3 PART SERIES:

How to Maximize the Value of Your Center

BY JONATHAN C. VICK

PART 1: *UNDERSTANDING YOUR CENTER'S VALUE*

PART 2: ***PREPARING YOUR CENTER FOR A VALUATION AND AN ACQUISITION TRANSACTION***

PART 3: *FINDING THE RIGHT BUYER/PARTNER*

Part 2: Preparing Your Center for a Valuation and an Acquisition Transaction

Recently, there has been a remarkable upsurge of activity with both hospitals and ASC management companies showing heightened interest in acquiring minority and/or majority interests in GI centers. Physician-owners can benefit from increased competition between buyers that results in more choices of partners, higher prices and better terms. With new procedures approved for reimbursement, increased volume, and more efficiencies, a well-managed GI center can be worth more than ever. Endoscopy center owners who want to sell some of their center should know how to maximize the value of their center and prepare for a potentially beneficial transaction.

In Part 1 of this series (***EndoEconomics***, Winter 2008), we discussed elements that contribute to a center's value, who the buyers are, and how value is calculated. In this article, we will discuss buyer and seller expectations, preparing your center for a valuation, how valuations are performed, what adds or detracts from the value of your center, actions that will make your center an attractive acquisition, steps you can take to obtain the highest offers and the best terms from potential partners, and how to determine the value of your center.

Buyer expectations: Knowledge is power. If you want to sell a portion of your endoscopy center to a hospital or an ASC management company, it is important that you know what your buyer's expectations are, otherwise, you will be shooting in the dark. Buyers interested in GI centers are looking for sustained historical growth in revenue and earnings and/or for centers that have good prospects for future growth. Buyers want to know that the sellers have a "growth" mindset, and that they are seeking and planning for future growth. A fully-utilized center with no growth prospects, even if it has high cash flow, is of little interest to growth-oriented companies. Buyers want to know that the physician partners and medical staff can generate and support sustained growth, and they will want to see that the equity structure of the center promotes such growth. You should also know the strategic considerations that are important to the buyer such as single-specialty vs. multi-specialty, competitive advantages, low-cost providers, expansion of service area, geographic location, contracting and referral potential, etc.

Seller expectations: It is important that the selling physicians know and agree on what their goals are. A primary goal might be to partner with a company that can help to significantly increase screening colonoscopy referrals from PCPs (this market is less than 40% penetrated and offers tremendous upside for most GI centers), as this could significantly increase the volume of higher paying procedures. The selling physicians will want a definitive offer from an established company that has the assets to close a deal. There are over 30 ASC management companies, but only a few are capable of offering a high multiple, being a good partner, and helping GI centers grow. The sellers need to determine which companies will be the best partners for them. Sellers want a high valuation from a company with proven management expertise, a track record of success, the ability to close, and cash available to close the deal. Perhaps most importantly, the operational philosophy of the buyer must be aligned with that of the seller. This means you have to invest some time getting to know the management and operations teams, speak with references and current physician-partners, and confirm that the company has a track record of helping their physician-partners achieve their goals.

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Preparing your center for a valuation: The first thing to do is to meet with your partners and draw up a list of your specific goals and objectives. How much do you want to sell? What are your long range goals? How much can you grow? Do you want your distributions to grow after the transaction? Do some partners want to retire? Do you need to recruit new partners? Are there other potential users who could be recruited? Can your center be expanded? Is there an opportunity to open a satellite center? Do you want more screening referrals? What business issues need to be resolved? Do you need contracting expertise? Do you want to partner with a hospital, an ASC management company, or both? Do you want to sell your real estate as well as the business, etc.?

Preparation for a valuation includes: a clear statement of goals, information on medical staff and employees, three years of financial statements, physician productivity history, a summary of payor contracts, copies of facility credentials, the partnership operating agreement, and the facility lease. It is also helpful to document the potential for continued growth, a user recruitment plan with new users identified, benchmarks and case costing data, and a financial proforma (or budget) that forecasts revenues, expenses and profits for the next twelve months. It is amazing how many GI centers do not use benchmarks and/or case costing data and that do not have a budget or proforma for the coming year; every center should know their case costs and operate on a budget. The credo, *"What gets measured gets managed, and what gets managed improves,"* is very true. If you want your center to perform well, you must establish goals and measure and manage to achieve them. Lack of benchmarking, case costing, and budgeting for the coming year are clear indicators that the center would benefit from professional management.

How valuations are performed: There are two ways to obtain a fair market valuation for your center: buy it from an accounting or appraisal firm, or solicit offers from bona fide potential buyers who are interested in buying your type of center. Purchased valuations typically cost between $5,000 and $15,000, depending on the goals of the valuation, the size and complexity of the facility, the qualifications and experience of the firm doing the valuation, and the urgency for the valuation. The best way to get a true fair market value (what a willing buyer will pay a willing seller) is to solicit one or more offers from qualified, bona fide potential partners who are interested in buying your center.

A potential buyer will value a center by analyzing the trailing-twelve months (TTM) revenues, profits and long-term debt, comparing with financial statements from past years and the budget for the coming year, and determining how a center compares with other centers that have recently sold. A market-rate multiple is then applied to the EBITDA (earnings before interest, taxes, depreciation, and amortization), long-term debt is deducted, and a market-based valuation is determined.

The multiple, which varies between five and eight times EBITDA, will be based on the historical performance of the center, the center's credentials, growth potential, quality of medical staff, and barriers to entry (such as a CON or moratorium). Other factors that are considered include the status of the center's payor contracts, out-of-network payments, and the number and quality of the companies competing to buy the center. Most importantly is the goal of the companies competing to buy your center. Of the 30+ ASC management companies, there are always a few that are seeking your type of center (high cash flow, turn-around, or de novo). It is important that you know the goals, expertise, and financial resources of the companies you are seeking proposals from.

Adjustments to value: All buyers are seeking quality, profitability and growth potential. Anything that improves or detracts from these will impact the value of a center.

Negative aspects that will significantly decrease a center's value include:

- Ownership by non-productive physicians and/or non-physicians
- Any significant volume of out-of-network billings
- Poor quality medical staff
- Poor quality and/or unlicensed physical plant
- A fully utilized center with no room for expansion
- Physicians who want to retire
- No growth opportunities identified
- Poor financial records
- Short term facility lease with no renewal options
- No budget for the coming year

Positive aspects that can significantly increase a center's value include:

- The area's leading specialists on the medical staff
- Payor contracts that can be renegotiated and improved
- A good IT system, a budget, and measurable management criteria
- Identification of new users who can be recruited
- A plan to significantly increase screening colonoscopies
- The potential to add new specialties and new cases
- The potential to expand the center to increase volume capacity
- A growth plan and budget that shows increased profitability
- The potential to add ancillary services: pathology, anesthesiology, radiology
- A sales prospectus that highlights the positive aspects of your center and includes important professional and business aspects that the potential buyers want to know

If you take action to eliminate the negatives and add to the positives, and if you are soliciting offers from several ASC management companies that are seeking your type of center, you can significantly increase the value of your center.

Hospital partners: While having a hospital as a corporate partner has some very attractive strategic implications, such as beneficial payor contracts, increased referrals, and potentially higher reimbursements, hospitals are the hardest type of partner to deal with. They typically want to buy at a below-market rate, own 51%, have control, and provide hospital-type management (i.e. less efficient and less economical). There is often a level of mistrust between the physicians and the hospital as the parties have become competitors, and it may be difficult for the parties to deal effectively with each other. The best way to partner with a hospital, for the physicians to retain control, and to get top value for your center is to first partner with one of the leading ASC management companies and then let the management company negotiate with the hospital. This way you get the best of both worlds—a professional ASC management company that will help you achieve a high price from the hospital, good strategic partners, retention of control, and a center that continues to be managed efficiently and economically.

How to determine the value of your center: Subject to the adjustments above which are both subjective and objective, a rule of thumb to calculate the fair market value of your center is to take the trailing-twelve months EBITDA, multiply by five on the low end and eight on the high end, and subtract long-term debt. For example, a GI center today, with no long term debt, that is earning an EBITDA of $1 million and that has solid growth potential will have a value of $6 million to $7 million in a non-CON state, and $7 million to $8 million in a CON state or a state with a moratorium or a threatened moratorium on ASC development. The buyer will then apply the adjustments above to arrive at a value that they will offer in a Term Sheet or Letter of Intent (LOI). If there are multiple offers, the purchase price can be leveraged higher.

In **Part 3** of this series, we will present: **Finding the Right Buyer/Partner** – There are over 30 ASC management companies that are interested in investing in certain types of centers, and many hospitals are now climbing on the bandwagon—and with good reason. In Part 3, we will discuss how to select the right partner, how to leverage the competition to get the best price and terms, and how to get the best deal with your local hospital without losing control in the process.

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