5,343</td>
</tr>
<tr>
<td>2014</td>
<td>5,446</td>
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Micro Supply + Demand Factors
Market-Specific Factors

- Size of primary service area
- Number of existing market participants
  - Hospitals/Health Systems
  - ASC Management Companies
  - Freestanding ASCs
  - Independent Surgeons
- State-Specific Items
  - Certificate of Need, reimbursement, employment
- Local economic and demographic conditions
Forms/Structures of Recent Joint Venture 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)
Hospital’s “position” within the local market
Declining Case Volumes
Engage experienced management company
Recognition of possible payment neutrality
  HOPD
  Freestanding
Less costly physician alignment opportunity
Other local environment factors
Valuation Overview and FMV Considerations

Income Approach
- Single Period vs. Multi Period

Market Approach
- Guideline Public Companies
- Comparable Transactions

Asset Approach
- Net Asset Method
FMV Considerations
Guideline Public Companies

Trailing Twelve Month Valuation Multiples
Enterprise Value / EBITDA

<table>
<thead>
<tr>
<th>Company</th>
<th>Multiples</th>
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</thead>
<tbody>
<tr>
<td>AMSURG</td>
<td>9.27x</td>
</tr>
<tr>
<td>Surgery Partners</td>
<td>9.64x</td>
</tr>
<tr>
<td>Surgical Care Affiliates</td>
<td>10.93x</td>
</tr>
</tbody>
</table>
FMV Considerations
Comparable Transactions - HAI's Annual ASC Valuation Survey

EBITDA Multiple Trend for Controlling Interests in Multi-Specialty ASCs

- 4.0-4.9x
- 5.0-5.9x
- 6.0-6.9x
- 7.0-7.9x
- 8.0+

2013 2014 2015 2016
Common Errors/Pitfalls in FMV Analyses for Joint Ventures

- Forgetting to Adjust the Income Statement
  - Normalize Revenue
  - Fully Accounting for Appropriate Expenses
    - Fixed Costs
    - Management, billing and collecting, other
    - Supplies

- Use of Valuation Approach(es)

- Assessment of “Risk”

- Level of Value (Secondary Discounts)

- Adjusting for Stock vs. Asset Deal
Thank You!
Valuation Considerations in ASC Joint Ventures

Please contact me if you have questions regarding this presentation.

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