Outpatient Surgery Magazine

What's Your Center Really Worth to a Corporate Partner?

Find out what you can do to command a premium price from a buyer in today's market.

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Picture a physician-owned ambulatory surgery center in its third year of operation. The center is profitable and thriving, and the owners decide it's time to cash out some of their equity, unload some risk and link up with a corporate partner to help take the business to the next level. They hear it's a seller's market these days, and that multiples are at an all-time high. There must be a dozen ASC companies chomping at the bit for a chance to partner with them, right?

Well, maybe. "Just because you're profitable doesn't mean you're going to command the highest multiples," says Todd Mello, a principal at Healthcare Appraisers in Castle Rock, Colo. Jon Vick, president of California-based consulting firm ASCs, Inc., says it may even be possible that a center is too profitable to attract a corporate partner. That's because most companies are looking to invest in a center with growth potential, not a business that's already peaked. Assessing an ASC's worth is like peering into a crystal ball: What's the likelihood that it will still be profitable three, six, 10 years down the line? What legal, regulatory and market risks are on the horizon? How does the potential buyer know you'll be faithful to the partnership? To help you answer those questions, we asked valuation experts, management consultants and ASC companies to give a buyer's-eye view of the valuation process.

Future growth and potential risk

"Value is the expectation of the future economic benefits of ownership," says Robert James Cimasi, president of St. Louis-based Health Capital Consultants. "What happened in the past is not always the best indicator of what's going to happen in the future." You've got to show the buyer that your center's going to stay profitable, and that there's room to grow. "Put yourself in your prospective partner's shoes," says Joni Steinman, managing principal of San Diego-based AUSMS Healthcare Consultants. Before you begin shopping around, obtain a better understanding of how corporate entities will assess the profitability and growth prospects of your ASC, since these are the things that will ultimately determine the dollar amount you'll be offered. "When you've got a buyer and a seller on a different planet in terms of pricing expectations, unless somebody gets realistic, [the deal] isn't going to happen," warns Mr. Mello.

Management and development companies consider many factors, both tangible and intangible, as they assess the potential for risk and growth. Here are the four main considerations.

How We Boosted Our Curbside Appeal

Last year AmSurg bought a 51-percent controlling interest in the Lancaster Gastroenterology Procedure Center in Lancaster, Pa., at a multiple of more than seven times EBITDA. Here's how we were able to boost our value in preparation for the sale.

- **Timing.** My physician-partners and I always knew, from the time we opened our GI center in September 2003, that we'd eventually want to bring in a corporate partner to help take some of the risk off the table and gain their expertise in contracting and other aspects of running the business. But instead of bringing the corporate partner in on the front end, we wanted to first build up the business on our own and obtain the profits from that endeavor. When we decided the time was right to begin shopping around for a corporate partner, we'd been operating for about three and a half years, and out of about 22 centers in all of Pennsylvania, we were the second or third most profitable. Our operating margin was about 68 percent — more than the average 50 percent to 60 percent for most surgery centers. We had done the work, and felt it was time to take some of the cash off the table.
- **Demonstrated growth.** I don't have an MBA, but I have a strong personal interest in business, and it seemed to me from the very beginning that the center's value to a corporate partner was going to be based not just on our cash flow, but on our profit generation and our growth rate — meaning the rate at which we had grown so far, and the rate at which we could expect to grow in the coming years. So we built several strategies into the fabric of our practice that would foster growth, such as a detailed patient recall program for colonoscopies (we have a successful recall rate of about 75 percent), a colonoscopy "on demand" referral program and the use of nurse practitioners to help with consults and case presentations, which increased our clinical efficiency and magnified the number of patients referred to our center. Those strategies let us nearly triple our endoscopy caseload in five years, and they greatly increased our value in the eyes of potential corporate partners.
- **Competitive bids.** With the help of an outside mediator — Jon Vick of ASCs, Inc. — we solicited bids from four competing companies. Two of the firms were concerned about investing in a single-specialty GI center, considering the recent changes in Medicare reimbursements. But after negotiating with the other two, we were able to raise our sales price 5 percent and command a higher multiple. It's been a very profitable move for our center so far, and we're continuing to grow by adding ancillary services and promoting our practice to referring doctors.

— Fred Saunders, MD

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1. The payor/case mix. Many of the experts we talked to said the No. 1 factor that tends to inflate a surgery center's perception of its own worth is if most of its cases are done out-of-network. Some ASCs, particularly in California and New Jersey, find that they can boost profits by taking on a lot of out-of-network patients, but Kenny Hancock, president and chief development officer at Meridian Surgical Partners in Brentwood, Tenn., says this strategy represents significant risk to a potential buyer because it may not be sustainable. If the center is forced to go in network down the line, profits will plunge considerably. "The biggest mistake that a buyer can make is to pay for a cash flow amount that is not stable," says Mr. Hancock. If more than 20 percent of a center's cases are out-of-network, "it's probably going to be beyond our risk tolerance."

Medicare's new ASC payment system has greatly impacted the value of some specialties, for better (orthopedics, ENT) or for worse (GI). If your center has a case mix that's highly concentrated in one specialty or procedure, that could increase the risk, says Mr. Cimasi. Most companies are looking to invest in multi-specialty centers. To demonstrate your facility's potential for growth, Joan Dentler, a principal at ASC Strategies in Austin, Texas, recommends preparing cost-benefit analyses of new cases you could bring in, including any new capital expenses that may be needed.

Although the market favors multi-specialty centers, a single-specialty facility with a savvy business plan can still attract corporate partners.

Chicago-based NovaMed recently purchased a 51-percent interest in the Interventional Pain Management Center in Baton Rouge, La. Physician-owner Mike Burdine, MD, admits that "most companies are looking for diversification," but says he and his partners "found our strength is knowing what we do and doing it better than the community standard, and being able to expand our model." Dr. Burdine, the majority physician-owner, had a detailed, post-sale growth plan for the center, and he says that's what was most attractive to prospective buyers. "If I had not had a plan, I don't think they would have been as interested."

Who's doing the cases at your center is also a consideration. Mr. Mello says that if surgeons who don't own shares are doing many procedures, or if a single owner is doing most of a center's procedures, those are considered risk factors that can bring down the value of the facility. Buyers want to see a balanced mix of cases, payors and surgeons.

2. The surgeons and staff. A corporate partnership is a business transaction, but it's also the start of a new relationship. Bill Kennedy, senior vice president for business development at NovaMed, says his company looks for "a functioning group of doctors" who can get along and demonstrate the ability to bring in new people. Nashville-based HealthMark Partners strives for "compatibility," not just with the doctors but also with administrators and staff, says president and CEO Bill Southwick. "The reason those things are so important to us is they often determine the life cycle of the surgery center."

How do ASC companies measure compatibility? Mr. Southwick describes it as "almost a gut check on the front end," but he says there are specific indicators companies look for in the due diligence process. The minutes from board meetings show who's engaged with the ASC's day-to-day operations and who's not. The average age and turnover rates of surgeons and staff are also clues. "Is there going to be a mass exodus of staff post-transaction?" asks Ms. Dentler. Have stringent non-compete clauses in your physician contracts that prevent your partners from investing in competing facilities. This lets buyers know that the doctors are committed to your facility and its future.

Recruitment opportunities can also indicate an ASC's growth prospects. Buyers will look to see if there's a crop of new doctors in the area and if your center's been able to woo any of them, or has a plan for doing so. Be prepared to give buyers the names, volumes (by CPT code) and contact information of potential physician-partners you've identified, says Ms. Dentler. Bob Goettling, partner at ASC consulting firm The Bloom Organization, says you should refine the language in the buy-in and buy-out provisions of your operating agreement so you can demonstrate that you've got a plan for letting older physicians go and bringing newer docs in.

Mr. Cimasi says buyers may request feedback from staff and patient satisfaction surveys. They're going to look at "depth of management" — the experience of the management team, their ability to handle exigencies and to recruit and retain talented nurses and staff. Are they staying on top of best practices, training and professional development? These factors have "a huge intangible value to a surgery center valuation," says Mr. Cimasi.

3. The market. Some of the main factors that can impact your ASC's valuation aren't directly within your control, such as federal and state regulations, local competition from hospitals and other ASCs, and the availability of new surgeons.

In addition to the federal laws that govern all ASCs, Mr. Cimasi notes that potential investors are going to look at state regulations that restrict physician ownership, such as New Jersey's Codey Act. Those types of laws "add a level of volatility to the investment," he says. "Volatility in the minds of many investors indicates risk.... The higher the risk, the higher the required rate of return and the lower the value." Mr. Cimasi recommends retaining the services of a health law attorney who can stay up to date on the regulatory issues impacting your business.

Other regulations, such as certificate of need requirements in some states, can work in your favor by creating "barriers to entry" for competing centers, says Mr. Hancock.

4. The facility. The physical aspects of the surgery center — everything from the size of the building to the technology and equipment within its walls — can also impact value. Does the facility have room to take on a more ambitious case mix and workflow, or is it already functioning at capacity? Again, buyers are looking for growth potential, which may mean adding different types of procedures and equipment down the line. If the facility looks well-equipped to deal with such changes, that will have a positive impact on the valuation.

Buyers want to see that ASCs "have the technology ... that's going to let them attract the 'primary customer' — the physicians," says Mr. Cimasi. He uses the term "technology" as a catch-all to describe not just the surgical and diagnostic equipment inside the walls of the facility, but also the configuration and infrastructure of the center itself.

Stephen Faro, vice president of development for Dallas-based National Surgical Care, says his company evaluates the age and condition of the capital equipment, the physical plant and the software used at a center when determining its value.

Putting a Price on Your ASC

The most common way to determine a surgery center's price, or valuation, is to apply a multiple to the center's real earnings. Since "real earnings" isn't an accounting term, most use the technical measure of EBITDA to approximate real earnings.

EBITDA (pronounced ee-bit-dah) is a measure of the center's Earnings Before Interest, Taxes, Depreciation and Amortization. Put simply: EBITDA best approximates how much cash the center would produce — and therefore how much cash the buyer could expect to put toward debt service, capital expenditures or partnership distributions — in an ideal situation. This number is higher than the ASC's income or profit since it doesn't include non-operating expenses (interest and taxes) and non-cash expenses (depreciation and amortization) that reduce the center's income or profit, but not necessarily its cash flow.

The multiple indicates how many times the EBITDA should be multiplied to get the purchase price. Put another way, it's the inverse of an expected rate of return. For example, to get a 20-percent rate of return, a 5 multiple would be applied to the EBITDA. Multiples for surgery centers selling a controlling interest (51 percent or more) currently range from 5 to more than 7. While each company has its own set of variables that determines the multiple they'll place on a transaction, ultimately the decision is guided by the company's expected internal rate of return on the ASC investment.

A word of advice: Don't focus solely on the multiple. By making downward adjustments to your EBITDA, buyers can convince unsophisticated sellers that they're getting a higher multiple, even though they're applying it to a discounted EBITDA number. In other words, getting a higher multiple doesn't necessarily mean you're getting a better price.

— Robert Goettling, JD

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Do your homework

Many surgeons prefer to focus on patient care instead of the nitty-gritty aspects of running a business, but experts say you should become knowledgeable of the valuation process and all the factors that go into it. "Instead of letting the process guide you, guide the process by knowing what you want the endgame to be and figuring out how to get there," says Mr. Southwick. "It's very much a process, and it takes months, not weeks."

Mr. Goettling uses the analogy of selling a house: Just as you're going to fix up the parts of your house that will give it the most "curb appeal" to a potential buyer, you've got to clean up your ASC to make it as attractive as possible to a corporate partner. "The buyers are going to do their own analysis, crunch the numbers, come out with an EBITDA, put a multiple on it and take it to the doctors. It behooves the doctors to ... have someone do some internal number crunching to examine if what the buyer came up with is fair," says Mr. Mello.

One way to stay on top of the game is to have your accountants keep your financial records on an accrual basis, not a cash basis. That means taking payables and receivables into account, which more "accurately reflects the ability of the ASC enterprise to generate profit," says Mr. Cimasi. He recommends keeping your books on an accrual basis from the start to avoid doing a costly and time-consuming cash accrual conversion once you decide to sell.

Benchmarking can also help you understand your facility's worth as it relates to the industry as a whole. "Most centers that I've worked with have no idea how their metrics compare with other centers," says Mr. Vick. "It's very important for them to know that, because the companies are going to compare them with other centers they're looking at."

As one of the founders of NovaMed and a 15-year veteran of the ASC mergers and acquisitions business, Mr. Goettling of The Bloom Organization is willing to let you in on a little secret: The ASC companies aren't just looking for a good deal. In fact, most of them are willing to get out their checkbooks and spend a little more for a center that, after all due diligence is complete, looks like a low-risk investment with high-growth potential. "They'd much rather pay more and have less risk," says Mr. Goettling, than get a great deal on a center that's bound to fail in another year or two. The key, then, is not to convince the corporate partner to pay more than it wants to, but to demonstrate that your surgery center truly is well worth the investment.