

New Jersey ASC Meets with Mark Manigan, Esq. of Brach Eichler

Mr. Manigan is one of the strongest advocates for the ASC community in New Jersey and for keeping legislation regarding ASCs favorable to the industry.

1. What kind of ASC activity are you seeing in your practice?

First, a number of our clients are currently in the process of going in-network. These agreements are complicated and often start out exceedingly one-sided. We help our clients get a fair deal, both on the business terms and the legal terms. Second, as more ASCs migrate in-network, economic success becomes dependent upon volume. We are assisting ASCs in recruiting new doctors, shedding unproductive doctors and analyzing merger opportunities. If you have two separate surgery centers operating at 50% capacity, it can make a great deal of sense to combine the two operations into one. Third, the level of acquisition activity is heating up. [Interest had waned after the Garcia decision]. Regional and national players are starting to show a lot of interest in New Jersey again. Many of the prominent hospital systems in the state (Saint Barnabas, Meridian, Virtua) are actively in the market looking to do deals.

2. There has been a tremendous amount of public debate and controversy surrounding out-of-network providers and benefits. How do you see this playing out?

Out-of-network reimbursement has, without question, been one of the hot button issues of the last year. A number of bills have been introduced to curtail the waiver of co-payments and deductibles.



3. What has been the impact of these developments on the ASC business in New Jersey?

Some centers are thriving, some are not. My standard advice during the planning stage has always been if the center doesn't work in-network, don't build it. We'll see how it shakes out, but without question competition for unaffiliated physicians is fierce, and as I mentioned earlier, many folks are examining consolidation opportunities.

We'll see some poorly planned or poorly operated centers close or merge with stronger facilities. I think continuing contraction in reimbursement will require centers to run more efficiently and at higher volumes in order to maintain margin. Talented operators will survive and thrive. The unsophisticated will fall by the wayside. The good news is, however, the national companies are back. These buyers are much more interested in stable in-network centers.

In fact, one bill proposes to criminalize waivers. On behalf of the New Jersey Association of Ambulatory Surgery Centers (NJAASC), we are actively engaged to make sure these bills are modified in a reasonable fashion before they become law.

Drastic changes are taking place in the insurance markets. Insurance companies are restructuring the design of insurance benefits to reduce out-of-network allowances for ASCs. Whether it is in the form of an annual cap on expenditures (i.e., the Horizon \$2,000 cap) or a benefit equal to a percentage of Medicare (i.e., 160% of Medicare), many products being sold at this time contain caps. These products have dramatically increased

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consumer cost when choosing to go out-of-network. Really a brilliant move by the carriers. These plans totally shift the cost of out-of-network care to the patient, many of whom failed to read the fine print on the insurance policy purchased by their employer and mistakenly believed they had out-of-network benefits when in fact they did not.

4. What do ASC acquisition deals look like?

Buyers of ASCs are in it for the cash flow. The play for them is not only a straight cash flow play, but a bet that they will be able to sell the sum of their collection of acquired interests at a higher multiple than they bought them for. The typical deal

formula is as follows: (I) 6-8 times EBITDA, less (II) long term debt, multiplied by (III) percentage of ASC sold. For example, an ASC with an EBITDA of \$2,000,000, long term debt of \$1,500,000, and a negotiated acquisition multiple of 7 would be valued as follows: (I) $7 \times 2,000,000 = \$14,000,000$, less (II) $\$1,500,000 = \$12,500,000$. If 50% of ASC is being sold, \$6,250,000 would be distributed to owners (and they still own the remaining 50%). Furthermore, these companies take a management fee in the range of 3% to 7% of gross revenues.

5. On the regulatory side, what are the most pressing challenges facing the ASC industry in New Jersey at this time?

There is no shortage of legislative and regulatory challenges facing the ASC industry in the state. Various bills aimed at regulating the out-of-network market are percolating through the legislature. The Department of Banking and Insurance is poised to propose a new PIP fee schedule rule, which we're being told will include a managed care option for PIP benefits. There is a movement to increase regulatory oversight and potentially require licensure for currently unlicensed centers. The Department of Health and Senior Services is in the process of drafting regulations implementing the 2009 amendments to the Codey Law, which will have a dramatic impact on the way business is conducted. The good news is the industry is engaged. We have been working hard with the NJAASC on these issues and will continue to make sure the industry gets a fair shake.

6. Why would some centers get purchased at a higher multiple than others?

A number of issues drive value in an ASC. First, let's talk about whether the ASC is in-network or out-of-network. Buyers are not going to go long on an ASC

based on the premise that out-of-network reimbursement will remain unchanged forever. Buyers will manage risk either through a reduction in the multiple, or by recasting and "normalizing" revenues based on projected in-network numbers. Specialty mix and the age and the quality of the doctors are also important. Whether there is a post-closing opportunity to recruit additional physicians is perceived as additional upside for buyers. The limitations on development created by the Codey Law amendments are actually a positive factor in this context.

7. In closing, what is your take on the State of New Jersey's ASC industry?

I remain bullish on the ASC industry in New Jersey. Without question the market is changing. I represent a number of ASCs that have remained very successful after transitioning in-network. At the end of the day, so long as ASCs continue to provide good service to patients, at a price that is competitive in the market place, there will be a role for them in our healthcare delivery system.

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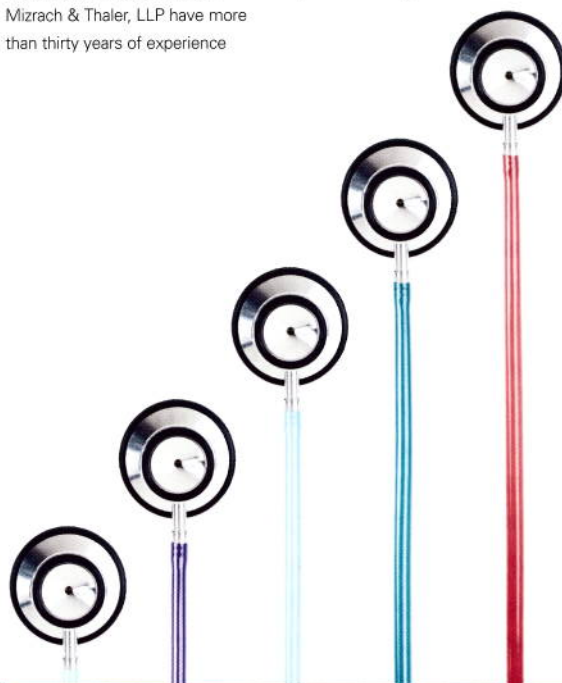
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