WAYS AND COSTS TO ALIGN: THE VALUATION OF PHYSICIANS, HOSPITALS, ASCs AND OTHER HEALTHCARE PROVIDERS

BECKER’S HOSPITAL REVIEW 8TH ANNUAL MEETING, CHICAGO, IL.

APRIL 17 – 20, 2017
ABOUT VMG HEALTH
THE RECOGNIZED LEADER IN FINANCIAL VALUATION AND ADVISORY FOR HEALTHCARE TRANSACTIONS
Our Mission

VMG Health strives to be a trusted advisor by providing thought leadership and valuation solutions to the healthcare industry. We seek to provide this expertise through our core values of integrity, depth of knowledge and responsiveness while providing outstanding opportunities for our professionals.
20+ YEARS

120+ PROFESSIONALS

25,000+ HEALTHCARE VALUATIONS
VMG HEALTH OVERVIEW

FAST FACTS

73 BUSINESS VALUATION PROFESSIONALS
28 COMPENSATION VALUATION PROFESSIONALS
12 REAL ESTATE APPRAISERS
8 CAPITAL ASSET APPRAISERS
3,332 VALUATION ENGAGEMENTS IN 2016

VMG HEALTH ADVANTAGE

With 120+ dedicated healthcare valuation professionals, VMG Health helps large, complex health systems aggregate valuation and transaction advisory activities resulting in operational time efficiencies and volume pricing economies (cost-saving synergies) that can be reallocated to more valuable, mission-fulfilling endeavors.
2016 VALUATIONS BY HEALTHCARE VERTICAL

3,300+
VALUATIONS IN 2016

NOTE
Data does not include international engagements classified as “Other”
Data does not include international engagements or those with unspecified US geographies.

NOTE
3,300+
VALUATIONS IN 2016

SIMPLIFYING FMV COMPLEXITY
2016 VALUATIONS BY US STATE
SIMPLIFYING FMV COMPLEXITY
VMG HEALTH RESEARCH

INSIGHTS
Analysis of current industry trends and regulatory changes that impact healthcare facilities

TRANSACTIONS
Examination of transactions, deal structures and multiples within the healthcare provider industry

ECONOMETRICS
Macro health economic trends and events that impact the value of healthcare facilities

INDUSTRIES
Coverage and analysis of virtually all major hospital and ancillary provider verticals

REIMBURSEMENT
Analysis of annual reimbursement changes that have an effect on healthcare facilities

PHYSICIAN ALIGNMENT
Unfolding developments in physician alignment strategies and their influence on facility value
BECKER’S HOSPITAL REVIEW 8TH ANNUAL MEETING

1. Setting the Stage
## Setting the Stage

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## Alignment Structures - General

### Acquisition
- 100% acquisition of entity
- Revenue Synergies
- Cost Synergies

### Co-Arrangement
- Joint Venture
- Joint Operating Agreement

### Strategic Affiliation
- Management Services Agreement
- PSA Model
- Employment Model

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**Level of Control**

**Capital Requirements**
- Low
- High

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**Alignment Structures - General**
Alignment through Acquisition

- Control v. Minority interest
- Assume management responsibilities
- Receive any post-transaction revenue and/or cost synergies

Joint Venture Arrangement

- Form a new entity (“JV”) in which both parties have partial ownership
- Each party would contribute assets to the JV, either cash or business interests
- The JV would then have equity shares which it could sell to additional affiliates
- Share any post-transaction revenue and/or cost synergies

Joint Operating Agreement

- Contributed Assets
- Leased Assets (real estate, staffing, providers, etc.)
- Duration of the JOA
- “Wind-down” of the JOA (ex. return of capital, working capital, etc.)
Management Services Organization (“MSO”)

• Performs management services for provider entity
• Management fee should consider Fair Market Value
• Affiliated investors may acquire interest in MSO

Other Alignment Models

• PSA Model
• Physician Employment (including call coverage, medical director, etc.)
• Contracted administrative services (i.e., billing and collecting, co-management, etc.).
  -Note, a contract to provide management services is separate from an MSO discussed above which is an entity set up for the purpose of executing contracts to perform administrative services.
• ACOs, IPAs, etc.
Outright Acquisition

**Costs**
- Price of Acquisition
- Capital is “locked up” (the only way to exit the investment is through another transaction, sale)
- Seller may not be “aligned” after selling

**Benefits**
- Potential revenue enhancement
- Can achieve full control with alignment
- Potential expense synergies

**Key considerations:**
- Control v. minority
- Non-compete agreement can be critical
Joint Venture Example: Structure of a JV

Alignment Structures

Entity A

Entity B

Assets / Funds Contributed

Joint Venture

Distributions

Distributions
Joint Venture

**Costs**
- Assets contributed or cash paid to acquire portion of JV
- Capital is “locked up”
- Share any revenue or expense enhancements with co-investor

**Benefits**
- Both parties “aligned” to maximize investment
- Can achieve full control if legally outlined in JV agreement (cost will be higher)

**Key considerations:**
- Assets contributed vs. cash contributed
- Who retains control?
Alignment Structures

Joint Operating Agreement: Structure of a JOA

Services to be aligned
Ex. professional services, staffing, management real estate (rent), equipment (lease)

Joint Operating Agreement
Various “unaligned” services are aligned through an enforceable Joint Operating Agreement
Alignment Structures

Joint Operating Agreement

**Costs**

- Assets / services locked up for term of the JOA
- Shared governance and control
- Market place and internal acceptance or resistance

**Benefits**

- Can be short-term or long-term
- Flexibility in structure, fee rates, etc.
- Aligning and sharing of resources

**Key considerations:**

- Services to be provided by each entity
- Fees for the services to be provided by each entity (fees)
- Duration of the JOA
Other Alignment Models

**Costs**

- Lower capital requirements
- Lower level of control

**Benefits**

- Flexibility in structure

**Types of Other Alignment Models:**
- Management Services Organization
- ACO / IPA
- PSA Model
- Direct Employment
- Contracted Administrative Services
II. Industry Trends
Ambulatory Surgery Centers

VMG Observed Transaction Multiples

<table>
<thead>
<tr>
<th>TIC / EBITDA</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
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<tr>
<td>25th Percentile</td>
<td>5.9x</td>
<td>5.7x</td>
<td>5.0x</td>
</tr>
<tr>
<td>Median</td>
<td>7.0x</td>
<td>6.7x</td>
<td>6.5x</td>
</tr>
<tr>
<td>75th Percentile</td>
<td>9.1x</td>
<td>7.2x</td>
<td>7.8x</td>
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Key Takeaways:
• Slight decline in Median TIC/EBITDA Multiples
• Wider difference between the bottom 25th percentile and the highest (i.e., those in the 75th percentile and above) TIC/EBITDA multiples

Source: VMG proprietary database
Joint Venture Example: Ambulatory Surgery Center

Hospital
Contracting

Management Company
Operations

Joint Venture

Physician Group
Minority Ownership

ASC
Control Ownership
Ambulatory Surgery Centers: Insights

- Highly fragmented: 72% of freestanding ASCs are independently owned and operated

- Two of the three publicly-traded ASC companies recently involved in megadeals
  - Amsurg Corporation merged with Envision Healthcare Holdings, Inc. on December 1, 2016
  - Surgical Care Affiliates, Inc. expected to close on merger with Optum (a subsidiary of UnitedHealth Group) in mid-2017

- CMS’s final rule for ASC will increase reimbursement rates by 1.65% in 2017

- CMS’s site neutral policy will affect the number of ASC’s that can be billed as a Hospital Outpatient Department

- VMG expects ASC multiples to trend neutral to favorable in 2017 due to continued high demand and favorable economic variables for ASC’s
Physician Services

Physician Services Index:
• IPC Healthcare, Inc. – data through November 20, 2015
• MEDNAX, Inc.
• Team Health Holdings – data through February 3, 2017
• Envision HealthCare Corporation – data starting December 1, 2016
Physician Services

Average of TEV/EBITDA

- Physician Services Index
- S&P 500 (*SPX) - TEV/EBITDA
INDUSTRY TRENDS

Physician Services: Insights

- Physicians are increasingly opting to align rather than face regulatory and data reporting requirements alone
- Shift to value-based reimbursement and alternative payment models
- MACRA will begin taking effect in 2017
- VMG expects to see an increase in the following APM models:
  - Next Generation ACO
  - Comprehensive Primary Care plus
  - Medicare Shared Savings Program
  - Comprehensive End-Stage Renal Disease Care
- VMG expects another year of high transaction volume and further consolidation as physician groups align to avoid penalties from MACRA’s data reporting requirements.
INDUSTRY TRENDS

Acute Care Hospitals

VMG Index – Hospitals Includes:
- Community Health Systems
- LifePoint Health Inc.
- Tenet Healthcare Corporation
- HCA Holdings, Inc.
- Universal Health Services, Inc.
INDUSTRY TRENDS

Acute Care Hospitals

Average of TEV/EBITDA

VMG Index - Hospitals
S&P 500 (^SPX) - TEV/EBITDA
Acute Care Hospitals: Insights

- Several public for-profit health systems have been divesting hospital assets to reduce debt and focus on core facilities
  - In April 2016, CHS completed spin-off of 38 hospitals into a new public company, Quorum Health Corporation
  - CHS announced plans to divest an additional 25 hospitals in 2017
  - THR has announced plans to divest non-core hospitals
  - Note, these above divestitures do not necessarily mean “non-performing” facilities, simply a re-focus on core assets

- Significant recent consolidation activity including:
  - Dignity Health and CHI announced plans to merge
  - Capella Healthcare, Inc. and RegionalCare Hospital completed merger
  - Ardent Health Services and LHP Hospital Group, Inc. completed merger

- VMG expects 2017 high level of M&A activity and other strategic alignments such as JV’s and JOA’s. VMG expects transaction multiples to trend neutral

Source: CHS 4th Quarter Earnings Call and company filings; Trevor Fetter announcement at JP Morgan Healthcare Conference
MORE ABOUT DON

Don Barbo, CPA/ABV is a managing director with VMG and is based in the Dallas office. He specializes in healthcare business valuations involving mergers and acquisitions, divestitures, partnership transactions, leasing arrangements, divorces, commercial damages and financial reporting. His extensive healthcare valuation engagements have included the following businesses and services: hospitals, including acute care, long-term care, critical access, and surgical; physician practices, variety of primary care and surgical specialties; physician practices, variety of hospital-based practices (i.e. radiology, pathology, anesthesiology, emergency room); ambulatory surgery centers; diagnostic imaging centers; cardiac catheter labs; pathology and clinical labs; cancer treatment centers; dialysis centers; various contracts between hospitals and physicians, including medical director agreements, on call agreements, lithotripsy service agreements, purchase services agreements; and management services agreements.

Mr. Barbo has spoken extensively to various legal and valuation organizations and has published articles regarding business valuation issues. He also serves as an expert witness in litigated matters for his clients, including testifying before the U.S. Tax Court.

Mr. Barbo has been performing healthcare valuations since 1998. Prior to his valuation career, he served as the chief financial officer for a physician practice management company that provides management services to a variety of physician practices. Before that, he served as the controller/financial officer for various emerging companies. He began his professional career as an auditor with an international accounting firm.

Mr. Barbo received a Bachelor of Business Administration in Accounting from Texas Tech University and a Master of Business Administration from Southern Methodist University, Cox School of Business. Mr. Barbo is a licensed Certified Public Accountant (CPA) in the State of Texas.
MORE ABOUT JOHN

John Meindl is a manager with VMG Health and is based in the Dallas office. In addition to providing valuation and transaction advisory services, Mr. Meindl is also involved in the firm’s Dispute Resolution and Litigation Advisory service line.

Mr. Meindl’s valuation experience includes providing advisory services for management planning, dispute resolution, transaction advisory, financial reporting, and tax purposes. He has provided dispute resolution and advisory services in matters including lost profits, business interruption, breach of contract, fraud, clinical compensation disputes, trademark infringement, patent infringement, and breach of fiduciary duty, among other various matters involving public and private entities.

Prior to VMG Health, Mr. Meindl was with Ernst and Young in the Transaction Advisory Services group where he performed valuation, transaction advisory, and dispute resolution services for the firm’s corporate and private clients.

Mr. Meindl received a Bachelor of Business Administration from Wake Forest University, and a Masters of Business Administration from Southern Methodist University. He is also a Chartered Financial Analyst (CFA).
Questions?