ASC VALUATION SURVEY

How do the ASC companies assess value?
TRANSACTION ACTIVITY

During 2015, our respondents were actively searching for potential acquisitions to grow the amount of ASCs under ownership. 17% of respondents have 11 to 30 ASCs under ownership, and 33% of respondents have 31 or more ASCs under ownership.

Respondents indicated significant levels of acquisition activity in the ASC space, with 41% reporting the acquisition of between one and five centers, 12% reporting the acquisition of between six and 10 centers, and 6% reporting the acquisition of over 16 centers in 2015. 41% of respondents did not acquire an ASC in 2015.

For 2016, acquisition activity is expected to remain high, as 61% of our respondents plan to purchase between one and five ASCs, 22% plan to purchase between six and ten ASCs, and 6% plan to purchase 16 or more ASCs. 11% of respondents are not planning to purchase over the next 12 months.

EXECUTIVE SUMMARY

We are pleased to announce the results of HealthCare Appraisers’ 2016 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 participants, representing well over 700 surgery centers throughout the country, responded to this year’s survey. The following summarizes highlights of the 2016 ASC Valuation Survey.

VALUATION MULTIPLES AND METHODOLOGIES

When purchasing a minority interest in a single-specialty ASC, 50% of the respondents reported prevailing valuation multiples of 3.0 to 3.9 times EBITDA, while 50% reported higher valuation multiples ranging from 4.0 to 6.9 times EBITDA.

When purchasing a controlling interest in a single-specialty ASC, 73% of the respondents reported prevailing valuation multiples of 6.0 to 7.9 times EBITDA, while 27% reported lower valuation multiples ranging from 4.0 to 5.9 times EBITDA.

These valuation multiples are reasonably consistent with the previous survey in which 65% of respondents reported valuation multiples of 6.0 to 7.9 times EBITDA for controlling interests in single-specialty ASCs, while 35% reported lower valuation multiples ranging from 4.0 to 5.9 times EBITDA.

When purchasing a minority interest in a multi-specialty ASC, 65% of the respondents reported prevailing valuation multiples of 4.0 to 5.9 times EBITDA, while 6% reported higher valuation multiples ranging from 6.0 to 6.9 times EBITDA, and 29% reported lower valuation multiples ranging from 3.0 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 22% reported lower valuation multiples ranging from 4.0 to 6.9 times EBITDA.

These valuation multiples are consistent with the previous survey in which 78% of respondents also reported valuation multiples of 7.0 to +8.0 times EBITDA for controlling interests in multi-specialty ASCs, while 22% reported lower valuation multiples ranging from 5.0 to 6.9 times EBITDA.

A majority of respondents are willing to pay a premium for an ASC with a certificate of need (CON). 56% of respondents would pay a premium of 0.51 to +1.0 to the typical multiple. For 53% 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 21% of respondents do not have a risk threshold with respect to out-of-network ASCs. In valuing out-of-network ASCs, of those respondents who would reduce the valuation multiple, 70% of respondents would reduce the typical multiple by greater than 2.0. 63% 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

78% of respondents prefer between six and ten 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 18% of respondents reporting they prefer less than 10% ownership, 47% of respondents reporting they preferred between 11% and 50% ownership, and 35% of respondents reporting they preferred greater than 50% ownership.

When determining purchase price for minority interest transactions with new or existing physician investors, 47% of respondents use a formula, and 37% of respondents obtain an independent FMV appraisal to determine value.

When selling a minority interest to new physician investors, 56% of respondents reported an average period of three to six months to consummate a sale. When selling a controlling interest in an ASC, 56% of respondents reported an average period of six months to one year to consummate a sale. 55% of respondents report they have sold a controlling ASC interest to a hospital/health system.

32% of respondents expect 3.1% to 6.0% earnings growth per year during the first several years post transaction, while 21% of respondents expect greater than 12% earnings growth per year in the first several years post acquisition.

MANAGEMENT FEES

61% of respondents report that their typical management fees range from 5% to 6% of net revenue, while 28% report typical management fees of 3% to 4% of net revenue.

These management fees are comparatively lower than the previous survey, in which 69% of management fees ranged between 5% and 6%, and only 21% ranged between 3% and 4% of revenue. Additionally, in the previous survey, 11% of respondents charged management fees of 7%, while only 5% of this year’s survey respondents charge 7%.

Of those 35% of respondents who reported charging a minimum management fee, 50% indicate that their typical minimum management fee ranges from $100,000 to $199,999 per year. Furthermore, 33% of respondents have arrangements whereby the management fee rate varies based on the revenue generated by the ASC (i.e., a sliding scale).

12% of respondents indicated they have management fee arrangements wherein part of their fee is “at risk” for performance metrics, while 88% of respondents indicated they have no “at risk” management fee arrangements.

58% of respondents observe typical fees for ASC billing and collection services ranging from 3.0% to 4.9% of collections.
01. How many ASCs do you have under ownership?

02. How many ASCs do you have under management?

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

04. How many ASCs (or ASC interests) do you plan to purchase Over the next 12 months?
05 How is the recently passed legislation that will restrict hospitals from converting ASCs to HOPDs expected to impact your decision on buying more ASCs over the next 12 months?

- No Impact: 78%
- Expected to buy fewer ASCs: 11%
- Expected to buy more ASCs: 11%

06 What valuation multiples have you most typically observed in the marketplace during the past 12 months for predominantly in-network centers?

### Minority Interest - Single-Specialty
- 3.0 - 3.4x: 14%
- 3.5 - 3.9x: 36%
- 4.0 - 4.9x: 29%
- 5.0 - 5.9x: 21%

### Minority Interest - Multi-Specialty
- 3.0 - 3.4x: 12%
- 3.5 - 3.9x: 18%
- 4.0 - 4.9x: 41%
- 5.0 - 5.9x: 24%
- 6.0 - 6.9x: 6%

### Controlling Interest - Single-Specialty
- 4.0 - 4.9x: 7%
- 5.0 - 5.9x: 20%
- 6.0 - 6.9x: 40%
- 7.0 - 7.9x: 33%

### Controlling Interest - Multi-Specialty
- 4.0 - 4.9x: 6%
- 5.0 - 5.9x: 17%
- 6.0 - 6.9x: 72%
- 7.0 - 7.9x: 6%
- 8.0 +: 6%

*Does not total 100% due to rounding
What is the typical annual change you observe in the ASC market for each of the following items?

### Commercial Payor Rates
- < 0.9%: 6%
- +1.0% - 1.9%: 67%
- +2.0% - 2.9%: 17%
- +3.0% - 3.9%: 11%

### Medical Supplies and Implantable Device Costs
- +1.0% - 1.9%: 31%
- +2.0% - 2.9%: 25%
- +3.0% - 3.9%: 25%
- +4.0% - 4.9%: 13%
- +5.0% - 5.9%: 6%

### ASC Staff Raises
- +1.0% - 1.9%: 12%
- +2.0% - 2.9%: 41%
- +3.0% - 3.9%: 35%
- +4.0% - 4.9%: 12%

### All Other ASC Expenses
- +1.0% - 1.9%: 29%
- +2.0% - 2.9%: 35%
- +3.0% - 3.9%: 35%

*Does not total 100% due to rounding.
What percentage of revenue do you observe for the following ASC operating expenses (in-network centers only)?

### Salary and Benefits

- **10% - 19.9%**: 12%
- **20% - 29.9%**: 65%
- **30% - 39.9%**: 24%

*Does not total 100% due to rounding

### Occupancy

- **0% - 9.9%**: 50%
- **10% - 19.9%**: 38%
- **20% - 29.9%**: 13%

*Does not total 100% due to rounding

### Drugs, Medical Supplies and Implantables

- **10% - 19.9%**: 19%
- **20% - 29.9%**: 62%
- **30% - 39.9%**: 19%
09 For single-specialty centers, your company generally prefers how many active physician owners?

Number of physicians

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

Number of physicians

11 From an equity standpoint, your company’s preferred ownership is:

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

**Minority Interest Valuation Method**

- Formula: 47%
- Independent FMV Opinion: 37%
- Other: 16%

13a **When selling minority interests** to new physician investors, on average, **how long does it take** to identify the buyer and consummate the sale?

- < 3 Months: 11%
- 3-6 Months: 56%
- 6 Months - 1 Year: 33%
- > 1 Year: 0%

13b If you have **sold a controlling interest** in a center during the last year, approximately **how long did it take** to identify the buyer and consummate the sale?

- < 3 Months: 11%
- 3-6 Months: 11%
- 6 Months - 1 Year: 56%
- > 1 Year: 22%

13c If you have **sold a controlling interest** was the buyer of your interest?

- Single Existing Owner: 0%
- Multiple Existing Owners: 9%
- Single Outside 3rd Party: 36%
- Hospital or Health System: 55%
- Multiple Outside Parties: 0%
In the past year, what best describes the multiples paid (or considered) by your company?

- No change from previous year: 33%
- Decreasing: 11%
- Increasing: 56%

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

- No change from previous year: 26%
- Decreasing: 11%
- Increasing: 63%

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

- No change from previous year: 37%
- Decreasing: 5%
- Increasing: 58%
What is the **magnitude of the premium paid** by your company for a surgery center with a CON?

<table>
<thead>
<tr>
<th>Premium</th>
<th>No Premium</th>
<th>&lt;0.25 Multiple</th>
<th>0.26-0.50 Multiple</th>
<th>0.51-0.75 Multiple</th>
<th>0.76-1.0 Multiple</th>
<th>&gt;1.0 Multiple</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>13%</td>
<td>6%</td>
<td>25%</td>
<td>25%</td>
<td>25%</td>
<td>6%</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Actual Earnings Growth</th>
<th>0-3.0% Per Year</th>
<th>3.1-6.0% Per Year</th>
<th>6.1-9.0% Per Year</th>
<th>9.1-12.0% Per Year</th>
<th>&gt;12% Per Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>16%</td>
<td>32%</td>
<td>21%</td>
<td>11%</td>
<td>21%</td>
</tr>
</tbody>
</table>

*Does not total 100% due to rounding

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

<table>
<thead>
<tr>
<th>Payor Mix</th>
<th>20%</th>
<th>40%</th>
<th>60%</th>
<th>80%</th>
<th>No Threshold</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>53%</td>
<td>26%</td>
<td>0%</td>
<td>0%</td>
<td>21%</td>
</tr>
</tbody>
</table>
How does your company adjust valuation models/pricing for out-of-network centers?

### Out of Network Adjustment Approach

- **63%** Convert Revenue To In-Network
- **16%** Apply Higher Risk Factor/Discount Rate
- **5%** Adjust Multiples Downward
- **5%** Combination
- **5%** Cannot Generalize
- **5%** Reduce OON Revenue by 50% Then Apply Market Multiple

*Does not total 100% due to rounding

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 commercial payors)?

### Out-of-Network Multiple Adjustment

<table>
<thead>
<tr>
<th>Multiple Interval</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; 0.5 Multiple</td>
<td>0%</td>
</tr>
<tr>
<td>0.51 - 1.5 Multiple</td>
<td>10%</td>
</tr>
<tr>
<td>1.51 - 2.0 Multiple</td>
<td>20%</td>
</tr>
<tr>
<td>&gt; 2.0 Multiple</td>
<td>70%</td>
</tr>
</tbody>
</table>

*Does not total 100% due to rounding

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

### Typical ASC Management Fee

- **11%** 3% 4% 5% 6% 7% Flat Fee

*Does not total 100% due to rounding
Do you have a **minimum annual management fee?**

- **35%** YES
- **65%** NO

If “yes”, what is the **typical annual minimum management fee** that you charge?

- **17%** < $100,000
- **50%** $100,000 - $199,999
- **33%** $200,000 - $299,999

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

- **33%** YES
- **67%** NO

If you responded “yes” to 23a, at **what threshold** for annual ASC net revenues **do management fees typically decrease?**

- **67%** $5,000,000 - $7,499,999
- **17%** $7,500,000 - $9,999,999
- **17%** $10,000,000 - $12,499,999

*Does not total 100% due to rounding*
24a. Do you have any ASC management fee arrangements wherein part of your fee is at risk?

- YES: 12%
- NO: 88%

24b. If you answered “yes”, which factors may influence the magnitude of the management fee which you ultimately earn?

- Revenue: 33%
- Growth (Revenue, Profitability, Cases): 33%
- Staffing Costs, Supply Costs, Growth in Income: 33%

*Does not total 100% due to rounding

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

- YES: 61%
- NO: 39%

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

<table>
<thead>
<tr>
<th>Management Fee Net Revenue</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.00% - 0.99%</td>
<td>0%</td>
</tr>
<tr>
<td>1.00% - 1.99%</td>
<td>0%</td>
</tr>
<tr>
<td>2.00% - 2.99%</td>
<td>17%</td>
</tr>
<tr>
<td>3.00% - 3.99%</td>
<td>25%</td>
</tr>
<tr>
<td>4.00% - 4.99%</td>
<td>25%</td>
</tr>
<tr>
<td>5.00% - 5.99%</td>
<td>25%</td>
</tr>
<tr>
<td>&gt; 6.00%</td>
<td>8%</td>
</tr>
</tbody>
</table>

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

- YES: 67%
- NO: 33%
Which **management services do you typically provide** as part of your management agreement?

**Management Duties (costs not passed through)**

- **Access to GPO**
  - Never: 6%
  - Rarely: 0%
  - Sometimes: 0%
  - Often: 6%
  - Always: 82%

- **Accounting**
  - Never: 19%
  - Rarely: 0%
  - Sometimes: 6%
  - Often: 6%
  - Always: 66%

- **Architecture & Design**
  - Never: 41%
  - Rarely: 18%
  - Sometimes: 6%
  - Often: 6%
  - Always: 35%

- **Benchmarking Based on Other Equity Owned Centers**
  - Never: 0%
  - Rarely: 6%
  - Sometimes: 6%
  - Often: 6%
  - Always: 82%

- **Coding**
  - Never: 47%
  - Rarely: 6%
  - Sometimes: 6%
  - Often: 0%
  - Always: 41%

- **Corporate Business Development Executive or Staff**
  - Never: 6%
  - Rarely: 0%
  - Sometimes: 0%
  - Often: 18%
  - Always: 76%
Which management services do you typically provide as part of your management agreement?

Management Duties (costs not passed through)

**Corporate Counsel or Legal Support**
- Never: 35%
- Rarely: 0%
- Sometimes: 12%
- Often: 0%
- Always: 53%

**Corporate Human Resources Executive or Staff**
- Never: 13%
- Rarely: 0%
- Sometimes: 25%
- Often: 63%

**Corporate Revenue Cycle Executive or Staff**
- Never: 12%
- Rarely: 0%
- Sometimes: 24%
- Often: 65%

**Corporate Supply Chain Executive or Staff**
- Never: 12%
- Rarely: 0%
- Sometimes: 6%
- Often: 76%

**Data Warehouse**
- Never: 29%
- Rarely: 0%
- Sometimes: 6%
- Often: 6%
- Always: 59%

**Dictation**
- Never: 88%
- Rarely: 0%
- Sometimes: 0%
- Often: 13%

*Does not total 100% due to rounding*
Which management services do you typically provide as part of your management agreement?

Management Duties (costs not passed through)

- Managed Care Contracting
  - Never: 0%
  - Rarely: 0%
  - Sometimes: 6%
  - Often: 29%
  - Always: 65%

- Mock Accreditation Surveys
  - Never: 0%
  - Rarely: 6%
  - Sometimes: 0%
  - Often: 18%
  - Always: 76%

- Oversight by Regional VP of Operations
  - Never: 6%
  - Rarely: 0%
  - Sometimes: 0%
  - Often: 6%
  - Always: 88%

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

- ASC Billing Fees
  - 2.0% - 2.9%: 11%
  - 3.0% - 3.9%: 32%
  - 4.0% - 4.9%: 26%
  - 5.0% - 5.9%: 21%
  - 6.0% - 6.9%: 0%
  - >7%: 11%

*Does not total 100% due to rounding
PARTICIPANTS:

- Ambulatory Alliances, LLC
- Ambulatory Surgical Centers of America (ASCOA)
- ASCs, Inc.
- ASD Management
- Avanza Healthcare Strategies
- Cleveland Clinic
- Community Health Systems, Inc.
- Covenant Surgical Partners, Inc.
- IASIS Healthcare
- LifePoint Health, Inc.
- Meridian Surgical Partners
- Merritt Healthcare
- National Surgical Healthcare
- Partners Medical Consulting
- Regent Surgical Health
- Surgery Partners
- Surgical Care Affiliates
- Sutter Health
- The Bloom Organization, LLC
- 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.

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