

*HOSPITAL ACQUISITIONS OF ASCs, IMAGING
FACILITIES, AND
OTHER ANCILLARY BUSINESSES*

*HOW TO EXAMINE OPPORTUNITIES AND HOW TO
ASSESS PRICING AND ROI*

May 17, 2012



PRESENTATION GOALS



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- Provide General Background on Ambulatory Surgery Centers ("ASCs"), Imaging Centers & Certain Ancillary Outpatient Businesses
- Describe Evolution of the Industry/Current State
- Outline Types of Partnerships, Structures & Joint Ventures
- Discussion of Key Development and Operational Issues
- Overview of Transactions & Return on Investment
- Discussion of Future Trends



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ABOUT OUTPATIENT SERVICES



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BACKGROUND

General Background

- Free standing outpatient healthcare facilities providing same day care have transformed outpatient services by providing a convenient, specialized, low priced alternative for surgery, imaging, PT, etc.
- Proliferation of ASCs & imaging centers began in 1970s. Now there are over 5,200 ASCs & 8,000 Imaging Centers in all 50 States creating over \$200b in economic impact and creating over 200,000 jobs. 2,000+ of these are owned in partnership with community hospitals.
- Care provided in outpatient facilities results in considerably lower costs to the healthcare system. From Medicare alone, these Facilities receive approximately 40-55% of the reimbursements provided to Hospitals for the same services.
 - 2007 impact of DRG payment systems on imaging
 - 2008-2011 changes in ASC payments.
 - Recent PT Changes.



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CURRENT ENVIRONMENT

- Maturing industry.
 - Growth rates have slowed, but still continuing at a modest pace. Focus on quality and cost savings driving continued growth.
 - Economies of scale and market share become increasingly important.
 - Cost increases outpace reimbursement increases. Out of network models phasing out.
- ASC & Imaging transactions are gaining momentum.
 - National companies are acquiring centers, consolidating other companies.
 - Collaborative Models with community hospitals are common and growing form of joint venture.
- Heightened compliance risk with health reform, requires expertise.
- Rate differential between hospitals and free standing centers can present compelling economics for hospital purchaser.



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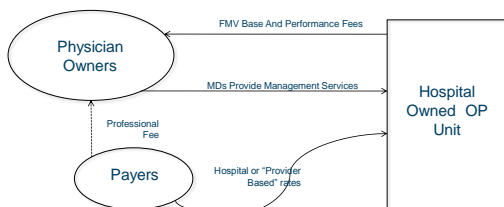
COLLABORATIVE MODELS HOSPITAL & PHYSICIAN JOINT VENTURES



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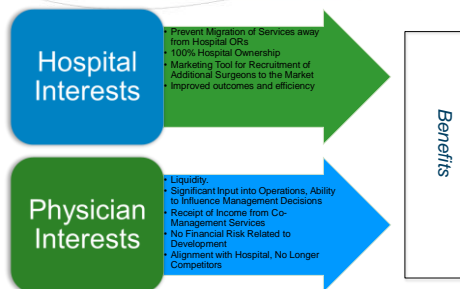
Model 1 - Service Line Co-Management Agreement

■ Service Line Co-Management Agreement



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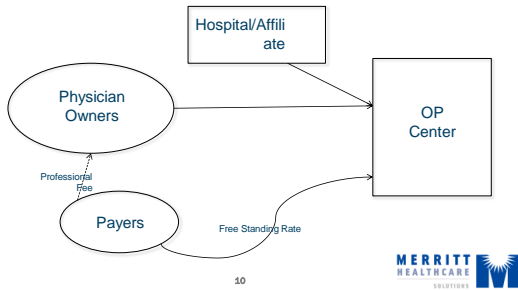
Service Line Co-Management Agreement Benefits to Hospitals and Physicians



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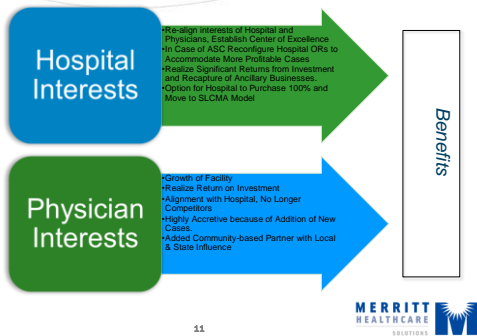
Model 2 - Hospital Physician Joint Venture

Hospital/Physicians JV



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Hospital Physician JV Benefits to Hospitals and Physicians



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ACQUISITIONS PROCESS AND PRICING

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Anatomy of a Deal

- Identification of Target
 - ASCs and Imaging Centers are typically licensed and easily identified.
 - Existing relationships.
- Determine Level of Interest
- Initial Pricing
- Documentation and Due Diligence
- ROI a Function of Investment and Income Stream
 - Initial estimate from Discounted Cash Flow Analysis (DCF)
 - Possible asset valuation in specific instances

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Understanding Operational Issues

- Increased Compliance & Regulatory Requirements
- Case Volume Challenges & Profitability of Cases
- Supply & Staff Management
- Reimbursement Pressures
- Lack of Revenue Cycle Optimization
- Complex Payer Contracting Processes
- Access to Essential Data
- Proper Governance

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Consolidation and Acquisitions Current Environment

- M&A Activity has picked up in recent years.
- Buyers include national companies, hospitals and private equity groups.
- Consolidation of companies is underway. Recent acquisitions of National Surgical Care (18 ASCs) by AmSurg and Titan (20 ASCs) by USPI highlight the trend.
- Multiples remain strong for centers with the right profile.
- Uncertainty driving some of the increase in activity.

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Consolidation and Acquisitions Motivation of Sellers

- Primary Motivation for Increase in M&A Activity
 - Sellers
 - Liquidity. Sale of a mature business at capital gains tax rates can be compelling. In some cases buyers will price deals up to 4-8x EBITDA.
 - Strategic partnerships bring economies of scale.
 - Concern over health reform and potential increases in capital gains tax rates.

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Consolidation and Acquisitions Motivation of Buyers

- Primary Motivation for Increase in M&A Activity
 - National Company Buyers
 - Drive growth. Economies of scale lower cost structure of individual acquisitions thereby lowering effective multiples paid.
 - Hospital Buyers
 - Alignment of interests with physicians.
 - Conversion of to HOPD results in higher rates paid, thereby lowering effective multiple paid for the ASC.
 - Private Equity Buyers
 - Returns...

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Consolidation and Acquisitions Valuation Ranges

- Deals valued between 3-8x EBITDA. Higher multiples paid to facilities with the following profile:
 - Diverse revenue base. No one physician more than 15% of production.
 - Demonstrable growth opportunities.
 - Large number of physicians utilizers.
 - Multiple specialties.
 - Little to no out-of-network exposure.
 - Hospital partner.
 - Limited competition (CON Barriers)
- Out-of-Network businesses or targets with other significant risk factors will trade in the 3-5x range.

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GOING FORWARD



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Current Environment/Conclusions

- The industry is maturing. Less OP Centers will be developed. Existing providers will continue to seek acquirers.
- Importance of economies of scale and market share. Reimbursement challenges will provide pressure as revenue growth is limited under rising cost structures. Margins will likely be compressed.
 - Rate differentials provide good opportunity for hospital purchasers.
- All will be required to report on quality. This should have a positive impact on the industry as payments are tied to quality and cost containment. Free standing facilities score well in these areas.
- Impact of ACOs uncertain. Compliance risk is considerable.



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ABOUT MERRITT HEALTHCARE

Over the Last 10 Years Merritt has Developed, Managed or Advised on Over 30 ASC Projects. Merritt also Maintains an Active Advisory Business with Many Hospital and Physician Clients.



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