What Is Your Surgery Center Worth?

Understanding how others view your ASC will help you get the greatest return.

Jon Vick I Valley Center, Calif.

To figure your facility’s worth, you’ll need to consider the reputation of your surgeons, your specialty mix and caseload, the facility’s earnings, long-term debt and a host of other factors, including:

- **Medical staff.** Buyers will look at the quality of the employees you’ve hired and focus on the reputation of your surgeons within your community.
- **Earnings.** Typically 25 percent to 45 percent of total revenue, earnings play a large part in the type of buyer your facility will attract. Facilities with sluggish earnings, perhaps 10 percent to 20 percent of revenues, represent opportunities for corporate partners specializing in facility turnarounds. Other management companies might be looking for centers with higher earnings, in the 40 percent to 50 percent range.
- **Cash flow.** Most ownership transactions are based on cash flow — earnings before interest, taxes, depreciation and amortization (EBITDA).
- **Growth potential.** Buyers might offer six to eight times EBITDA for facilities with growth potential, determined in part by analyzing the type of procedures your facility hosts (spine and orthopedics, for example, are considered growth specialties) and its capacity to add more cases. A perfectly run, profitable center humming along at full capacity is less attractive to buyers than a facility with half-filled ORs. Some buyers want to invest in fairly successful centers with room for improvement.
- **Cash on hand.** Simply put, the amount of liquid cash available. It’s added to the overall purchase price.
- **Long-term debt.** Long-term debt is comprised of outstanding loans, and the related inter-
est, from capital equipment purchases. This figure is subtracted from your center’s overall purchase price. Centers with little or no long-term debt will sell for more than facilities with outstanding loans on the books.

- **Quality earnings.** This relates to the primary source of a facility’s earnings. Centers that bill to a high number of out-of-network providers collect higher fees, but actually rate poorly on the quality earnings scale because of a reimbursement and legal landscape that frowns on that type of billing. Buyers tend to prefer the security of steady and predictable income derived from in-network billing. Facilities with high earnings but long accounts receivables also rate low in buyers’ eyes because of the uncertainty surrounding the collection of the money they’re owed.

- **Minority or majority interest.** The amount of ownership shares you sell will factor into the suitors you attract. Some companies want a majority interest in the facilities they purchase while others are satisfied with a minority holding. Your center will attract a higher multiple if you partner with a company interested in the amount of ownership shares you’re willing to sell.

- **Negotiating ability.** Don’t limit yourself to one offer. Request purchase proposals from three or four interested buyers and have them bid against each other. Being a savvy negotiator takes some doing, but remember that you hold the hammer if your center matches the management and financial interests of the buyer.

### The four approaches

Let’s take a look at the four main approaches buyers will use to determine your surgery center’s market value.

#### 1. Sales approach

- **When it’s used.** Also called the market approach, most ASC management companies use this formula, which relies on valuation multiples derived from transactions involving selected similar centers.

- **How it works.** You adjust valuation multiples based on your center’s strengths and weaknesses relative to selected comparable centers. You then apply those multiples to your center to arrive at an indication of value. You determine the center’s value by multiplying the trailing-twelve month (TTM) cash flow or EBITDA (earnings before interest, taxes, depreciation and amortization) by the valuation multiple, subtracting long-term debt and adding cash. Here’s how to value an ASC using the sales approach calculation.

<table>
<thead>
<tr>
<th>Step</th>
<th>Formula</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Total revenue</td>
<td>$4,500,000</td>
<td></td>
</tr>
<tr>
<td>(-) Total expense</td>
<td>$2,500,000</td>
<td></td>
</tr>
<tr>
<td>(=) Net Income</td>
<td>$2,000,000</td>
<td></td>
</tr>
<tr>
<td>2. (+) Interest</td>
<td>$50,000</td>
<td></td>
</tr>
<tr>
<td>3. (+) Taxes</td>
<td>$0</td>
<td></td>
</tr>
<tr>
<td>4. (+) Depreciation and amortization</td>
<td>$100,000</td>
<td></td>
</tr>
<tr>
<td>(=) EBITDA (cash flow)*</td>
<td>$2,150,000</td>
<td></td>
</tr>
<tr>
<td>5. Multiple of EBITDA (x) EBITDA</td>
<td>6.5* x</td>
<td>$2,150,000</td>
</tr>
<tr>
<td>6. (-) Long-term debt</td>
<td>$600,000</td>
<td></td>
</tr>
<tr>
<td>7. (+) Cash on hand</td>
<td>$500,000</td>
<td></td>
</tr>
<tr>
<td>(=) Valuation</td>
<td>$13,875,000</td>
<td></td>
</tr>
</tbody>
</table>

Value of 51 percent ownership share $7,076,250

*Based on 2008 market average for majority interests in multi-specialty surgery centers.

#### 2. Internal sales approach

- **When it’s used.** To syndicate surgery center shares to new physician-owners.

- **How it works.** The multiple is typically discounted by up to 50 percent, based on the valuation theory of “discounts for fractional interests.” The small (typically 5 percent to 20 percent) minority interest purchased by a new physician-partner with no management control is presumed to be worth up to 50 percent less than a larger minority or majority interest accompanied by a management contract and management control. This discount makes it...
Factors That Impact The Almighty Multiple

Typical multiples range from four to six times EBITDA for minority interests, and six to eight times EBITDA for majority interests. The goal for physician-owners is to command a premium multiple. As a general rule, a premium valuation is in excess of a 7 multiple of EBITDA. Some companies will initially purchase a minority interest and give physician-owners an option to sell more shares 12 to 24 months later when the center is worth more.

The time to sell is when your facility is working between 50 percent and 70 percent of its full capacity.

Factors that impact the multiple include how many surgeons and cases are available to recruit, how much future growth potential your center represents, restrictions to market entry (Certificate of Need laws, for example), local competition, which company is making the offer and how good a deal you (or your representative) can negotiate.

Other factors can include the “quality” of the center’s earnings. That refers to the sources and sustainability of your revenue. Too much (20 percent or more) out-of-network revenue, for example, can significantly lower the perceived quality of your revenue and earnings. If your center is very profitable and fully utilized, it may not represent a growth opportunity. The time to sell is when your facility is working between 50 percent and 70 percent of its full capacity.

A good strategy is get three of four companies interested in your center. Then you try to push the multiple up by negotiating one deal against the other. If you can get two or three offers for your center, chances are you’ll increase the multiple by half a multiple to a whole multiple. Finally, keep in mind that older docs can’t sell their shares to younger docs at same multiple they can get form corporate partners.

— Jon Vick

easier to attract new physician-partners and results in a very good return on investment for new partners. Many ASC management companies include a clause in their operating agreement stipulating that the company will buy the physicians’ shares at a discounted multiple (typically about 50 percent of the purchasing multiple), less long-term debt, if state or national legislation is passed that prohibits or restricts physician ownership or forces the physician-owners to sell.

3. Income approach

• When it’s used. Some not-for-profit hospitals have protocols for purchase of physician-owned centers that require the use of the income (also called the discounted cash flow) approach to valuation. Potential buyers, however, rarely use this approach to determine a value or purchase price, as it’s usually difficult to accurately project a center’s future cash flow.

• How it works. This approach focuses on the center’s expected future cash flow available for distribution for a finite period (usually seven years). Cash flow available for distribution is the amount of cash available as dividends without impairing the future profitability or operations of the center. The cash flow available for distribution and the terminal value (the value of the center at the end of the estimation period) are discounted to present value in order to derive an indication of the center’s value. Interest bearing debt, if any, is then subtracted from the center’s value to arrive at an indication of the shareholders’ equity value.

4. Cost approach

• When it’s used. To value centers that are only slightly profitable, breaking even or losing money.

• How it works. You’d perform a valuation analysis for a center’s identified fixed assets (building infrastructure and capital equipment, for example), financial assets (like accounts receivable, cash on hand and liquidity of investments) and other miscellaneous assets. The derived aggregate value of these assets is then netted against the estimated value of all existing and potential liabilities, resulting in an
indication of value of the shareholder’s equity, less depreciation. This approach helps determine the cost of replacing a center.

**Mergers and Acquisitions 101**

Dozens of ASC management companies are interested in buying interests in surgery centers, but it’s important that you solicit companies that are interested in your type of center, that have the capital to consummate your deal and that have a track record of operational success with other similar centers. Follow these steps to get the best partner, terms and price:

- Write down the physician-partners’ goals and determine the center’s growth opportunities.
- Prepare a sales prospectus that includes the preliminary due diligence material.
- Solicit interest from three or four ASC management companies that meet your criteria and sign confidentiality agreements.
- Interview at least three competing companies with all the partners present. Then interview these companies’ physician-partner references.
- Confirm the “same-store growth” experienced by the companies’ other centers.
- Have each company develop a five-year pro-forma for your center.
- Review term sheets and proposals from at least three companies.
- Negotiate (or have your representative negotiate) terms that are best for you.
- Sign a letter of intent with the company that is the best fit (not necessarily the company that offers the most money) and that will help you achieve your objectives. **OSM**

Mr. Vick (jonvick2@aol.com) is founder and president of ASCs Inc., an ASC development, merger and acquisition company.