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ASC Valuation and Transaction Trends

Transaction activity remains robust, more HOPDs convert to ASCs and median reported EBITDA multiples continue to increase

BY DANIEL I. LEVIN



HealthCare Appraisers released its 2020 ASC Valuation and Benchmarking Survey in spring. ASCA collaborated with HealthCare Appraisers on conducting the survey, which includes insights from owners and managers of more than 1,200 ASCs throughout the US. We have published our annual survey for more than a decade, providing valuable insights into trends in valuation as well as the financial and operating performance of surgery centers.

We conducted and published our 2020 survey prior to the profound effects of COVID-19 in the US. Since that time, many states issued orders limiting elective surgical procedures, which caused sharp declines in ASC case volumes in the second half of March and April. A few of the largest publicly traded operators of surgery centers indicated case volumes were down as much as 85 percent in April. As of mid-August, most ASCs have experienced a rebound in volumes but are still below pre-COVID-19 or budgeted levels and some orders banning non-emergency procedures in hospitals due to local outbreaks have been reinstated in recent weeks. The long-term outlook for ASCs, however, is as positive as ever.

Valuation Survey Highlights

In the 2020 survey, the consensus among respondents was that transaction activity remained robust and competitive, with the trend expected to continue going forward. The majority of respondents indicated that transaction activity and competition for acquisitions increased in 2019. As a result of this competition, valuation multiples for controlling interest purchases



increased as well. Many factors drove increased activity in the ASC space including increased interest from private equity sponsors in surgical specialty physician practices, hospital outpatient departments (HOPD) converting to freestanding ASCs and health systems attempting to recapture procedure volume as it migrates to lower cost settings. We anticipate these trends will continue given more procedures are being approved for the outpatient setting—i.e., the inpatient-only procedure list continuing to shrink—including total joint replacements and cardiovascular procedures.

Valuation multiples in the ASC sector continued their upward trend in our 2020 valuation survey. Details surrounding the increase in valuation multiples, including comparisons of valuation multiples as compared to previous years, are discussed and referenced in greater detail in the survey.

From our perspective, the primary buyers at the high end of the valuation multiple range are private equity sponsors consolidating physician practices and affiliated ASCs. A wealth of data as well as commentary from public companies and other market participants support the fact that private equity firms

are driving up valuation multiples across a range of medical specialties and entity types. Some of the earliest specialties to see strong interest from private equity were dermatology and ophthalmology, however, the last few years have seen a surge in consolidation activity within the specialties of orthopedics, radiology, gastroenterology, urology, cardiology and podiatry. With private equity firms sitting on more than \$1.5 trillion in cash, we believe these trends could continue for the foreseeable future.

Companies with a historical focus on ASCs, such as private equity-backed Covenant Surgical Partners, which recently rebranded as Covenant Physician Partners, have broadened their strategy to include physician practices. Covenant Physician Partners now operates more as a physician services organization akin to many of the private equity physician practice management platforms that have formed in recent years. This suggests that companies that have focused primarily on ASCs in the past see growth opportunities in managing physician practices and recognize the importance of aligning physician groups with their ASCs. The strategy could also be defensive in some cases to retain volume at existing ASCs and avoid having high-volume physician groups acquired by a competitor platform.

In our 2020 survey, we also observed an increase in HOPD conversions to freestanding ASCs. Approximately three quarters of respondents indicated that HOPD to freestanding ASC conversions increased in the last year. Hospitals often view the conversion of HOPDs to freestanding ASCs as part of a physician alignment strategy, and the conversion is frequently conducted simultaneously with a transaction in order to syndicate

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equity to physician owners. Conversions might also take place when an HOPD is underperforming financially and the hospital owner wants to bring in an ASC management company to form a three-party joint venture to help improve the performance. In our 2020 survey, nearly two-thirds of respondents indicated seeing an increase in three-party joint ventures, suggesting hospitals and health systems continue to see value in partnering with ASC management services organizations.

Respondents in the 2020 survey also expressed some changing preferences

for the types of cases being performed at their ASCs. In particular, each year we ask respondents about the desirability of having cases of various surgical specialties performed at their surgery centers. In 2020, the largest increase in desirability was for cardiology and vascular procedures, which we believe is attributable to the Centers for Medicare & Medicaid Services' (CMS) recent approval of several cardiology and cardiovascular procedures for payment in the ASC setting, including many catheterization, angioplasty and stenting procedures. Other highly desirable spe-

cialties including orthopedic and spine cases recently had additional procedures approved for the ASC setting as well, including total joint procedures that have the potential to increase profitability when managed effectively. More broadly, the shifting of surgical procedures to the ambulatory setting will likely have a continued impact on the desirability of various medical specialties, as well as the strategies pursued by providers over the coming years.

Benchmarking Survey Highlights


Our benchmarking survey provides insight into the financial and operational performance of single-specialty and multispecialty ASCs across the country. Some of the major trends highlighted in the 2020 survey relate to changes in reimbursement rates and operating costs. More than half of respondents indicated that commercial reimbursement rates are increasing at a rate below inflation, while expenses are increasing faster than inflation. This contributed to a slight decline in the median reported earnings before interest, taxes, depreciation and amortization (EBITDA) margin in the 2020 survey as compared to the 2019 survey. ASCs with the ability to perform higher acuity cases in specialties such as orthopedics or spine might be better positioned to deal with these pressures going forward due to the higher reimbursement and profit potential associated with these cases.

Our annual survey also asks respondents about a variety of important metrics including net revenue per case, cases per operating room per day, revenue concentration among the top performing physicians, payer mix and working capital needs. These metrics, along with the insight provided in our valuation survey can serve as a helpful tool for stakeholders across the ASC spectrum. <<

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