What is Your ASC Worth?

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Presentation Overview

I. Current Market Analysis
II. ASC Transaction Market
III. ASC Valuation – In Practice
Current Market Analysis

- Observing a Maturation of the ASC Industry
- Economic Downturn Continues to Impact ASC Volumes
- Significant Managed Care & Medicare Reimbursement Pressure
- Uncertainty Regarding Healthcare Reform’s Long-Term Impact on ASCs
Current Market Analysis

- All Signs Point to a Mature ASC Industry

- Growth in ASC Development has Leveled Off

- Same Center Growth has Flat-Lined

- ASC Supply Exceeds Physician Demand in Most Markets

- Significant Capacity at Many ASCs

- Growth in Observed ASC Mergers & Consolidation

- Initial Stages of Consolidation among ASC Management Companies
Current Market Analysis

Declining Growth in New ASC Development

Prior to 2008: Significant ASC Development to Meet Physician Demand

Post 2008: Supply of ASCs has Met or Exceeded Physician Demand

>10% Annual Growth

2-3% Annual Growth
Current Market Analysis

- Same Center Growth has Flat-Lined

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<tr>
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<td>7.0%</td>
<td>6.0%</td>
<td>2.0%</td>
<td>2.0%</td>
<td>(1.0%)</td>
</tr>
<tr>
<td>HCA</td>
<td>(1.2%)</td>
<td>(1.1%)</td>
<td>(0.2%)</td>
<td>(0.1%)</td>
<td>(1.3%)</td>
</tr>
<tr>
<td>AMSURG</td>
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<td>4.0%</td>
<td>4.0%</td>
<td>1.0%</td>
<td>(1%) - 0%</td>
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<tr>
<td>NOVAMED</td>
<td>1.3%</td>
<td>9.3%</td>
<td>(1.4%)</td>
<td>(2.1%)</td>
<td>(5.1%)</td>
</tr>
</tbody>
</table>

Source: Company’s Annual Reports

Market Forces Driving this Trend:

1. Diminishing Ability to Attract New Volume / Physicians
2. Trend has been Accelerated by the Economic Downturn
Current Market Analysis

- Growing Excess Capacity in Existing ASCs

Median Cases per OR per Day

<table>
<thead>
<tr>
<th>Year</th>
<th>Median Cases per OR per Day</th>
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</thead>
<tbody>
<tr>
<td>2007</td>
<td>3.1</td>
</tr>
<tr>
<td>2008</td>
<td>3.0</td>
</tr>
<tr>
<td>2009</td>
<td>2.6</td>
</tr>
<tr>
<td>2010</td>
<td>2.7</td>
</tr>
</tbody>
</table>

25% Decline in OR Utilization from 2007 to 2010

Source: VMG Health Intellimarker ASC Survey
Current Market Analysis

Greatest Challenges Facing ASCs in Today’s Market

I. Inability to Attract New Physician Investment & Volume
   ▪ Declining Physician Investor Pool
   ▪ Price Prohibitive Cost for Investment
   ▪ Inability to show Attractive Return
   ▪ Existence of Alternatives for Physicians

II. Declining Reimbursement Rates
   ▪ Out of Network Drying Up
   ▪ Squeezed by Managed Care
   ▪ Current & Projected Medicare Pressure
Current Market Analysis

- Supply of ASCs has Exceeded Demand from Physicians

# of Eligible Physicians per ASC

- 9-10% Annual Growth in ASCs
- 2-3% Annual Growth in Eligible Drs
- >40% Decline in Eligible Drs Per ASC

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Current Market Analysis

- **Aging Physician Demographic will Further Limit Recruitment & Volume**

Demographics of the Physician Workforce

1980 – Approx 20% over Age 55

1990 – Approx 30% over Age 55

2007 – Approx 40% over Age 55

Current Market Analysis

- Supply of New Physicians will Likely not Meet Demand of Existing ASCs

First – Year MD Enrollment per 100,000 Population has Declined Since 1980

Source: “Help Wanted: More US Doctors – Projections Indicate American will Face Shortage of MDs by 2020” by AAMC

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Current Market Analysis

- New Competition: Hospital Employed Physicians on the Rise

Current and Projected Hospital Employment

Since 2000:
- Employed PCPs has Doubled
- However Employed Specialists has increased 5-fold
Current Market Analysis

- What to Expect in a Mature Industry Environment?

Attracting New Volume with Physicians being the Greatest Challenge

- Increase in ASC Mergers & Limited ASC Failure
- Increased Involvement of Hospitals in ASC Industry
- Expected Return for ASC Investors will be Moderated
- Existing ASCs will need to Focus Efforts on Implementing Efficiencies

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ASC Transaction Market

ASC Acquisition Market – Who are the Buyers?

I. Acute Care Hospitals – *On the rise*

II. National Owner/Operators – *Consolidations*

III. Other ASCs – *Consolidations*

IV. Physician Owned Hospitals – *New strategy to expand*
The ASC Market Has Evolved...

- DeNovos
- Turnarounds
- Hospital JVs
ASC Transaction Market

Key Recent Transactions

Amsurg Corp. announces acquisition of National Surgical Care
- NSC – 18 ASCs
- $173MM transaction price
- 7.8x adjusted forward EBITDA
- 8.1x adjusted historical EBITDA

Surgery Center Holdings, Inc. (Surgery Partners) acquisition of NOVA
- Definitive Agreement
- $109MM, or $13.25/share
- $105MM debt repayment, total transaction valued at $214MM
- 7.5x 2011 EBITDA
ASC Transaction Market

Key Recent Transactions (continued)

Sunlink Health Systems, Inc. announces merger with Foundation HealthCare Affiliates

- FHC – 14 ASCs and 1 specialty hospital
- Noncash merger
- 1.56MM common shares
- Contingent upon negotiation completion

USPI acquisition of HealthMark Partners

- HealthMark – 14 ASCs
- $32MM acquisition value
Hospital Buyers – Primary Theme...

I. Desire to Gain Market Share

II. Take Advantage of Reimbursement Arbitrage

III. Reconnect with High Quality Physicians

Hospital-ASC acquisitions must occur at Fair Market Value and usually require an independent third party opinion.
Hospital Buyers – Fair Market Value Issues...

I. Cannot Consider Hospital Rates

II. Can Consider Other Factors:

- Physician Base
- Growth
- Staffing
- Management
ASC Valuation Trends as Multiple of EBITDA

- **Control Multiples**: Acquisition multiples have remained high but widened.
- **Minority Multiples**: Minority multiples have declined and widened.

**Key Takeaway** - All ASCs are not created equal with respect to valuation multiples.
What are the Nations Largest Acquirers Saying?

- Acquisitions in 2010 have more than doubled over 2009 and they will be even greater next year.
  
  ~ Andrew Hayek – CEO of Surgical Care Affiliates

- Despite troubles in the economy, our firm remains committed to pursuing a significant number of acquisition opportunities, with a focus on markets in which we have a strategic presence.
  
  ~ Christopher Holden – CEO of AMSURG

- Our surgery center holdings have increased two-fold over the last 2 years and we expect to continue to increase our presence in the ASC market.
  
  ~ John Dickenson – Senior Director – Catholic Healthcare West
## ASC Acquisition History

<table>
<thead>
<tr>
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<td>24</td>
<td>20</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>8</td>
<td>14</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>7</td>
</tr>
<tr>
<td>Novamed</td>
<td>2</td>
<td>3</td>
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<tr>
<td>USPI</td>
<td>9</td>
<td>11</td>
<td>2</td>
<td>2</td>
<td>-</td>
<td>2</td>
<td>6</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>20</td>
<td>27</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>35</strong></td>
<td><strong>34</strong></td>
<td><strong>5</strong></td>
<td><strong>4</strong></td>
<td><strong>1</strong></td>
<td><strong>10</strong></td>
<td><strong>20</strong></td>
<td><strong>3</strong></td>
<td><strong>4</strong></td>
<td><strong>4</strong></td>
<td><strong>23</strong></td>
<td><strong>34</strong></td>
</tr>
</tbody>
</table>

ASC Acquisitions: 2007 - 2010
ASC Transaction Market

Acquisition Activity will Accelerate in 2011

Not Much DeNovo Activity

Looking for ASCs with a Proven History of Successful Performance

Higher Level of Due Diligence Required

2011 ValueDriver ASC Survey Summary
Summary

- Purposes for ASC valuation
- Primary drivers of value
- Valuations of a controlling interest
- Valuations of a non-controlling equity interest
- Considerations for hospitals acquiring and converting ASCs
Purposes for ASC Valuation

- Over-riding purpose for most ASC Valuations is compliance with the Federal Anti-Kickback Statute
  - No specific application of Stark Law or limitations on physician ownership since outpatient surgery is not a designated health service (DHS)
  - Statute prohibits offer, solicitation, payment or receipt of remuneration if intent is to induce referrals of patients or other business paid for in whole or in part by a federal program
  - Includes certain exceptions, or Safe Harbors, that allow certain conduct that would otherwise violate the statute, one of which is
    - ASC Safe Harbor
Purposes for ASC Valuation (continued)

- **ASC Safe Harbor**
  - Protect opportunity for investment in ASCs by physicians who use the ASC as an “extension of practice”
  - 4 Categories
    1. 100% surgeon-owned ASCs
    2. Single-specialty ASCs
    3. Multi-specialty ASCs
    4. Hospital / Physician ASCs
  - Permitted Investors:
    - Physicians performing surgery that meet the “one-third” tests
    - Multi-specialty groups whose individual physicians all meet the requirements to invest individually
    - Physicians and others not employed by the ASC or an investor and are not in a position to make or influence referrals to the ASC or any of the investors
Purposes for ASC Valuation (continued)

- ASC Safe Harbor (continued)
  - “One-third tests”
    - One-third of practice income comes from ASC procedures (“one-third income test”)
      - Not applicable to single-specialty ASC
    - One-third of physician’s ASC procedures performed at the subject ASC (“one-third procedures test”)
  - Investment returns must be directly proportional to capital investment
    - Safe Harbor does not consider investment at different times / prices
    - OIG Advisory 01-21 views subsequent purchases at *fair market value* as reasonable basis
  - Not all, and perhaps not even a majority, of ASCs fit in the safe harbor
Primary Drivers of Value

- **ASC Inputs Analysis**
  - **Revenues**
    - Case volumes analysis
      - By physician critical to understand where individual physician utilizers are at in respective practices
      - By specialty critical to understand changes in operating expenses and reimbursement
      - By payor type critical to understand impact of changes in reimbursement, in particular Medicare
    - Net revenue per case analysis
      - Net revenue per case varies widely by specialty
      - Impact of reimbursement changes on net revenue per case varies widely by specialty
  - **Operating expenses**
    - Not complex
    - Largest components, staffing and supplies are mostly variable
Primary Drivers of Value (continued)

- ASC Inputs Analysis (continued)
  - Benchmarking a very useful tool in analyzing
    - Revenues
    - Operating expenses
  - VMG HEALTH – Intellimarker
  - 2010 Fifth Annual Study available for **FREE** download [www.vmghealth.com](http://www.vmghealth.com)
Primary Drivers of Value (*continued*)

- Benchmarking – Using the VMG HEALTH Intellimarker
  - Income Statement / Common Size
  - Balance Sheet / Common Size
  - Liquidity Analysis
  - Accounts Receivable Analysis
  - Case Volume Mix (by Specialty)
  - Payor Mix
  - Gross / Net Revenue per Case (by Specialty)
  - EBITDA Margin Analysis
  - Staffing Hours per Case
  - Leverage
  - Aggregated / Regional / Facility Size / Specialty Concentration
Primary Drivers of Value (continued)

### Revenue per Case

<table>
<thead>
<tr>
<th>Specialty</th>
<th>Gross Charges</th>
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<tbody>
<tr>
<td>ENT</td>
<td>$7,066</td>
</tr>
<tr>
<td>GI/Endoscopy</td>
<td>$3,216</td>
</tr>
<tr>
<td>General Surgery</td>
<td>$5,534</td>
</tr>
<tr>
<td>OB/GYN</td>
<td>$6,404</td>
</tr>
<tr>
<td>Ophthalmology</td>
<td>$5,395</td>
</tr>
<tr>
<td>Oral Surgery</td>
<td>$3,024</td>
</tr>
<tr>
<td>Orthopedics</td>
<td>$8,973</td>
</tr>
<tr>
<td>Pain Management</td>
<td>$3,835</td>
</tr>
<tr>
<td>Plastic Surgery</td>
<td>$6,198</td>
</tr>
<tr>
<td>Podiatry</td>
<td>$7,061</td>
</tr>
<tr>
<td>Urology</td>
<td>$5,937</td>
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</table>

<table>
<thead>
<tr>
<th>Specialty</th>
<th>Net Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>ENT</td>
<td>$1,742</td>
</tr>
<tr>
<td>GI/Endoscopy</td>
<td>$746</td>
</tr>
<tr>
<td>General Surgery</td>
<td>$1,545</td>
</tr>
<tr>
<td>OB/GYN</td>
<td>$1,757</td>
</tr>
<tr>
<td>Ophthalmology</td>
<td>$1,227</td>
</tr>
<tr>
<td>Oral Surgery</td>
<td>$1,041</td>
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<tr>
<td>Orthopedics</td>
<td>$2,443</td>
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<tr>
<td>Pain Management</td>
<td>$898</td>
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<tr>
<td>Plastic Surgery</td>
<td>$1,415</td>
</tr>
<tr>
<td>Podiatry</td>
<td>$1,664</td>
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<tr>
<td>Urology</td>
<td>$1,435</td>
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</table>

VMG HEALTH Multi-Specialty ASC Intellimarker 2010
### ASC Valuation – In Practice

### Primary Drivers of Value (continued)

#### Operating Expense Analysis Comparison

<table>
<thead>
<tr>
<th>as a % of Net Revenue</th>
<th>Median All MS</th>
<th>Median MS &gt; 50%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee Salary &amp; Wages</td>
<td>23.1%</td>
<td>20.7%</td>
</tr>
<tr>
<td>Employee Taxes &amp; Benefits</td>
<td>4.9%</td>
<td>3.9%</td>
</tr>
<tr>
<td>Occupancy Costs</td>
<td>6.7%</td>
<td>5.8%</td>
</tr>
<tr>
<td>Medical &amp; Surgical Supplies</td>
<td>20.8%</td>
<td>19.9%</td>
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<tr>
<td>Other Medical Costs</td>
<td>0.9%</td>
<td>0.7%</td>
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<tr>
<td>Insurance</td>
<td>0.7%</td>
<td>0.4%</td>
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<tr>
<td>General &amp; Administrative</td>
<td>20.6%</td>
<td>13.1%</td>
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<tr>
<td><strong>Total Operating Expenses</strong></td>
<td>68.8%</td>
<td>64.6%</td>
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<table>
<thead>
<tr>
<th>per Case</th>
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<tbody>
<tr>
<td>Employee Salary &amp; Wages</td>
<td>$337.13</td>
<td>$429.19</td>
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<td>Employee Taxes &amp; Benefits</td>
<td>73.27</td>
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<td>Occupancy Costs</td>
<td>109.33</td>
<td>153.90</td>
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<tr>
<td>Medical &amp; Surgical Supplies</td>
<td>311.19</td>
<td>497.22</td>
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<td>Other Medical Costs</td>
<td>9.74</td>
<td>22.89</td>
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<td>Insurance</td>
<td>10.69</td>
<td>12.42</td>
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<tr>
<td>General &amp; Administrative</td>
<td>237.29</td>
<td>48.15</td>
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<tr>
<td><strong>Total Operating Expenses</strong></td>
<td><strong>$1,088.64</strong></td>
<td><strong>$1,249.58</strong></td>
</tr>
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</table>

VMG HEALTH Multi-Specialty ASC Intellimarker 2010

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Primary Drivers of Value (continued)

- **Primary Drivers of Value = Revenues**
  - **Case volumes considerations**
    - By physician – critical to understand where individual physician utilizers are at in respective practices
      - Risk associated with wide vs. narrow distribution of physicians
      - Physicians approaching end of productive path
    - By specialty – critical to understand changes in operating expenses and reimbursement
      - Growth associated with lower revenue or higher revenue specialties
    - By payor type – critical to understand impact of changes in reimbursement, particularly Medicare
      - Impact of transitioning from out-of-network to in-network with commercial/managed care payors
Primary Drivers of Value (continued)

- Primary Drivers of Value = Revenues (continued)
  - Reimbursement considerations
    - Impact of changes in Medicare reimbursement
      - Largest negative impact
        - GI
        - Pain
      - Largest positive impact
        - General Surgery
        - OB/GYN
        - Orthopedics
        - ENT
    - Impact of Workers Comp reform in many states
    - Impact of transition from out-of-network to in-network
Primary Drivers of Value (continued)
Out of network reimbursement impact
- Timing – immediate vs. future
- Converting to in-network likely impacts volumes as well
- Consider impact on operating expenses
- Similar impact on reimbursement if a joint venture ASC is receiving hospital or hospital-like reimbursement

Primary Drivers of Value (continued)

<table>
<thead>
<tr>
<th>Case Volume</th>
<th>Base Year</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Terminal Year</th>
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<tbody>
<tr>
<td></td>
<td>3,116</td>
<td>3,584</td>
<td>3,871</td>
<td>4,039</td>
<td>5,030</td>
<td>6,270</td>
<td></td>
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<tr>
<td>% Change</td>
<td>15%</td>
<td>8%</td>
<td>4%</td>
<td>4%</td>
<td>25%</td>
<td>25%</td>
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</table>

<table>
<thead>
<tr>
<th>Net Revenue per Case</th>
<th>Base Year</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Terminal Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 3,273</td>
<td>$ 3,250</td>
<td>$ 3,237</td>
<td>$ 3,230</td>
<td>$ 2,526</td>
<td>$ 1,817</td>
<td></td>
<td></td>
</tr>
<tr>
<td>% Change</td>
<td>-1%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>-22%</td>
<td>-28%</td>
<td></td>
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</table>

<table>
<thead>
<tr>
<th>Net Revenues</th>
<th>Base Year</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Terminal Year</th>
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<tr>
<td>$ 10,197,994</td>
<td>$ 11,649,267</td>
<td>$ 12,529,376</td>
<td>$ 13,046,691</td>
<td>$ 12,705,351</td>
<td>$ 11,392,747</td>
<td>$ 11,734,530</td>
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</table>

<table>
<thead>
<tr>
<th>Operating Expenses</th>
<th>Base Year</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Terminal Year</th>
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<tbody>
<tr>
<td>$ 6,091,576</td>
<td>$ 6,564,085</td>
<td>$ 6,932,277</td>
<td>$ 7,234,068</td>
<td>$ 7,938,354</td>
<td>$ 8,974,530</td>
<td>$ 8,498,574</td>
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<table>
<thead>
<tr>
<th>EBITDA</th>
<th>Base Year</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Terminal Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of Net Revenue</td>
<td>40%</td>
<td>44%</td>
<td>45%</td>
<td>45%</td>
<td>38%</td>
<td>21%</td>
<td>28%</td>
</tr>
</tbody>
</table>
Valuations of a Controlling Interest

- National ASC companies generally price transactions as a multiple of EBITDA
  - Generally 7.0x + less Debt
  - Before applying the multiple, EBITDA may be adjusted for projected changes in reimbursement
    - Medicare
    - Transition from out-of-network to in-network
      - May also take into account change in volumes associated with this transaction
  - Fairly common for Income Approach results to yield a value that is typically 1.0 to 2.0x EBITDA less than Market Approach
    - This differential may be largely due to earnings associated with management contracts
      - Not in all cases, but in most, the national ASC companies get a management contract for management fees that are typically 5% to 7% of net revenues
      - While ASC companies maintain a great deal of infrastructure, the incremental expenses are fairly low
Valuations of a Controlling Interest **(continued)**

### Management Fee Valuation Impact

<table>
<thead>
<tr>
<th>Subject ASC</th>
<th></th>
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<tbody>
<tr>
<td>Revenues</td>
<td>$ 4,000,000</td>
</tr>
<tr>
<td>Operating Expenses (Excluding Depreciation)</td>
<td>3,000,000</td>
</tr>
<tr>
<td>EBITDA</td>
<td>$ 1,000,000</td>
</tr>
<tr>
<td>Management Fee</td>
<td>5.0%</td>
</tr>
<tr>
<td>Contribution Margin</td>
<td>50.0%</td>
</tr>
</tbody>
</table>

#### Valuation of 60% Interest (assumes no Long-Term Debt)

<table>
<thead>
<tr>
<th>EBITDA (60% Interest)</th>
<th>$ 600,000</th>
<th>$ 100,000</th>
<th>$ 700,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Invested Capital / EBITDA Multiple</td>
<td>7.0</td>
<td>→ 6.0</td>
<td></td>
</tr>
<tr>
<td>Value Indication - 60% Interest</td>
<td>$4,200,000</td>
<td>$4,200,000</td>
<td></td>
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</tbody>
</table>
Valuations of a Non-Controlling Equity Interest

- Converting the value indication for a controlling interest in an ASC to a non-controlling equity interest requires consideration for the somewhat unique provisions typically included in the operating / ownership agreements:
  - No management fee
  - Most ASCs not only make regular distributions of virtually all distributable cash but are often required to do so
  - Provisions to buy or sell ownership interests at fair market value or based on a formula such as 3.0 to 5.0x EBITDA less debt
  - Non-compete agreements
  - Physician owners actively participate in clinical and operational management
  - Physicians are not only owners but customers
ASC Valuation – In Practice

Considerations for Hospitals Acquiring ASCs

- Valuations of ASCs historically operated as a department of a hospital (HOPD) – much less relevant today than 2 years ago
  - Historical financial data may require a great deal of adjustment
    - Revenues converted to free-standing levels
    - Operating expenses presented on hospital department income statements usually not all inclusive and at the same time may include a number of complex cost accounting allocations
  - Some case volume not eligible for performance post-conversion to free-standing facility
  - Complexities in reflecting conversion to a free-standing entity while at the same time, not anticipating the change in ownership when projecting earnings / cash flows
    - Consideration for potential competition
Considerations for Hospitals Acquiring ASCs (continued)

- Valuations of ASCs being purchased for the purposes of converting to HOPD – more relevant today than 2 years ago
  - Often involve marginal or underperforming centers but not always the case
  - Physicians and operators understand the potential impact on reimbursement
  - May be pressure from all sides to move toward Investment Value standard
  - Historical financial data should be used as is
    - Revenues in the valuation remain at free-standing levels
    - Operating expenses considered in the valuation should reflect continuing operations
  - Usually inappropriate for FMV – but hospital’s business case should consider impact on volumes
  - Reliance on Cost Approach not at all uncommon – consider relevant intangibles such as CON, Development Fees, Licensing, etc.
What Does the Future Hold?

Summary

- Continued Consolidation in the Industry
- Increased Hospital involvement in the ASC Industry
- Industry Participants should Expect Reduced Reimbursement
- Completely Independent ASCs will have Greater Risk Exposure
- As a Low Cost Provider, ASCs will Have a Place at the Table
Questions

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