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Practical Business, Legal and Clinical Guidance for Ambulatory Surgery Centers

2009 Physician Hospital Valuation Survey

By Jason Ruchaber, CFA, ASA

For the first time HealthCare Appraisers has surveyed the physician hospital industry to determine current perspectives among industry participants regarding valuation, transaction activity and management fees. With the help of Physician Hospitals of America, 30 respondents participated in our survey, representing approximately 100 physician-owned hospitals throughout the country. The following summarizes highlights of the survey.

Valuation multiples and methodologies

When purchasing a controlling interest in a physician hospital, 54 percent of the respondents reported prevailing valuation multiples of 5.0-6.9 times EBITDA. Forty percent of respondents perceive that valuation multiples have stayed consistent with the prior year, while 55 percent perceive that multiples have decreased. Only 5 percent believe multiples are increasing.

Valuation Multiples	% Respondents
< 4.0	9%
4.0 to 4.9	19%
5.0 to 5.9	27%
6.0 to 6.9	27%
7.0 to 7.9	9%
8.0+	9%

Somewhat surprisingly, 72 percent of respondents reported that political proposals related to banning or limiting self-referrals to physician-owned hospitals have no impact on the valuation process primarily because facilities currently in existence would likely be grandfathered in if the hospital had physician ownership as of Jan. 1, 2009, and had its Medicare provider agreement in effect as of such date. This grandfathering may not apply to hospitals under development that have not yet obtained their Medicare license. Even though such proposals are not new to the industry, the current focus on reform and democratic control of both the House and the Senate seem to indicate that such proposals stand a greater chance of being passed. Survey participants overwhelmingly agree that this is a risk factor, with 81 percent of respondents reporting that President Obama and the Democratic majority in Congress have a negative effect on the outlook for physician hospitals.

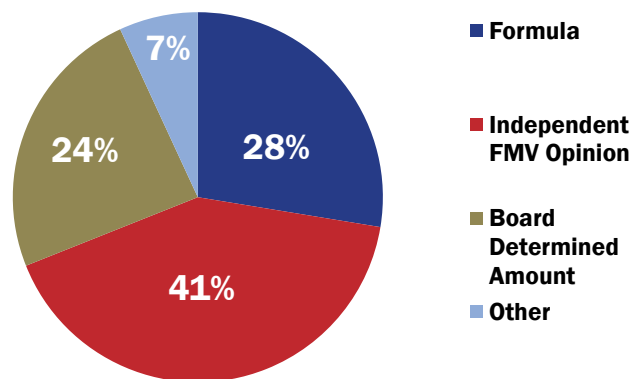
Impact on Outlook	% Respondents
No Impact	11%
Positive	4%
Slightly Positive	4%
Slightly Negative	29%
Negative	26%
Very Negative	26%

Because there exists an inverse relationship between risk and valuation (i.e., higher risk equals lower valuation) we would have expected stronger downward pressure on valuation multiples.

For minority interests it is generally accepted financial theory that valuation of such interests should trade at a discount to controlling interests. Appraisers refer to these discounts as discounts for lack of control and/or discounts for lack of marketability. Acceptance of this concept is supported by survey participants, 50 percent of whom reported that when buying out retiring or departing physicians pricing is set between 3.0-4.9 times EBITDA.

Valuation Multiples	% Respondents
< 2.0	17%
2.0 to 2.9	8%
3.0 to 3.9	13%
4.0 to 4.9	37%
5.0 to 5.9	17%
6.0+	8%

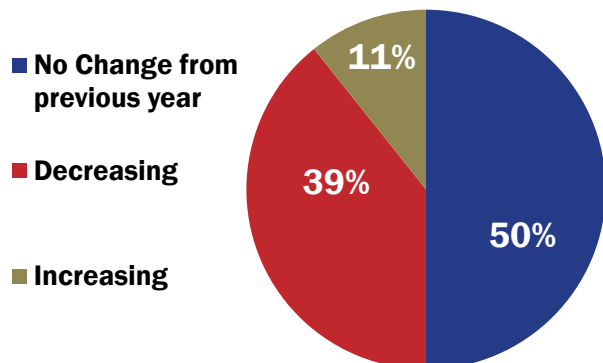
Mathematically this represents a discount from the controlling interest multiples of approximately 30-40 percent. When determining the price to pay departing physicians, 52 percent of respondents base the redemption price on a predetermined formula. For new physician investors, 28 percent of respondents report using a formula to establish the buy-in price; 24 percent allow the board to determine the purchase price; and 41 percent obtain an independent, fair market value opinion.



Regarding the measure of profitability utilized by the respondents, 88 percent measure earnings based on EBITDA. In valuing potential acquisitions, 57 percent look at trailing 12 months of financial data and 19 percent rely on the most recently completed fiscal year.

Transaction activity

With the uncertainty surrounding healthcare reform, tightening in the credit markets and overall economic distress, acquisition activity has waned over the last year with 39 percent of the respondents reporting declines.



For some this has translated into opportunity, with 32 percent of respondents reporting that competition for physician-hospital investment opportunities has declined and only 18 percent reporting that competition has increased. When bidding on acquisition targets, half of the respondents report 2-3 bidders and 30 percent report 4 or more bidders. During 2008, 63 percent of respondents reported performing due diligence for physician-hospital acquisitions but only 21 percent of respondents actually completed one or more acquisitions. For 2009, 42 percent of respondents plan to purchase between 1-3 physician-hospitals. Sixty-five percent of respondents stated that they were opportunistic with respect to selecting physician-hospital opportunities. Despite the tight credit markets, more than two-thirds of the respondents fund their acquisitions principally through debt and 71 percent of respondents will consider a purchase opportunity regardless of the magnitude of the investment.

De novo (start-up) versus purchase

One-third of the respondents report that they seek de novo opportunities; 23 percent seek turnaround opportunities; and 43 percent seek established cash-flowing centers.

Acquisition Strategy	% Respondents
Established cash-flowing centers	43%
Turnarounds	23%
De Novo (i.e., start-ups)	33%

For a start-up hospital, 54 percent of respondents reported "buy-in" prices of less than \$75,000 per 1 percent interest. Respondents were fairly evenly spread on the ownership interest they seek to purchase; however, 42 percent of respondents indicated that a 50-75 percent ownership interest was most desirable.

Preferred physician specialties

The respondents indicated the following strongly desired specialties for physician-investors: orthopedics, spine, general surgery, ENT, and gastroenterology. Cosmetic surgery and oncology were identified as undesirable specialties in a physician-owned hospital.

(Data sorted from most desired to least desired)	Undesirable	No Preference	Desirable
Orthopedics	0	0	29
Spine	0	1	28
General Surgery	1	3	24
ENT	1	4	22
GI	3	4	21
Urology	5	3	20
Neurosurgery	1	4	19
OB/GYN	6	5	15
Cardiology	2	10	14
Interventional Radiology	5	7	12
Ophthalmology	6	9	11
Vascular Surgery	3	10	11
Neurology	2	12	10
Cardiac Surgery	5	11	8
Plastic Surgery	7	12	7
Medical Oncology/Hematology	9	10	4
Radiation Oncology	9	10	4

Management fees

The majority of respondents reported management fees ranging from 5-6 percent of net revenue. Seventy-three percent of respondents indicate they have an equity position in the hospitals they manage, but 68 percent of the respondents indicate that equity ownership has no influence on the level of the management fee charged. ■

A copy of the 2009 *Physician Hospital Valuation Survey* can be obtained by visiting the HealthCare Appraisers Web site at www.healthcareappraisers.com.

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