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How to Value an Unprofitable Surgery Center
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There are a number of Ambulatory Surgery Centers (ASC's) failing in the market for a variety of reasons. Poor payer contracts, incompetent management, lack of commitment from physicians or poor case mix are some of the reasons a center fails to be profitable. Oftentimes, ASC development/management firms are brought in to support failing ASC's. These firms often purchase an interest in the business and assume management of its daily operations. As part of this process, an accurate valuation of the failing ASC may be required. Valuation analysts normally apply three different approaches in valuing an ASC: the Asset, Market, and Income Approaches.

The **Asset Approach** is premised upon the idea that the value of a business can be determined by its underlying assets and liabilities. Very simply, a center's assets (tangible and intangible) and liabilities are adjusted to their fair market value and the difference represents the net asset value of the enterprise. It is important to note that in most cases, a company's book value or cost-based values do not represent fair market value.

The **Market Approach** to value is based upon an analysis of comparable equity transactions of similar surgery centers throughout the country. Through this process, a valuation analyst can determine a reasonable range of "market multiples" based on actual sales. The most common market multiple is Enterprise Value/EBITDA (earnings before interest, taxes, depreciation and amortization). The market-derived EBITDA multiple is applied to the subject company's EBITDA to estimate its market value of total invested capital.

The **Income Approach** to value uses one or more valuation methods to convert anticipated economic benefits into their present value. In valuing ASC's, the most widely recognized and utilized method is the discounted cash flow (DCF) method. This method measures the present value of future distributable earnings of an ASC over a long-term horizon. In applying the DCF method, the distributable cash flows of the center are discounted to present value at a discount rate that reflects the risk associated with the projected cash flow stream. If the projections reflect very aggressive and optimistic earnings, then the discount rate is normally higher than if the projections are more conservative.

When the financial outlook of an ASC is truly challenging, however, the Income and Market approaches are not applicable. In this case, it is most appropriate to utilize the Asset Approach. An ASC's tangible assets are easily identifiable and normally include cash, accounts receivables, pre-paid expenses, furniture, fixtures, computers and medical equipment. Intangible assets may include a trained and assembled workforce, IT systems in place and a **Certificate of Need** (CON - if operating in a CON state).

The valuation of tangible and intangible assets

The valuation of tangible assets is rather straightforward. The analysis of an ASC's accounts receivable will yield the actual collectible amount. Cash and prepaid expenses are valued at their face amount. An equipment appraisal can ascertain the value of furniture, fixtures and equipment.

In regard to intangible assets, a qualified business appraiser will utilize special techniques and methods to estimate the value of a trained workforce in place or other recognizable intangible assets. An experienced appraiser can also estimate the value of what is commonly the most valuable intangible asset of an ambulatory surgery center – the CON.

In estimating the value of a CON, the "excess earnings" method is often used. This method is performed by first determining the "excess" portion of an ASC's earnings over and above a market rate of return on the tangible assets of the center. Next, a projected *pro forma* earnings statement is developed using reasonable and attainable assumptions and industry benchmarks[1]. The *pro forma* earnings that remain after the deduction of a return on the net tangible assets or the "residual" are then presumed to be attributable to the intangible assets. The *pro forma* earnings that have been attributable to the CON are then capitalized utilizing a capitalization rate to reflect the risk of achieving the cash flows. Finally, the indicated value of the intangible assets is added to the value of the tangible assets to arrive at an estimate of overall asset value on a going concern basis.

ASC's experiencing challenges in their day-to-day operating environment may still have positive equity value. A professional business appraisal conducted by an accredited appraiser is the first step toward defining what the business is actually worth.

[1] There are many other factors that should be incorporated in constructing a *pro forma* that is beyond the scope of this article.