

Ambulatory Surgery Center M&A: Providing Liquidity for Physicians and Growth for Investors

Ambulatory surgery center (ASC) mergers and acquisitions continued to be announced through the first half of 2016. ASCs hold promise for higher case volume and earnings growth, as healthcare payors, whether they be Medicare, Medicaid, commercial insurance plans, employer-funded plans or even self-payors, gradually migrate to ASCs in search of lower costs for outpatient surgeries.

In the first half of 2016, valuations were strong with expectations to remain strong in the second half. ASC transaction valuations are highest for centers in certificate of need (CON) states, for multi-specialty centers, for centers with in-network reimbursement, and when a controlling interest is being acquired.

Active acquirers range from local hospital systems to ASC management companies to diversified for-profit providers. Typically, these acquirers invest in ASCs in partnership

with surgeons or other physicians. Physician ownership of ASCs, which is permitted under safe harbors in the Anti-Kickback Statute and completely exempt from the Stark Law, is critical to an ASC's top line. Two ownership structures that are commonly proposed in the current market are discussed below.

TWO PROPOSED TRANSACTION STRUCTURES

- Hospital, Management Company and Physician Group in a Two-Tiered Joint Venture (JV)
- ASC Investor and Physician Group in a Partnership

Hospital, Management Company and Physician Group in a Two-Tiered Joint Venture (JV)

One market structure that ASC management companies propose to potential partners is a two-tiered joint venture involving three partners: a hospital system, the ASC management firm and a group of physicians. The hospital system and the management company form a joint venture that, for purposes of example, owns 51% of the ASC, and the physicians collectively own the remaining 49%. The joint venture itself is 51% owned by the hospital system (for ~26% beneficial ownership in the ASC) and 49% owned by the management company (for ~25% beneficial ownership in the ASC), with the management company serving as the center's manager.

The two-tiered joint venture structure is based on and demonstrates the two drivers of an ASC's profitability: payor rates and case volumes. Within a given market, the hospital system typically brings the most leverage to negotiations with the dominant payors in the market. For this reason, the two-tiered JV is structured to make the hospital system the controlling entity among the ASC owners (as 51% owner of the ASC's 51% owner) and thus the entity responsible for payor contract negotiations, in spite of having only ~26% of the beneficial ownership in the ASC. Among the three partners, the physicians are the partner likeliest to generate outpatient surgery case volume. For this reason, the two-tiered JV is usually structured to reserve to physician-owners the maximum aggregate ownership that is short of majority control.

HighBank's Recent Ambulatory Surgery Center Transactions

HighBank advised LifeBridge Health on its acquisitions of a controlling interest in two Maryland ambulatory surgery centers.



"HighBank ran a very thorough acquisition target search process and provided insight, advice and counsel through the negotiation, diligence and documentation stages. The entire HighBank team went above and beyond our expectations..."

— Steve Witman
Vice President, LifeBridge Health

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An ASC with 49% aggregate physician ownership naturally can accommodate investment by a greater number of physicians than an ASC with only 10-40% aggregate physician ownership. Each physician-owner is expected to add case volume to the ASC, although under the Anti-Kickback Statute, among other requirements, investment returns to physicians may not be based on the volume of cases referred.

The remaining beneficial ownership stake available to the management company (~25%) is sufficient to attract a management company's investment and stewardship, particularly when coupled with a market-based management fee.

ASC Investor and Physician Group in a Partnership

Another market structure involves only two partners: an ASC investor and a group of physicians. The ASC investor might be a developer, manager or passive investor. These partnerships do not include a local hospital; instead they look to one of the partners – the physician group or the investor -- to bargain for the “rate-lift” that would improve the center's profitability. Either partner might own the majority of shares in the ASC. The partnership would be structured in order to maximize the number of physician-owners generating cases and/or to provide a controlling interest to the partner with the greater bargaining strength.

ASC providers who partner with physician groups come in all sizes – from United Surgical Partners International, an affiliate of Tenet Health Care, and Amsurg, which will soon merge with Envision Healthcare Holdings, to an ASC developer or passive investor with an interest in fewer than 10 centers. The larger partners offer greater bargaining power, although the state-by-state landscape of the payor market may neutralize this impact.

HighBank Advisors A Trusted Advisor

The dynamic ASC industry presents many expansion or restructuring options to an operator or physician group considering a transaction. These options should be critically evaluated. HighBank Advisors has a team of senior bankers with industry specific and extensive transaction experience. We welcome an opportunity to discuss your strategic options.

HighBank Advisors offers investment banking, financial advisory and restructuring services to meet the needs of both middle market and emerging companies. We provide thorough, objective and conflict-free advice, innovative solutions and outstanding execution to our clients, delivering large investment bank caliber skills and experience, while offering the benefits of a client-centric boutique advisor. We serve as advisors first and investment bankers second – our goal is to partner with our clients through the entire life cycle of their business.

**HighBank Advisors...we are advisors first, investment bankers second...
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