

Using Valuation Multiples to Assess ASC Value

Owners of ambulatory surgery centers (ASCs) have a keen interest in what their facility is worth. Because ASC partnership shares are not publicly traded and the share price is not readily available, the process of valuing privately held ASCs is subjective. A widely used and simple valuation methodology is the use of valuation multiples. The proper use of multiples depends on a subjective assessment of the facts and circumstances of the ASC and the characteristics of the individual ASC partnership units.

Although multiples are useful as a tool in the valuation process, the misuse of multiples could lead to inaccurate value assessments and widely differing opinions between ASC partners in the same partnership regarding share price value. In the valuation profession, multiples are synonymous with "rules of thumb." This term is defined as "an easily learned and easily applied procedure for approximately calculating or recalling some value, or for making some determination." The use of rules of thumb provide a useful and simple tool for providing quick estimates of ASC share value when an actual assessment is not easily obtainable.

ASC Industry Multiples

ASCs are typically valued using a multiple that falls within a distinct range, which is different and unique from other business segments in the healthcare industry. Examples of ranges of valuation multiples typically utilized by industry experts in the ASC industry are illustrated in Table 1.

Table 1 Financial Metric Valuation Multiple Range

	Low	High
Cash flow	4	7
Revenue	.7	1.4
Net income	6	12

As the table illustrates, it is important to determine the correct financial metric. In the ASC industry, the most commonly used financial metric is cash flow. Cash flow is defined as cash collections less operating expenses, and can be approximated by calculating earnings before interest, taxes and depreciation (EBITDA) from the ASC's income statement. Revenue and net income are financial metrics that are also used to value ASCs.

For example, if an ASC's EBITDA calcu-

lated for the last 12 months is \$1 million and the midpoint of the valuation multiple range is 5.5, the value of the ASC can be calculated using the following simple computation: ($5.5 \times \$1 \text{ million} = \5.5 million). When calculating the appropriate financial metric, it is important to exclude nonrecurring items such as one-time payments.

As the valuation example above illustrates, the calculations are simple. The difficulty is determining which financial metric and multiple to choose. Because the range of multiples is so wide, it is difficult to ascertain which multiple within the range is most applicable to value the ASC partner's specific interest. In addition, uniformly applying market multiples ignores the obvious fact that not all ASCs are alike and not all equity interests within the same ASC partnership are similar in the value metrics of control and marketability. The complexity and subjectivity of the valuation process ensures that the only dependable method of valuing ASC units is an independent valuation assessment performed by a qualified third party.

Definition of a Multiple

A multiple offers guidance to what other people are willing to pay for comparable earnings streams. A multiple is simply the inverse of the capitalization rate. The capitalization rate converts the income stream into an indication of value by dividing the selected definition of the stream by a factor.

For example, if an income stream of \$10,000 per year were to be capitalized at 25 percent, the calculation would be \$10,000 divided by .25, which equals a capitalized value of \$40,000. The inverse of a 25 percent capitalization rate yields a multiple of four. The income stream to be capitalized can be defined in an almost infinite variety of ways, and it is essential that the capitalization rate chosen be appropriate for the particular definition of that income stream.

Disadvantages of Using Multiples

While the primary advantage to utilizing multiples in the valuation process is simplicity, the disadvantages are plentiful. Disadvantages of utilizing multiples include the following:

- Different industry experts may provide different rules of thumb
- Application of a uniformed rule of thumb

may result in an incorrect estimate of value.

- While simplistic in application, rules of thumb may ignore the economic reality of the situation and the specific financial and risk characteristics of the ASC
- Multiples for a controlling interest (greater than 50 percent) are typically higher than that of a minority interest and misapplication can lead to inaccurate valuation.

Specific ASC Characteristics

Many factors can affect the unique characteristics of an ASC. They include, but are not limited to, the following issues: physician ownership, case load, competition in the service area, reimbursement, case mix, payor mix, outpatient surgery technology, staffing levels, supply costs, occupancy costs, equipment and occupancy leases, other operating expenses, general condition of equipment, payor concentration, capital expenditure requirements, and working capital requirements.

In addition to these characteristics, each ASC's risk profile is unique. An ASC with a small number of physician-owner utilizers and two of its high case-volume physicians nearing retirement has a higher risk profile (and therefore deserves a lower multiple) than an ASC with a large diversified base of physician ownership with physicians in various stages of the practice cycle.

Because each ASC is unique, a thorough valuation analysis performed by an independent third party which takes into account the fundamental characteristic and future prospects of the ASC is the only reliable means to assess the value of the subject ASC. A third-party valuation analysis will utilize, in most cases, a discounted cash flow analysis where the objective is to determine the value of the business given the cash flow generating capacity of the business adjusted by growth and risk characteristics.

The valuation of an ASC is as much of an art as it is a science. Although valuation multiples are simple to use and useful as one tool in the valuation process, the misuse of multiples could lead to inaccurate value assessments and widely differing opinions between ASC partners in the same partnership regarding ASC share price value. Careful consideration should be given to the unique characteristics and risk profile of the subject ASC. □