



# COVID-19's IMPACT ON ASC OPERATIONS AND VALUATIONS

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# INTRODUCTION & OVERVIEW

# INTRODUCTION

VMG HEALTH



VMG Health is a one-of-a-kind firm, offering a combination of expertise and comprehensive services that simply cannot be found elsewhere under one roof. This is part of our longstanding commitment to meet the healthcare industry's unique, complex, and ever-evolving needs.

For more than 20 years, since our inception in 1995, VMG Health has provided valuation and transaction advisory services related to over 30,000 engagements, exclusively for the healthcare industry. As the recognized leading healthcare valuation firm, we pride ourselves on our ability to serve as a single source for all our clients' valuation and transaction advisory service needs.

Today, our client base is national and broad in scope, ranging from large healthcare systems to individual financial lending institutions.

*A Leading Healthcare Valuation and Consulting Firm Committed to Service Excellence*

VMG's Health's strong market position, extensive contacts, and expert insights – combined with our expanded service offerings -- help our clients succeed in the ever-changing healthcare landscape.

Our healthcare valuation firm's more than 150 dedicated professionals have an extensive array of credentials in their respective fields and keep their skills up-to-date through continuing education. Many of our associates also serve as educators, thought leaders and authors through leading national healthcare organizations.

With offices in Dallas, Denver, and Nashville, VMG Health is a healthcare valuation firm dedicated to providing trusted leadership and valuation solutions for the healthcare industry.



# VMG HEALTH

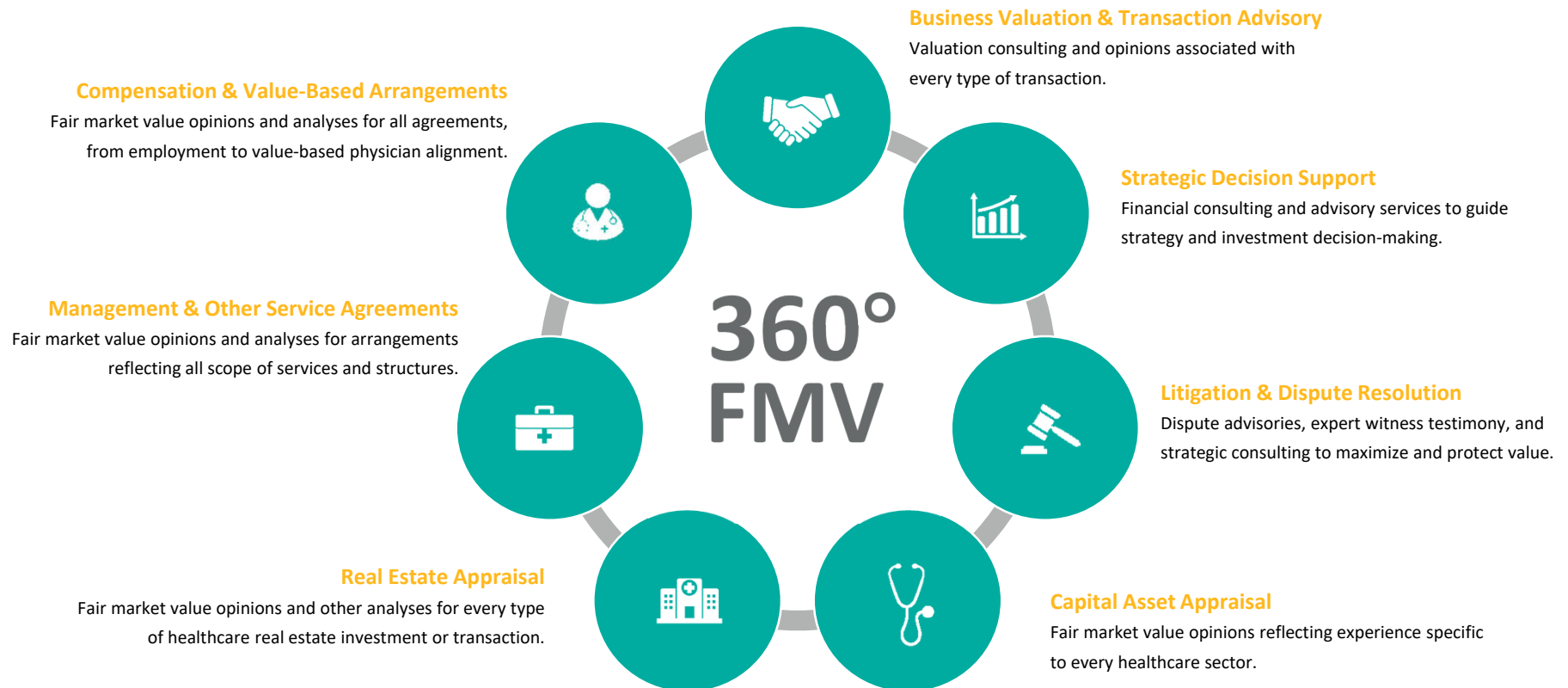
Focused only in Healthcare





# SIMPLIFYING FMV COMPLEXITY

## VMG Health Overview





# OVERVIEW OF FMV CONCEPTS



# FAIR MARKET VALUE

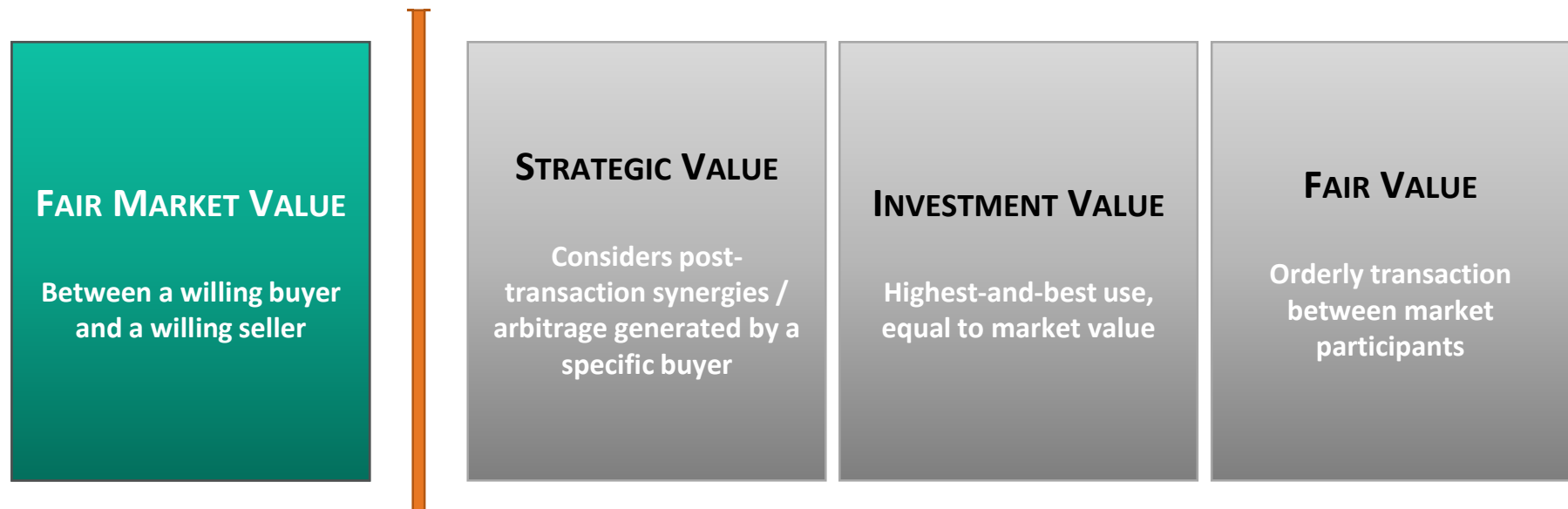
## *WHAT IS FAIR MARKET VALUE?*

- According to the International Glossary of Business Valuation Terms, FMV is defined as follows:
  - The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms-length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.
- According to the IRS's Revenue Ruling 59-60, FMV is defined as:
  - FMV, in effect, is the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts.
  - Most widely accepted definition
- Fair Market Value ("FMV") – the only premise of value to meet the Anti-Kickback Statute and Private Inurement Regulations



# FAIR MARKET VALUE

*FAIR MARKET VALUE DIFFERS FROM OTHER TYPES OF VALUE*



**Fair Market Value is NOT Strategic Value**





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# FAIR MARKET VALUE

## *WHY DO WE NEED AN FMV OPINION*

- Provides objective and independent opinion of value
- Both parties agree to rely on independent valuation firm
- Relevant in acquisitions and compensation agreements
- Assist in ensuring compliance with regulatory issues
- Ensure transaction terms occur at FMV



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# FAIR MARKET VALUE

## *WHY DO WE NEED AN FMV OPINION*

- Physician buy-in/buy-out
- Change in managed care contracts
- New competition
- New facility / expansion / renovation
- Taxation (Estate, Inheritance, Gifts, Charitable Contributions)
- Divorce
- Buying, Selling, or Merging a Business
- Shareholder/Partnership/Commercial Disputes

# FAIR MARKET VALUE

WHY DO WE NEED AN FMV OPINION



## Alternatives to Fair Market Value:

### BOOK VALUE

- Based on the balance sheet at a point in time
- Does not take into consideration the profit-generating capacity of the business

### STANDARD MARKET MULTIPLE

- Backwards looking; does not consider future projections or changing dynamics

### OPERATING AGREEMENT FORMULA

- Backwards looking
- ASC performance is often not consistent YoY

**The Impact of COVID Cannot be Captured Adequately Utilizing these Approaches**



# VALUATION METHODOLOGY: COVID IMPACT

# VALUATION METHODOLOGY

HOW FAIR MARKET VALUE IS MEASURED



## COST APPROACH

- Provides a floor for value
- Tangible assets + identifiable intangibles



## INCOME APPROACH

- Discounted cash flow value
- Dependent upon historical & projected profitability
- Measure future benefits of ownership



## MARKET APPROACH

- Analyze transaction values of comparable companies

**COVID CRISIS LIKELY TO IMPACT ALL 3 APPROACHES**

# VALUATION METHODOLOGY

## *COST APPROACH*



### **COST APPROACH**

- Also known as the asset or build-up approach, is a method that attempts to value a business by identifying and valuing each tangible and intangible asset



- Can be considered to provide a “floor” or lowest minimum value related to a business



- Under this approach, the identified tangible and intangible assets are valued based on the cost associated with “recreating” each asset.

# VALUATION METHODOLOGY



## COST APPROACH

The **Cost Approach** considers the cost of replicating a comparable asset, security or service with the same level of utility.

### Tangible Assets / Liabilities

- Working capital
- Fixed assets
- Real estate (if applicable)
- Debt & Other LT Liabilities



### Intangible Assets

- Legal title, protectable, separately marketable
- Certificate of Need
- Trade Name
- Goodwill

### COVID IMPACT

Cash balances drained  
Federal grants / PPP  
Diminished A/R  
Increased payables / deferred expense  
Increased debt / LOC

# VALUATION METHODOLOGY



## COST APPROACH

	Pre-COVID Dec. 31, 2019	Post-COVID Apr. 30, 2020	\$ Decrease	
<i>Current Assets</i>				
Cash & Equivalents	\$400,000	\$250,000	(\$150,000)	↓ Current assets negatively impacted
Net Accounts Receivable	480,000	300,000	(180,000)	
Inventories	200,000	180,000	(20,000)	
	1,080,000	730,000	(350,000)	
<i>Current Liabilities</i>				
Accounts Payable	220,000	310,000	90,000	↑ Current liabilities increase
Accrued Salaries & Benefits	70,000	80,000	10,000	
Other Current Liabilities	70,000	70,000	-	
	360,000	460,000	100,000	
Reported Net Working Capital	\$720,000	\$270,000	(\$450,000)	↓ Results in working capital deficiency
FYE 2019/TTM 2020 Revenue	4,800,000	4,300,000	(\$500,000)	
Working Capital as a % of Revenue	15.0%	6.3%		
<i>Fixed Assets</i>				
Buildings & Improvements	60,000	60,000	-	
Equipment	1,300,000	1,300,000	-	
Accumulated Depreciation	(1,170,000)	(1,210,000)	(\$40,000)	
Total Fixed Assets	\$190,000	\$150,000	(\$40,000)	
<b>Cost Approach Value Indication</b>	<b>\$910,000</b>	<b>\$420,000</b>	<b>(\$490,000)</b>	
Normalized Working Capital	\$720,000	\$645,000	(\$75,000)	↓ Working capital deficiencies impact future cash flow and result in a decrease in value
Actual Working Capital	\$720,000	\$270,000	(\$450,000)	
Working Capital Surplus (Deficit)	\$0	(\$375,000)	(\$375,000)	



# VALUATION METHODOLOGY

## INCOME APPROACH



### INCOME APPROACH



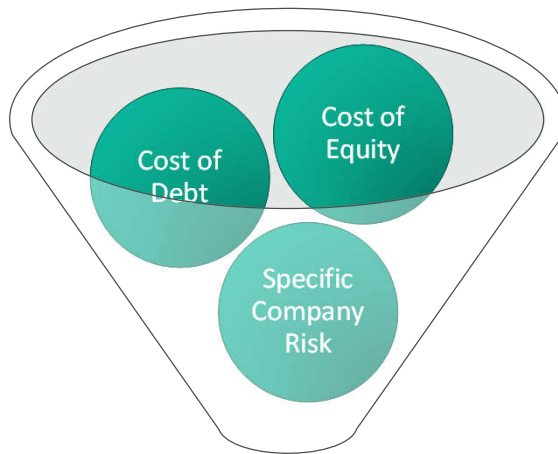
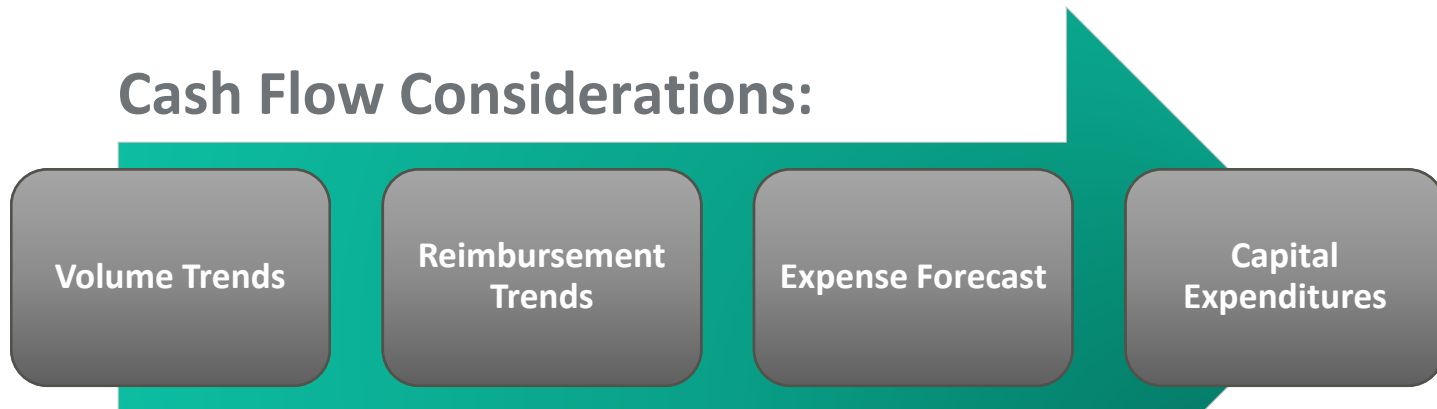
- Discounting of several future periods' net cash flow (the discounted cash flow method) which allows for the forecasting of a finite period of annual net cash flows
- An important assumption of any method of the Income Approach is that the business or asset being valued remains a going concern and has distributable cash flows; meaning there are excess earnings after physician compensation
- This approach is based on the fundamental valuation principle that the value of a business is equal to the present value (or worth) of the future benefits of ownership

# VALUATION METHODOLOGY

## INCOME APPROACH



### Cash Flow Considerations:



Discount Rate

Income Approach  
Value Indication

# VALUATION METHODOLOGY



## INCOME APPROACH

We attempt is to reflect those factors that can be reasonably measured or forecasted within the Cash Flow Projection.

### Cash Flow Considerations: COVID Impact

#### Volume Trends

- Geography is important
- State/local guidance
- Pent-up demand
- Physician clinic activity
- Will vary by specialty
- Specialty mix

#### Reimbursement Trends

- MCR Advanced Payments
- Bad debt impact
- MCR reimbursement trends
- Employment trends impact on payor mix

#### Expense Forecast

- Cost containment during shutdown
- Deferred expenses
- Enhanced testing/PPE considerations
- Staffing shortages
- Possible overtime

#### Capital Expenditures

- COVID impact to capital plan
- Investment in testing equipment/supplies
- Equipment needs to accommodate vol fluctuations

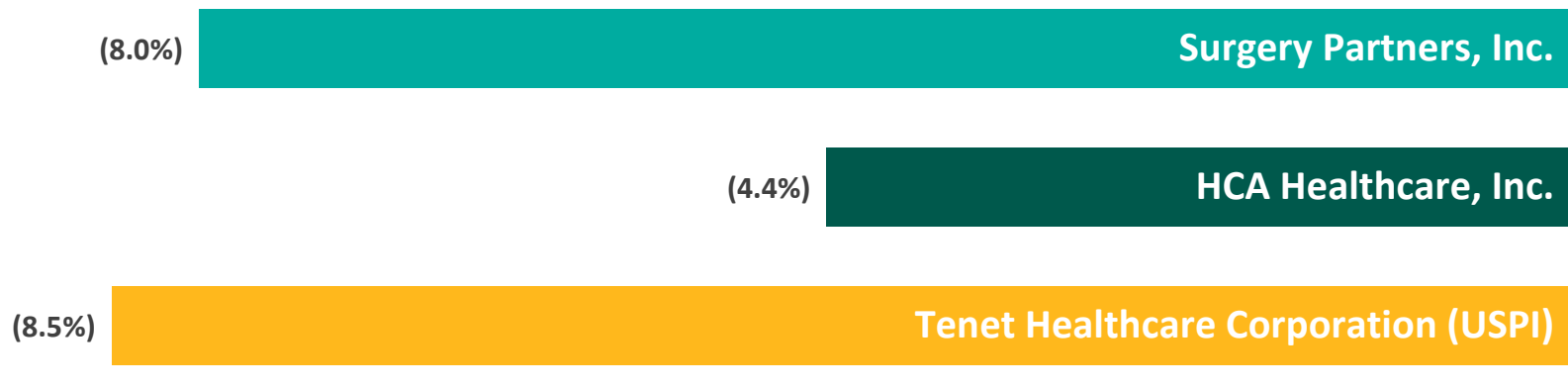


# COVID-19 IMPACT

## 2020 Q1 OPERATING PERFORMANCE

Company	Quarter 1 Volume YoY Growth (%)	April Volume YoY Growth (%)	2020 Earnings Guidance	M&A Guidance
Tenet Healthcare Corporation (USPI)	(8.5%)	(80.0%)	<i>Pulled</i>	"Net cash used in investing activities increased \$65 million compared to 1Q19, primarily due to \$53 million of additional investments to acquire interests in various ambulatory surgery centers." - <b>Tenet Healthcare Corporation Q1 2020 Earnings Presentation</b>
HCA Healthcare, Inc.	(4.4%)	(70.0%)	<i>Pulled</i>	"Acquisitions of hospitals and health care entities declined from \$1.474 billion in the first quarter of 2019 to \$328 million in the first quarter of 2020, primarily related to the acquisition of a seven- hospital health system in North Carolina in 2019." - <b>HCA Healthcare, Inc. 2020 Q1 Form 10-Q</b>
Surgery Partners, Inc.	(8.0%)	~ (80.0%) - (90.0%) Est.	<i>Pulled</i>	"We deployed approximately \$5.5 million early in the quarter, primarily related to the acquisition of a new ASC in the state of Ohio." - <b>Thomas Francis Cowhey, Executive VP &amp; CFO, Surgery Partners, Inc. Q1 Earnings Call</b>

## 2020 Q1 VOLUME VS. 2019 Q1



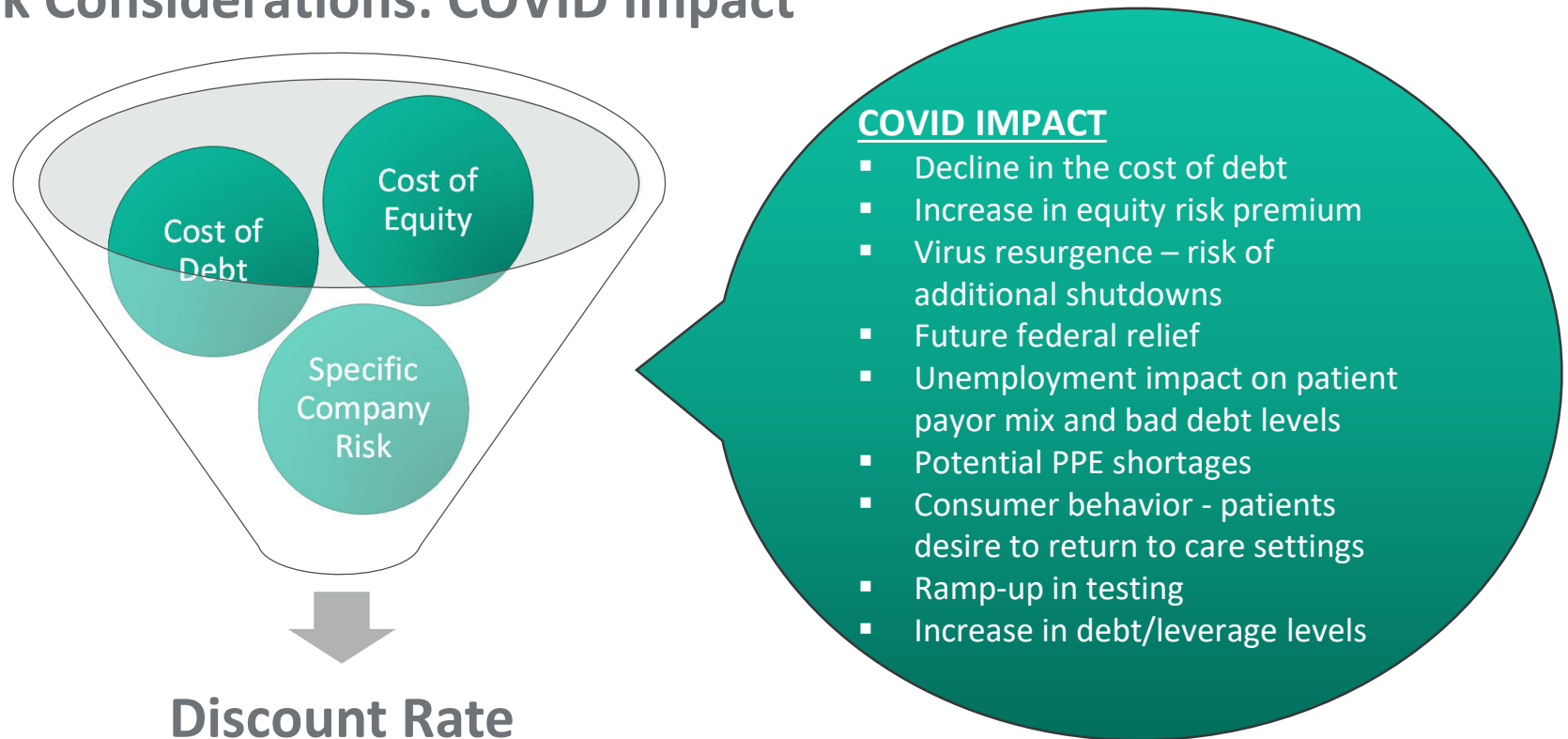
# VALUATION METHODOLOGY

## INCOME APPROACH



Those factors that cannot be reasonably measured or forecasted are reflected in the Discount Rate selection.

### Risk Considerations: COVID Impact

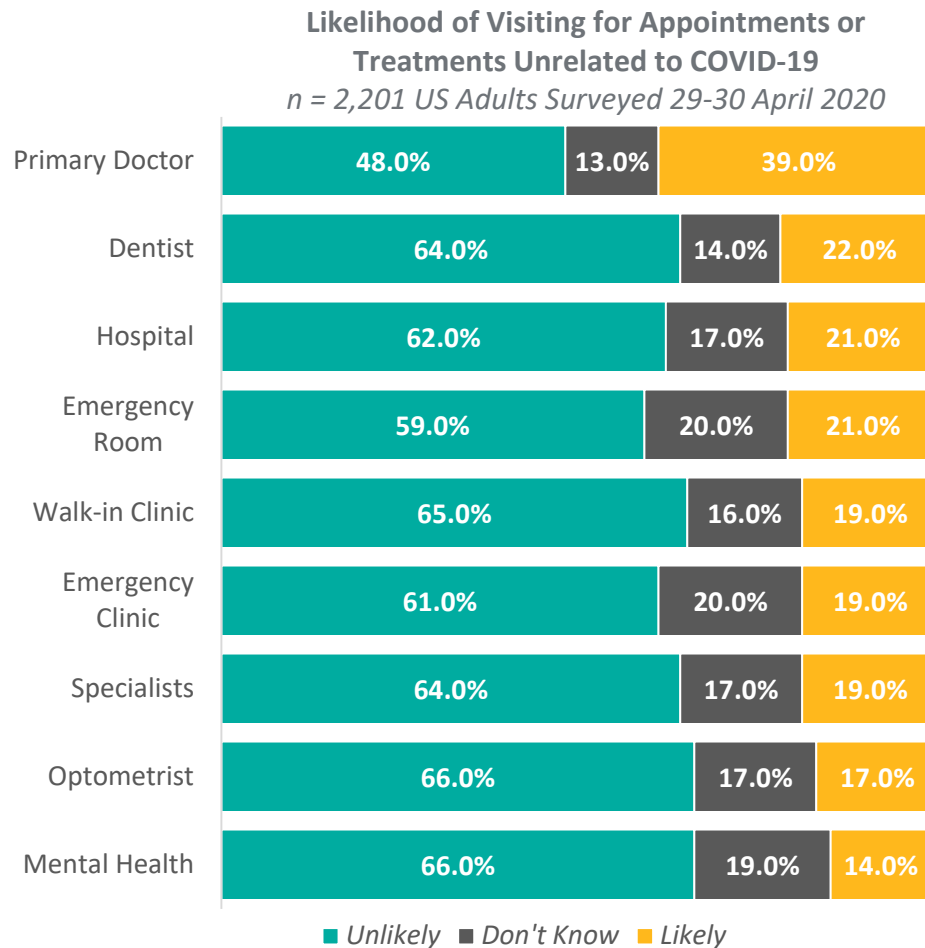




# VALUATION METHODOLOGY

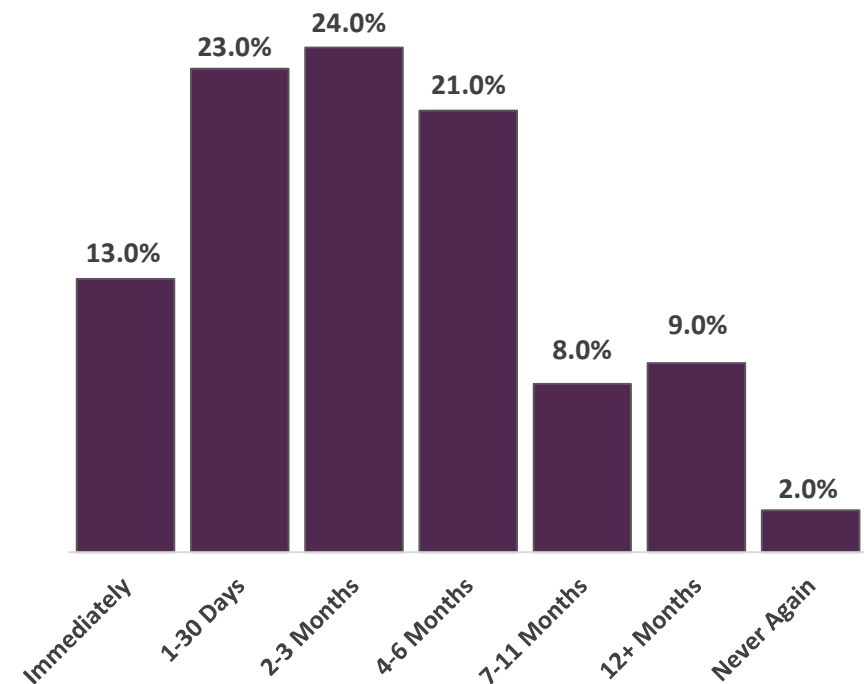
## INCOME APPROACH – VOLUME PROJECTIONS IN POST-COVID WORLD

- According to survey data from Gist Healthcare, patient consumer behavior remains uncertain



Source: Gist Healthcare, April 2020

**When Consumers Will Schedule a Routine Visit in Their Doctor's Office**  
*n = 1,000 US Adults Surveyed 16-20 April 2020*



# VALUATION METHODOLOGY



## INCOME APPROACH – SCENARIO EXAMPLE

PRE-COVID						
	Year 1	Year 2	Year 3	Year 4	Year 5	Terminal Year
Revenue	\$4,800,000	\$4,900,000	\$5,000,000	\$5,100,000	\$5,200,000	\$5,300,000
Expenses	(4,080,000)	(4,170,000)	(4,250,000)	(4,340,000)	(4,420,000)	(4,510,000)
<b>EBITDA</b>	<b>\$720,000</b>	<b>\$730,000</b>	<b>\$750,000</b>	<b>\$760,000</b>	<b>\$780,000</b>	<b>\$790,000</b>
<b>Net Discretionary Cash Flow</b>	<b>430,000</b>	<b>420,000</b>	<b>430,000</b>	<b>440,000</b>	<b>460,000</b>	<b>460,000</b>

Sum of the Present Value of the Years One through Five Projected Cash Flows \$1,450,000 56.6%

Present Value of the Terminal Year \$1,110,000 43.4%

**Value Indication \$2,560,000 100.0%**

POST-COVID						
	Year 1	Year 2	Year 3	Year 4	Year 5	Terminal Year
Revenue	\$4,300,000	\$4,900,000	\$5,000,000	\$5,100,000	\$5,200,000	\$5,300,000
Expenses	(3,740,000)	(4,170,000)	(4,250,000)	(4,340,000)	(4,420,000)	(4,510,000)
<b>EBITDA</b>	<b>\$560,000</b>	<b>\$730,000</b>	<b>\$750,000</b>	<b>\$760,000</b>	<b>\$780,000</b>	<b>\$790,000</b>
<b>Net Discretionary Cash Flow</b>	<b>300,000</b>	<b>420,000</b>	<b>430,000</b>	<b>440,000</b>	<b>460,000</b>	<b>460,000</b>

Sum of the Present Value of the Years One through Five Projected Cash Flows \$1,330,000 52.0%

Present Value of the Terminal Year \$1,110,000 43.4%

**Value Indication \$2,440,000 95.3%**

Value Indication Pre-Covid \$2,560,000

Value Indication Post-Covid \$2,440,000

Decrease in Value (\$) \$120,000

Decrease in Value (%) -4.7%



# VALUATION METHODOLOGY

## CASH FLOW & WEAKENED BALANCE SHEET IMPACT ON VALUE



- Total Invested Capital value impacted by lower Year 1 projections
- Equity calculation impacted by both the lower Year 1 projections and working capital deficit
- Working capital deficit potentially minimized by federal funding

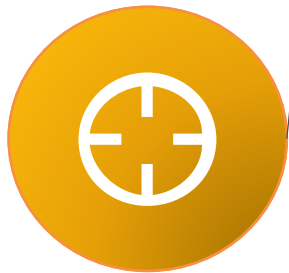
Conclusion of Value	Pre-Covid	Post-Covid	\$ Delta	% Delta
Value of the Total Invested Capital, Rounded	\$2,560,000	\$2,440,000	(\$120,000)	-4.7%
Less: Net Working Capital Deficit	-	(375,000)	(375,000)	
Less: Interest-Bearing Debt Outstanding	-	-	-	
<b>Value of the Center, Minority Equity Level</b>	<b>\$2,560,000</b>	<b>\$2,065,000</b>	<b>(\$495,000)</b>	<b>-19.3%</b>

*The impact of a material working capital deficit can dwarf the cash flow impact of a Center's value*



# VALUATION METHODOLOGY

## MARKET APPROACH

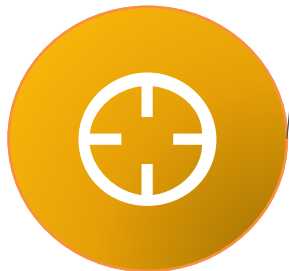


## MARKET APPROACH

- Estimates value by comparing the value of similar assets, securities or services traded in a free and open market to the subject asset
- The underlying premise is the economic principle of substitution – assets of similar utility should have similar value
- Uses relative value measures such as “multiples”, which are factors by which some fundamental financial variable is multiplied to derive a value indication

# VALUATION METHODOLOGY

## MARKET APPROACH



## MARKET APPROACH

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# VALUATION METHODOLOGY

## MARKET APPROACH



Compares the value of similar assets, securities or services traded in a free and open market to the subject asset, security or service.

### Guideline Public Company Method

- Analyzing and applying the valuation multiples of publicly-traded companies that operate in the ASC space. Can present challenges in application due to vast differences in size, diversification, access to capital, etc.

#### COVID IMPACT

Public companies share price and multiples have deteriorated materially; forward looking multiples look normal

### Merger & Acquisition Method

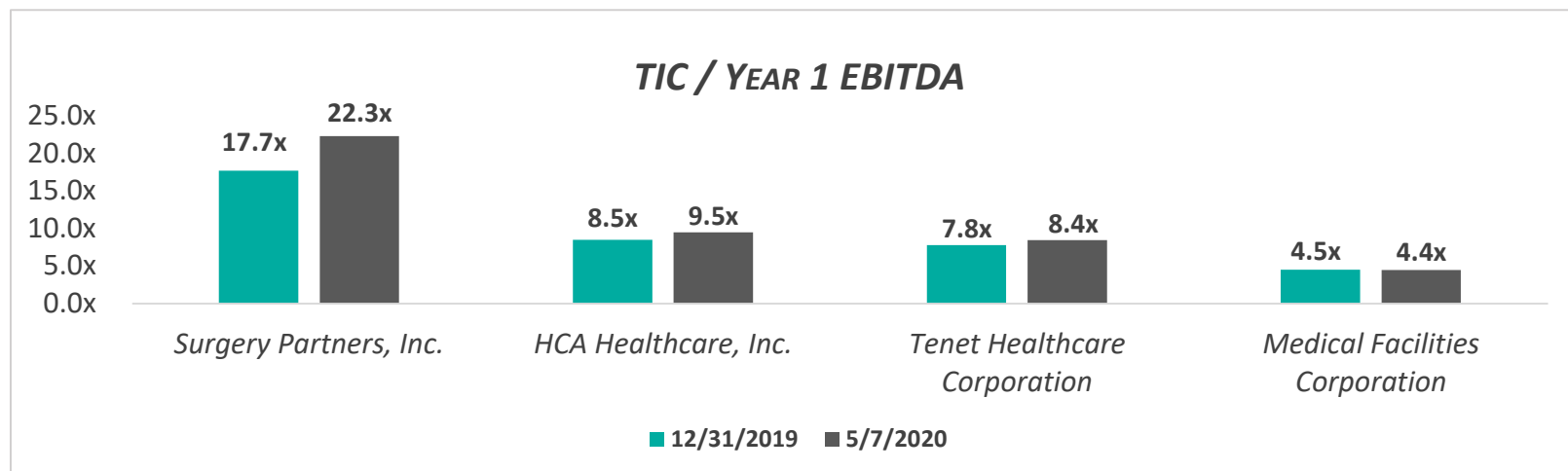
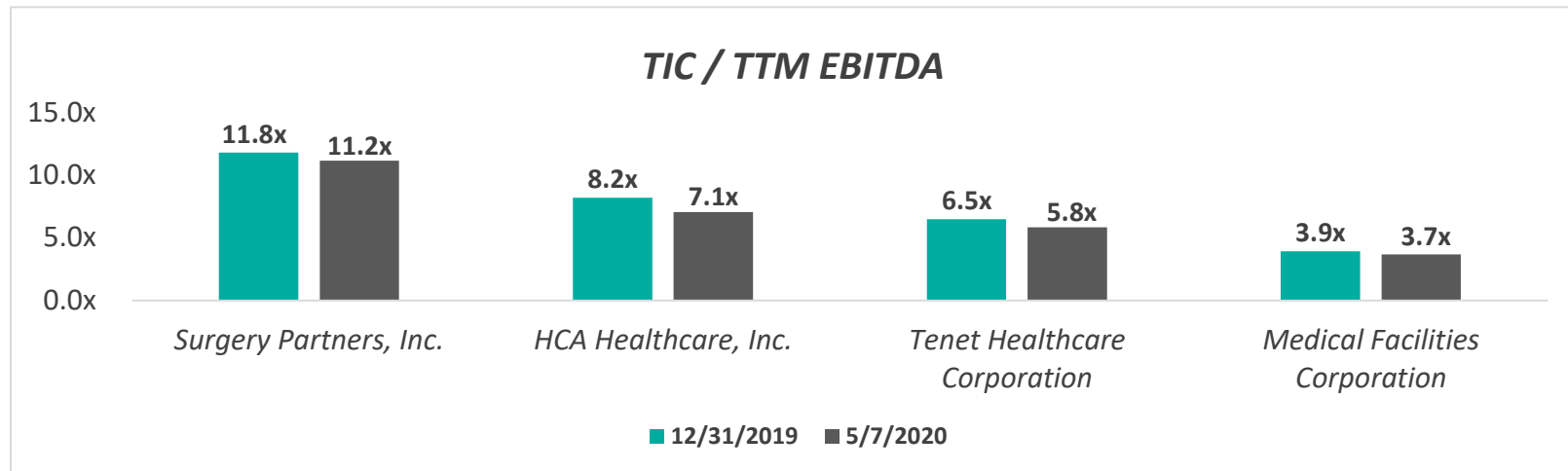
- Analyzing and applying the valuation multiples from comparable ASC transactions. Can present challenges as the economics of most ASC deals are not made public. As such there is a reliance on proprietary datasets and anecdotal evidence.

#### COVID IMPACT

Impact is of yet unknown; M&A activity generally halted across the industry

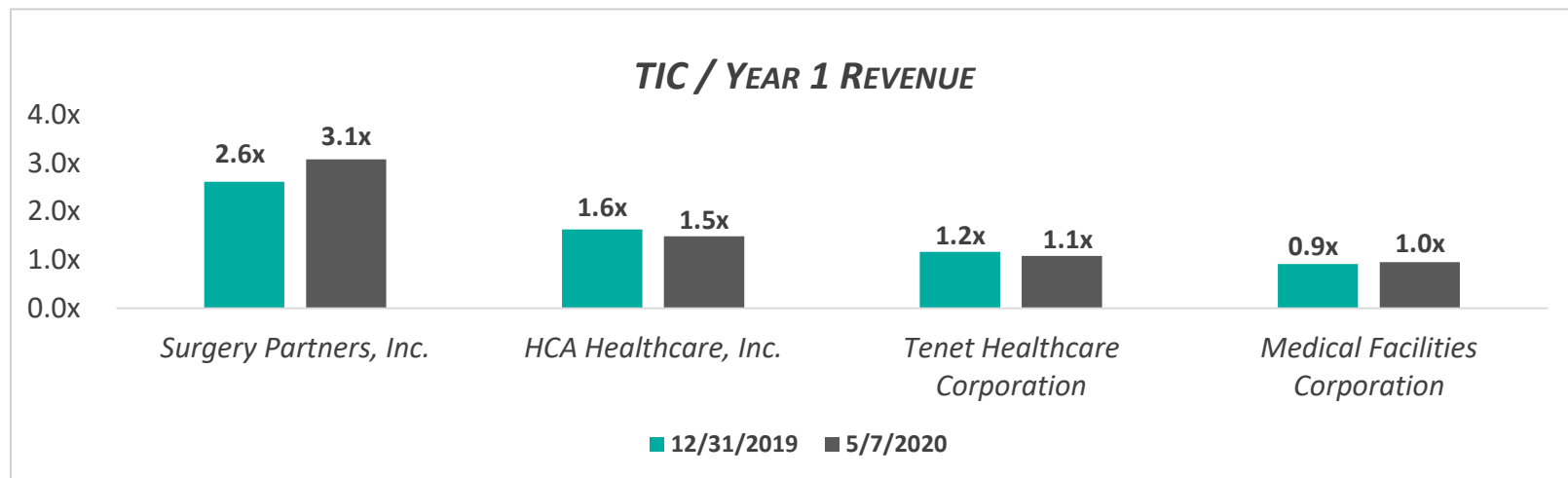
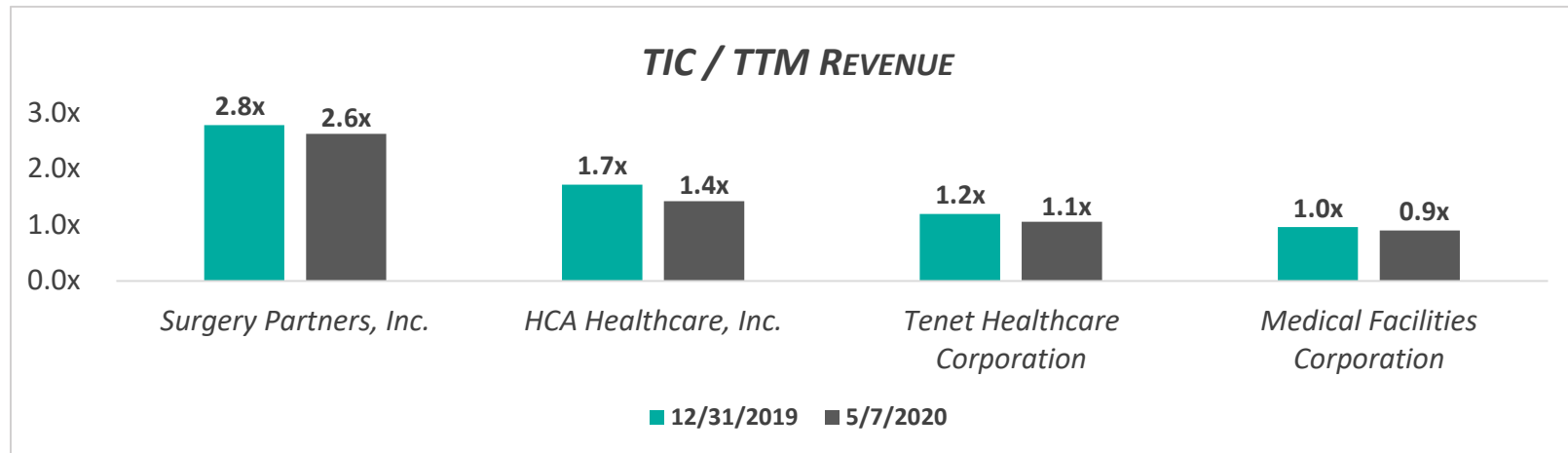
# COVID-19 IMPACT

GPC TIC / EBITDA TRENDS



# COVID-19 IMPACT

GPC TIC / REVENUE TRENDS





# PRESENTER BIOS



## MEET THE TEAM



**KEVIN  
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Managing Director

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### EXPERIENCE

Kevin McDonough is a managing director at VMG Health and is based out of the Dallas office. During his tenure at VMG, Mr. McDonough has provided valuation, transaction advisory, feasibility, and operational consulting services to the firm's healthcare clients. His clients include acute care hospitals and health systems, ambulatory surgery centers, surgical hospitals, oncology centers, diagnostic imaging centers, dialysis centers, home health agencies, physicians groups, physical and occupational therapy centers, long term care facilities, and numerous other ancillary healthcare service businesses. In addition, Mr. McDonough helps to lead the firm's life sciences practice, providing valuation services related to many forms of medical device and pharmaceutical consulting arrangements. Finally, he has served as a consultant in the formation and development of numerous physician-hospital joint venture initiatives.



### MORE ABOUT ME

Mr. McDonough graduated cum laude and holds a degree in Finance from the McCombs School of Business at the University of Texas at Austin. Additionally, Mr. McDonough is a Chartered Financial Analyst (CFA). He is a member of the CFA Institute, CFA Society of Dallas-Fort Worth, Ambulatory Surgery Center Association, American Society of Appraisers (ASA), Healthcare Financial Management Association and the Physician Hospitals of America (PHA).

### AREAS OF EXPERTISE

Business Valuation  
Transaction Advisory  
Strategic Decision Support  
Financial Due Diligence





## MEET THE TEAM



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Director

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### EXPERIENCE

Colin Park is a Director at VMG Health and is based in the Dallas office. His focus has been on developing client relationships and providing valuation, transaction advisory, and operational consulting services in the healthcare services industry. Specifically, he has significant experience with the acute care and specialty hospital, ambulatory surgery center, oncology center, diagnostic imaging center, dialysis center, physicians group, and numerous other ancillary healthcare service business segments.

In addition to the extensive valuation experience for transaction planning and financial reporting purposes, he has consulted on numerous development, feasibility, and denovo business development engagements. Clients include for-profit and not-for-profit health systems, ancillary services providers, development companies across several healthcare industry sub-specialties, and other publicly owned and privately held healthcare entities.

Prior to joining VMG Health, Mr. Park worked as a senior associate in the Planning and Financial Group at Greystone Communities, Inc. and as an analyst in the Tangible Asset Group in Financial Advisory Services at Houlihan Lokey.



### MORE ABOUT ME

Mr. Park received a Bachelor of Business Administration in Accounting, a Certificate in International Business and a Masters of Real Estate Finance from the Mays Business School at Texas A&M University. Mr. Park is a licensed Certified Public Accountant (CPA) in the state of Texas, an Accredited Senior Appraiser (ASA) with the American Society of Appraisers and holds the Accredited in Business Valuation ("ABV") designation.

### AREAS OF EXPERTISE

[Business Valuation](#)  
[Transaction Advisory](#)








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# WE VALUE HEALTHCARE QUESTIONS?

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