

ASC VALUATIONS

When Does Your ASC Need a Fair Market Value Analysis?

Who Is Qualified to Perform One?

By C. Elliott Jeter

Many ASCs today operate as partnerships typically between surgeons, surgeons and hospitals, or surgeons and ASC corporate companies. Frequently, as a result of these partnerships, the question of equity valuation arises. Several specific situations that require an independent equity valuation of an ASC are:

- government regulations that require an independent assessment of fair market value
- normal changes in ownership (e.g., physician purchases and sales of partnership units)
- enterprise sale or acquisition of an existing ASC
- a need for an understanding of the elements that drive the value of the ASC so that shareholder value can be assessed, usually on a yearly basis

The type of valuation needed and the qualifications required of the person who performs the analysis vary based upon the purpose of the valuation.

Regulatory Requirements

In joint ventures that involve hospitals and physicians, the federal anti-kickback statutes (fraud and abuse laws) require that all transactions between physicians and hospitals be consummated at fair market value. In addition, federal statutes (private inurement regulations) require tax-exempt hospitals that enter into joint ventures with physicians to enter into those transactions at fair market value or risk losing their tax-exempt status.

Fair market value is defined as the price at which an entity's assets or services would exchange between a willing buyer and a willing seller when both parties have reasonable knowledge of the relevant facts and neither party is under compulsion to buy or sell. When conducting fair market value studies, analysts are required to conduct the valuation based upon generally accepted valuation methodologies. Generally accepted valuation methodologies require the consultant to consider the three approaches to value: the cost, market and income approaches. The cost approach identifies the cost to re-create a business, the market comparison approach computes value by examining the purchase price of similar companies in a free and open market, and the income approach projects a future income stream attributable to a business and then discounts those earnings back to present value. Typically, ASCs hire qualified, independent third-party valuation firms to provide opinions of fair market value in situations that pose a risk of violating the federal fraud and abuse statutes.

Because ASC shares or units are not publicly traded, fair market value is used as the industry standard to estimate the price at which the ASC shares would be bought and sold in an open market. Because no open market exists, an independent, qualified valuation consultant estimates the value based upon

generally accepted valuation methodologies. Those who perform independent fair market value assessments should

- have appropriate business valuation training,
- focus on valuations as a primary business, and
- focus on the health care industry, and specifically, ASCs.



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Appropriate business valuation training includes designations associated with the American Society of Appraisers (ASA) and the Institute of Chartered Financial Analysts (CFA). These designations call for the successful completion of rigorous coursework and exams along with extensive experience requirements. The valuation consultant must be knowledgeable about the health care industry and the elements that drive the operations of ASCs. A business valuation consultant who does not understand what makes an ASC partnership succeed will often misinterpret important equity valuation data. Independence or impartiality is also important. The valuation consultant must be impartial in the treatment of the valuation regardless of the outcome.

Normal Changes in Ownership

The value of ownership interests in publicly traded companies is easy to measure. Simply refer to newspaper stock market quotes for current prices. Privately held equity interests, such as ASC shares, are more difficult to value. Although physician-owned ASCs do not always require the same stringent evaluations of fair market value as physician/hospital joint

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ventures, an independent and impartial estimate of fair market value can be very useful.

We suggest that an independent fair market value study be performed whenever

- a surgeon shareholder moves out of the area,
- a surgeon shareholder dies and the estate needs to be bought out,
- a surgeon shareholder retires and needs to be bought out, or
- a surgeon desires to buy into an existing partnership.

To reduce the risk associated with shareholder disputes or potential regulatory issues, we suggest that ASC partnerships engage a qualified, independent valuation firm to provide either an annual or semi-annual fair market value study. The shareholders of a group may elect not to engage in an independent fair market value study for purposes of shareholder buy in and out. The values established by the partnership, however, must not in any way be affected by the value or volume of referrals associated with an individual surgeon partner.

Buying or Selling an Existing ASC

ASC shareholders or buyers frequently obtain a valuation of an ASC when selling or buying the enterprise (100% interest). Fundamentally, the dynamics that affect the value of the ASC in these transactions are the same as those in the previous examples even though the enterprise transaction is typically more involved than the other transactions and affects all shareholders rather than just a few. As a result, the shareholders or buyers may elect to engage a qualified, independent valuation firm to perform the valuation. This process gives the shareholders a better understanding of where the negoti-

ated price lies within a range of fair market value (i.e., high, low or middle ground).

Enhancing Shareholder Value

In ASCs, the underlying factors that affect profitability, cash flow, distributable earnings and capital investment also affect the equity value of the partnership. Because these value drivers are not always readily apparent, an ASC valuation can be used as a tool for enhancing shareholder value. A manager who adopts the perspective of managing value can present the shareholders of the partnership with information that allows better business management and decision making for the partnership.

To become a value manager, an ASC manager must adopt a unique perspective that involves understanding and adopting a shareholder's view of the business and then demonstrating a willingness to act on opportunities that create incremental value. To be effective, the ASC manager must also understand the components of value and the factors that affect value, including:

- specialty mixes
- case volumes
- payer mixes
- physician preferences
- procedure mixes
- staffing levels
- capital equipment purchases
- scheduling efficiency
- medical supply costs
- operating room turnover time
- accounts receivable management

A properly prepared fair market value analysis will clearly delineate the factors that enhance or affect shareholder value. That analysis can be an effective tool to use in managing value on an ongoing basis. ♦

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