Ambulatory Surgery Center
Transactions: Successful Strategies
for Mergers, Acquisitions, Divestitures
and Restructuring

90-minute audio conference

July 24, 2008

2:00 p.m.–3:15 p.m. (Eastern)
1:00 p.m.–2:15 p.m. (Central)
12:00 p.m.–1:15 p.m. (Mountain)
11:00 a.m.–12:15 p.m. (Pacific)
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Welcome!

We are pleased that you have chosen to set aside a part of your day and join us for our **Ambulatory Surgery Center Transactions: Successful Strategies for Mergers, Acquisitions, Divestitures and Restructuring** audio conference with Sami Abbasi, Jon O'Sullivan and Tom Yerden. We are sure you will find the conference educational and worth your time, and we encourage you to take advantage of the opportunity to ask our experts your questions during the audio conference.

If you would like to submit a question before the audio conference, please send it to rob@beckersasc.com. Although we cannot guarantee your question will be answered during the program due to time constrictions, we will include it if time permits.

If you have comments, suggestions or ideas about how we might improve our audio conferences, or if you have any questions about the audio conference itself, please do not hesitate to contact me.

Thanks again for taking part in this program.

Sincerely,

Robert Kurtz  
Director of Communications  
Phone: (410) 874-7681  
rob@beckersasc.com
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Speaker bios

Sami S. Abbasi leads National Surgical Care as its chairman and CEO. Prior to National Surgical Care, Mr. Abbasi served as president and CEO of Radiologix, Inc., a leading national provider of diagnostic imaging services. Mr. Abbasi co-founded Radiologix in 1996 and was instrumental in building the company from a creative idea to one of the nation’s leading providers of diagnostic imaging services. He led Radiologix through its initial public offering in November 1997 and its sale to RadNet, Inc. in November 2006. Mr. Abbasi previously served as COO and CFO of Adminiquest, Inc., a Web-enabled, full-service outsourcing solutions provider to the insurance and benefits industry. Mr. Abbasi also was a vice president in the health care group of Robertson Stephens, Inc., and CitiGroup.

Jon O’Sullivan is a principal of VMG Health. His focus is the development of valuation analysis, business plans, financial structures, operational restructurings, compensation structures and investment strategies for healthcare clients. He has conducted financial engagements relating to transactions and relationships including physician practices, practice management companies, independent physician associations, management service organizations, acute care hospitals, healthcare venture capital companies and numerous ancillary business. Mr. O’Sullivan has provided strategic and business planning services to physician groups and has acted as financial advisor in mergers, acquisitions and consolidations of physician groups in various business structures. He has assisted in the formation and growth of IPAs, MSOs, PPMs and other group models. In addition to working for a wide variety of clients across United States, Mr. O’Sullivan has worked with clients internationally in markets such as Singapore, Thailand and Hong Kong.

Tom Yerden is the President and CEO of TRY Health Care Solutions. TRY Health Care Solutions provides ambulatory surgery consulting services to large healthcare systems, group practices, independent physicians and existing surgery centers throughout the United States. Mr. Yerden is a recognized leader in the industry with over 27 years of service spanning the development of over 70 surgery centers and the founding of Aspen Healthcare, which Mr. Yerden sold to a national firm in 2005. Tom served on the FASA board of directors for nine years, was a finalist in 2003 for Ernst & Young’s Entrepreneur of the Year and has been listed as one of the country’s “Top 50” most experienced ambulatory surgery executives the past five years in a row.
Presentation
by Sami Abbasi, Jon O'Sullivan and Tom Yerden
Sami S. Abbasi, Chairman and CEO
Enhancing the Value of an ASC in an Acquisition

Jon O’Sullivan
Senior Partner
Challenges to ASC Owners

The challenging questions faced by successful ASC’s in a competitive market?

- Is the value of my ASC at its highest point?
- Is there a “best” time to sell all or part of the ASC?
- What is the basis for determining the value of my ASC?
- Who is the best buyer for the ASC?
- Can value be enhanced prior to a sale?
- Is there an ability to add new physicians to the ASC before or after the sale?
- Can the ASC demonstrate an attractive return to prospective buyers or physicians as compared to a new ASC?
The Current Market

• There are over 25 companies creating strong demand for the acquisition of control interests in an ASC (50% or greater)

• Many of those companies will not be here in 3-5 years. Almost all are privately held with the intention of either going public or selling to a larger company

• Hospital systems are prospective purchasers for strategic reasons

• The value of a control interest can vary widely in a range from 2x EBITDA to 7X EDBITDA depending on a number of factors

• Specific risk factors impact value and transactions more today than anytime in the past

• Due to competition, the value of a physician’s (minority) interest is worth far less in today’s market
Some Definitions

Control Interest - Generally greater than 50% interest in the ASC
The right to manage the facility
The right to make decisions on many issues
Not subject to repurchase provisions

Minority Interest - Generally less than 50% interest in the ASC
No management authority
No decision making authority
Subject to repurchase provisions
Identifying a Buyer

• Strategic Buyers: Typically a local or regional hospital system (some are partnered with ASC management companies)

• Financial Buyers: Typically, one or more of over 25 ASC management companies

• Potential buyers are NOT hard to identify, the difficulty is identifying the right one for your strategy and market

• Identifying a potential buyer is a process – not a chance meeting at an ASC conference
Assessing a Buyer

1. Pricing: How will the buyer determine the value of your ASC

2. Strategic Value:  
   - Ability to access better contracts
   - Ability to add case volume (physician owners)
   - Enhanced operating efficiencies

3. National scale and local market presence (sustainability)

4. Demonstrated Success: Definable and measurable best practices

5. Agreements: What changes can you expect to operating agreements
Measuring Value

1. Hospital buyers are confined by the concept of “Fair Market Value”
   - Hospital buyers are strategic buyers
   - Emphasis on a discounted cash flow
   - Consideration given to similar market transactions
   - Greater potential for strategic value after the sale

2. ASC Company buyers often define value only on a multiple of EBITDA
   - These are financial buyers
   - Value is based relative to company valuation (accretive)
   - Generally, no referral (anti-kickback) issues
   - Generally less potential for strategic value after the sale

3. Either way, the valuation will depend on an assessment of “Risk Factors” that impact the future earnings of the ASC
20 Top Risk factors that Define Value

<table>
<thead>
<tr>
<th>Percent of Revenue Produced by Owners</th>
<th>Specialty Mix</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Physician Owners</td>
<td>Age Dispersion</td>
</tr>
<tr>
<td>Number of Non Owner Physician Users</td>
<td>Ownership by Utilizers in Competing Centers</td>
</tr>
<tr>
<td>Revenue Dispersion Among Owners</td>
<td>Revenue Concentration by Specialty</td>
</tr>
<tr>
<td>Revenue Dispersion Among Non Owners</td>
<td>Existence of Certificate of Need</td>
</tr>
<tr>
<td>Physician Ownership Growth and Retention</td>
<td>Managed Care Barriers</td>
</tr>
<tr>
<td>Revenue Concentration by Payor</td>
<td></td>
</tr>
<tr>
<td>Percentage of out of network business</td>
<td></td>
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<tr>
<td>Legislation Impacting Reimbursement</td>
<td></td>
</tr>
<tr>
<td>Health system competition</td>
<td></td>
</tr>
<tr>
<td>Freestanding surgery center competition</td>
<td></td>
</tr>
<tr>
<td>Potential For New Centers</td>
<td></td>
</tr>
<tr>
<td>Pct of Physicians W/ No ASC Investment</td>
<td></td>
</tr>
<tr>
<td>Location in Relation to Acute Care Hospital</td>
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</tbody>
</table>
Can the ASC Demonstrate this:

Valuation Date: June 30, 2008

Majority Valuation: 6-7x EBITDA

Minority Valuation: 4-5x EBITDA
When most ASC’s experience this:

< 20% of ASC’s will have steady growth

@ 50% will experience slow decline

@ 25% will lose significant physicians

@ 20% will have significant reimbursement impact
Enhancing Value – The Opportunity

Clearly define the strategy and objectives relating to a sale of either a majority or minority interest

Understand the incentives, structures, synergies and limitations for both types of buyers

Know how to identify and measure the specific risk factors that support or destroy the value of your ASC

Communicate risk factors to shareholders to facilitate acceptance of the need to address issues prior to initiating discussions with prospective acquirers

Enhance value by addressing identified weaknesses, primarily through the addition of targeted physician investors
Conclusion: An Approach to Success

1. Assess and understand the value of the ASC to both strategic and financial buyers

2. Identify the specific risk factors that impact the value of the ASC and address as many as possible BEFORE entering into discussions

3. Identify the strategic and financial buyers best qualified to become your partner based on carefully defined requirements

4. Define a “term sheet” that outlines the parameters of a relationship and develop a “book” containing relevant financial, operating, and strategic information that buyers can use to assess their offer. Include your estimate of value for each type of buyer.

5. Contact prospective partners to discuss potential interest in the ASC.

6. Execute a methodical process that leads towards the consummation of a transaction
VMG Health, LLC

We Value Healthcare

www.vmghealth.com

Three Galleria Tower
13155 Noel Road Suite 2400
Dallas, Texas 75240
Merging Two Competing Surgery Centers:

A Case Study

Tom Yerden, MHA
President & CEO
TRY Health Care Solutions, LLC
Paris, Chicago, NYC, & Salmon, Idaho
“Challenges for Successful Surgery Centers”

1. Complacency
2. Lack of Strategic Vision
3. Aggressive Cash Distribution Policies
4. Country Club Membership
5. Operating Agreement Not Up To Date
6. Lack of Exit Strategy for Physicians
7. Divided Loyalty
8. Market Competition: Retaining Market Share
Potential ASC Partnership Models

1. Hospital & Independent Physicians
2. Hospital & Independent Physicians & Core Group Practice
3. Hospital & Existing Freestanding ASC
4. $ASC_1$ Acquiring $ASC_2$
5. Hospital (HOPD) Conversion to FASC
6. FASC Conversion to HOPD
7. Provider-Based JV – “Circumvention Scheme?”
Case Study

Background: Two ASCs in Same Market

ASC-1:
- Multispecialty ASC – 20 years – 4 ORs
- Capacity Issues – “swimming pool expansion”
- Law suit against corporate partner
- Managed by 2 MGP-physicians: solid ROI

ASC-2:
- Ortho-driven ASC – 2 years – 4 ORs
- Out-of-Network Provider strategy
- Under-utilization – “divided loyalty”
- Poor relationship with corporate (general) partner
- Ortho group not functioning as a “Group Practice”
“What to do when the swimming pool will not provide sufficient expansion of capacity”
Two ASCs with Shared Challenges

1. Structured as General Partnerships
2. *Capacity* Issues in (ASC-1), *Demand* challenges in (ASC-2)
3. Competition from new Hospital/MD JV’d ASC
4. Divided Loyalty by Physicians
5. Payor Contracting issues
6. Some Physicians had Ownership in Both ASCs
7. **Lack of Trust among physicians (CONFLICT!)**
8. Frustrations with level of cash distributions
Conflict?

1. Divided Loyalty: “1/3 Rule?”
2. Ortho Group lacked defined leadership: “Cowboys”
3. Allowed one physician (pain) dictate policy
4. Management Company not trusted
5. Physicians within same practice competing for “status” at the surgery center
Available Solutions?

OR Capacity
- Fill the pool – OR expansion ($2m)
- Improve operational efficiency – expand hours
- Relocate facility

Competition
- Resyndicate: expand physician ownership
- Poach MDs from competing surgery centers
- Enforce 1/3 rule
- Offer new services & programs
- Restructure payor agreements
Available Solutions?

Restructure Legal Entity & Address Divided Loyalty
- Restructure to LLC (from GP)
- Craft Operating Agreement (compliance)
- Resyndicate Newly-Structured ASC
- Remove “Barriers to Entry”
- Non-Compete Provisions
- Educate Physicians re: “costs associated with divided loyalty

** 1/3 rule doesn’t mean you should have ownership in 3 ASCs!
Merging Two Competing ASCs
A Phased Approach??

Step 1. ASC 1 purchases 30% interest in ASC 2
Step 2. ASC 1 assumes management of ASC 2
Merging ASCs
“Complete Merger of Assets”

Step 1. ASC 1 purchases 100% interest in ASC 2 - One License!
Step 2. ASC 2 physicians receive units in newly-formed ASC 1
Challenging Process !!

- Valuation of both surgery centers
- Post-transaction ownership by physicians: Dilution or Leveraging?
- Restructuring to LLC
- Buying our corporate partner
- Staff, medical director, management
- Merger of systems
- Contracting
- Merger of cultures !!
## Combined Performance of Surgery Centers

<table>
<thead>
<tr>
<th></th>
<th>ASC-1</th>
<th>ASC-2</th>
<th>Combined</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Rev</td>
<td>30,345,465</td>
<td>26,379,815</td>
<td>56,725,279</td>
</tr>
<tr>
<td>C/A</td>
<td>20,928,261</td>
<td>20,160,601</td>
<td>41,088,862</td>
</tr>
<tr>
<td>NPR</td>
<td>9,422,203</td>
<td>6,219,213</td>
<td>15,636,417</td>
</tr>
<tr>
<td>Gross Rev/Case</td>
<td>5,800</td>
<td>8,848</td>
<td>6,906</td>
</tr>
<tr>
<td>NPR/Case</td>
<td>1,800</td>
<td>2,086</td>
<td>1,904</td>
</tr>
<tr>
<td>Salary Exp</td>
<td>3,019,734</td>
<td>2,404,687</td>
<td>12,882,720</td>
</tr>
<tr>
<td>Sal/Case</td>
<td>577</td>
<td>807</td>
<td>660</td>
</tr>
<tr>
<td>EBITDA</td>
<td>1,939,410</td>
<td>819,339</td>
<td>2,758,749</td>
</tr>
<tr>
<td>Volumes</td>
<td>5,232</td>
<td>2,981</td>
<td>8,213</td>
</tr>
</tbody>
</table>
"Value-Added" Performance of Merger

Direct Financial Impact of Merger:

- Improved payor contracts $140,000/yr
- Going in network (ASC-2) ($590,000) year one
- Reduction in salary expense $740,000/year
- Reduction in supply expense $290,000/year

Indirect Benefits of Merger:

- Combined management team with regional focus
- Eliminate competitive threat
- Restructure from GP to LLC
- Offer exit strategy for physicians
- Improve operational (scheduling efficiency)
The Price of Divided Loyalty

TRY HEALTH CARE SOLUTIONS, LLC
P. O. BOX 98
NORTH FORK, ID 83466

PAY TO THE ORDER OF: DR. LESS LOYAL

Three Thousand 00/00

FOR: Divided loyalty - 1/3 Rule

DATE JUNE 14, 07

DOLLARS $3,000
Loyalty Yields $ Distributions

TRY HEALTH CARE SOLUTIONS, LLC
P. O. BOX 98
NORTH FORK, ID 83466

DATE JUNE 14, 07

PAY TO THE ORDER OF DR. LOYAL
Sixteen Thousand DOLLARS

FOR First Qtr Distributions

WELLS FARGO
Wells Fargo Bank, N.A.
Idaho
wellsfargo.com
First Meeting between Physician Owners
A few Months Later.....
“Perhaps we should partner with one another?”
“Maybe those other physicians are not so bad after all?”
Looking for ASC Consulting?

- Seeking to maximize your ASC’s success?
- Perhaps you’re considering the development of a new surgery center?
- Or
- Trying to solve problems among partners?

TRY Health Care Solutions, LLC is your best solution.

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