What Makes an ASC Attractive to Investors?

By Bruce Maller
President and CEO, BSM Consulting
At some point, most ambulatory surgical center (ASC) owners will consider selling their interest in the facility. It is, of course, human nature for investors to think in terms of maximizing their return on investment.

As with other practice-related investments, achieving success can be complicated by myriad factors. Whereas some of these factors are within the control of the center or investor, there are many external factors that cannot be easily controlled, including future reimbursement changes, the impact of health care reform legislation, and possible legislative initiatives that might infringe upon physician ownership interests in ASCs. This article will focus on those factors within the control of ASC owners.

One of the most important aspects of selling an interest in any business is to look objectively at the opportunity from the standpoint of a potential buyer. This exercise will focus a seller on the issues that matter most in terms of sustainability of the business post-sale. This assessment will allow a seller to prioritize business planning opportunities. For example, an existing center operating at or near capacity with a desire to sell in the next five to 10 years might want to expand its physical plant. This decision presupposes that there is the room to expand and there are opportunities to grow the center’s volume responsibly with the right mix of cases.

This article addresses some of the most common issues that a potential buyer of all or a portion of the ASC is likely to consider. It is important to point out that potential buyers can include other surgeons, a hospital, or corporate partners. In the end, any buyer will be concerned about the sustainability of the center’s cash flow after closing on the transaction. Any risk factors that might impact future cash flow, positively or negatively, will influence value.

This article addresses the following key factors:

- Business concentration risk
- Barriers to entry
- Diversification of service lines
- Capacity to grow the business
- Facility infrastructure
- Contractual considerations
- Succession planning for key surgeons
- Sustainability of cash flow

The importance of these issues will vary by center; however, any sophisticated investor will consider each when weighing the overall impact on facility operations.

Business Concentration Risk

As the words imply, business concentration risk measures the degree to which a business is dependent on a smaller number of customers. In the case of an ASC, these risks could be reflected in a dependence on a small number of surgeons, specialties, or both, as well as payer considerations. A facility wholly dependent on one surgeon poses transition risks and as such would be less attractive to an outside investor, unless of course there are succession and/or expansion plans in place with other surgeons. On the other hand, a single-specialty center with 20 surgeons, where no single surgeon performs in excess of 10 percent of total case volume, would clearly present less business concentration risk.

Business concentration risk can also apply to single- versus multi-specialty center models. It is important to point out that a potential purchaser might not necessarily “mark down” the value of a successful single-specialty center. These “focused facilities” can be seen as attractive because of the efficiencies and high quality that can be gained from performing one class of cases.

At the same time, one cannot assume, absent other factors, that a multi-specialty center will be attractive. Many multi-specialty centers never achieve productivity and efficiency gains because of the diverse staffing and equipment requirements of these centers. In addition, many multi-specialty centers end up
having to accommodate the needs of a diverse and often large group of surgeons, and struggle in achieving optimum efficiency.

Business concentration risk can extend to the payer side of the equation. On the surface, a center with a diversified payer mix could be more attractive to a buyer. This becomes a very interesting dynamic in centers where there is a high concentration of geriatric patients. One could make the argument that a center with a high concentration of Medicare patients might be very attractive, assuming the Medicare patients are not concentrated in one or two Medicare Advantage plans; a center with a high percentage of Medicare “fee for service” patients might very well satisfy a “diversification” test since Medicare is not likely to contract with a specific hospital or ASC facility.

**Barriers to Entry**

Perhaps the single biggest potential barrier to entry would be whether the state requires a Certificate of Need (CON) to develop a new facility. At the same time, a state-based moratorium on development of new facilities would, in theory, also make an existing facility more attractive. Acquiring a CON can take several years and significant expense, with no guarantee of success. Other market influences can create unique challenges and, as such, make a facility more attractive. These factors would include competitive activity from hospitals, other community surgeons, and existing centers managed or controlled by corporate operators. Other barriers to entry include payer restrictions on ASC panel participation, new facility development costs, availability of land or space for buildout, as well as access to capital. Although for many years availability of capital was a non-issue for many surgeons, changes in the capital markets over the past 24 months have made it increasingly difficult to obtain attractive financing for new ASC projects.

**Diversification of Service Lines**

One cannot always assume that more is better: Community-based and center-specific issues will dictate whether multiple service lines are preferable to a single-specialty center. Other factors, including the specialty in question, as well as the production and efficiency of the facility surgeons, will come into play. Some buyers will find it more attractive to acquire a center that has a focus on certain specialties such as orthopedics, ophthalmology, or gastroenterology. As mentioned, many single-specialty centers operate in a very efficient manner, and may be perceived as offering a lower-risk profile.

**Capacity to Grow the Business**

From a buyer’s perspective, capacity to grow is an important factor when considering a possible multiple of earnings to be paid for the center. To the extent the seller wants to maximize the purchase multiple, buyers need to be confident that they can implement a business plan to achieve a reasonable rate of growth in center volume. On the other hand, just because a center has the capacity to grow, does not necessarily make it more attractive. Any buyer needs to be confident that there is a conservative business plan to grow surgical volume in preferred specialties, possibly by adding new surgeons, new service lines, or both. Without the capacity to grow, even the most profitable facility might not command an optimum valuation.

**Facility Infrastructure**

Infrastructure includes the physical plant, medical equipment, IT systems, patient management systems and staff. From a buyer’s perspective, these factors may represent an opportunity or incremental cost. To the extent that a buyer will not have to make substantial investment in developing or strengthening center infrastructure, this obviates the need for incremental capital investment post-closing. On the other hand, some buyers find their niche in “turnaround” opportunities. These same buyers, however, also will discount the purchase multiple to the extent that it will be necessary to make substantial post-closing investment in facility and equipment.
Buyers will focus on whether the existing facility and staff have the temperament and skill sets necessary to adapt to the new ownership group while supporting a new business plan. In particular, the buyer will be looking for strong administrative and clinical managers who enjoy respectful relations with key surgeons. These individuals need the ability to adapt to change, and embrace the business model and philosophy of the buyer.

Other important issues include the quality of the physical plant and the terms of the facility lease. In some instances, the seller might own the land and building that the ASC occupies. Although the real estate transaction is handled separately (from the acquisition of the ASC operating company), this is a critical component of the overall transaction since the buyer needs to have the flexibility to maintain the current space on terms consistent with historical facility costs. Otherwise, this could materially impact the purchase terms. A review of facility leases, including renewal terms, is an important part of the buyer’s due diligence.

**Contractual Considerations**

A prospective buyer of a facility will review carefully a number of provisions in the existing facility operating or shareholder’s agreement. One of the more important issues will involve non-competition provisions or any other type of restrictions on surgeons who may wish to leave the facility. The buyer needs to be convinced that existing center surgeons do not have the ability to move easily to a competing facility or develop a new one. Other important contractual considerations include the redemption provisions for existing owners. Redemption provisions that do not clearly define exit terms for partners who choose to retire or slow down likely will be of concern. In addition, “expensive” buyout provisions also may compromise a buyer’s interest in acquiring an interest in the facility.

Facility governance provisions can also create unique challenges for a new owner. A hospital or corporate purchaser will focus on whether adequate safeguards exist to ensure the handling of new capital purchases in a disciplined fashion within budgetary guidelines. The overall mechanism for center decision making needs to be carefully defined. The makeup of the center’s management committee is also an important consideration for a new owner.

**Succession Planning Considerations**

Sustainability of an ASC is predicated on stability in the surgeon ranks. Over the past 10 to 20 years, many investors have discovered this issue the hard way. Many center owners simply do not pay enough attention to the dynamics of what happens when a key surgeon retires or leaves practice. Many owner-surgeons simply have not developed well-thought out plans to succeed or transition their professional practice, thereby leaving the other center owners vulnerable.

In order to maximize the value of one’s investment, it is essential to have a sensible plan that brings other practice associates into the ownership structure of the center. For many surgeons, this is a difficult task given that they might be unwilling or unable to see the wisdom of giving up ownership shares in the near term as a good strategy to optimize the long-term value of the center.

**Sustainability of Cash Flows**

All of the factors discussed have a direct bearing on the ability to ensure sustainability of facility cash flows well into the future. Awareness of these issues should focus owners on adopting a business plan that minimizes future risks of center ownership. Looking at these issues from the vantage point of a potential buyer will enable the surgeons to identify key areas of opportunity to enhance the center’s value. As the next article in this series will discuss, the most common method of valuing an ASC is by taking a multiple of the center’s net income or cash flow. Needless to say, the seller would like to maximize the purchase multiple. The best way to accomplish this is by demonstrating that the cash flow of the center is stable and that there is a rational business plan to increase cash flows in the future.
Conclusion

Even if a decision is made not to sell shares for a longer time frame, these factors are all essential to running the facility in a more efficient manner that enhances the experience of surgeons and patients.

About the author: Bruce Maller is the founder and President of BSM Consulting, a nationally recognized health care technology and consulting firm with offices in Scottsdale, Arizona and Incline Village, Nevada. Mr. Maller is a frequent lecturer for various medical societies and national conventions. He is a regular contributor to many health care publications on different facets of practice management.