

Business Considerations When Acquiring Shares in an ASC

BY BRUCE MALLER



The recent changes in facility reimbursement for retina cases make this an interesting time for retina surgeons and owners of existing ambulatory surgery centers (ASC). For many surgeons who have been accustomed to performing their surgeries in a hospital setting, considering a business model seems a foreign concept.

In this issue, Bruce Maller provides pertinent information for the retina specialist who may be contemplating becoming involved in an ASC. There are many legal and financial implications that must be considered and Bruce discusses each in detail in his article.

-Pravin U. Dugel, MD

As has been well documented, changes in facility reimbursement over the past couple of years has created quite a bit of “buzz” concerning the economics of performing retina surgery in an ambulatory surgical center (ASC) setting. In addition to studying the financial feasibility of this opportunity, it is important to address other legal, regulatory, and business issues before proceeding with any type of transaction.

GETTING STARTED

Several business models may be available to the retina practice. The feasibility of each option must be carefully considered. The practice is strongly encouraged to engage experienced business and legal experts to assist with the process.

Here are the most common strategic options:

Build-out and ownership of a new facility. The facility could be leased from an unrelated third party or owned by the physician partners. This option may be considered with or without involvement of an outside party: ie, corporate partner or hospital.

Acquisition of an existing facility. Although these opportunities are not common, it is certainly worth exploring before embarking on development of a new facility.

Bring cases to an existing facility that is associated with the practice. By way of example, the retina surgeons may be part of a larger multispecialty practice that has an ASC; however, retina cases are currently not performed at the facility.

Bring cases to an existing “unaffiliated” community-based facility. The facility may be a single specialty eye facility or possibly a multispecialty ASC. The facility may be physician or hospital-owned or in some cases, a physician-hospital joint venture.

Before implementing your business plan, several key questions should be considered.

- What are the primary objectives for moving cases to an ASC?
- Is there a desire for physician ownership in the facility?
- If ownership is an objective, does the practice have a need to be in a voting control position?
- What are the risks and benefits associated with the investment?
- If developing a new facility, will you be able to obtain third-party contracts?
- What options exist for financing the venture?
- Do the partners have the means and the willingness to invest the required capital into the venture?
- What are legal and regulatory issues that may influence decision-making?

Based on my experience, most transactions involve integrating retina services in to an existing facility. In the vast majority of these transactions, the retina physicians desire ownership in the facility. Outlined below are the key business issues that must be discussed among the parties.

TERMS OF THE BUY-IN OR SHARE PURCHASE

The first questions most physicians want answered are how many shares can be acquired and at what price per share. If the facility has entered into similar transactions with other surgeons, it generally has some sense of how the business opportunity will be structured. If, on the other hand, the center has limited experience with these types of transactions, the owners will generally rely on the advice of outside consultants and advisors in coming up with a proposal. The Federal anti-kickback statutes (and the associated ASC "Safe Harbor" provisions) will generally weigh heavily on the structure and terms of the transaction.

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In structuring a proposed transaction, the current owners will consider the following: the required capital investment to accommodate the new case mix, the need or desire to maintain voting control, the dilutive effect of adding new owners, and the impact on center operations of adding a new line of service.

In the end, the retina physician should expect to pay fair market value for the shares and in most cases end up with a minority ownership stake in the facility. This business opportunity should then be compared with the economics of building one's own facility. In many cases, the economics favor owning a minority interest in an

TABLE 1. CALCULATION OF EBITDA

	Year-End Totals
Total ASC Revenue	\$2,400,000
Cost of Goods Sold	-525,000
Contribution Margin	\$1,875,000
Operating Expenses	-1,355,000
Net Operating Income	\$520,000
Plus Depreciation	\$75,000
Plus Interest Expense	\$6,000
Plus Taxes	\$9,000
EBITDA	\$610,000
ASC VALUATION	
EBITDA	\$610,000
Multiple of Earnings	3
Total Estimated ASC Value	\$1,830,000
Value per 1% Share	\$18,300

existing facility vs ownership of all or a majority interest in a new facility.

The determination of “fair market value” is the subject of much discussion and debate. In my experience, most transaction values gravitate within a range of two to four times the trailing 12 months or previous fiscal year earnings before interest, taxes, depreciation, and amortization (EBITDA). In essence, this amount reflects the cash flow available from operations before consideration is given to payment of debt service (and before any distributions are paid to the facility owners).

It is important to point out that the determination of EBITDA or cash flow is normally made without effect to the contribution margin or incremental cash flow from the case volume to be contributed by the retina surgeons.

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Table 1 is an example of a normal computation of EBITDA and a valuation assessment assuming a three-times multiple of EBITDA.

Once the price per share and number of shares are resolved, the parties then normally focus on payment terms. Given the provisions of the anti-kickback statutes, most advisors recommend payment for the shares in cash at the time of closing. Another important consideration is whether the shares will be acquired from the company or from the existing owners. If the shares are acquired from the company, it is important to consider what will happen to the proceeds from the sale. Will these proceeds be kept in the company (for general working capital purposes) or will the proceeds be paid out in some manner to the existing owners? Tax and legal advisors must be intimately involved in this aspect of the transaction.

BUY-SELL CONSIDERATIONS

There is an old business adage that when one enters into a transaction it is important to assess the exit strategy. Such should be the case when acquiring shares in an existing ASC.

First of all, at the time shares are acquired in an existing facility, the new shareholders normally agree to abide by the terms of the existing entity agreement. The exact

legal documents will be predicated on the form of entity. By way of example, if the entity form is a limited liability company the new owners become parties to what is called the operating agreement. If the entity form is a corporation, a buy-sell agreement or shareholder's agreement is normally used.

Regardless of the document form, the critical issues contained in the document include:

Entity governance:

- How are decisions made by the company? This is particularly important as it relates to the need for the purchase of new equipment.
- Is there a management committee or managing partner for the company?
- Will you have any involvement in management of the facility?
- What percentage of voting shares is required to modify or amend the agreement?
- What happens to your shares if the majority owners want to sell to a third party?
- Are there “drag along” and/or “tag along” rights?

Redemption of Shares:

- How are shares disposed of in the event of death, permanent disability, or other termination of an owner?
- How is the redemption price determined?
- How are proceeds paid to a terminating owner?
- Can one's shares be maintained following termination or retirement?
- What are the events that could lead to a termination of one's interest in the facility?
- If one voluntarily terminates or is asked to leave, what, if any, restrictions exist for performing cases or having an ownership interest in another facility?

The recent changes in facility reimbursement provide a unique and worthwhile opportunity for most retina physicians to evaluate the business opportunity of performing surgical cases in an ASC. Ownership of shares in an ASC provides a new and exciting “passive” income opportunity. As is the case with any new business opportunity, it is important to exercise proper due diligence and to engage experts in the field to assist you in making a good business decision. ■

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