

2015
ASC
Valuation
Survey

*How do the ASC
companies assess value?*



Executive Summary

We are pleased to announce the results of HealthCare Appraisers' 2015 ASC Valuation Survey. Since 2003, HealthCare Appraisers, Inc. has surveyed the ambulatory surgery center (ASC) industry to determine trends in the value and characteristics of ASC ownership interests and management fees charged to ASCs. Twenty-one respondents, representing well over 500 surgery centers throughout the country, responded to this year's survey. The following summarizes highlights of the 2015 ASC Valuation Survey.

Transaction Activity

During 2014, our respondents were actively searching for potential acquisitions to grow the amount of ASCs under ownership. 25% of respondents have 11 to 30 ASCs under ownership, and 30% of respondents have 31 or more ASCs under ownership.

Respondents indicated significant levels of acquisition activity in the ASC space, with 38% reporting the acquisition of between one and five centers, 24% reporting the acquisition of between six and

10 centers, and 10% reporting the acquisition of over 16 centers in 2014. 29% of respondents did not acquire an ASC in 2014.

For 2015, acquisition activity is expected to remain high, as 60% of our respondents plan to purchase between one and five ASCs, 25% plan to purchase between six and ten ASCs, and 5% plan to purchase 16 or more ASCs. 5% of respondents are not planning to purchase over the next 12 months.

Valuation Multiples and Methodologies

When purchasing a **minority** interest in a **single-specialty** ASC, 25% of the respondents reported prevailing valuation multiples of 3.0 to 3.9 times EBITDA, while 62% reported higher valuation multiples ranging from 4.0 to 6.9 times EBITDA.

When purchasing a **controlling** interest in a **single-specialty** ASC, 65% of the respondents reported prevailing valuation multiples of 6.0 to 7.9 times EBITDA, while 35% reported lower valuation multiples ranging from 4.0 to 5.9 times EBITDA.

These valuation multiples are consistent with the previous survey in which 70% of respondents reported valuation multiples of 6.0 to 7.9 times EBITDA for controlling interests in single-specialty ASCs, while 30% reported lower valuation multiples ranging from 4.0 to 5.9 times EBITDA.

When purchasing a **minority** interest in a **multi-specialty** ASC, 60% of the respondents reported prevailing valuation multiples of 4.0 to 5.9 times EBITDA, while 14% reported higher valuation multiples ranging from 6.0 to 7.9 times EBITDA, and 27% reported lower valuation multiples ranging from 2.0 to 3.9 times EBITDA.

When purchasing a **controlling** interest in a **multi-specialty** ASC, 78% of the respondents reported prevailing valuation

multiples of 7.0 to +8.0 times EBITDA, while 23% reported lower valuation multiples ranging from 5.0 to 6.9 times EBITDA.

The current survey indicates that multiples for multi-specialty ASCs are comparatively higher than the previous survey. According to the current survey, 78% of respondents reported multiples of 7.0 to +8.0 times EBITDA for controlling interests in multi-specialty ASCs, versus 56% in the prior survey.

A majority of respondents are willing to pay a premium for an ASC with a certificate of need (CON). 57% of respondents would pay a premium of 0.51 to 1.0 to the typical multiple.

For 57% of respondents, out-of-network revenue at 20% of the ASC's total revenue would exceed the risk tolerance as a viable investment. However, we note that 16% of respondents do not have a risk threshold with respect to out-of-network ASCs. In valuing out-of-network ASCs, 40% of respondents would reduce the typical multiple by greater than 2.0. 47% of respondents report they utilize an adjusted pricing model by converting revenue to reflect in-network rates and then modeling the ASC's adjusted EBITDA multiplied by unadjusted market multiples.

ASC Characteristics

Respondents indicated that annual inflation is evident, particularly for Commercial payor rates, medical supplies and implantable device costs, ASC staff raises, and all other ASC expenses.

90% of respondents prefer between six and fifteen physician owners for a **single-specialty** ASC. 89% of respondents prefer between 11 and 20 physician owners for a **multi-specialty** ASC.

From an equity standpoint, our respondents' preferred ownership varied, with 10% of respondents reporting they prefer less than 10% ownership, 60% of respondents reporting they preferred between 11% and 50% ownership, and 30% of respondents reporting they preferred greater than 50% ownership.

When determining purchase price for minority interest transactions with new or existing physician investors, 50% of

respondents use a formula, and 30% of respondents obtain an independent FMV appraisal to determine value.

When selling a minority interest to new physician investors, 55% of respondents reported an average period of three to six months to consummate a sale. When selling a controlling interest in an ASC, 60% of respondents reported an average period of six months to one year to consummate a sale. 44% of respondents report they have sold a controlling ASC interest to a hospital/health system or one or more third parties.

40% of respondents expect 3.1% to 6.0% earnings growth per year during the first several years post transaction, while 20% of respondents expect greater than 12% earnings growth per year post acquisition.

Management Fees

69% of respondents report that their typical management fees range from 5% to 6% of net revenue, while 11% report typical management fees of 7% of net revenue.

These management fees are comparatively lower than the previous survey, in which 79% of management fees ranged between 5% and 6%. Additionally, contrary to thinking, the proportion of respondents charging management fees of 7% increased year over year, while that proportion charging 4% also increased.

45% of respondents indicate that their typical minimum management fee ranges from \$100,000 to \$199,999 per year. Furthermore, 40% of respondents have arrangements whereby the management fee rate varies based on the revenue generated by the ASC (*i.e.*, a sliding scale).

15% of respondents indicated they have management fee arrangements wherein part of their fee is "at risk" for

performance metrics, while 85% of respondents indicated they have no "at-risk" management fee arrangements.

68% of respondents maintain an equity interest in all of the ASCs they manage.

Respondents indicated that management duties commonly provided as part of the management contract include: access to GPO, accounting services, financial and operational benchmarking, business development services, legal support, human resources, access to revenue cycle and supply chain executive(s), managed care contracting, data warehouses, mock accreditation surveys, and oversight from a regional vice president.

58% of respondents observe typical fees for ASC billing and collection services ranging from 3.0% to 4.9% of collections.

1. How many ASCs do you have under ownership?

ASCs Under Ownership	% Respondents
10 or fewer	45%
11 to 20	10%
21 to 30	15%
31 to 40	5%
41 to 50	5%
51+	20%

2. How many ASCs do you have under management?

ASCs Under Management	% Respondents
10 or fewer	45%
11 to 20	5%
21 to 30	20%
31 to 40	5%
41 to 50	5%
51+	20%

3. How many ASCs (or ASC interests) did you purchase during the last 12 months?

Number of ASCs Purchased	% Respondents
None	29%
1 to 5	38%
6 to 10	24%
11 to 15	0%
16+	10%

* Does not total 100% due to rounding

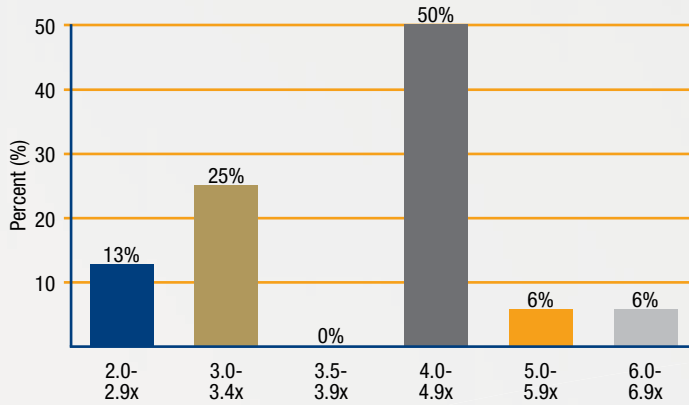
4. How many ASCs (or ASC interests) do you plan to purchase over the next 12 months?

Number of ASCs Planned for Purchase	% Respondents
None	5%
1 to 5	60%
6 to 10	25%
11 to 15	5%
16+	5%

5. What valuation multiples have you most typically observed in the marketplace during the past 12 months for predominantly in-network centers? Please select one value for each column.

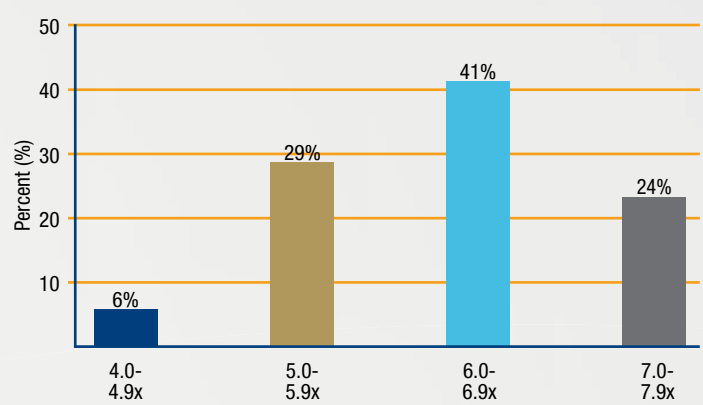
Minority Interest

Single-Specialty



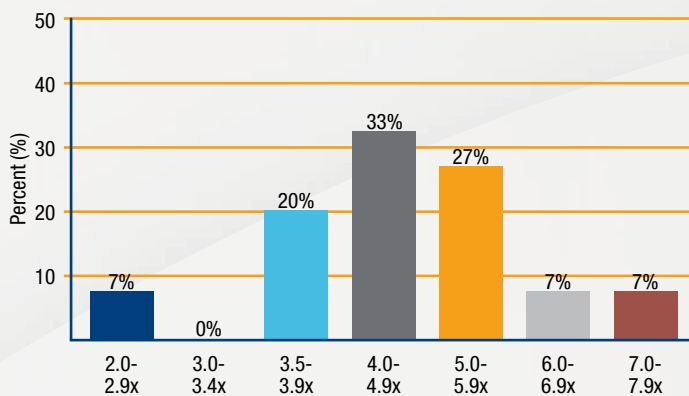
Controlling Interest

Single-Specialty



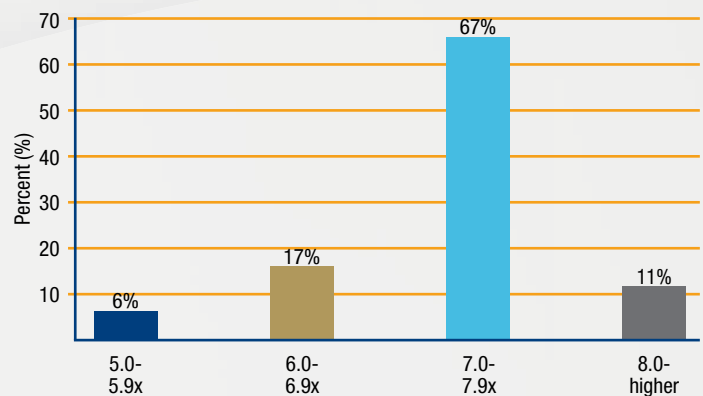
Minority Interest

Multi-Specialty



Controlling Interest

Multi-Specialty

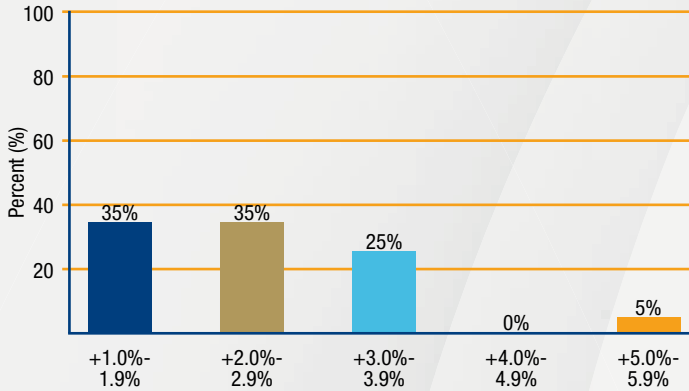


* Does not total 100% due to rounding

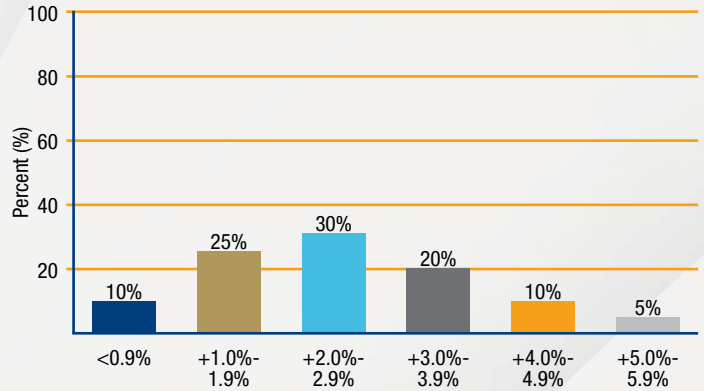
* Does not total 100% due to rounding

6. What is the typical annual change you observe in the ASC market for each of the following items?

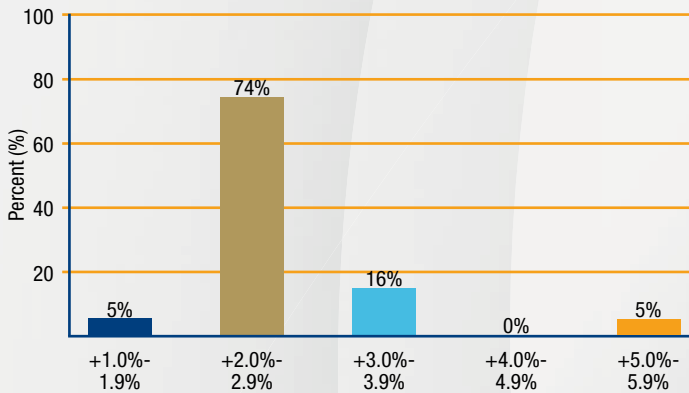
Commercial Payor Rates



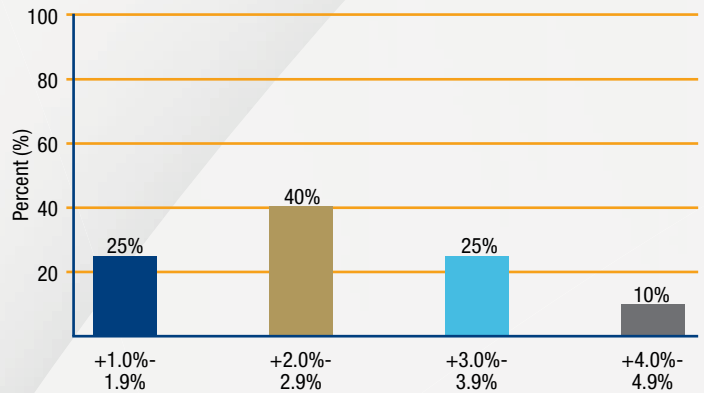
Medical Supplies and Implantable Device Costs



ASC Staff Raises

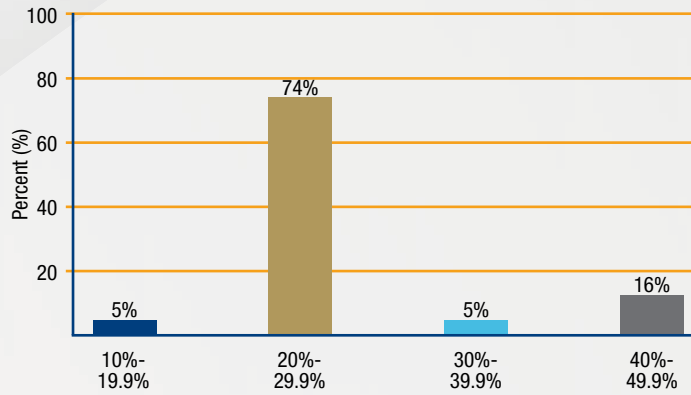


All Other ASC Expenses

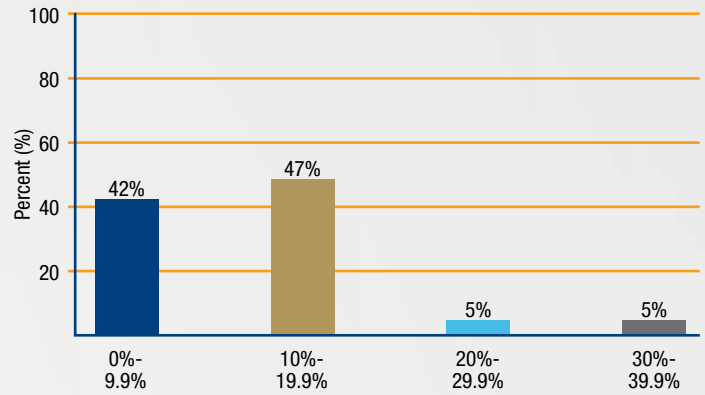


7. What percentage of revenue do you observe for the following ASC operating expenses (in-network centers only)?

Salary and Benefits

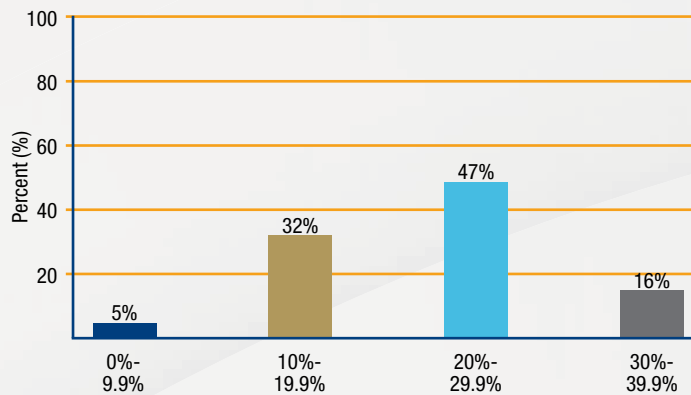


Occupancy

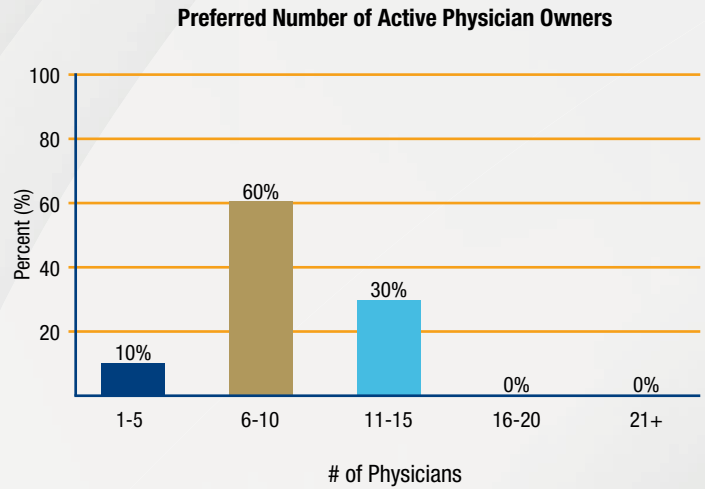


* Does not total 100% due to rounding

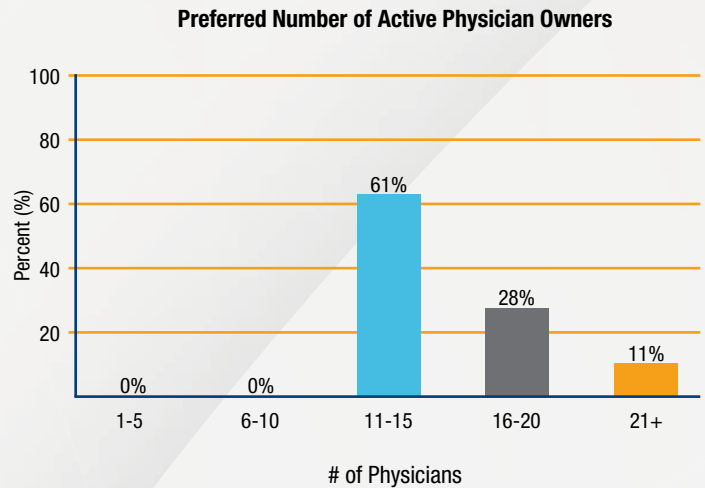
Drugs, Medical Supplies and Implantables



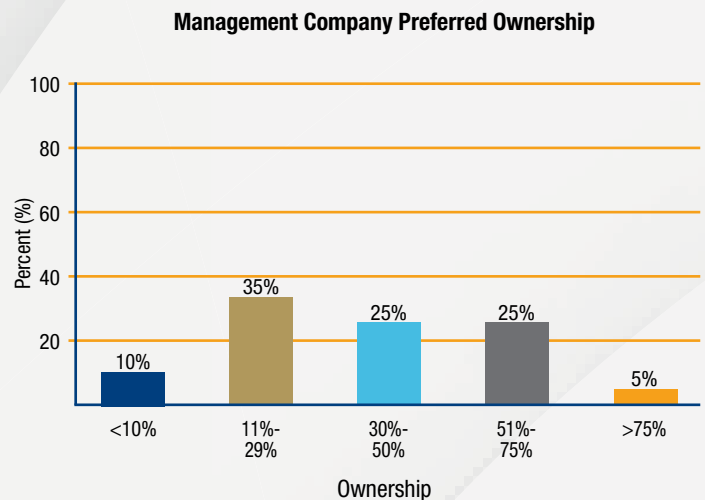
8. For single-specialty centers, your company generally prefers how many active physician owners?



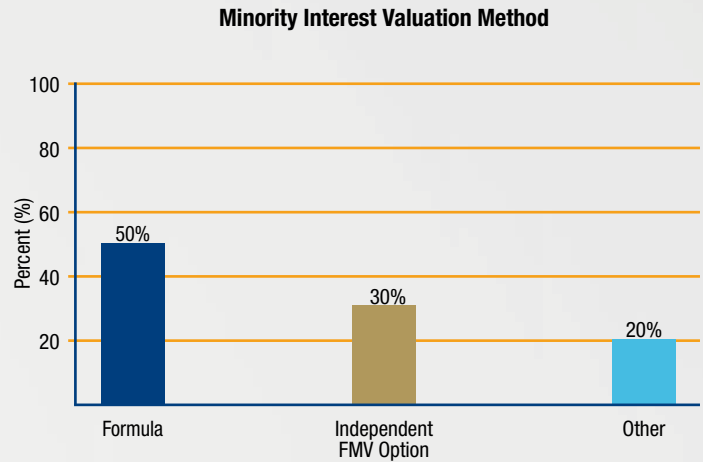
9. For multi-specialty centers, your company generally prefers how many active physician owners?



10. From an equity standpoint, your company's preferred ownership is:



11. How do you determine the purchase price for minority interest transactions (e.g., new or existing physician investors)?



12a. When selling minority interests to new physician investors, on average, how long does it take to identify the buyer and consummate the sale?

Time to Sell	% Respondents
Less than 3 months	15%
3 to 6 months	55%
6 months to 1 year	20%
Greater than 1 year	10%

12b. If you have sold a CONTROLLING interest in a center during the last year, approximately how long did it take to identify a buyer and consummate the sale?

Time to Sell	% Respondents
Less than 3 months	0%
3 to 6 months	30%
6 months to 1 year	60%
Greater than 1 year	10%

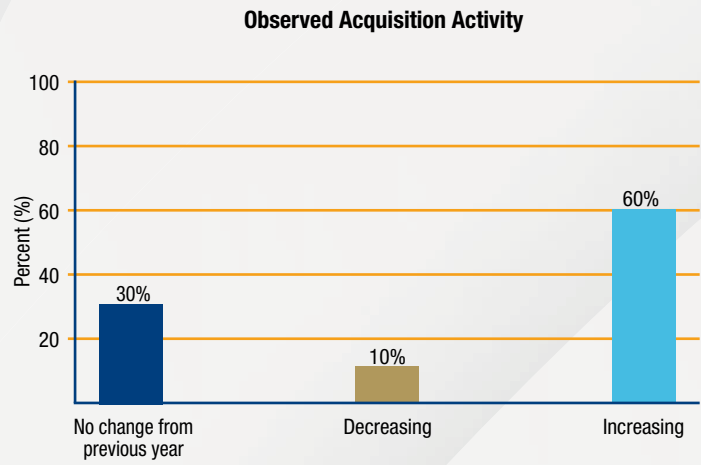
12c. If you have sold a CONTROLLING interest, was the buyer of your interest?

Buyer	% Respondents
A single outside 3rd party	56%
A single existing owner	0%
Multiple outside parties	0%
Multiple existing owners	0%
A hospital or health system	44%

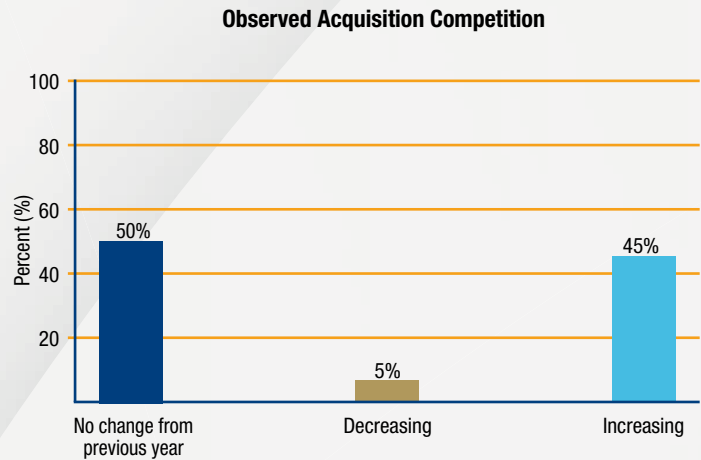
13. In the past year, what best describes the multiples paid (or considered) by your company?

Multiple Trends	% Respondents
No change from previous year	45%
Decreasing (<i>i.e.</i> , less competition)	5%
Increasing (<i>i.e.</i> , more competition)	50%

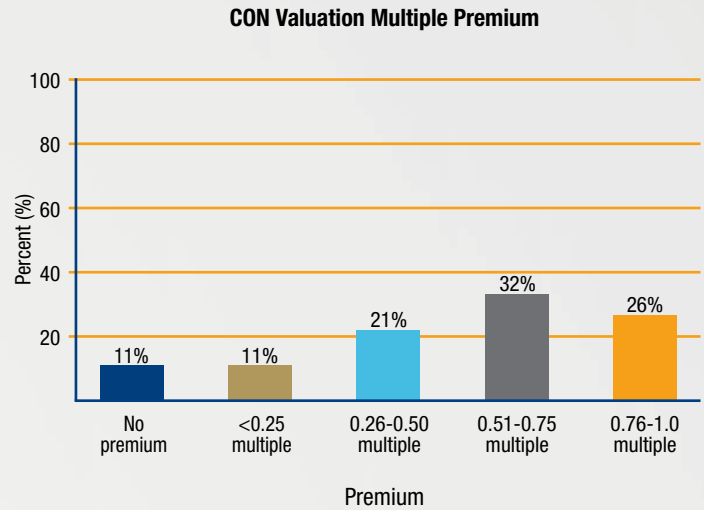
14. In the past year, what best describes your observations in the ASC marketplace related to acquisition activity?



15. In the past year, what best describes your observations related to competition for acquisitions?

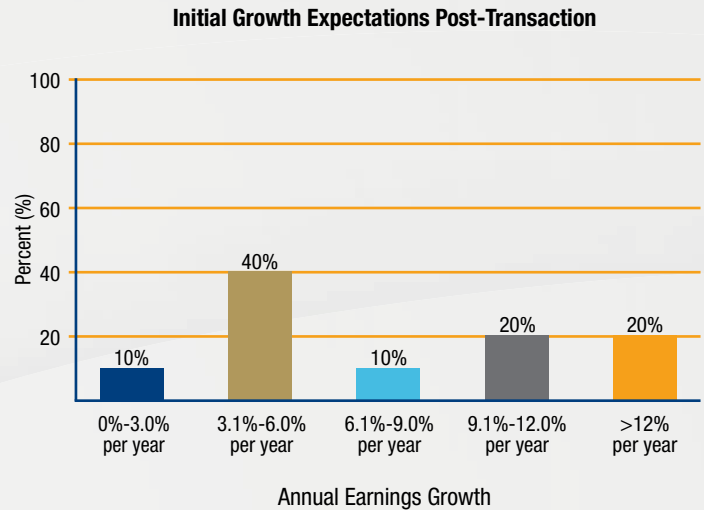


16. What is the magnitude of the premium paid by your company for a surgery center with a CON?

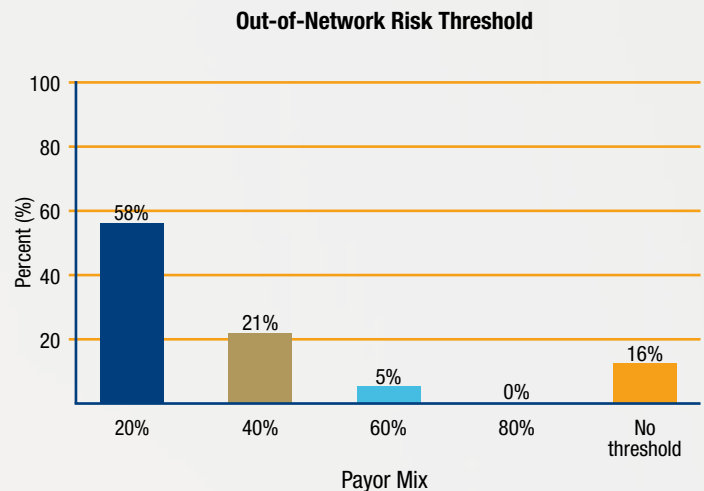


* Does not total 100% due to rounding

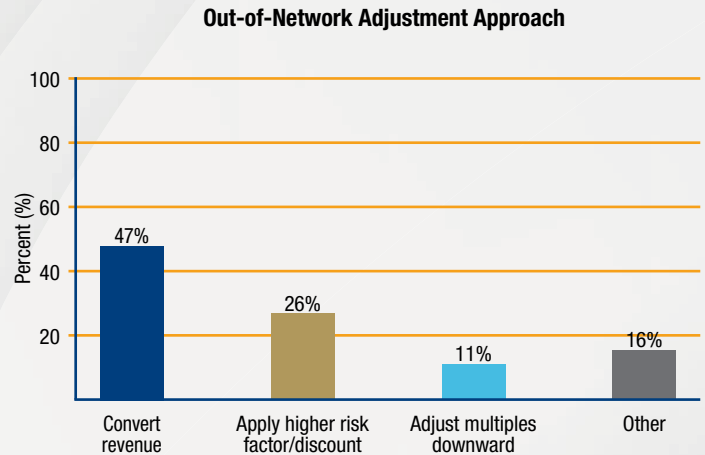
17. When evaluating an acquisition target, what level of earnings growth is typically expected in the first several years post acquisition?



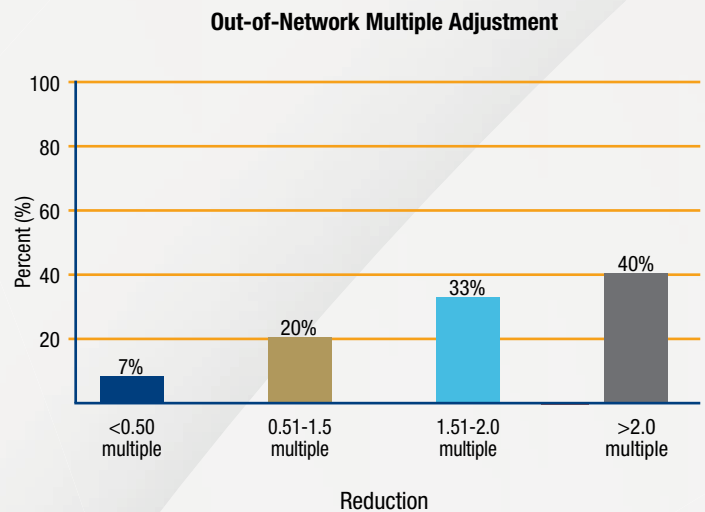
18. At what percentage of total revenue does out-of-network volume exceed your risk tolerance?



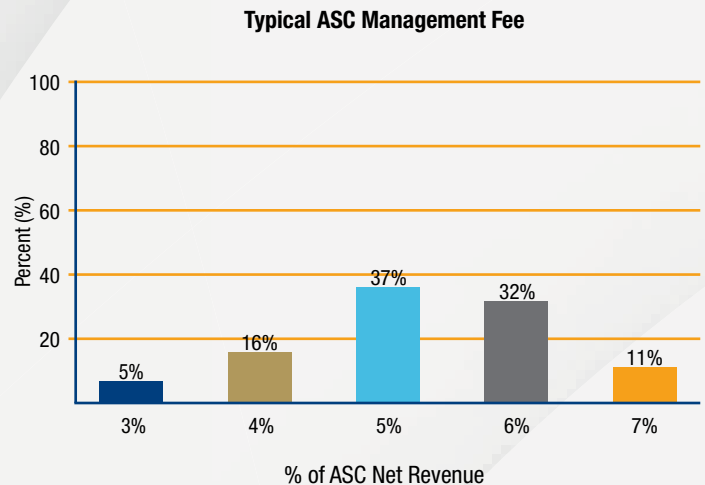
19. How does your company adjust valuation models/pricing for out-of-network centers?



20. If applicable, what is the magnitude of the reduction to the multiple for a center with an out-of-network strategy (i.e., the center generally is not contracted with any payors)?



21a. What is the typical management fee rate your company charges for ASCs (% of net revenue)?



* Does not total 100% due to rounding

21b. Do you have a minimum annual management fee?

Minimum Fee	% Respondents
Yes	50%
No	50%

21c. If yes, what is the typical annual minimum management fee you charge?

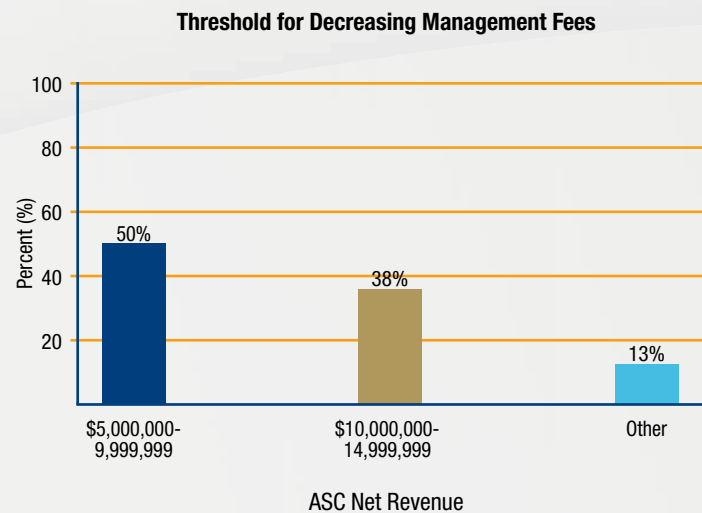
Minimum Fee	% Respondents
<\$100,000	9%
\$100,000 to \$199,999	45%
\$200,000 to \$299,999	27%
>\$300,000	18%

* Does not total 100% due to rounding

22a. Do you have any ASC management arrangements wherein the management fee charges vary based on revenue levels of the surgery center (*i.e.*, do you use a sliding scale)?

Sliding Scale	% Respondents
Yes	40%
No	60%

22b. If you responded yes to 22a, at what threshold for annual ASC net revenues do management fees typically decrease?



* Does not total 100% due to rounding

23. Do you have any ASC management fee arrangements wherein part of your fee is at risk?

Part of Management Fee at Risk	% Respondents
Yes	15%
No	85%

24. Does the management fee charged vary based on the level of services provided?

	% Respondents
Yes	40%
No	60%

25. What is the typical management fee rate your company charges for surgical and specialty hospitals?

Management Fee % Net Revenue	% Respondents
0.00% to 0.99%	0%
1.00% to 1.99%	0%
2.00% to 2.99%	0%
3.00% to 3.99%	30%
4.00% to 4.99%	40%
5.00% to 5.99%	20%
>6.00%	10%

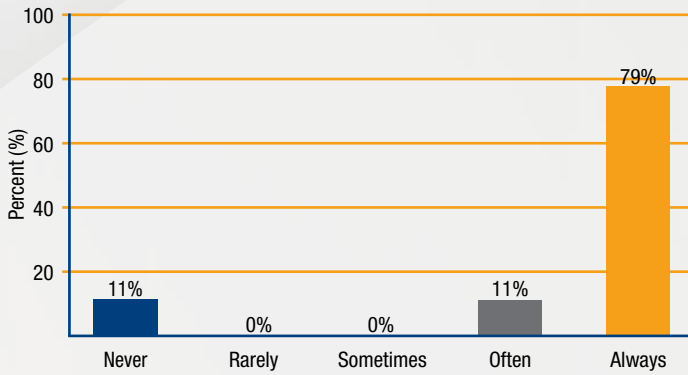
26. Do you maintain an equity ownership in all freestanding entities that you manage?

Management Equity	% Respondents
Yes	68%
No	32%

27. Which management services do you typically provide as part of your management agreement?

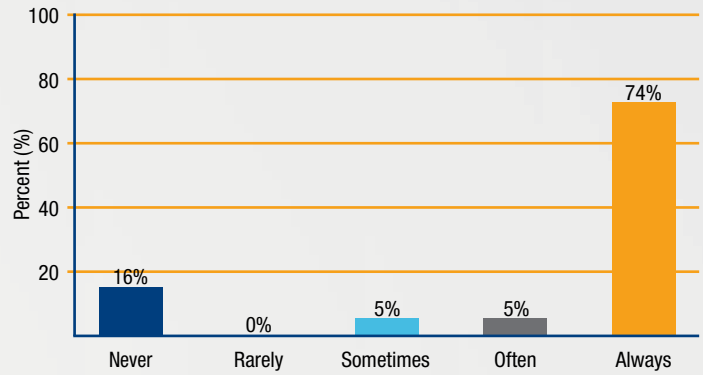
Management Duties (costs not passed through)

Access to GPO

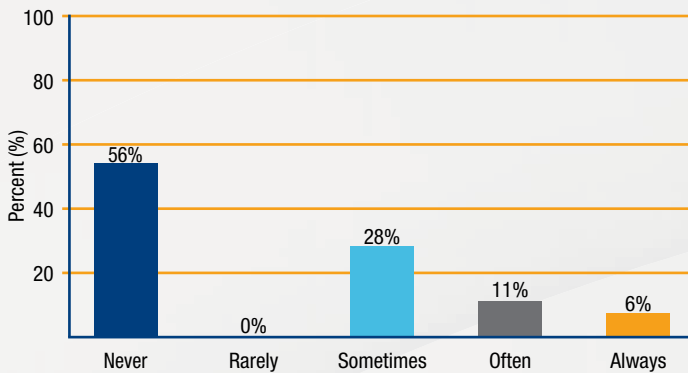


* Does not total 100% due to rounding

Accounting

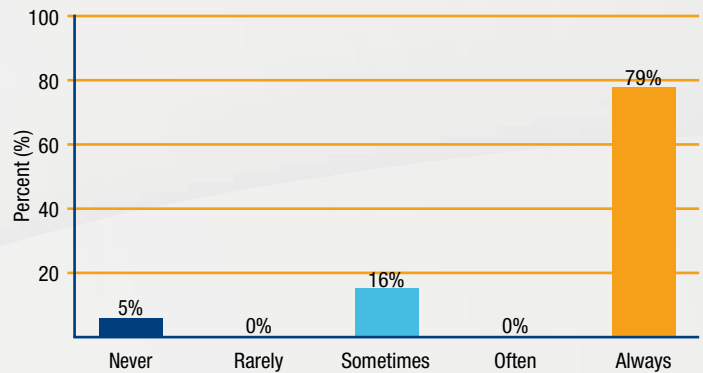


Architecture and Design

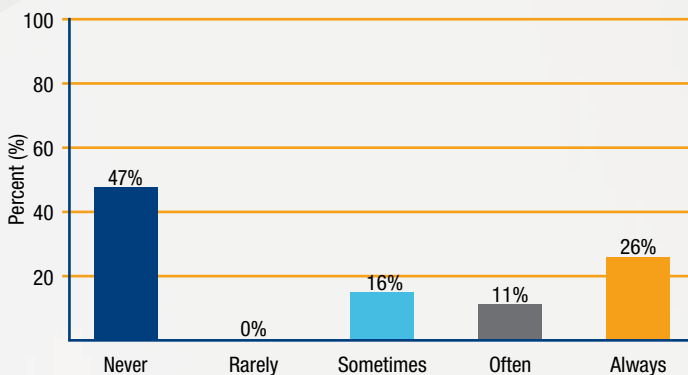


* Does not total 100% due to rounding

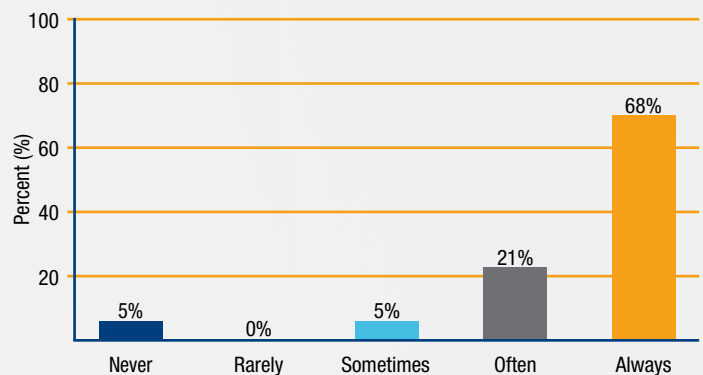
Benchmarking Based on Other Equity Owned Centers



Coding



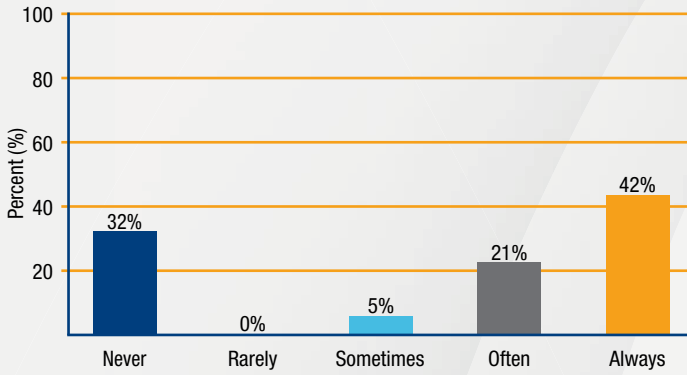
Corporate Business Development Executive or Staff



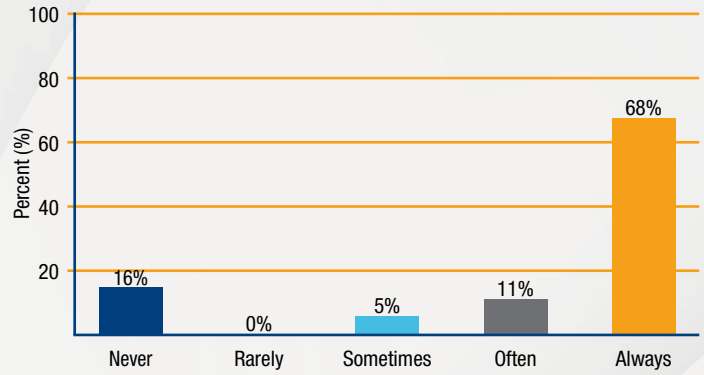
* Does not total 100% due to rounding

27. Continued from previous page

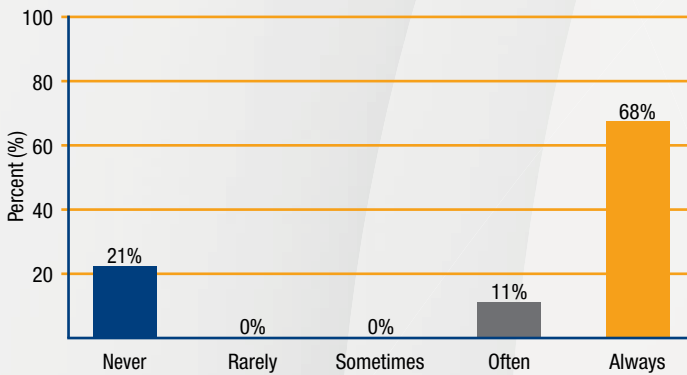
Corporate Counsel or Legal Support



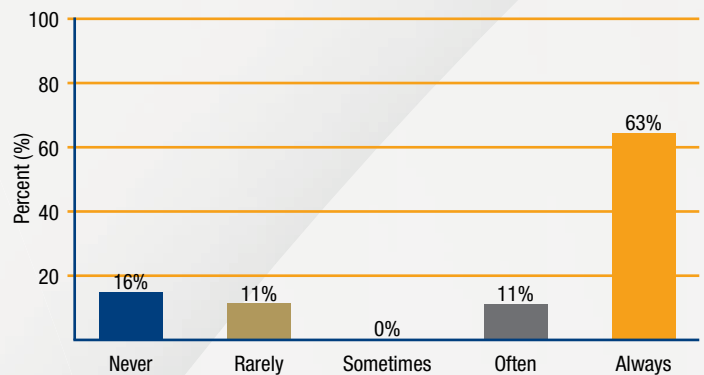
Corporate Human Resources Executive or Staff



Corporate Revenue Cycle Executive or Staff

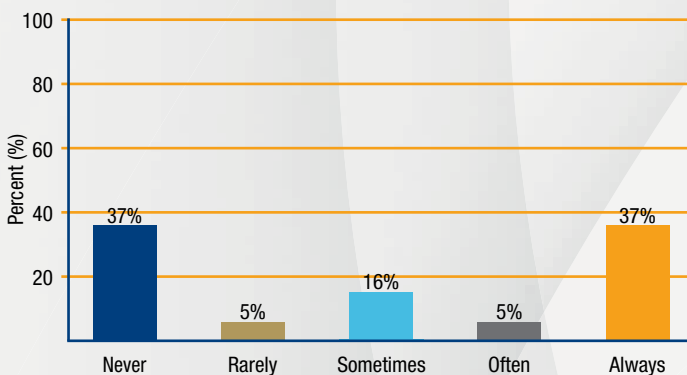


Corporate Supply Chain Executive or Staff

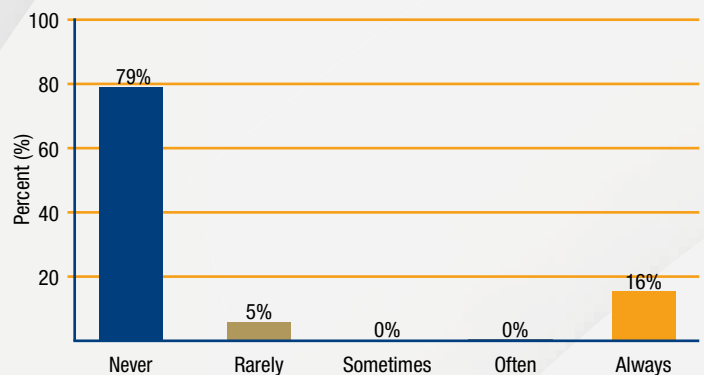


* Does not total 100% due to rounding

Data Warehouse

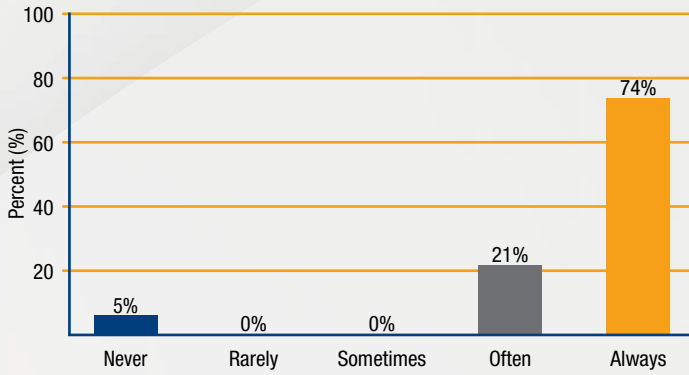


Dictation

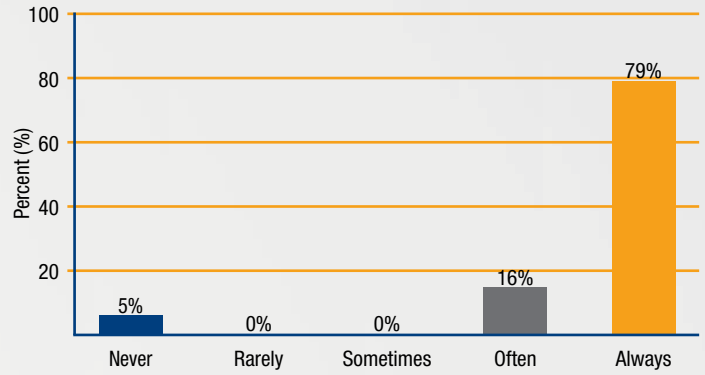


27. Continued from previous page

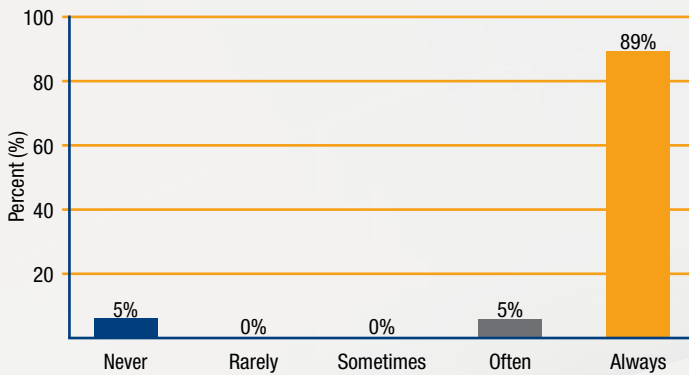
Managed Care Contracting



Mock Accreditation Surveys



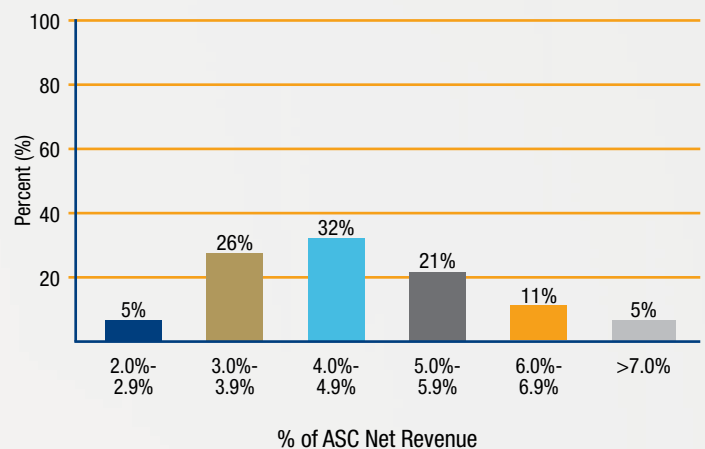
Oversight by Regional Vice-President of Operations



* Does not total 100% due to rounding

28. What are the typical fees you have observed in the market for surgery center billing and collections services provided by third parties? (as a % of net revenues)

ASC Billing Fees



Participants

- Ambulatory Alliances, LLC
- ASCOA
- ASCs Inc.
- ASD Management
- Arise Healthcare
- Avanza Healthcare Strategies
- The Bloom Organization, LLC
- Community Health Systems, Inc.
- Compass Surgical Partners
- Covenant Surgical Partners, Inc.
- LifePoint Hospitals, Inc.
- Meridian Surgical Partners
- Merritt Healthcare
- National Surgical Healthcare
- Nueterra
- Partners Medical Consulting
- Physicians Endoscopy
- Regent Surgical Health
- Surgery Partners
- Surgical Care Affiliates
- United Surgical Partners International

Disclaimer

The intent of this survey is to provide a summary of industry respondents' views regarding valuation, acquisition activity, ownership preferences and other trends regarding ASCs. Though our survey includes statistics regarding valuation multiples, this information should be used as general information only and should not be considered as providing any value guidance for any specific ASC interest. Business valuation is a complex process involving consideration and analysis of both financial and non-financial factors. The determination of fair market value should always be made by a qualified business appraiser with specific knowledge of the subject healthcare industry.

Notes:



HealthCare Appraisers

INCORPORATED

The Recognized Leader in Fair Market Value Analysis

www.HealthCareAppraisers.com

(561) 330-3488

Corporate Office: 75 NW 1st Avenue, Delray Beach, Florida 33444

Delray Beach | Chicago | Dallas | Denver | Nashville | Philadelphia