Uncertainty will be fact of life in healthcare
HealthyCare Reform?

Expansion of Government Insurance Program

The Real Problem Has Not Been Addressed in the Affordable Care Act - Cost

Fee For Service Prohibits Cost Reform
• Historical Perspective of Practice Transactions

• Physician Practice Transaction Trends

• Valuation Primer

• ASC Transaction Environment
AMERICAN ACADEMY OF ORTHOPEDIC SURGEONS

HISTORICAL PERSPECTIVE OF TRANSACTION TRENDS
**Historical Perspective of Practice Transactions**

**Physician Practice Transaction Timeline**

- **1993-1995**: Number of hospital-owned physician practices tripled.

- **1995-2002**: Hospital-owned physician practices suffered significant operating losses. Acquisitions slowed, divestitures increased.

- **1998**: PhyCor & MedPartners merger collapses.

- **2007 - Present**: "The Great Reconsolidation" - Physician Practice Management Companies proliferate.

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*VMG Health*\[1\]  
*We Value Healthcare*\[2\]
**Historical Perspective of Practice Transactions**

The Evolution of Physician-Hospital Integration

<table>
<thead>
<tr>
<th>Period</th>
<th>Events</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990s</td>
<td>Capitation and Physician Practice Management Co. Expansion</td>
</tr>
<tr>
<td></td>
<td>• Managed Care Focus</td>
</tr>
<tr>
<td></td>
<td>• Competition for Primary Care</td>
</tr>
<tr>
<td></td>
<td>• Desire to achieve economies of scale</td>
</tr>
<tr>
<td></td>
<td>• Hospitals purchased physician practices</td>
</tr>
<tr>
<td>1994-2004</td>
<td>Shake-Out / Retrenchment</td>
</tr>
<tr>
<td></td>
<td>• Hospital losses on physician employment</td>
</tr>
<tr>
<td></td>
<td>• HMOs lose favor with public</td>
</tr>
<tr>
<td></td>
<td>• Shift from physician employment to joint ventures</td>
</tr>
<tr>
<td>2005-2009</td>
<td>Focus on Market Share</td>
</tr>
<tr>
<td></td>
<td>• Increasing PPO enrollment/declining HMO enrollment</td>
</tr>
<tr>
<td></td>
<td>• Joint Venture Growth</td>
</tr>
<tr>
<td>2010-2009</td>
<td>Payment Reform</td>
</tr>
<tr>
<td></td>
<td>• Move away from traditional fee-for-service?</td>
</tr>
<tr>
<td></td>
<td>• Capital demands due to infrastructure requirements</td>
</tr>
<tr>
<td></td>
<td>• Collaboration to achieve quality and cost reduction</td>
</tr>
</tbody>
</table>

Source: California HealthCare Foundation
American Academy of Orthopedic Surgeons

Physician Practice Transaction Trends
**Physician Practice Transaction Trends**

*Information & Statistics*

- **32%**
  - Increase in hospital physician employment from 2000 to 2010

- **25%**
  - Of physicians have a hospital contract

- **20%**
  - Of physicians are employed by hospitals

- **59%**
  - Of hospitals employed hospitalists in 2010, up from 29.6% in 2003

- **76%**
  - Of hospitals employ physicians

- **66%**
  - Of hospitals report physicians’ request for employment
The Integrated Deliver Model – Part II

Physician Practice Transaction Trends

High Volume of Transaction Activity

Transaction Reported by Irving Levin
By Quarter

Source: Irving Levin
**Physician Practice Transaction Trends**

**Major Ortho Transactions**

Orthopedic Transaction Reported by Irving Levin

<table>
<thead>
<tr>
<th>Year</th>
<th>Transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>Affiliated Community Medical Centers acquires Allina Medical Clinic, Litchfield</td>
</tr>
<tr>
<td>2009</td>
<td>Christ Hospital acquires Freiberg Orthopaedics &amp; Sports Medicine</td>
</tr>
<tr>
<td>2009</td>
<td>Christ Hospital acquires physician practice of Daniel Funk M.D.</td>
</tr>
<tr>
<td>2009</td>
<td>OrthoCarolina, PA acquires NorthEast Orthopedics</td>
</tr>
<tr>
<td>2009</td>
<td>White Plains Hospital Center acquires White Plains Surgical Specialists</td>
</tr>
<tr>
<td>2009</td>
<td>Wilmington Orthopaedic Group acquires Atlanta Orthopedics, PA</td>
</tr>
<tr>
<td>2010</td>
<td>Surgical Care Affiliates acquires St. Cloud Orthopedic Associates, Ltd.</td>
</tr>
<tr>
<td>2010</td>
<td>Christ Hospital acquires physician practice of Marc Schneider M.D.</td>
</tr>
<tr>
<td>2010</td>
<td>SwedishAmerican Health System acquires Lundholm Surgical Group</td>
</tr>
<tr>
<td>2011</td>
<td>Darmouth-Hitchcock acquires Quality Orthopaedic Care</td>
</tr>
<tr>
<td>2011</td>
<td>Medical Billing Assistance, Inc. acquire First Choice Medical Group of Brevard, LLC</td>
</tr>
<tr>
<td>2012</td>
<td>Memorial Hermann System acquires Richmond Bone &amp; Joint Clinic</td>
</tr>
</tbody>
</table>
Physician Practice Transaction Trends

Driving Forces for Hospitals

- Healthcare Reform – ACOs
- Herd Mentality
- Secure/Expand Referral Network
- Defensive Strategy
- Advantageous Reimbursement
- Staffing Shortages
- Need for Call Coverage
The primary buyer of a physician practice is a healthcare system.

The transaction must be priced at Fair Market Value (FMV).
Stark Law
- Requires Fair Market Value

Anti-Kickback Statute
- Requires Fair Market Value

Private Inurement
- Requires Fair Market Value
Fair Market Value ("FMV") – the only premise of value to meet the Anti-Kickback Statute and Private Inurement Regulations.

Both for-profit and not-for-profit health care providers that accept payments from government programs (i.e., Medicare) must ensure that exchanges between them and other providers are at FMV.

Definition
• The price, expressed in terms of cash equivalents, at which a property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm’s length in an open and unrestricted market, when neither is under compulsion to buy nor to sell, and when both have reasonable knowledge of the relevant facts.
**Valuation Primer**

*Typical Components of a Transaction*

- **Total Value**
  - Working Capital
  - Fixed Assets
  - Intangible Assets (Goodwill)

- **Retained by Physician**
  - Working Capital
  - Personal Fixed Assets

- **Purchased by Hospital**
  - Inventory
  - Fixed Assets
  - Intangible Assets
Business Valuation Methods

**Income Approach**
- Discounted Cash Flow Method

**Asset (Cost) Approach**
- Tangible Assets
- Intangible Assets

**Market Approach**
- Guideline Public Company Method
- Similar Transactions Method
Income Approach

Present Value of Future Cash Flows

- Projection of future revenues and expenses
- Projection of future capital expenditures and working capital requirements
- Physician compensation

Present Value of Cash Flows = Value Indication
Valuation Primer

Asset (Cost) Approach

Takes into consideration the cost of replicating a comparable asset, security or service with the same level of utility. Typically used when the entity has historical losses or nominal projected cash flow.

Tangible Assets
• Working capital
• Fixed assets
• Real estate (if applicable)

Intangible Assets
• Legal title, protectable, separately marketable
  ▪ Trade name
  ▪ Phone number
  ▪ Medical chart
  ▪ Non-physician trained workforce
• Also generate an economic return (typically based on positive Income Approach)
  ▪ Covenants not to compete
  ▪ Physician workforce

Tangible Assets + Intangible Assets = Value Indication
Market Approach

Estimates value by comparing the value of similar assets, securities or services traded in a free and open market to the subject asset, security or service.

• Similar publicly-traded companies are not comparable from a size or growth standpoint and often include practices with a variety of management services agreements.

• Similar transaction information in the public domain is rarely useful because details on transaction structure (including post-transaction compensation and employment terms) are not included.

• Market Approach rarely used alone as a determinant of FMV for a physician practice.

Selected Multiple(s) x Subject Metric(s) = Value Indication
Physician Compensation Post Transaction

Post Transaction Compensation

Practice Value
What is Ortho Practice Value Driven By?

Valuation Primer

- Ancillary
- Imaging
- Physical Therapy
- DME
Valuation Primer

Qualitative Factors Influencing Value

- Competition
- Patient volume
- Payor contracts
- Staffing levels
- Demographics
- Compensation
- Management capability
- Working and fixed capital needs
- Transaction terms and structure
- Size of group
You may be required to divest ownership.

Where you perform cases may be a question.

If you sell your practice you should understand what the hospital wants you to do with your ASC ownership interest.
ASC TRANSACTION ENVIRONMENT

Overview

- ASC Market Analysis
- Valuation Primer
ASC TRANSACTION ENVIRONMENT

Declining Growth in New ASC Development

ASC Development

- Medicare Certified ASCs
- Growth (Y.O.Y.)

<table>
<thead>
<tr>
<th>Year</th>
<th>Medicare Certified ASCs</th>
<th>Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>3,000</td>
<td>-1%</td>
</tr>
<tr>
<td>2001</td>
<td>3,200</td>
<td>1%</td>
</tr>
<tr>
<td>2002</td>
<td>3,400</td>
<td>4%</td>
</tr>
<tr>
<td>2003</td>
<td>3,600</td>
<td>6%</td>
</tr>
<tr>
<td>2004</td>
<td>3,800</td>
<td>8%</td>
</tr>
<tr>
<td>2005</td>
<td>4,000</td>
<td>10%</td>
</tr>
<tr>
<td>2006</td>
<td>4,200</td>
<td>8%</td>
</tr>
<tr>
<td>2007</td>
<td>4,400</td>
<td>6%</td>
</tr>
<tr>
<td>2008</td>
<td>4,600</td>
<td>4%</td>
</tr>
<tr>
<td>2009</td>
<td>4,800</td>
<td>2%</td>
</tr>
<tr>
<td>2010</td>
<td>5,000</td>
<td>1%</td>
</tr>
</tbody>
</table>
ASC TRANSACTION ENVIRONMENT

Management Company Consolidation

“Our M&A pipeline is very robust. Today there are over 2,000 centers we would evaluate in the prospecting pool.”

Christopher Holden: CEO, President & Director of AmSurg Corp.

“So ‘13 and ‘14 I think are going to be high volume years for transactions. I think there will be some substantial consolidation during that period of time.”

Christopher Holden: CEO, President & Director of AmSurg Corp.

AmSurg acquires National Surgical Care

- 18 surgery centers
- $173.5 million in cash
- 1.4 x Revenue, 8.0 x EBITDA

Surgery partners acquires NovaMed

- 37 surgery centers, 19 states
- $214 million, assumes $105 million of debt
- 1.4 x Revenue, 5.1 x EBITDA
ASC TRANSACTION ENVIRONMENT

Who Are the Buyers?

1. Acute Care Hospitals – On the rise, better HOPD rates, physician affiliation strategy, growth in market share

2. National Owner/Operators – Acquisitions, growth strategy and expense synergies

3. Other ASCs – Mergers, expense synergies

4. Physician Owned Hospitals – Barred from adding capacity – need strategy to expand
ASC TRANSACTION ENVIRONMENT

What Do They Pay?

1. Acute Care Hospitals – industry-wide capital constraints, balance many priorities

2. National Owner/Operators – usually very motivated, focused on ASCs

3. Other ASCs – Mergers, usually no cash changes hands – relative valuation

Control EBITDA Multiples

All ASCs are Not Created Equal with Respect to Valuation Multiples

Acquisition multiples have remained high but widened
Return: Future Cash Flow
• The ability of an ASC to generate cash flow to the investor after all operating expenses and capital requirements

Risk
• The likelihood of projected levels of cash flows realized given the operating, strategic, and legal environment under which the ASC operates

For regulatory compliance purposes, ASC transactions must happen at Fair Market Value
CONCLUSIONS

Uncertainty will be fact of life in healthcare

Impact of Reform Unknown

Bundled Payments or Fee for Service?
CONCLUSIONS

High Levels Uncertainty = Risk

Risk Impacts Valuations

Higher Risk = Lower Valuations
Questions?

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