Current Valuation Trends: Physician-Owned Hospitals

Nicholas J. Janiga, Manager
David M. Walline, Senior Associate
Financial Disclosure

Other than being an employee of HealthCare Appraisers, Inc., we have no financial relationships to disclose relating to this presentation or conference.
Valuation Overview

Current Valuation Trends: Physician-Owned Hospitals
Valuation Overview

Standard of Value
Fair Market Value
Investment Value

Premise of Value
Going-concern
Assemblage of Assets

Valuation Approaches
Income
Market
Cost
Income Approach

Discounting future benefit(s) back to present value

Single Period (Capitalization of Earnings Method)

VS.

Multi Period (Discounted Cash Flow Method)
Market Approach

Guideline Public Company Method ("GPCM")

Value per relative unit of revenue, profitability, cash flow

Comparability and Standard of Value

Price-to-Earnings

Invested Capital-to-Revenue

Invested Capital-to-EBITDA
Market Approach Continued…

Comparable Transaction Method ("CTM")

Value per relative unit of revenue, profitability, cash flow

Comparability, Standard of Value & Data limitations

Invested Capital-to-Revenue

Invested Capital-to-EBITDA
Cost Approach

Net Asset Method

Value through direct examination of the underlying assets of a business; economic principal of substitution

De Novo

Holding Companies

Distressed Companies

Asset Intensive Companies with Marginal Profitability
Secondary Discounts

Discount for Lack of Control (DLOC)

Discount for Lack of Marketability (DLOM)

Discount for Lack of Liquidity (DLOL)

Discount for Lack of Voting Rights
Transaction Structure

Stock vs. Asset

Levels of Value (Example on next slide)

Equity vs. Market Value of Invested Capital (Example on following slide)
Transaction Structure

Levels of Value

Synergistic, Strategic, or Investment Value
- Premium for Synergies

Value of Marketable, Control Shares
- Control Premium
- Discount for Lack of Control

"Publicly Traded Equivalent Value" or "Stock Market Value" of Minority Shares if Freely Traded
- Discount for Lack of Liquidity

Value of Restricted Stock of Public Company
- Discount for Lack of Marketability

Value of Non-Marketable, Minority Shares
Transaction Structure

Equity Vs. Market Value of Invested Capital

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities and Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Working Capital</td>
<td></td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>Interest Bearing Debt</td>
</tr>
<tr>
<td>Other Assets</td>
<td>Stockholders' Equity</td>
</tr>
<tr>
<td>Intangible Assets</td>
<td></td>
</tr>
</tbody>
</table>

Invested Capital
FMV Pitfalls

Misapplied and Unreliable FMV Analyses:

Valid over a specified range of outcomes, conditional, governing assumptions, etc.

Assumed terms and provisions do not match the agreement

Lack of sufficient knowledge of certain subject matters

“Shelf Life” of the appraisal and whether any post-closing obligations (such as a true-up) are necessary
What Impacts Value of Physician-Owned Hospitals

Recent White Paper on Valuation of Physician-Owned Hospitals
Growth

Limited Growth through Expansion (§6001 of PPACA)

Select Service Line Expansion

Physician/Specialty Syndication

Physician Availability (Illustrated on following slide)

Higher growth leads to higher valuation multiples, *ceteris paribus*
Growth Continued...

Current Valuation Trends: Physician-Owned Hospitals

<table>
<thead>
<tr>
<th>Year</th>
<th>Est. # of Non-Independent Physicians</th>
<th>Est. # of Independent Physicians</th>
<th>% of Independent Physicians</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>400,000</td>
<td>600,000</td>
<td>20.0%</td>
</tr>
<tr>
<td>2001</td>
<td>350,000</td>
<td>700,000</td>
<td>25.0%</td>
</tr>
<tr>
<td>2002</td>
<td>300,000</td>
<td>750,000</td>
<td>35.0%</td>
</tr>
<tr>
<td>2003</td>
<td>250,000</td>
<td>800,000</td>
<td>31.25%</td>
</tr>
<tr>
<td>2004</td>
<td>200,000</td>
<td>850,000</td>
<td>23.53%</td>
</tr>
<tr>
<td>2005</td>
<td>150,000</td>
<td>900,000</td>
<td>16.67%</td>
</tr>
<tr>
<td>2006</td>
<td>100,000</td>
<td>950,000</td>
<td>10.53%</td>
</tr>
<tr>
<td>2007</td>
<td>50,000</td>
<td>1,000,000</td>
<td>5.0%</td>
</tr>
<tr>
<td>2008</td>
<td>0</td>
<td>1,050,000</td>
<td>0%</td>
</tr>
<tr>
<td>2009</td>
<td>0</td>
<td>1,100,000</td>
<td>0%</td>
</tr>
<tr>
<td>2010</td>
<td>0</td>
<td>1,150,000</td>
<td>0%</td>
</tr>
<tr>
<td>2011</td>
<td>0</td>
<td>1,200,000</td>
<td>0%</td>
</tr>
<tr>
<td>2012</td>
<td>0</td>
<td>1,250,000</td>
<td>0%</td>
</tr>
<tr>
<td>2013 (Proj)</td>
<td>0</td>
<td>1,300,000</td>
<td>0%</td>
</tr>
</tbody>
</table>

Total Practicing Physicians

% if Independent Physicians
Growth Continued…

Sequestration – Budget Control Act of 2011

Recent MedPAC Recommendation (example on next slide)

Specialties / Investments Going Forward

Declining Reimbursement and Profitability lead to Lower Valuation Multiples, *ceteris paribus*
## MedPAC “Site” Neutral Example

### Current Payment Rates

<table>
<thead>
<tr>
<th>Service in Free Standing ASC - CPT Code 64633 Payment</th>
<th>$317</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service in Hospital Outpatient Department - APC 0207 Payment</td>
<td>$566</td>
</tr>
</tbody>
</table>

*Premium Over Free Standing ASC* 78%

### "Site-Neutral" Policy

<table>
<thead>
<tr>
<th>Service in Hospital Outpatient Department - APC 0207 Payment</th>
<th>$317</th>
</tr>
</thead>
</table>

*Implied Discount From Current Payment Rates* -44%

Source: ASCA 2013 Medicare Rate Calculator and CMS' 2013 HOPD Final Payment Rates
Efficient Operations

OR Turnover

Additional Staff

Additional Hours

Increased Return on Assets ("ROA") and Profitability leads to Higher Valuation Multiples, *ceteris paribus*
Corporate Partners

Management Fee

In-house Billing, Collecting, etc.

Buyout of Management Agreement

New Corporate Partners
Management Fee

Management Fee by Company
2011 Medicare Cost Report

Hospital Revenues (in Thousands)

Management Fees (in Thousands)

Mgt Co #1  Mgt Co #2  Mgt Co #3  Mgt Co #4  Mgt Co #5  Mgt Co #6  Mgt Co #7
Management Fee as a % of Revenue
2011 Medicare Cost Report
# Valuation Impact Example

## Summary Income Statement

<table>
<thead>
<tr>
<th>Summary Income Statement</th>
<th>Base Year</th>
<th>Syndication</th>
<th>Payor Contracts</th>
<th>Mgt. Svcs In-House</th>
<th>Increased Efficiencies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Case Volume</td>
<td>20,000</td>
<td>21,000</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Reimbursement per Case</td>
<td>$1,700</td>
<td>$1,700</td>
<td>$1,750</td>
<td>$1,700</td>
<td>$1,700</td>
</tr>
<tr>
<td>Net Revenue</td>
<td>$34,000,000</td>
<td>$35,700,000</td>
<td>$35,000,000</td>
<td>$34,000,000</td>
<td>$34,000,000</td>
</tr>
<tr>
<td>Management Fee</td>
<td>1,360,000</td>
<td>1,428,000</td>
<td>1,400,000</td>
<td>-</td>
<td>1,360,000</td>
</tr>
<tr>
<td>Internal Contracting, Billing, and Collecting</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>680,000</td>
<td>0</td>
</tr>
<tr>
<td>Other Operating Expenses</td>
<td>24,480,000</td>
<td>24,888,000</td>
<td>24,480,000</td>
<td>24,480,000</td>
<td>23,460,000</td>
</tr>
<tr>
<td>Total Operating Expenses</td>
<td>25,840,000</td>
<td>26,316,000</td>
<td>25,880,000</td>
<td>25,160,000</td>
<td>24,820,000</td>
</tr>
<tr>
<td>EBITDA</td>
<td>8,160,000</td>
<td>9,384,000</td>
<td>9,120,000</td>
<td>8,840,000</td>
<td>9,180,000</td>
</tr>
<tr>
<td>Depreciation and Amortization</td>
<td>1,360,000</td>
<td>1,360,000</td>
<td>1,360,000</td>
<td>1,360,000</td>
<td>1,360,000</td>
</tr>
<tr>
<td>EBIT</td>
<td>6,800,000</td>
<td>8,024,000</td>
<td>7,760,000</td>
<td>7,480,000</td>
<td>7,820,000</td>
</tr>
<tr>
<td>Income Taxes @ 40.0%</td>
<td>2,720,000</td>
<td>3,209,600</td>
<td>3,104,000</td>
<td>2,992,000</td>
<td>3,128,000</td>
</tr>
<tr>
<td>Net Operating Income After Tax</td>
<td>4,080,000</td>
<td>4,814,400</td>
<td>4,656,000</td>
<td>4,488,000</td>
<td>4,692,000</td>
</tr>
</tbody>
</table>

## Adjustments to Determine Cash Flow

<table>
<thead>
<tr>
<th>Adjustments to Determine Cash Flow</th>
<th>Plus: Depreciation and Amortization</th>
<th>Less: Capital Expenditures</th>
<th>(Increases)/Decreases in Working Capital</th>
<th>Free Cash Flow</th>
<th>Divided by Capitalization Rate [(wacc-g) / (1+g)]</th>
<th>Indicated Market Value of Total Capital</th>
<th>Change in Value Relative to Base Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>500,000</td>
<td>(500,000)</td>
<td>(51,000)</td>
<td>4,029,000</td>
<td>12.0%</td>
<td>$33,575,000</td>
<td>N/A</td>
</tr>
</tbody>
</table>

## Scenarios

<table>
<thead>
<tr>
<th>Scenarios</th>
<th>Base Year</th>
<th>Syndication</th>
<th>Payor Contracts</th>
<th>Mgt. Svcs In-House</th>
<th>Increased Efficiencies</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

## Change in Value Relative to Base Year

- **Current Valuation Trends: Physician-Owned Hospitals**

<table>
<thead>
<tr>
<th>Change in Value Relative to Base Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indicated Market Value of Total Capital</td>
</tr>
</tbody>
</table>

### Free Cash Flow

| Free Cash Flow | $33,575,000 | $39,670,000 | $38,358,333 | $36,975,000 | $38,675,000 |

### Indicated Market Value of Total Capital

| Indicated Market Value of Total Capital | $33,575,000 | $39,670,000 | $38,358,333 | $36,975,000 | $38,675,000 |

### Change in Value Relative to Base Year

| Change in Value Relative to Base Year | N/A | 18.2% | 14.2% | 10.1% | 15.2% |
Alternatives
Alternatives

Expanding Patients' Access to Quality Care Act of 2013
Bi-partisan, but limited

Physician-Owned Hospital, not accepting Government Payors
Inherent weaknesses given PPACA

Public Company

Alternative Structure
Alternative Structure

Unsecured Debt, Paid-In-Kind Interest, Convertible (§6001 PPACA)

Management Agreement

Real Estate and/or Equipment Holding Company

White Paper Further Describing Alternative Structures
Guideline Public Company Valuation Multiples
Public Company Multiples

Size & Profitability

2013 LTM Revenue in Billions (left axis)  2013 LTM EBITDA Margin (right axis)

- HCA
- CYH
- THC
- UHS
- HMA
- VHS
- LPNT
- AMSG

- 2013 LTM Revenue in Billions (left axis)
- 2013 LTM EBITDA Margin (right axis)
Public Company Multiples

5-Year Compound Annual Growth Rate

[CYH, VHS, UHS, HMA, LPNT, HCA, THC, AMSG]
Public Company Multiples

Debt-to-Assets
2013 LTM

<table>
<thead>
<tr>
<th>Company</th>
<th>Debt-to-Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>UHS</td>
<td>0.0%</td>
</tr>
<tr>
<td>THC</td>
<td>40.0%</td>
</tr>
<tr>
<td>CYH</td>
<td>80.0%</td>
</tr>
<tr>
<td>LPNT</td>
<td>120.0%</td>
</tr>
<tr>
<td>HCA</td>
<td>0.0%</td>
</tr>
<tr>
<td>HMA</td>
<td>40.0%</td>
</tr>
<tr>
<td>VHS</td>
<td>80.0%</td>
</tr>
<tr>
<td>AMSG</td>
<td>120.0%</td>
</tr>
</tbody>
</table>
Public Company Multiples

2013 LTM Valuation Multiples

Enterprise Value / EBITDA (left axis)  Enterprise Value / Revenue (right axis)

UHS  THC  CYH  LPNT  HCA  HMA  VHS  AMSG

Enterprise Value / EBITDA (left axis)  Enterprise Value / Revenue (right axis)
Comparable Transaction Valuation Multiples
Comparable Transactions

HAI Selected Hospital Acquisitions by Year

From Irving Levin Associates, Inc.
Comparable Transactions

**Target Hospital Legal Structure**
*January 2010 through June 2012*

- Private 59.5%
- Non-profit 18.9%
- Public 21.6%

*Data compiled from Irving Levin Associates, Inc.*
Comparable Transactions

Target Hospital Structure
January 2010 through June 2012

- Large Private Ownership Involved: 40.5%
- Physician-Ownership Involved: 56.8%
- Critical Access: 2.7%

Data compiled from Irving Levin Associates, Inc.
Comparable Transactions

Transactions by Region
January 2010 through June 2012

South 51.4%
Northeast 16.2%
Midwest 18.9%
West 13.5%

Data compiled from Irving Levin Associates, Inc.
Comparable Transactions

Size & Profitability
January 2010 through June 2012

Data compiled from Irving Levin Associates, Inc.
Comparable Transactions

Number of Beds
January 2010 through June 2012

Data compiled from Irving Levin Associates, Inc.
Comparable Transactions

Price-to-Revenue Multiples
January 2010 through June 2012

Data compiled from Irving Levin Associates, Inc.
Comparable Transactions

Price-to-EBITDA Multiples
January 2010 through June 2012

Data compiled from Irving Levin Associates, Inc.
Recent Transactions of Public Companies

Terms of CHS and HMA Purchase/Merger

Combination of stock and cash; complicated

Once complete, CHS will own and operate approximately 206 hospitals in 29 states with a total bed count of over 31,000

Take Under vs. Premium

Expected to close by the end of the first quarter of 2014
Recent Transactions of Public Companies

Terms of Tenet’s Acquisition of Vanguard

$4.3 billion purchase price, includes $2.5 billion in debt

Tenet to pay a 70% premium over Vanguard’s prior closing price

Tenet will own 79 hospitals and 157 outpatient facilities

Expected to close by the end of 2013
HAI’s 2013 ASC Survey

TTM EBITDA Multiples
Controlling Interest Multiples - Multi Specialty ASCs

Based on HealthCare Appraisers, Inc. 201ASC Valuation Survey
Physician-Owned Valuation Multiples

Valuation Multiples
Physician-Owned Hospitals (2010 -2012)

Price to EBITDA Multiple (left axis)  Price to Revenue Multiple (right axis)
Benchmarking
Medicare Cost Reports

Includes comparable physician-owned / specialty hospitals

Presents key financial and operational metrics

- Gross inpatient and outpatient charges, net revenue, total operating expense, net income
- Cash, inventory, gross and net accounts receivables, accounts payable, total assets, total liabilities
- All beds (including long-term care), total bed days, discharges, FTE employees
<table>
<thead>
<tr>
<th>PHA Benchmarking Data</th>
<th># of Respondents</th>
<th>25&lt;sup&gt;th&lt;/sup&gt;</th>
<th>Median</th>
<th>75&lt;sup&gt;th&lt;/sup&gt;</th>
<th>90&lt;sup&gt;th&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Expense as a % of Net Revenue</td>
<td>42</td>
<td>92.93%</td>
<td>84.85%</td>
<td>68.13%</td>
<td>62.22%</td>
</tr>
<tr>
<td>Personnel Expense as a % of Net Revenue</td>
<td>42</td>
<td>37.49%</td>
<td>28.36%</td>
<td>22.11%</td>
<td>19.27%</td>
</tr>
<tr>
<td>Bad Debt as a % of Net Revenue</td>
<td>42</td>
<td>11.51%</td>
<td>2.69%</td>
<td>1.21%</td>
<td>0.00%</td>
</tr>
<tr>
<td>Supply Cost as a % of Net Revenue</td>
<td>42</td>
<td>31.31%</td>
<td>24.40%</td>
<td>20.01%</td>
<td>14.30%</td>
</tr>
<tr>
<td>Days in Accounts Receivable</td>
<td>41</td>
<td>58.7</td>
<td>42.5</td>
<td>29.8</td>
<td>29.8</td>
</tr>
<tr>
<td>Days Cash on Hand</td>
<td>42</td>
<td>0.5</td>
<td>0.5</td>
<td>30.7</td>
<td>58.0</td>
</tr>
<tr>
<td>Cost of Benefits as a % of Personnel Expense</td>
<td>42</td>
<td>15.77%</td>
<td>13.80%</td>
<td>14.24%</td>
<td>10.84%</td>
</tr>
<tr>
<td>Average Length of Stay (In Days)</td>
<td>42</td>
<td>3.76</td>
<td>2.75</td>
<td>2.22</td>
<td>1.10</td>
</tr>
</tbody>
</table>
HAI’s 2009 Physician Hospital Valuation Survey

Conducted in Cooperation with Physician Hospitals of America

Includes 30 participants

Out-Dated but Comprehensive

Presents Valuation Multiples and Methodologies

Presents Management Fee Guidance and Other Helpful Metrics
Guideline Public Companies

Key operational data often disclosed within public filings

Key financial metrics are disclosed within public filings

Publicly traded company data is often used as a basis for the industry as a whole
QUESTIONS?
Current Valuation Trends: Physician-Owned Hospitals

Presented By

Nicholas J. Janiga | Manager
(231) 218-5375 | njaniga@hcfmv.com

David M. Walline | Senior Associate
(303) 688-0700 | dwalline@hcfmv.com

Physician Hospitals of America’s 13th Annual Conference & Exhibits
September 18 - 20, 2013
HealthCare Appraisers, Inc.

Established in 2000 by healthcare executives

43 Professionals working with Clients across the U.S.

Offices: Florida, Colorado, Chicago, Philadelphia, and Dallas

Services: Business Valuations, Litigation Support, Compensation Valuations, Life Science Valuations

Additional Information: Corporate Profile