ASC Transaction Value: The Not-So-Simple Algebra of Multiples

Ambulatory surgery centers (ASCs) continue to be the target of health systems, physicians, and financial investors due to their straightforward business model and ability to align with physicians. As more high-acuity, high-reimbursing procedures transition to the outpatient setting, ASCs will become increasingly attractive for investment and will further cement their status as a preferred, low-cost surgical setting. Given the considerable attention from potential investors, it is crucial to understand how value is measured, how that value is derived, and the common terms used to describe value.

What is a multiple?

To convey value, market participants often speak in terms of "multiples." A multiple is simply a company's enterprise value divided by an industry-specific metric. Multiples are used due to their simplicity and ability to compare subjects to industry peers without the need for complex analyses. Although multiples within healthcare can be based on many different metrics, such as number of beds, revenue, covered lives, panel size, etc., ASCs are most discussed in terms of EBITDA multiples.

Why EBITDA?

EBITDA, defined as earnings before interest, taxes, depreciation, and amortization, generally approximates a center's cash flow, and by extension, its profitability. By calculating earnings before non-cash charges, such as depreciation and amortization, EBITDA represents earnings available to shareholders better than net income. Additionally, excluding interest expense removes the effect of capital decisions, whereby shareholders decide to finance purchases with debt or purchase equipment outright. Due to the discretionary nature of utilizing debt instead of cash, removing the impact of such decisions makes EBITDA an easily comparable metric between industry participants.

Understanding EBITDA and its benefits provides a clearer picture of multiples and their meaning. For example, a multiple of 8x EBITDA means the target ASC can be wholly acquired for a sum equal to eight times its EBITDA. Despite the prevalence and simplicity of EBITDA multiples, there are a few significant pitfalls to be aware of.

It's not that simple.

First, it is important to recognize that EBITDA multiples are often discussed in terms of "implied" multiples rather than "applied" multiples. Put another way, the final transaction value is typically determined through a detailed analysis of the subject ASC's historical and projected financial performance. This value is then divided by EBITDA to arrive at an implied multiple.

Investors and valuation professionals are concerned about the ultimate distributions received from an investment in an ASC and the associated risk/return. The distributions are assessed through a discounted cash flow analysis where future earnings are projected and discounted back to present-day dollars using a discount factor. The sum of these discounted cash flows is then used to estimate the value. This analysis allows for the consideration of many idiosyncratic factors relevant to the subject ASC, such as size, geography, capacity, specialty/case mix, payor mix, staffing and supply expense growth, capital requirements, and many other factors.

Conversely, simply applying a market multiple to EBITDA will give an indication of value but may not accurately reflect the specific factors of the subject ASC. Given the intricate analysis used to determine value, it is clear why ASC transactions at the control level do not all occur at the same multiple; one center may be valued at a 7.3x implied EBITDA multiple, and another may be valued at an 8.2x multiple.

Buyers and sellers must understand the range of EBITDA multiples in the market to ensure the analysis produces an appropriate result. If the implied multiple lies outside the market range the discounted cash flow analysis will provide an explanation as to why.

Which EBITDA?

To fully understand an implied EBITDA multiple is it critical to know the EBITDA by which the multiple is calculated. As shown in the table below, the implied EBITDA multiple of ASC value can be expressed using several different types of EBITDA; however, the most common are historical, normalized, and projected. Historical EBITDA represents the actual earnings of the center in the prior 12 months. On the other hand, normalized or adjusted EBITDA represents earnings after adjusting revenues and expenses to depict what a normal past 12 months of operations would have looked like.

Typical adjustments include the removal of one-time expenses and revenues, transaction adjustments for related-party arrangements (i.e., management agreements, billing fees, rent expenses), and adjustments for the timing of certain revenues and expenses that are over-represented or under-represented in the examined historical period. Lastly, projected EBITDA represents the expected next 12 months of earnings after normalization. It may account for many specific factors, but commonly it varies from normalized EBITDA due to expected changes in case volume.

Using different types of EBITDA can have a material effect on multiples. For example, after removing certain nonrecurring expenses, a center's normalized EBITDA might be $100,000 higher than the historical level. As a result, a control-level value indication of $10,000,000 would produce a multiple of 8.3x based on historical EBITDA, whereas using normalized EBITDA would imply a multiple of 7.7x.

EBITDA's Effect on Multiples	Historical	Normalized	Projected
EBITDA	$1,200,000	$1,300,000	$1,400,000
Value Indication (Purchase Price)	$10,000,000	$10,000,000	$10,000,000
Multiple	8.3x	7.7x	7.1x

Though implied multiples are often discussed in terms of normalized or projected EBITDA, sellers should be cautious when hearing rumored valuation multiples among their peers. A possible disconnect between the various indications could distort the view of how ASCs are valued.

So, what is the value of an ASC?

While it is beneficial to understand the general market ranges for ASC transaction multiples, an extensive assessment of the specific facts and circumstances of any singular center is required to determine its precise value. This valuation requires detailed knowledge of the operations and financial performance of the ASC from both a historical and future perspective. To determine an accurate valuation range for a center, buyers and sellers commonly engage the services of qualified advisors, such as VMG Health, who have extensive experience in ASC valuation.

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