

# 2009 Physician Hospital Valuation Survey

How do physician hospital companies  
assess value?

HealthCare Appraisers  
INCORPORATED

in cooperation with

PHYSICIAN  
HOSPITALS  
OF AMERICA



We are pleased to announce the results of the 2009 Physician Hospital Valuation Survey. In cooperation with Physician Hospitals of America, HealthCare Appraisers, Inc. surveyed the physician hospital industry to determine trends in both the value of physician hospital ownership interests and the management fees charged to these entities. Thirty respondents, representing approximately 100 hospitals throughout the country, responded to this year's survey. The following summarizes highlights of the survey.

### Valuation Multiples and Methodologies

- When purchasing a controlling interest in a physician hospital, 54% of the respondents reported prevailing valuation multiples of 5.0 to 6.9 times EBITDA, while 18% reported higher valuation multiples, and 28% reported lower multiples. 40% of respondents perceive that valuation multiples have stayed consistent with the prior year, while 55% perceive that multiples have decreased. Only 5% believe multiples are increasing.
- When buying out retiring or departing physicians, half of the respondents pay between 3.0 to 4.9 times EBITDA, but a quarter of the respondents pay a multiple of 5.0 times or higher.
- When buying out retiring or departing physicians, 52% of respondents base the redemption price on a predetermined formula. For new physician investors, 28% of respondents report using a formula to establish the buy-in price; 24% allow the board to determine the purchase price; and 41% obtain an independent, fair market value opinion.
- Regarding the measure of profitability utilized by the respondents, 88% measure earnings based on earnings before interest, taxes, depreciation and amortization (EBITDA). In valuing potential acquisitions, 57% look at trailing 12 months of financial data, and 19% rely on the most recently completed fiscal year.
- With respect to political proposals related to banning or limiting self-referral to physician-owned hospitals, 72% report that this has no impact on the valuation process; however, 81% of respondents report that President Obama and the Democratic majority in Congress have a negative effect on the outlook for physician hospitals, including 26% who indicated that the effect is very negative.

### Transaction Activity

- 39% of the respondents reported that acquisition activity in the physician hospital market is declining, while half indicated that there has been no change in activity from the prior year. 32% of respondents reported that competition for physician hospital investment opportunities has declined, while 18% reported that competition has increased. Half reported no change.

- During 2008, 63% of respondents reported performing due diligence for physician hospital acquisitions, but only 21% of respondents actually completed one or more acquisitions. When bidding on acquisition targets, half of the respondents report 2 to 3 bidders, and 30% report 4 or more bidders.
- For 2009, 42% of respondents plan to purchase between 1 to 3 physician hospitals. Of these, 10 respondents report plans to close only 1 transaction, and 5 respondents plan to purchase between 2 and 3 hospitals. 65% of respondents stated that they were opportunistic with respect to selecting physician hospital opportunities.
- More than two-thirds of the respondents fund their acquisitions principally through debt, while 18% fund principally with cash. 71% of respondents will consider a purchase opportunity regardless of the magnitude of the investment, while 21% of respondents will not consider an investment over \$50 million.

### De Novo (Start-up) versus Purchase

- One-third of the respondents report that they seek *de novo* opportunities; 23% seek turnaround opportunities; and 43% seek established cash-flowing centers.
- For a start-up hospital, 54% of respondents reported "buy-in" prices of less than \$75,000 per 1% interest. Respondents were fairly evenly spread on the ownership interest they seek to purchase; however, 42% of respondents indicated that a 50-75% 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.

### Management Fees

- The majority of respondents reported management fees ranging from 5-6% of net revenue, with 50% listing 5% as the minimum fee and half of the respondents listing 6% as the maximum fee. 73% of respondents indicate that they have an equity position in the hospitals they manage, but 68% of the respondents indicate that equity ownership has no influence on the level of the management fee charged.

1. Your company is:

Public	Private
0%	100%

2. How many Hospitals do you have under ownership?

Hospitals Under Ownership	% Respondents
1 to 3	73%
4 to 6	10%
7 to 10	10%
11+	7%

3. How many Hospitals do you have under management?

Hospitals Under Management	% Respondents
1 to 3	78%
4 to 6	11%
7 to 10	7%
11+	4%

4. How many potential acquisition candidates have you performed due diligence on over the last year?

Potential Acquisition Candidates	% Respondents
None	37%
1	20%
2	13%
3	13%
4	4%
5+	13%

5. Including your company, how many potential acquirers typically participate in the bidding process?

Potential Acquirers	% Respondents
1	20%
2 to 3	50%
4 to 5	20%
6+	10%

6. How many Hospitals have you purchased over the last year?

Number of Hospitals Purchased	% Respondents
None	79%
1	7%
2	10%
3	4%
4	0%
5+	0%

7. How many Hospitals do you plan to purchase over the next year?

Number of Hospitals to Purchase	% Respondents
None	58%
1	28%
2	7%
3	7%
4	0%
5+	0%

8. Of the following specialties, we regard their desirability in a physician-owned Hospital as follows:

(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

9. In the context of a start-up Hospital share pricing, what is the typical range observed per 1% interest?

Start-up Share Pricing Per 1%	% Respondents
< \$50,000	29%
\$50,000 - \$75,000	25%
\$75,001 - \$100,000	8%
\$100,001 - \$150,000	21%
\$150,001 - \$200,000	4%
\$200,001 - \$250,000	13%
> \$250,001	0%

10. For single-specialty Hospitals, your company generally prefers how many active physician owners?

Preferred Number of Physician Owners	% Respondents
1 to 5	0%
6 to 10	32%
11 to 15	32%
16 to 20	8%
21+	28%

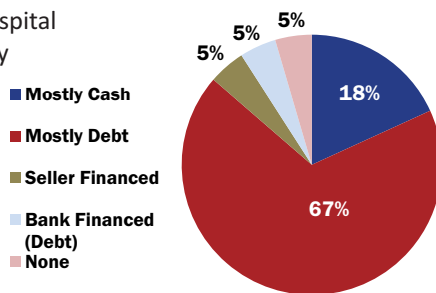
11. For multi-specialty Hospitals, your company generally prefers how many active physician owners?

Preferred Number of Physician Owners	% Respondents
1 to 5	0%
6 to 10	4%
11 to 15	4%
16 to 20	24%
21+	68%

12. From an equity standpoint, your company's preferred ownership is:

Preferred Equity Ownership	% Respondents
< 10%	13%
11% to 29%	20%
30% to 50%	17%
51% to 75%	42%
> 75%	8%

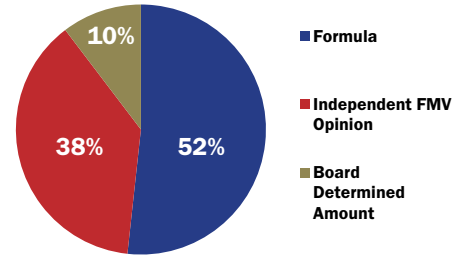
13. How are your Hospital acquisitions generally financed?



14. What is the total investment level (buy-in price) that would preclude your company from participating in a Hospital acquisition?

Investment Level (Buy-in Price)	% Respondents
\$15,000,000	8%
\$50,000,000	13%
Not Applicable - any potential investment is considered	71%
Not Applicable - other	8%

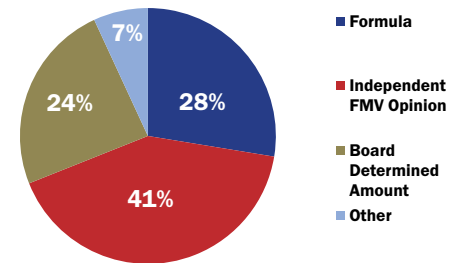
15. How do you determine FMV for *buy-out* transactions (e.g., retiring physicians or departing physicians)?



16. What valuation multiples (i.e., for *minority interest buy-out*) have you most typically observed in the marketplace during the past 12 months?

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%

17. How do you determine FMV for new physician-investor *buy-ins*?



18. What valuation multiples have you most typically observed in the marketplace during the past 12 months for physician-investor *buy-ins*?

Valuation Multiples	% Respondents
< 2.0	29%
2.0 to 2.9	14%
3.0 to 3.9	29%
4.0 to 4.9	9%
5.0 to 5.9	14%
6.0+	5%

19. When *selling* minority interests to new physician investors, on average how long does it take to identify the buyer and consummate the sale?

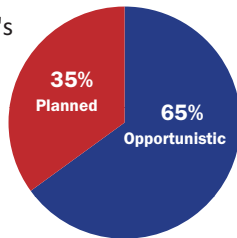
Time Period	% Respondents
< 3 months	27%
3 to 6 months	46%
6 months to 1 year	23%
> 1 year	4%

20. With respect to your acquisition strategy, do you prefer established facilities with immediate cash flow, turnaround situations at lower multiples/asset values or *de novo* development opportunities?

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

(Multiple responses allowed)

21. What best describes your company's posture with respect to selecting new Hospital opportunities?



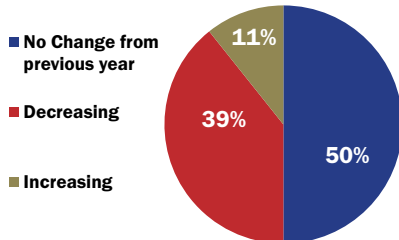
22. What valuation multiples (i.e., for *controlling interest*) have you most typically observed in the marketplace during the past 12 months?

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%

23. In the past year, what best describes the multiples paid (or considered) by your company?

Change in Valuation Multiples	% Respondents
No Change from previous year	40%
Decreasing	55%
Increasing	5%

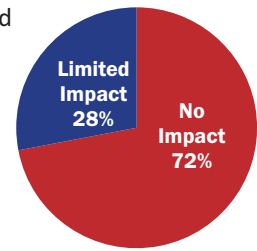
24. In the past year, what best describes your observations in the marketplace related to acquisition activity?



25. In the past year, what best describes your observations related to competition for acquisitions?

Change in Acquisition Competition	% Respondents
No Change from previous year	50%
Decreasing	32%
Increasing	18%

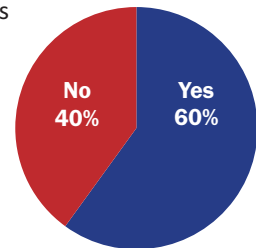
26. How have political proposals related to banning or limiting self-referral of Medicare/Medicaid cases to physician-owned hospitals impacted your valuation process?



27. How has the election of President Obama and a stronger Democrat majority in Congress affected your outlook for physician-owned hospitals?

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

28a. Do you consider paying premiums for Hospitals in CON states and/or where there are significant barriers to entry?



28b. What is the magnitude of the premium paid by your company in a CON state?

Impact Expressed in Multiples of EBITDA	% Respondents
< 0.25x	10%
0.26x to 0.50x	18%
0.51x to 0.75x	36%
0.76x to 1.0x	18%
> 1.0x	18%

29. When valuing a potential acquisition candidate, on what primary earnings measure do you rely?

Primary Earnings Measure	% Respondents
EBITDA	88%
Cash Flow to Shareholders	4%
Net Income	4%
All of the Above	0%
IRR Model	0%
N/A	4%

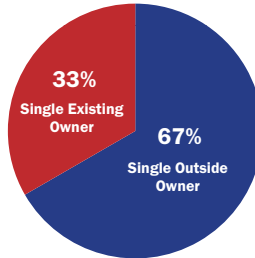
30. In valuing a potential acquisition candidate, what periods are most typically incorporated into the valuation/ purchase offer?

Measurement Period	% Respondents
Trailing 12 months ("TTM")	57%
Most recently completed fiscal year	19%
Average or weighted average of historical periods	19%
Other	5%

31a. If you have sold a **controlling** interest in a Hospital during the last year, approximately how long did it take to identify a buyer and consummate the sale?

Time Period	% Respondents
< 3 months	0%
3 to 6 months	0%
6 months to 1 year	9%
> 1 year	4%
Not Applicable	87%

31b. If you sold a controlling interest, the buyer of your interest was:



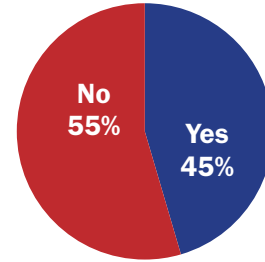
32. What is the **minimum** management fee your company charges? (stated as a % of net revenue)

% of Net Revenue	% Respondents
3%	25%
4%	15%
5%	50%
Other/Flat Fee	10%

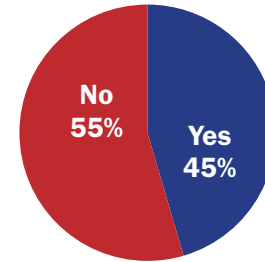
33. What is the **maximum** management fee your company charges? (stated as a % of net revenue)

% of Net Revenue	% Respondents
5%	22%
6%	50%
7%	11%
Other/Flat Fee	17%

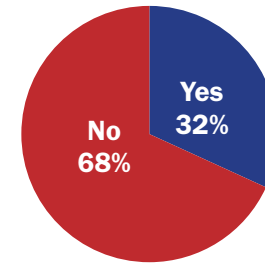
34. Does the management fee vary based on revenue levels of the Hospital (*i.e.*, do you use a sliding scale)?



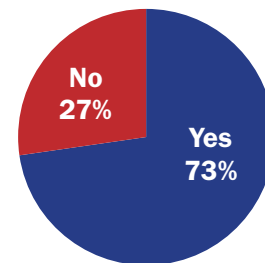
35. Does the management fee vary based on the level of services provided?



36. Does the management fee vary based on your level of equity ownership?



37. Do you maintain an equity ownership in all Hospitals that you manage?



HealthCare Appraisers and Physician Hospitals of America would like to thank the following companies for their participation in the 2009 Physician Hospital Valuation Survey:

- **Ameris Health Systems, LLC**
- **Beaumont Bone & Joint Institute**
- **Brownsville Doctors Hospital, LLC**
- **Cirrus Health**
- **Cook Children’s Northeast Hospital**
- **Edgewood Surgical Hospital**
- **Foundation Surgical Hospital Affiliates**
- **Kansas Medical Center, LLC**
- **Kansas Spine Hospital**
- **Lafayette Surgical Specialty Hospital**
- **National Surgical Care**
- **Nebraska Orthopaedic Hospital**
- **NSH**
- **Nueterra Healthcare**
- **Orthopedic Hospital**
- **P & S Surgical Hospital**
- **Physicians Hospital System**
- **Pine Creek Medical Center**
- **Presbyterian Plano Center For Diagnostics & Surgery**
- **Prexus Health**
- **Reliant Healthcare Partners**
- **Rockwall Hospitals, Inc.**
- **Sugar Land Surgical Hospital**
- **Surgical Care Affiliates, LLC**
- **Surgical Development Partners**
- **Surgical Specialty Center at Coordinated Health**
- **Surgical Specialty Center of Baton Rouge**
- **Symbion Healthcare**
- **Texas Institute for Surgery**
- **The NeuroMedical Center Surgical Hospital**



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