

2016

ASC VALUATION SURVEY

How do the ASC companies assess value?




HealthCare Appraisers
INCORPORATED



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.

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.

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).

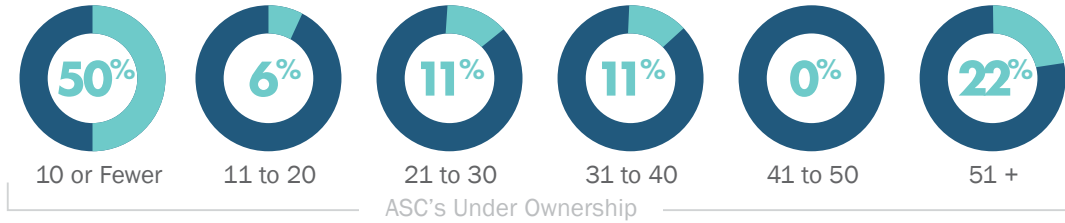
12% of respondents indicated they have management fee arrangements wherein part of their fee is "at risk" for performance metrics, while 88% of respondents indicated they have no "at risk" management fee arrangements.

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

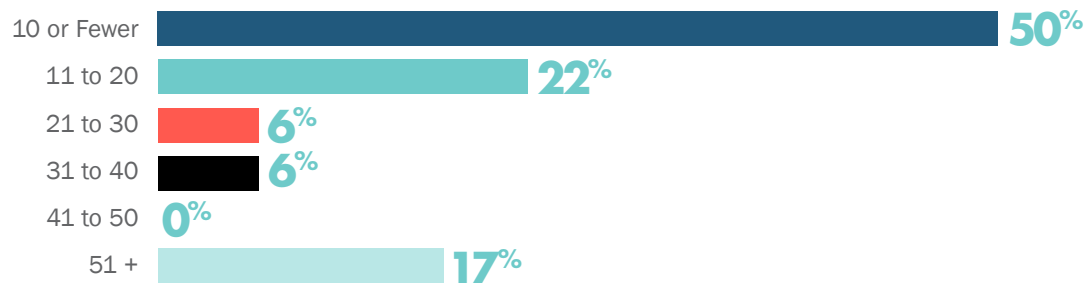


2016 ASC VALUATION SURVEY RESULTS

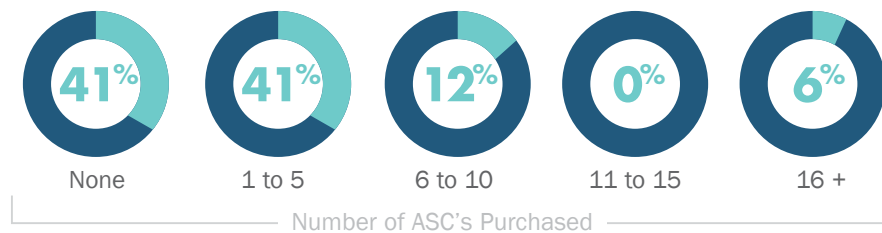
01 How many **ASCs** do you have under **ownership**?



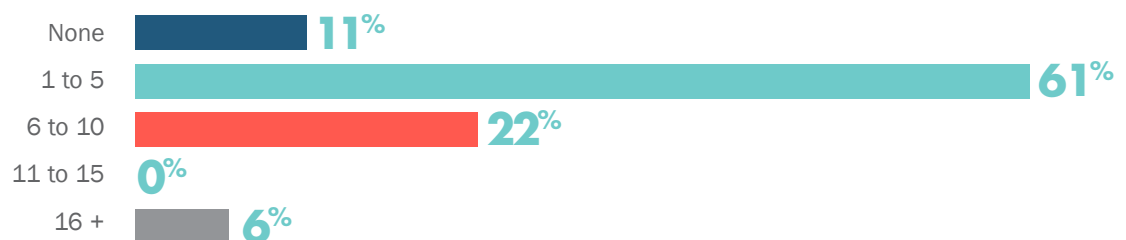
02 How many **ASCs** do you have under **management**?



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?

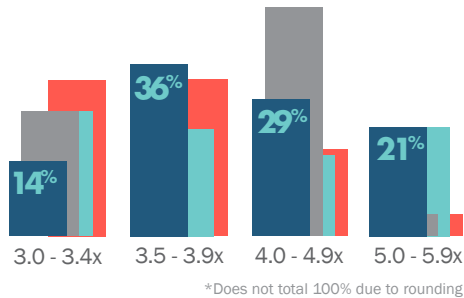


05 How is the recently **passed legislation** that will restrict hospitals from converting ASCs to HOPDs expected to **impact your decision on buying more ASCs** over the next 12 months?

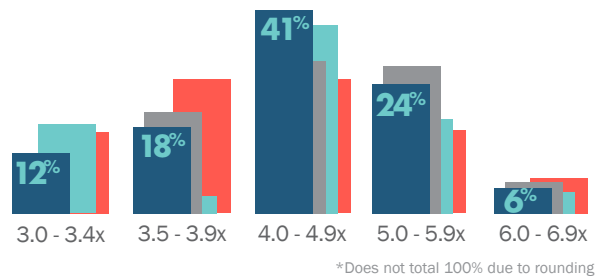


06 What **valuation multiples** have you most typically observed in the marketplace during the past 12 months for predominantly **in-network centers**?

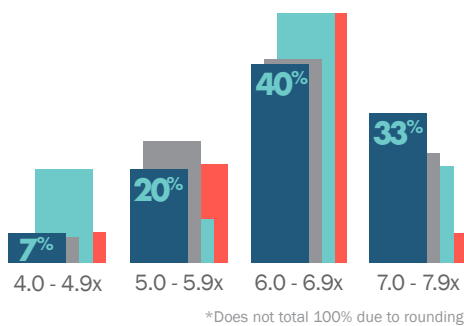
Minority Interest Single-Specialty



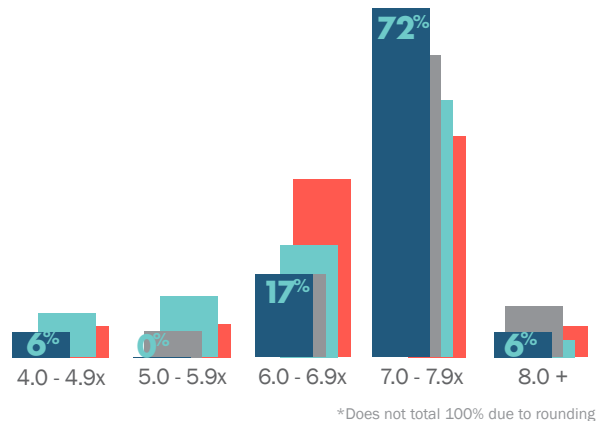
Minority Interest Multi-Specialty



Controlling Interest Single-Specialty



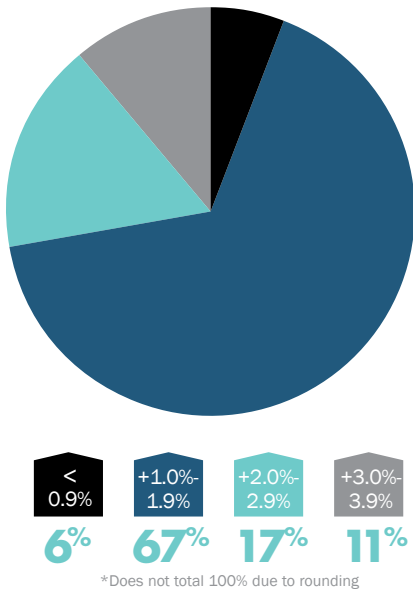
Controlling Interest Multi-Specialty



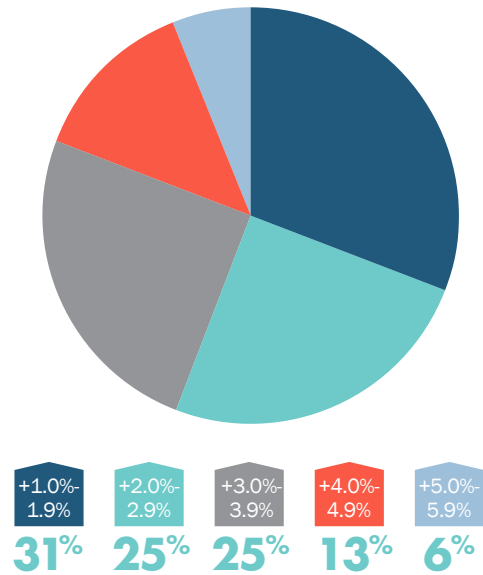
2016 2015 2014 2013

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

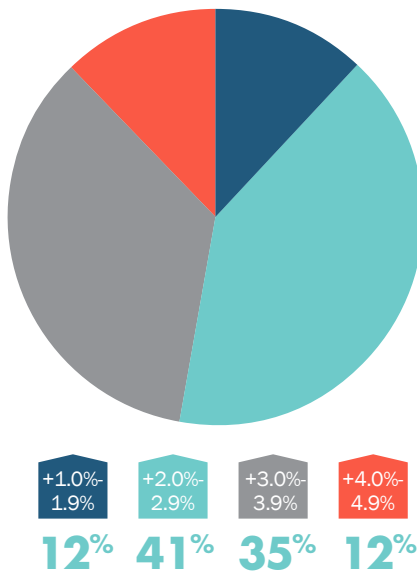
Commercial Payor Rates



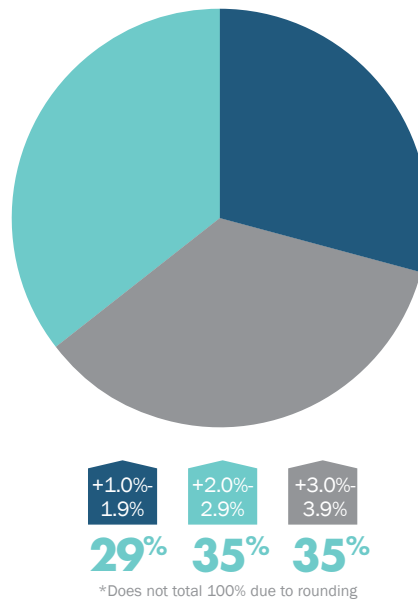
Medical Supplies and Implantable Device Costs



ASC Staff Raises



All Other ASC Expenses



08

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

Salary and Benefits



*Does not total 100% due to rounding

Occupancy

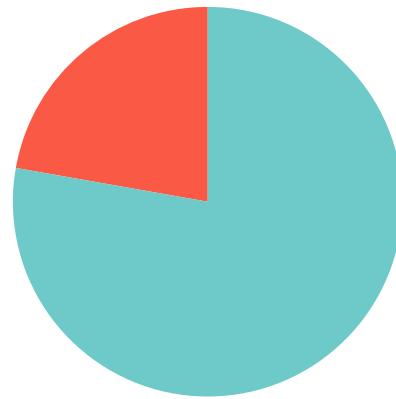


*Does not total 100% due to rounding

Drugs, Medical Supplies and Implantables

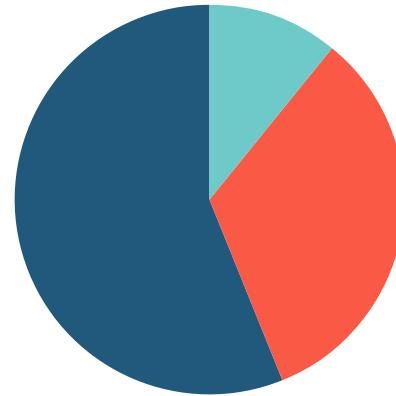


09 For **single-specialty** centers, your company generally prefers how many **active physician owners**?



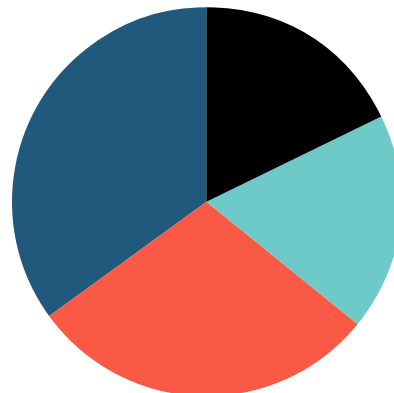
Number of physicians

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



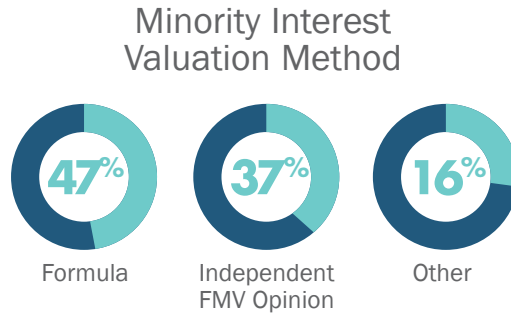
Number of physicians

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

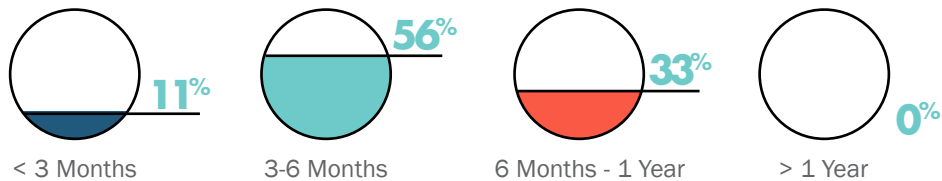


Ownership

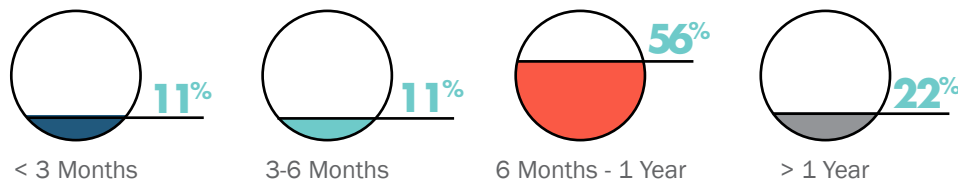
12 How do you determine the **purchase price for minority interest transactions** (e.g., new or existing physician investors)?



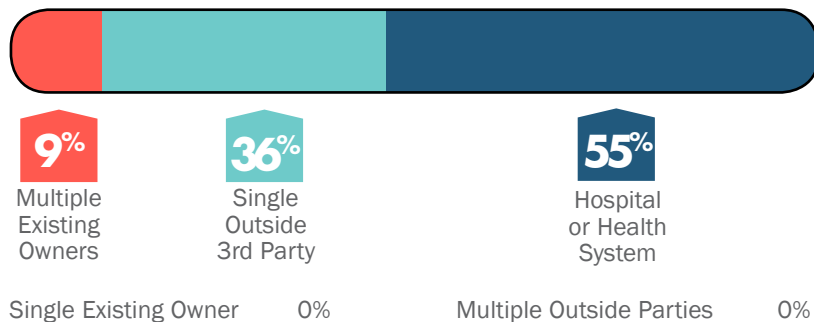
13a When **selling minority interests** to new physician investors, on average, **how long does it take** to identify the buyer and consummate the sale?



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?



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

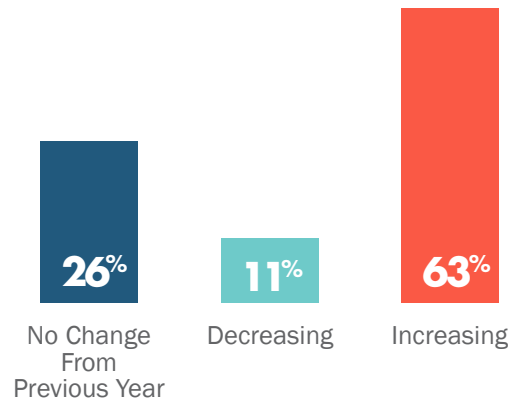


14 In the past year, what best describes the **multiples paid** (or considered) **by your company?**



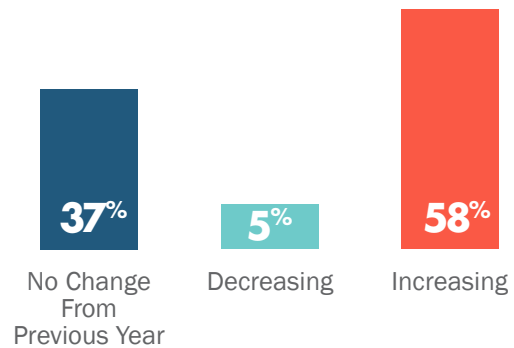
15 In the past year, what best describes your **observations in the ASC marketplace** related to acquisition activity?

Observed Acquisition Activity

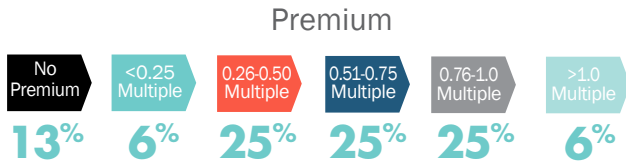


16 In the past year, what **best describes** your observations related to **competition for acquisitions?**

Observed Acquisition Competition

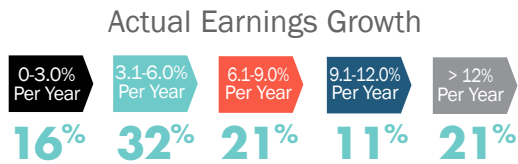


17 What is the **magnitude of the premium paid** by your company for a surgery center with a CON?



CON Valuation Multiple Premium

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

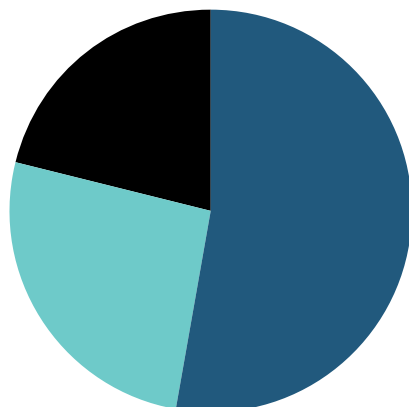
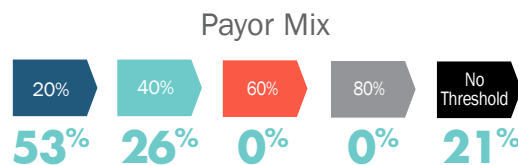


* Does not total 100% due to rounding



Initial Growth Expectations Post-Transaction

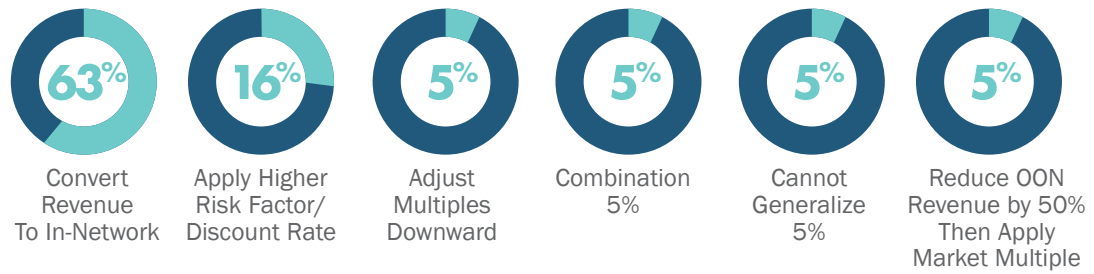
19 At **what percentage** of total revenue does out-of-network volume **exceed** your risk tolerance?



Out-of-Network Risk Threshold

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

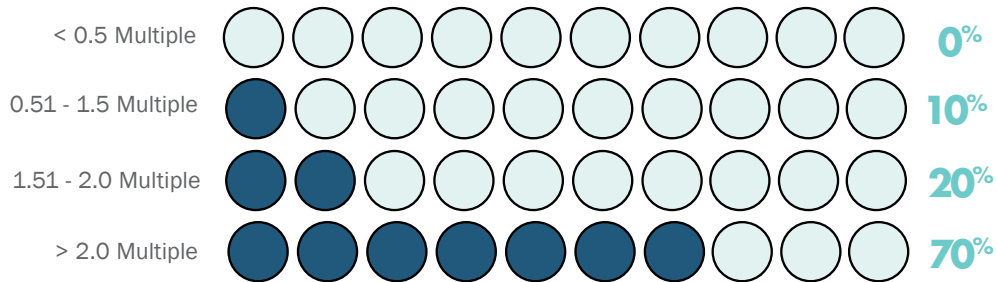
Out of Network Adjustment Approach



*Does not total 100% due to rounding

21 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 in not contracted with any commercial payors)?

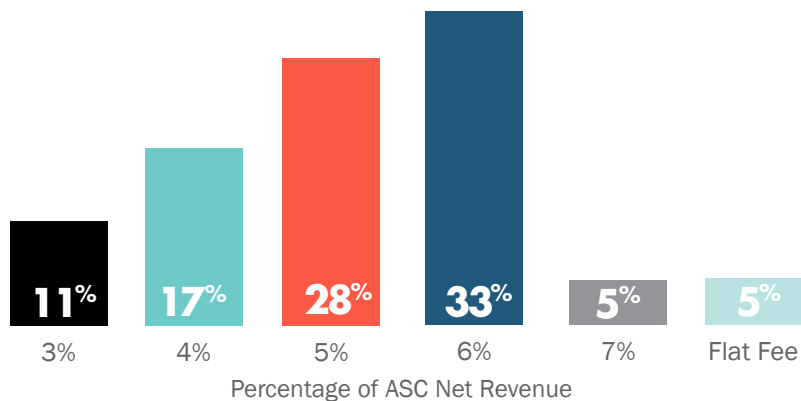
Out-of-Network Multiple Adjustment



*Does not total 100% due to rounding

22a What is the **typical management fee** rate your company charges **for ASCs** (% of net revenue)?

Typical ASC Management Fee

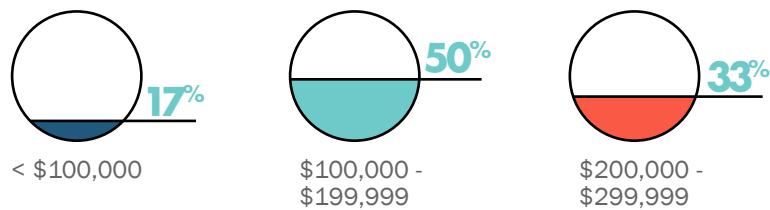


*Does not total 100% due to rounding

22b Do you have a **minimum annual management fee**?



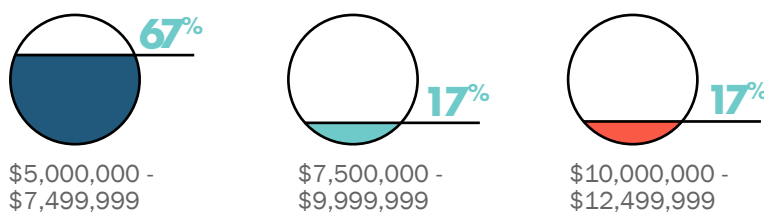
22c If “yes”, what is the **typical annual minimum management fee** that you charge?



23a 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)?



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

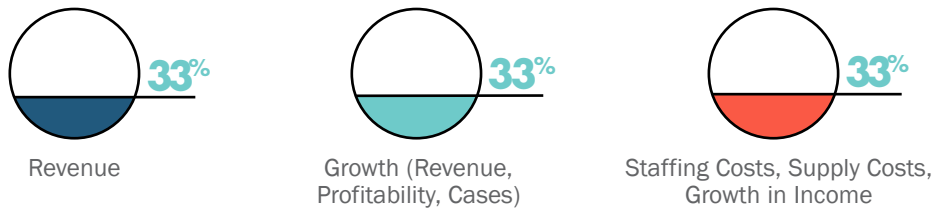


*Does not total 100% due to rounding

24a Do you have any ASC management fee arrangements wherein **part of your fee is at risk**?



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

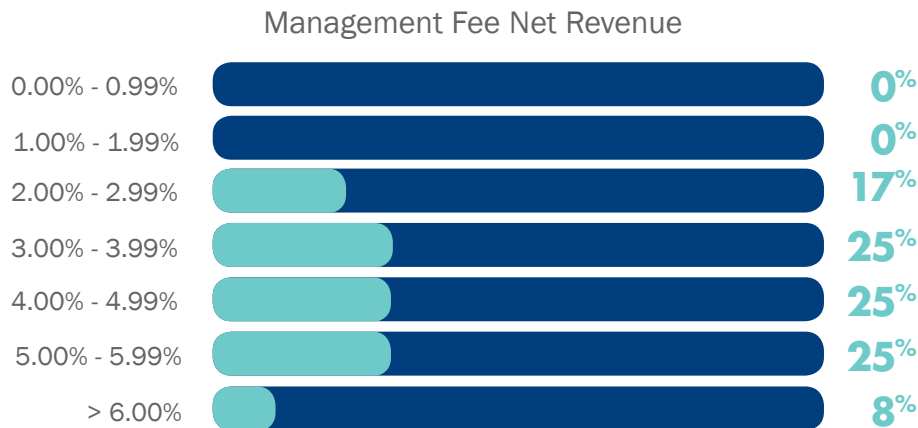


*Does not total 100% due to rounding

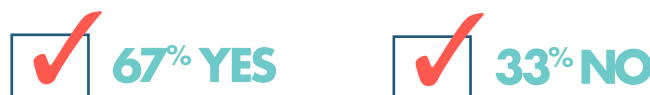
25 Does the **management fee charged vary** based on the level of services provided?



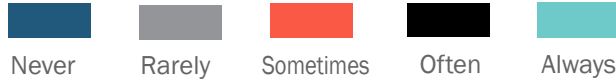
26 What is the **typical management fee rate** your company charges for **surgical and specialty hospitals**?



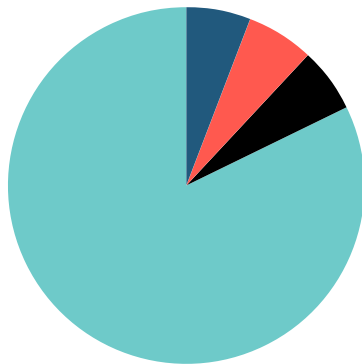
27 Do you maintain an **equity ownership in all freestanding entities** that you manage?



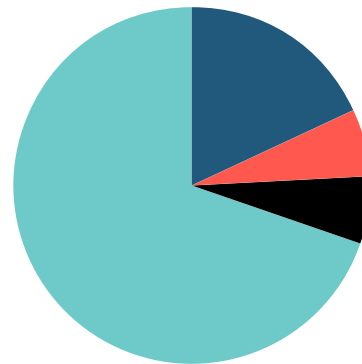
28 Which **management services** do you typically provide as part of your management agreement?



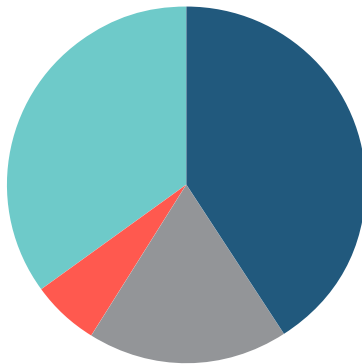
Management Duties (costs not passed through)



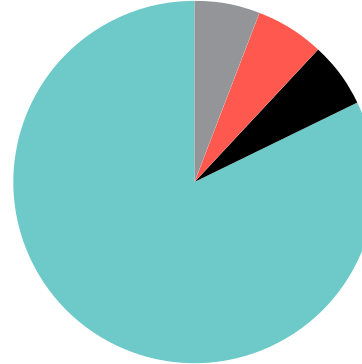
Access to GPO



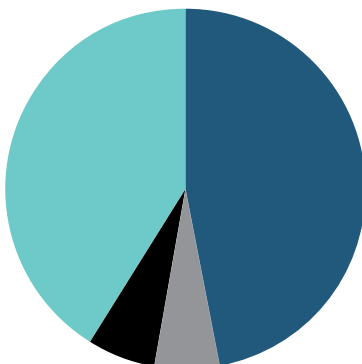
Accounting



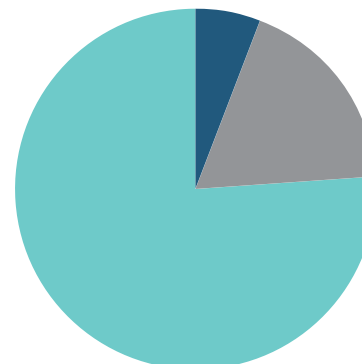
Architecture & Design



Benchmarking Based on Other Equity Owned Centers



Coding

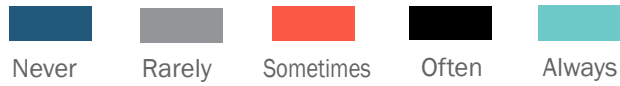


Corporate Business Development Executive or Staff

28

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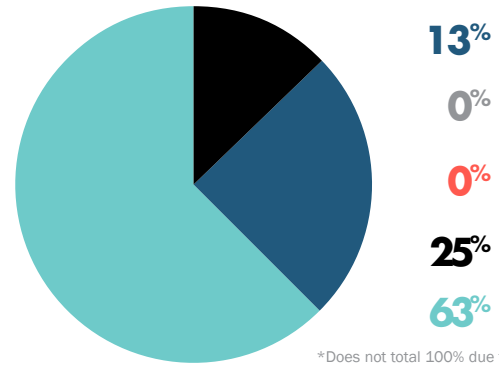
Which **management services** do you typically provide as part of your management agreement?



Management Duties (costs not passed through)

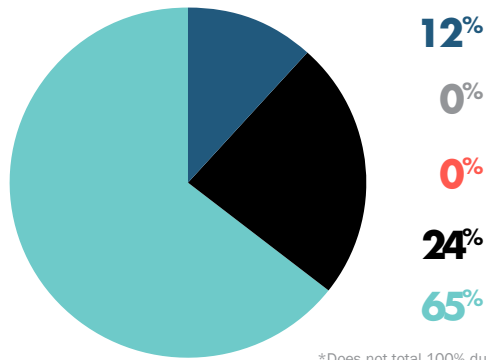


Corporate Counsel or Legal Support



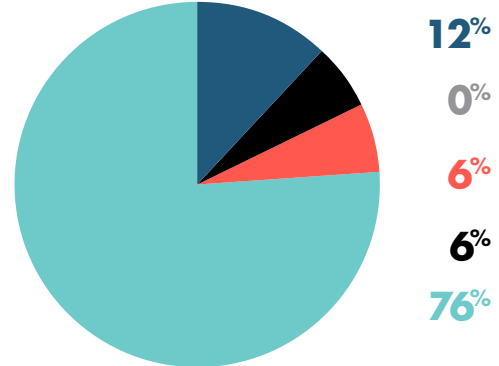
Corporate Human Resources Executive or Staff

*Does not total 100% due to rounding

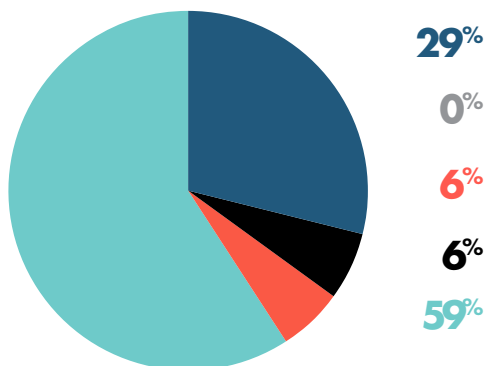


Corporate Revenue Cycle Executive or Staff

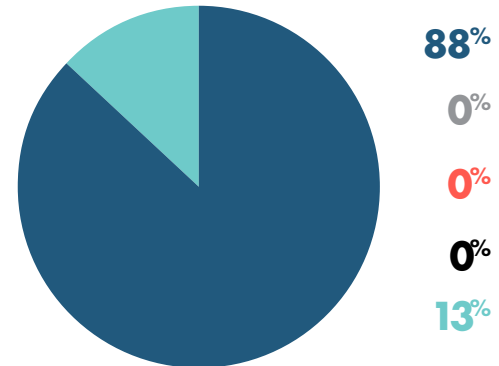
*Does not total 100% due to rounding



Corporate Supply Chain Executive or Staff



Data Warehouse



Dictation

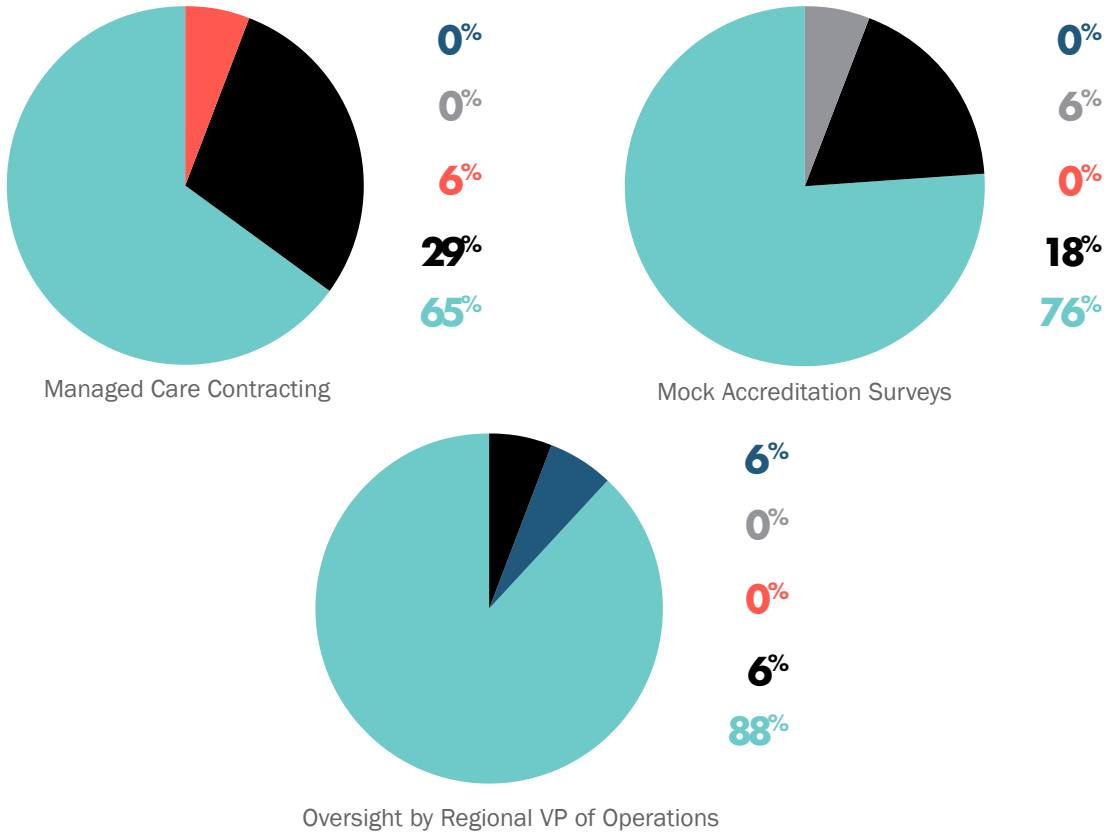
*Does not total 100% due to rounding

28

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

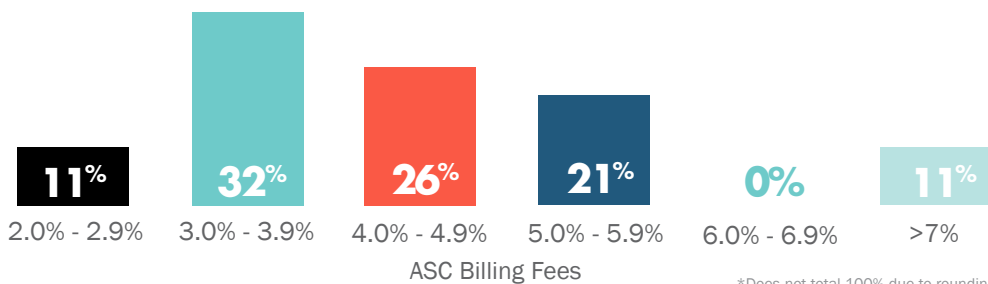
Never Rarely Sometimes Often Always

Management Duties (costs not passed through)



29

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)



*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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