West Coast Ambulatory Surgery Center Seminar

City Club Los Angeles
Thursday, October 2, 2014
7:30 a.m. - Noon

Tools to prepare your ASC for sale and successfully navigate a three-way joint venture and ASC transaction

NOSSAMAN LLP
SECTIONS AGENDA

7:30 – 8:30 a.m.
Registration and Networking Breakfast

8:30 – 9:30 a.m.
Session 1: Preparing an ASC for Sale and Valuation Trends and Issues
Jon Vick, Bill Simon, and Kevin McDonough will discuss preparing an ASC for sale, including timing, strategies to maximize sale price, marketing and key factors in selecting the right buyer. The discussion will focus on the different valuation trends and methodologies used and the key factors that impact valuation, including historical and future earnings, single specialty vs. multi-specialty, in-network vs. out-of-network, physician pool and utilization.

9:30 – 9:45 a.m.
Networking Break

9:45 – 10:45 a.m.
Session 2: The Three Way Partnership – Joint Ventures Among Physicians, Hospitals and Management Companies
James Jackson, Peggy Sanborn, and Dr. Paul Lynch will discuss the key advantages of and considerations in forming a three-way joint venture among physicians, hospitals and management companies. The discussion will cover the roles and responsibilities of each joint venture partner, as well as potential benefits of a joint venture, including reimbursement improvements through managed care contracting, case volume “lift,” exposure to key relationships, joint purchasing arrangements and other cost reductions and efficiencies through management company expertise. The discussion will also include a case study from a physician’s perspective of what changed after the joint venture relationship.

10:45 – 11:00 a.m.
Networking Break

11:00 a.m. – 12:00 p.m.
Session 3: Key Deal Terms and Select Regulatory Issues in ASC Transactions
Robert Mosher and Gregory Cochran will provide insights on the key provisions that go into a purchase and sale agreement and operating agreement and the hot topics that are frequently negotiated, including representations and warranties, indemnification, noncompetition covenants, buy/sell provisions, transfer restrictions, board structure and minority voting rights. The panel will also include a discussion of the Medicare change of ownership process in connection with an ASC sale, as well as a brief overview of key regulatory issues applicable to ASC transactions, including the Anti-Kickback Statute and Stark Law.

All sessions will be moderated by Ron Grace, Partner and Chair of the Corporate Practice Group at Nossaman LLP.
Panel 1
West Coast Ambulatory Surgery Center Seminar

Tools to prepare your ASC for sale and successfully navigate a three-way joint venture and ASC transaction

NOSSAMAN LLP
Preparing an ASC for Sale and Valuation Trends and Issues

- **Jon Vick** – Founder and President, ASCs Inc.
- **Bill Simon** – Senior Vice President, The Bloom Organization
- **Kevin McDonough** – Partner, VMG Health
Preparing Your ASC For Sale

Jon Vick
President, ASCs Inc.
ASCs Inc.’s Services

Consulting firm that advises ASC owners on:

- Valuations, timing and marketing your ASC
- How to get maximum value for your ASC
- Who the best buyers are
- How to get competitive bids
- How to select the best strategic partner
- How to sell/leaseback your ASC real estate
Navigating Your Way

- Timing to go to the market
- How to market your ASC
- Selecting the right buyer
- Due diligence – how to prepare
Sellers’s Goals

Step One: Know Your Goals

- Are all partners on same page?
- What do you want to accomplish?
- Sell minority or majority interest?
- Sell to ASC management company, hospital, or 3-way deal?
- What is meant by “Strategic Partner”?
- Define your growth strategies
Buyer’s Goals

- Step Two: Know The Buyer’s Goals
  - ASC management company = Growth
  - Hospital = relationships, ACO goals

To get the highest value for your ASC you must know how your center will help the buyer achieve its goals.
Timing To Go To The Market

- Good timing for a majority sale:
  - Doctors less than 60 years old
  - ASC is highly profitable
  - ASC has excess capacity = growth
  - Growth strategies have been identified
  - Value has been maximized
How To Market Your ASC

- Know buyer’s and seller’s goals
- Maximize the value of your ASC
- Identify 3 or more potential strategic partners
- Confidentiality Agreements (NDAs)
- Comprehensive package of information
- Meet and present ASC & Partners
- Present ASC growth opportunities
Selecting The Right Buyer

The Right Buyer:

- Will help you achieve your goals
- Will offer a competitive price
- Is “strategic” – i.e. brings growth strategies
- Will help increase distributions
- Will provide “exit strategies”

After meetings, discussing mutual goals, contacting references = clear choice
Due Diligence Process

- Sellers Should:
  - Contact company’s physician references
    - Has the company performed as promised?
  - Check company track record
    - How many failed deals?
    - Why Failed?
  - Are strategic relationships successful?
  - What is company’s long range plan?
“Preparing an ASC for a Strategic Partnership”

Bill Simon
Senior Vice President, The Bloom Organization
The Bloom Organization

Services:

- Represent ASC physician owners in seeking out strategic partners (sell >50% ownership to health system and/or corporate partner)
  - Increase utilization through physician syndication
- Development and management

- ~$350M enterprise value in 2014
- Licensed investment banker
- Offices in San Diego, Miami, Chicago and New Jersey
- Represent transactions in all states
Increasing Value: Focus on the EBITDA, Not Multiple

<table>
<thead>
<tr>
<th></th>
<th>Unadjusted Model</th>
<th>Higher Multiple</th>
<th>Higher EBITDA</th>
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<tbody>
<tr>
<td>EBITDA</td>
<td>$5,000,000</td>
<td>$5,000,000</td>
<td>$5,357,143</td>
</tr>
<tr>
<td>Multiple</td>
<td>7.0</td>
<td>7.5</td>
<td>7.0</td>
</tr>
<tr>
<td>Value</td>
<td>$35,000,000</td>
<td>$37,500,000</td>
<td>$37,500,000</td>
</tr>
<tr>
<td>51% Price</td>
<td>$17,850,000</td>
<td>$19,125,000</td>
<td>$19,125,000</td>
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Trying to convince a buyer to pay an above market multiple is an ineffective approach to negotiation.

Proving a model with higher EBITDA is more likely to get you the higher price.
The Value Creators

Easily addressed near term
1. Recruiting New Partners

Long term value creation
2. Improve Managed Care Contracts
3. Improving Collections Process
4. Reducing Supply Cost

The best way to immediately add value prior to a sale

These tend to take a long time to achieve and/or are what most ASCs have already been trying to do. A strategic partnership is often the best way to address.
The Recruiting Process

- Developing a robust list of doctors from ALL specialties in the community
- Doctor to doctor introductions
- Data gathering / analyzing the potential
- Importance of 3rd party

And …….
Show Me The Money!

EBIT DA 5,000,000$     6,000,000$         1,000,000$

Multiple 7.0                  7.0                      -

% So ld 51.0% 51.0% 0.0%

Price 17,850,000$   21,420,000$       3,570,000$

Price Per Share 350,000$        420,000$            70,000$

New Doctor Price (750,000)$      1,071,000$         321,000$

New Doctor Own 5.0% -2.6% 2.5%

Current Doctors Get 18,600,000$   20,349,000$       1,749,000$

Photo from Jerry Maguire courtesy of TriStar Pictures
Strategic Partnership Increasing EBITDA

- $300,000 Expenses
- $1M Case Volume
+ $1M Managed Care Lift

$5M EBITDA

Joint Venture

$7.3 Million

Operational Expertise
Strategic Alliance
Payer Contracting
How Value Created by Strategic Partnership Changes the “Multiple”

<table>
<thead>
<tr>
<th></th>
<th>Before Partnership</th>
<th>After Partnership</th>
<th>Change</th>
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<tbody>
<tr>
<td>EBITDA</td>
<td>$ 5,000,000</td>
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<td>$ 2,300,000</td>
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<tr>
<td>Amount Sold</td>
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</tr>
<tr>
<td>Multiple</td>
<td>6.5</td>
<td></td>
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<tr>
<td>Price</td>
<td>$ 16,575,000</td>
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**Effective Multiple**

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<tr>
<td>Δ Distributions</td>
<td>$ (1,423,000)</td>
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<tr>
<td>Price</td>
<td>$ 16,575,000</td>
</tr>
<tr>
<td>Multiple</td>
<td>11.6</td>
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A Fair Market Primer – How and Why?

Kevin McDonough
Partner, VMG Health
VMG Health provides transaction advisory and valuation services solely in the healthcare industry:

- The largest and most experienced dedicated healthcare valuation/transaction advisory firm in the United States
- Exclusively focused in healthcare valuation and transaction advisory services
- More than 20,000 valuation and transaction advisory engagements since inception
- Clients include non-profit and for-profit health systems throughout the United States in addition to ancillary health services providers, physician organizations and health plans
- The VMG team performs over 1,500 engagements each year
Players In The Acquisition Market

- In the current ASC market, who are the buyers?

**Acute Care Hospitals**
- Broader consolidation trend
- Easy reimbursement arbitrage
- Goals of system cost reduction

**ASC Management Companies**
- Interested in expanding existing market presence
- JVs w/ Hospitals

**Competing ASCs**
- Merger Scenarios
  - Successful ASCs absorbing struggling ASCs

**Physician Owned Hospitals**
- Limited, Niche expansion play
- Limited by Capacity / Ownership Restrictions
### Benefits of Obtaining a FMV

<table>
<thead>
<tr>
<th>Compliance</th>
<th>Knowledge</th>
<th>Credibility</th>
<th>Independence</th>
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<tbody>
<tr>
<td>• Stark Law</td>
<td>• What is my center worth?</td>
<td>• Thousands of valuations</td>
<td>• No emotional involvement</td>
</tr>
<tr>
<td>• Anti-Kickback</td>
<td>• 2\textsuperscript{nd} Opinion</td>
<td>• Both sides of the table</td>
<td>• Just the facts</td>
</tr>
</tbody>
</table>

- Over-riding purpose for most ASC Valuations is compliance with the Federal Anti-Kickback Statute
  - No specific application of Stark Law or limitations on physician ownership since outpatient surgery is not a designated health service (DHS)
  - Statute prohibits offer, solicitation, payment or receipt of remuneration if intent is to induce referrals of patients or other business paid for in whole or in part by a federal program
  - Includes certain exceptions, or **Safe Harbors**, that allow certain conduct that would otherwise violate the statute, one of which is **ASC Safe Harbor**
## Approach To Determine FMV

### Asset Approach / Cost Approach
- Cost to Recreate the value of the tangible assets of the business.
- Essentially provides an overall “floor” value for the ASC.

### Market Approach
- Comparable transactions or public company valuation multiples
- Multiples Analysis – generally EBITDA for when valuing ASCs

### Income Approach (DCF)
- “Discounted Cash Flow” Analysis
- Value based on projected earnings and risk of the specific center
Approach to Determine FMV

Keys to Value – Not all ASCs are created equal…

- **Future Cash Flow** – The ability of the ASC to generate cash flow to the investor after all operating expenses, capital requirements, and debt service

- **Risk** – The likelihood of projected levels of cash flows realized given the operating and strategic environment under which the ASC operates

Valuation is not a one-size fits all – each ASC has unique growth and risk characteristics
Approach to Determine FMV

- Primary Factors Affecting Future Cash Flow
  - Growth Potential
  - Ownership Flexibility
  - Facility Capacity
  - Case Mix / Service Line Mix
  - Market Patient Demographics
  - Physician Employment in the market
  - Historical Performance Trends
  - Historical Recruitment Efforts/Ability
  - Payor Mix – Mgd Care Strength
Approach to Determine FMV

- Primary Factors Affecting Risk
  - Facility & Equipment Age/Condition
  - Financial Leverage (Debt Load)
  - Legal/Partnership (Non-Compete)
  - Healthcare Reform
  - Physician Diversification
  - Barriers to Entry (CON)
  - Service Line Diversification
  - Reliance on Non-Owner Physicians
  - Market Competition
  - Out-of-Network Exposure
  - Stable Past Performance (Longevity)
Observed Valuation Trends

Valuation Methodologies

- **Cost Approach**
  - Provides a Floor for Value – Tangible Assets + Identifiable Intangibles

- **Income Approach**
  - Discounted Cash Flow Value – Measure Future Benefits of Ownership

- **Market Approach**
  - What are Transaction Values of Comparable Companies

Valuation Impact – Last 12 Months

- **Stable**
- **Stable/Down**
- **Up**

*Fair Market Value Opinion should Consider these Three Approaches to Value – the forces driving these approaches are dynamic*
Observed Valuation Trends

- Demand for Acquisitions is High
  - Frothy stock market – particularly for healthcare
  - Need for ASC management companies to exhibit growth
  - Diminished ability to pursue growth through de novo development
  - Same center performance does not provide growth investors expect
  - Market consolidation strategies are being pursued aggressively
  - Hospitals are joining management companies in the buyers market
  - ASC attracts significant interest from private equity due to their high cash flow generating ability
Observed Valuation Trends

- Buyers are Keenly Aware of Their Own Company Valuations

Source: S&P Capital IQ
Control Multiples have widened and trended up slightly in last 1-2 years.

Minority multiples have Declined and Widened.
Questions?
How to Increase the Value of Your ASC

By Doug Goldfarb and Jon Vick/Beckers ASC Review, June 19, 2014

Each year many ASC physician-owners seek to sell interests in their centers for a variety of reasons. The reasons range from exit strategies for retiring partners to attracting a strategic partner that will improve the financial performance of the center and increase distributions to the partners, or just to take some money off the table while selling prices for ASCs are high. Whatever the reason for the sale, there are steps you can take beforehand to significantly increase the value of your center and make it more attractive to multiple buyers so they will compete to invest and thus increase the selling price.

Since the value of your center is directly tied to your center’s profitability, anything you do to improve your center’s bottom line will increase the value of your center. Here are strategies that, if successfully executed, will accomplish this:

Improve your managed care contracts:
• Are you negotiating new contracts when old contracts expire? Do not allow “evergreen clauses” to automatic extend existing contracts = lost revenue
• Compare health plan contracts to each other to determine which health plans are below market rate and take action to renegotiate.
• Determine rates for high volume cases by specialty and compare health plans rates to Medicare – should be at least 160% to 180% of Medicare.
• Carve outs for implants at cost or cost plus - especially for Orthopedics, Podiatry, and Gyn specialties - will greatly improve profitability for these cases
• Carve outs of high volume cases from grouper rates will ensure greatly improved profitability of these cases

Recruit new physicians
• Identify targeted specialties for your center to eliminate a shotgun approach
• Use center’s resources for introduction to targeted specialties and physicians, referrals from current Partners for targeted specialties, and referrals from supply vendors.
• Have shares available for newly recruited physicians as incentive to maintain loyalty to center - may need to do syndication.
• Develop forward-looking proforma and term sheet to show prospective Partners the value of their investment in the center

Know your case costs and how to reduce them
• Maintain accurate financial statements that reflect your cost per case by specialty – have a tool to monitor your cost
• Create a weekly report to monitor hours and supply cost per case, and overtime to reduce operations costs
• Adjust daily case schedule to consolidate rooms to reduce staffing cost
• Overlap nursing staff in 2 shifts to cover afternoon cases to eliminate overtime

Improve your billing and collections
• Coding is key to reimbursement - use a professional coder especially for Ortho and DPM
• Monitor delays in coding & billing of claims
• Research, correct and/or eliminate delays in operative reports beyond 4-5 days
• Determine collectability of accounts over 90 days and take action
• Monitor accounts with no payment transaction over 60 days – re-bill accounts every 30 days to reduce delays in payment

Reduce your supply cost
• Become member of a Group Purchasing Organization (GPO) to realize significantly lower costs, especially on implants
• Standardize implant vendors to 1-2 vendors for each specialty to get preferred vendor pricing for volume.
• Obtain implants on consignment to lower implant inventory costs
• Implant carve-outs ensure implant cost is captured in health plan reimbursements

Know the value of your ASC business and real estate
• How will your ASC business be valued?
• What criteria go into valuing your ASC business?
• Value of a minority interest vs. a majority interest
• How will your out-of-network cases impact value?
• What multiples are being offered for similar centers?
• What will be offered for your center?
• What is the value of your ASC/MOB real estate

Successfully executing these strategies and knowing the answers to these questions will enable you to negotiate from a position of strength. If the strategies above are successfully executed you will greatly increase your center’s profits and the value of your center. ASCs are valued based on a multiple of earnings, every $1 earnings increase = a $7 increase in ASC value.

To maximize the value of your center and to have a choice of strategic partners you should seek partnership proposals from at least 3-4 of the 30+ ASC management companies [and the local hospital]. This allows you to select the Partner(s) that will best help you achieve your goals and gives you negotiating leverage to obtain the highest price and best terms.

ASCs Inc., has assisted in development, merger, and strategic acquisition transactions for over 250 physician-owned ambulatory surgery (ASCs), endoscopy centers (ECs) and surgical hospitals since 1984. Jon Vick and Doug Goldfarb have extensive experience in ASC and EC operations, sales, real estate sales, valuations, and ASC strategic mergers & acquisitions. They can be reached at 760-751-0250 or at e-mail: jonvick2@asc-s-inc.com. More information can be obtained at website: www.asc-s-inc.com
What Do ASC Buyers Look for in Potential Acquisitions?
Q&A With Jon Vick of ASCs Inc.

Written by Carrie Pallardy | February 10, 2014

Jon Vick of ASCs Inc. gives a detailed picture of the ambulatory surgery center buyer's market, what qualities buyers look for in potential ASC acquisitions and how ASC leaders can position their centers to attract the right buyers.

**Question: Who are the primary buyers in the current ASC market?**

**Jon Vick:** The primary buyers are the 30-plus ASC management companies, also referred to as strategic partners because they help ASCs improve their performance through various proven strategies. In our experience over 90 percent of the acquisition transactions for ASCs are initiated by the ASC management companies. Several of the leading ASC management companies will then recruit a hospital partner as a minority (26 percent or so) partner. The center would then be owned 51 percent by the ASC management company and hospital partner together, usually in about equal amounts, and 49 percent by the physicians so the physicians end up owning the largest block, which helps them maintain some control. We recommend that the initial sale be to the management company as these companies value the centers as a multiple of EBITDA or cash flow, the market approach, while hospitals use the income approach (present value of future cash flows) which discounts future cash flow and results in a lower value for the center. The higher value offered by the management companies establishes a higher fair market value for the center and this becomes the benchmark for the hospital's investment.

**Q: Do different buyers look for different qualities in potential acquisitions?**

**JV:** Yes, the goals of the two buyers are very different, as is the culture, and they look for different qualities in their acquisitions. The management companies are seeking situations where they can bring value to the center in the form of recruiting more physicians, increased volume, renegotiating payer contracts, increased revenues, profits, cash flow and increased distributions to the partners. The management companies are business-oriented and are looking for business opportunities. Hospital partners, on the other hand, are relationship-oriented and are seeking relationships with the physicians as potential referral sources, a lower cost facility to augment their ACO, and more in-patient referrals. Hospitals are low margin facilities and they have a "low margin" mind set. The ASC management companies typically achieve EBITDA margins of 30 percent to 50 percent, compared with hospital EBITDA margins of 5 percent to 10 percent. The most productive partnerships we have seen are those that are three-way deals: the physician-owners, an ASC management company partner, whose goal is profitability, and a hospital partner, with contracts that can benefit the ASC. The biggest mistake we see the physician-owners make is to speak with the potential hospital partner first when they should speak with several ASC management companies first, as their corporate partner can help to bring in the hospital partner in a way that is strategically beneficial for the ASC and financially significantly more beneficial for the physician-owners.

**Q: Is there anything ASC owners can do to position their centers as attractive to buyers?**
JV: The most constructive steps ASC owners can take to make their center more attractive to buyers include the following: prepare a sales prospectus that includes at least two full years of financial statements; buy-out "deadwood" physicians who bring few cases and physicians who own shares in other centers; make a list of physicians who are potential new recruits, especially orthopedics, pain management, GI and general surgeons; eliminate out-of-network business and replace with in-network business. Finally, summarize growth opportunities that a strategic corporate partner can execute to increase revenues and profits at the center.

Q: Are there any particular ASC markets buyers are more interested in than others?

JV: Strategic buyers are more interested in the growth opportunities for the ASC than in particular markets, with a few exceptions. Urban and suburban markets are more attractive than rural markets; New York has always been the most difficult market due to the tough certificate of need (Article 28) requirements; reimbursements in California have been cut more than in some other markets.

Q: Are there any factors, common or unexpected, that make ASCs less attractive to buyers?

JV: Centers that rely too heavily of out-of-network or workers comp business are out of favor with buyers as these strategies do not produce sustainable revenue and are under attack by the payers. In addition, no buyer is interested in buying single-OR ASCs or ASCs that do any significant volume of cosmetic plastic surgery. Even two-OR ASCs may not be attractive to buyers if they are small, have limited recovery beds and/or are not expandable.

Q: What should ACS owners look for in potential buyers?

JV: First, ASC owners should interview at least three ASC management companies that have a track record of success with the type of ASC that is being sold. Secondly, the sellers should solicit competitive partnership proposals from these companies so the sellers can see a range of offers, terms and conditions. Third, the sellers should obtain a preliminary plan from the buyers regarding how the prospective buyer would help the center grow, become more profitable and increase distributions. Lastly, the sellers should speak with the references provided by the companies to ensure that the centers already partnered with the companies are getting value for the management services they are receiving from their corporate partner and that the corporate partner is meeting the physician-partners' expectations.

Jonathan C. Vick, the founder and President of ASCs Inc., has assisted in development, merger and strategic acquisition transactions for over 250 physician-owned ambulatory surgery centers, endoscopy centers and surgical hospitals since 1984. He has extensive experience in ASC and EC sales, development, business planning, operations, valuations and strategic mergers and acquisitions. He can be reached at 760-751-0250 or at jonvick2@ascs-inc.com. More information can be obtained at www.ascs-inc.com.

More Articles on Transactions and Valuation Issues: 5 Recent Ambulatory Surgery Center Acquisitions & Partnerships ASC & Hospital Partnerships: Weighing the Pros & Cons 6 Recent Ambulatory Surgery Center Plans, Openings & Expansions

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Questions to Ask
Potential “Strategic” Corporate Partners

BY JONATHAN C. VICK

It is a seller’s market for ASCs. More than 30 ASC management companies and many local hospitals are competing to invest in surgery and endoscopy centers. While the ASC management companies will almost always place a higher value on an ASC than a hospital, a strategy proven to be successful is to first negotiate the best possible deal with an ASC management company to establish the fair market value for the ASC, then let your corporate partner bring the hospital in as a minority, non-managing partner. This results in the best of both worlds: an ASC management company that has expertise in managing ASCs and the goal of increasing profits and distributions, and a hospital partner with potential referrals and better paying contracts.

In most cases, there will be several ASC management companies that stand out as leading potential “strategic” corporate partners for your center based on the needs of the center, the goals of the physicians and the expertise required to increase center profits. While more companies may be interested in investing in your center, it is important that your corporate partner bring more to the table than just cash. Some partnerships fail because of mis-alignment of goals and/or lack of company expertise to help the center grow and increase profits. In fact, some partnerships have resulted in decreased distributions due to lack of adequate management by the ASC corporate partner. So, the first goal of physicians wishing to sell an interest in their center should be to identify several of the best ASC management companies that can help their center grow and become sustainably more profitable. This proven expertise is what a “strategic” corporate partner should bring to the table.

Once the best corporate partner candidates are identified, their interest must be solicited and appropriateness as your partner proven. Here are 12 questions that will help you learn what to expect from the proposed partnership.

1. Our center is seeking a strategic partner that can help build our ASC business and make it substantially more profitable. What strategic advantages do you bring to the table and how will these benefit our center and the physician-partners? What are your company’s proven strengths?

2. What are your expectations from your proposed investment in our center and how will these expectations benefit the current partners?

3. Will you create a business plan for our center and when will a draft be available to review with the partners?

4. What contracts do you currently have in our market and how will these benefit our center?

5. What is your philosophy regarding partnerships with hospitals? Will you be interested in bringing in a hospital as a partner in our center? How will this benefit our center?

6. How will you value our center, and from what date will the valuation be determined? How will you value out-of-network revenue? How will our liquid assets and A/R be treated in the valuation?

7. If the physicians have been receiving a management fee, and/or buying supplies in advance to take advantage of buying opportunities, how will the management fees and/or value of advance purchases be reflected in the valuation of the center?

8. What management services will you provide and how will these benefit our center, and at what cost? What same-store revenue growth have your centers experienced? What bottom line growth, after payment of management fees, have your centers experienced?

9. What will you do to increase distributions to the physician partners? When do you expect to see improved financial results?

10. How and when will new physician partners and new services be added?

11. What control will the physician partners have? (discuss ASC governance and how decisions will be made).

12. What will be the timetable to close once we have signed your letter of intent (LOI)?

Responses to the above questions should be provided in writing by the companies being solicited so the physician partners have a record of what is presented during the meetings leading up to the signing of an LOI. Prior to signing a LOI, we strongly recommend the sellers discuss the experience of other physicians who have partnered with the companies under consideration to confirm the promises made before the LOI is signed were met after the deal was closed.

Jonathan C. Vick, the founder and president of ASCs Inc., has assisted in development, merger, and strategic acquisition transactions for over 200 physician-owned ambulatory surgery (ASCs), endoscopy centers (ECs) and surgical hospitals since 1984. He founded and was a principle shareholder of SurgiCenter Development Corporation (90 ASC partnerships) in 1984 and Endoscopy Center Affiliates (20 endoscopy center partnerships) in 1994. He participated as a corporate partner for a national network of surgery and endoscopy centers that was acquired by a national ASC management company in 1996. Mr. Vick has a B.A. from Hamilton College and an LL.B. from La Salle University. He has extensive experience in ASC and EC sales, development, business planning, operations, valuations and strategic mergers and acquisitions. He can be reached at 760-751-0250 or e-mail: jonvick@ascinc.com. More information can be obtained at www.ascinc.com.
What ASC Physician-Owners Need to Know About ASC Real Estate Sales & Leasebacks

Written by Carrie Pallardy | May 07, 2014

Oftentimes ambulatory surgery center physicians own not only their center, but its real estate as well. Jonathan Vick, founder and president of ASCs Inc., answers questions on successfully selling ASC real estate and obtaining favorable leases for the buildings.

**Question: When does it make sense for ASC physicians to consider a lease back transaction for their center?**

**Jonathan Vick:** It makes sense when the physicians own the ASC/MOB real estate and want to realize a profit from the sale of the real estate. If the physicians own the ASC/MOB real estate, they have probably greatly increased the value of the real estate by operating a successful center on the premises. This is true because the value of the real estate is based on the rent and the rent for successful centers can be at the maximum fair market value, thus greatly increasing the value of the real estate. However, this value is locked up in the real estate and the only way to unlock the profit is to sell the real estate.

There is an excellent market for ASC/MOB real estate and buyers are paying top dollar as there is a scarcity of good properties. The physician-owners can sell the ASC real estate, realize a significant profit, and lease back the ASC at the same rent. The physicians have cash so they can diversify their investments while the value of the ASC and its distributions are not affected.

**Q: Are REITs and private equity firms the primary ASC buyers interested in lease back transactions?**

**JV:** While REITs are a primary buyer of large ASC real estate deals, private equity firms are not typically interested in real estate investments. However, there are a significant number of well-capitalized specialty real estate investment firms that are seeking investments in ASC/MOB real estate. This is because ASC real estate is an attractive investment as ASCs are stable and highly profitable businesses with long time horizons and a willingness to sign long leases that are attractive to the buyers. There are also individual investors who are seeking tax-deferred 1031 exchanges. The physician-owners of ASC real estate can also transact a tax-deferred 1031 exchange so they do not have to pay capital gains taxes on the ASC sales transaction.

**Q: What kinds of lease terms are attractive for both ASC physicians and potential buyers?**

**JV:** In most cases, the sellers want to get the highest price and the buyers want long term income and security. The two parties achieve their goals by establishing terms in the lease agreement that allow each party to get what they want. The physician-owners get the highest price by agreeing to a long-term lease (10 years to 15 years), triple net lease with annual 2 percent to 3 percent rent increases. The buyers get their long term income and the security they are seeking by having the surgery center guarantee a long-term lease.

**Q: How can ASC physicians ensure they are maximizing the value of their center's real estate?**

**JV:** The value of the real estate will be maximized by increasing the rent up to fair market value and by
agreeing to a long-term lease that is guaranteed by the surgery center. For each region of the country there are documented fair market rents for surgery centers.

Q: Are there any situations that could potentially lead to unfavorable lease terms? How can ASC physicians avoid this?

JV: The lease terms should be reviewed by an attorney and/or a CPA to determine if the terms are fair market and if they are fair for the physician-owners.

Q: What are the benefits of a lease back transaction?

JV: The benefits are that the physician-owners can sell their real estate, unlock the profits and diversify their investments while retaining the use, ownership and distributions from the surgery center. The rent they pay, which may be unchanged from before the sale, remains an expense to the business, just as before. The physician-owners have gained from the sale of the real estate and retained all the benefits of the ASC business ownership. Prices for ASC real estate are the highest we have seen in a decade as there is a shortage of good quality properties. Competition to buy pushes the prices up, and the current low interest rate environment enables the buyers to offer higher prices. We are currently in a "sellers market" for ASC/MOB properties. Who knows how long this will last.

Jonathan C. Vick, the founder and President of ASCs Inc., has assisted in development, merger, and strategic acquisition transactions for over 250 physician-owned ambulatory surgery (ASCs), endoscopy centers (ECs) and surgical hospitals since 1984. He has extensive experience in ASC and EC sales, real estate sales, valuations, and ASC strategic mergers & acquisitions. He can be reached at 760-751-0250 or at e-mail: jonvick2@ascs-inc.com. More information can be obtained at the website http://www.ascs-inc.com/.

More Articles on Transactions and Valuation Issues:
ASCs vs. HOPDs: 4 Unexpected Consequences of Rate Equalization
4 Recent ASC Acquisitions, Mergers & Conversions
CON Drama: The Battle Over South Carolina's Program Continues

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Panel 2
The Three Way Partnership – Joint Ventures Among Physicians, Hospitals and Management

- **James Jackson** – Senior Vice President of Development, United Surgical Partners International, Inc.
- **Peggy Sanborn** – Vice President Partnership Integration, Dignity Health
- **Dr. Paul Lynch** – Co-Founder, Pain Doctor
USPI – Dignity Health
Joint Venture Overview

James Jackson
Senior Vice President, United Surgical Partners International, Inc.
USPI Overview

- Industry leader in developing and operating ASCs and surgical hospitals
- Championed model to joint venture with leading health systems & physician partners
- Currently own & operate 219 facilities (2/3 with hospital partner)
- Over $2.25B in 2013 revenues
- Significant infrastructure to support physician and hospital partners
USPI Facilities

USPI operates 219 facilities in the United States

Key Markets

- **Denver**
  - 4 facilities
  - Centura Health Partnership

- **Phoenix/Las Vegas**
  - 11 facilities
  - Dignity Health Partnership

- **Los Angeles**
  - 6 facilities
  - Providence Partnership

- **Kansas City**
  - 6 facilities
  - North Kansas City Hospital Ascension Partnership

- **St. Louis**
  - 19 facilities

- **Chicago**
  - 5 facilities
  - Evanston Northwestern, Adventist Partnership

- **New Jersey**
  - 7 facilities
  - Meridian Health Partnership

- **Nashville**
  - 20 facilities
  - St. Thomas Partnership

- **Atlanta**
  - 6 facilities

- **San Antonio/Corpus Christi**
  - 3 facilities
  - CHRISTUS Health Partnership

- **Austin**
  - 4 facilities
  - Seton Partnership

- **Houston**
  - 19 facilities
  - Memorial Hermann Partnership

- **Dallas/Ft. Worth**
  - 31 facilities
  - Baylor Health Care System Partnership

- **Oklahoma City**
  - 19 facilities

- **Okaloosa**
  - 2 facilities
  - INTEGRIS Health Partnership
Health Systems Partners

USPI partners with some of the nation’s most progressive health systems, providing long-term growth opportunities in surgical space as well as ancillary opportunities.

Robust pipeline provides for additional joint venture and consolidation opportunities.
Traditional JV Partnership Structure

**USPI/Health System JV**
- Dignity Health: 50.1% ownership
- United Surgical Partners International: 49.9% ownership

**Governance:**
- Physician Representation
- USPI/Health System Representation

**ASC**

**Individual/Physician Investors**
- 49% ownership

Must be operated in a manner consistent with tax-exempt status including promotion of health for a broad cross section of the community, adoption of charity care policy, providing access to patients covered by Medicare and Medicaid, and meeting standards of quality patient care that are commensurable with those at Health System.
Dignity Health – USPI
Joint Ventures

- 16 ASC joint ventures
  - Redding, CA (2)
  - Folsom, CA
  - Roseville, CA
  - Grass Valley, CA
  - Stockton, CA (2)
  - Las Vegas, NV (2)
  - Phoenix, AZ (10)

- 2 Orthopedic Surgical Hospitals
  - Phoenix, AZ (2)

- 85,000+ cases in 2013
- 230+ physician partners
# Dignity Health – USPI Joint Venture Results

**Center 1 - Northern California**

<table>
<thead>
<tr>
<th></th>
<th>TTM Pre-Acquisition</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
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<tr>
<td>Cases</td>
<td>5,264</td>
<td>5,605</td>
<td>8,222</td>
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<td>Net Revenue</td>
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<td>$8,557,000</td>
<td>$15,843,000</td>
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<td>EBITDA</td>
<td>$2,754,000</td>
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<td>Net Income</td>
<td>$2,142,000</td>
<td>$2,388,000</td>
<td>$4,408,000</td>
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</table>

- Year 1 – OON transition to INN for large payor while preserving historical level of reimbursement
- Year 2 – Contractual enhancements increase overall net revenue per case
- Year 2 / 3 – Continued rate improvement combined with partnership expansion
## Dignity Health – USPI Joint Venture Results

### Center 2 - Northern California

<table>
<thead>
<tr>
<th></th>
<th>TTM Pre-Acquisition</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cases</td>
<td>3,017</td>
<td>3,425</td>
<td>3,654</td>
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<td>Net Revenue</td>
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<td>EBITDA</td>
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<tr>
<td>Net Income</td>
<td>$1,671,000</td>
<td>$2,245,000</td>
<td>$4,235,000</td>
<td>$3,632,000</td>
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</table>

- Year 1 – Dignity-negotiated addition of medical group product center had been unable to access historically
- Year 1 – OON transition to INN for large payor while increasing historical level of reimbursement
- Year 2 – Contractual enhancements continue to increase overall net revenue
Dignity Health Today

Peggy Sanborn
Vice President Partnership Integration,
Dignity Health
Dignity Health Today

One of the largest health systems in the nation

20
400+
9,000

State Network
Care Sites
Affiliated Physicians

$16
56,000
39

Billion in Assets*
Employees
Acute Care Hospitals

193
109%
44%

Days Cash*
Cash to Debt*
Debt to Cap*

530,000

Attributable Members
(Including 270,000 capitated lives)

Providing integrated, patient-centered care to more than two million people annually

Diversified service offerings and partnerships supporting population health

Growing national footprint with U.S. HealthWorks

Hospitals in Arizona, California, and Nevada
Approach to Growth

Emerging technologies, unique care models, and innovative partnerships have potential to accelerate changes in care delivery, grow and differentiate our integrated delivery networks, and dramatically improve the patient experience.

Our approaches include:

- Acquisitions and joint ventures
- Partnerships and co-development
- Company creation or incubation
- Co-investing or other financial alignment
- Intellectual property/commercialization
Focus on Diversification and Innovation

Partnerships and Investments

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<th>Expanding Access</th>
<th>Next Generation Analytics</th>
<th>Physician Alignment</th>
<th>Digital</th>
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<td>PriMed</td>
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<td>SOUND Physicians</td>
<td>PROPELLER HEALTH</td>
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<td>U.S. HealthWorks</td>
<td>evariant</td>
<td>Hill Physicians</td>
<td>AIRSTRIP GLASS</td>
</tr>
<tr>
<td>A Dignity Health Member</td>
<td>MOVING HEALTHCARE AHEAD™</td>
<td>You need it, we deliver.</td>
<td></td>
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<tr>
<td>New Primary Care Group*</td>
<td>SAS</td>
<td>Multi-Specialty Medical Group*</td>
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<tr>
<td>Freestanding ED Company*</td>
<td>United Surgical Partners International</td>
<td>ACN</td>
<td>Arizona Care Network</td>
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* Confidential transactions in progress
Priorities and Approach

Dignity Health is repositioning the organization through continued integration, growing and diversifying sources of revenue and profitability. Priorities are:

*Integrated Delivery Networks*

*Diversified Assets*

*Employee Health/Occupational Medicine*

Dignity Health seeks to partner with others to leverage best-in-class expertise and capital.
Importance of Brand Identity

In a consumer-focused health care world, **reputation** and **quality experience** are vital

**Strong brands**

- Build **customer loyalty** and preference
- Influence **consumers’ response** to services
- Deliver consistency to the customer
- Attract **passionate employees**
- Communicate **core values** and **quality** of services
- Differentiate the organization
- Acquire **loyal customers** who recruit more customers
- Create stronger **employee engagement**

**Elevate performance for better clinical outcomes and patient experience**

Hello humankindness™
Value of USPI Partnership

- Best in class provider for development and management of ASCs and Specialty Hospitals in partnership with Physicians and Health Systems
- Focus on quality, safety, patient experience and partner satisfaction
- Shared values and culture with Dignity Health
- Innovative development and operational teams who effectively collaborate with the local service area teams to continuously advance the care provided in our JV sites
The Physician Perspective

Dr. Paul Lynch
Co-Founder, Pain Doctor
Pain Doctor – Who We Are

ARIZONA PAIN
WE CHANGE LIVES HERE

NEVADA PAIN
WE CHANGE LIVES HERE

Holistic Pain

PAIN DOCTOR
WE CHANGE LIVES HERE

SENTINEL LABS

PainDoctor.com

Boost Medical

MOUNTAINVIEW
SURGERY CENTERS

ARIZONA PAIN STEM CELL INSTITUTE
A DIVISION OF ARIZONA PAIN SPECIALISTS
## Overview

### Pillars
- Mom or Dad Test
- Partnerships
- Outcomes
- Growth through Analytics
- Consumer Behavior

### Footprint
- 12 Locations in Arizona, Nevada, and Colorado
- 5 Partnership Surgery Centers
- 13 Physicians, 15 MLP, 6 Chiro
- 13,500 patient encounters per month

### Operating Model
- Mom or Dad Test
- Comprehensive, Integrated Centers
- Focus on Eliminating Unnecessary Opioid Medications and Unnecessary Surgery
- Focus on Outcomes – Global Pain Scale & Full-time Research Ph.D.

### Growth
- Acquire and Partner with great Clinicians across the country to build the most influential Pain Platform in the United States
- Partner with Industry to create optimal value

### Support Businesses
- Boost Medical
- Sentinel Labs
- Holistic Pain
- PainDoctor.com
Value Creation Lever: Why Partner with an ASC?

- Stability
- Sustainability
- Cost

- Market Dynamics
- Out-of-Network
- Existing Infrastructure
De-valuing Lever: Challenges to Establishing a Successful JV

- Lack of Financial Alignment
- Lack of Physician Commitment
- Efficient Decision-Making
- Lack of Clear Vision for the Future of the Partnership
Value Creation Lever: Physician Commitment

Commitment

- “It’s the last case not the first case that matters”
- 100% of case Volume through meaningful ownership
- Stickiness at the Center
- Customer Service
Questions?
Panel 3
Key Deal Terms and Select Regulatory Issues in ASC Transactions

- Bob Mosher – Partner, Nossaman LLP
- Gregory Cochran – Partner, Nossaman LLP
Key Deal Terms in ASC Transactions

Bob Mosher
Partner, Nossaman LLP
Key Deal Terms

- Overview of transaction structures (equity vs. asset deal)
- Key deal terms in purchase and sale agreements
  - Escrows/holdbacks/offsets (working capital, indemnity)
  - Working capital adjustment to purchase price
  - Representation and warranties (clean vs. knowledge/materiality qualifiers)
  - Indemnity (baskets, cap, survival)
Key Deal Terms
(continued)

- Key provisions in operating/partnership agreements
  - Capital calls
  - Buy/sell provisions – triggering events, purchase price
  - Transfer restrictions
  - Management – board composition and structure
  - Voting rights
  - Noncompetition covenant – separate from purchase agreement noncompete
Key Deal Terms
(continued)

- Dilution
- Safe Harbors for physician owners
- Distributions – must be proportionate to ownership, not based on referrals
Select Regulatory Issues in ASC Transactions

R. Gregory Cochran, MD, JD, Partner, Nossaman LLP
Overview of ASC Certification and Licensure

- ASCs with no physician owners: licensed by the California Department of Public Health (CDPH)
- ASCs with partial or full physician ownership: not subject to CDPH licensure (2007 Capen decision), but statutes require accreditation by AAAASF, AAAHC, TJC, HFAP or IMQ (pursuant to Medical Board jurisdiction) or CMS-certified
The CHOW Regulation

42 CFR §489.18: a change of ownership (CHOW) includes:

- Removal, addition or substitution of a partner (unless partners expressly agree otherwise);
- Transfer of title and property;
- Merger or consolidation of corporation; or
- Leasing of all or part of facility (as to the leased portion)
The CHOW Regulation and ASCs

- Medicare Program Integrity Manual, §15.7.8.3: “Though ASCs . . . are not mentioned in 42 CFR §489.18, CMS generally applies the change of ownership provisions of §489.18 to them.”

- CMS contractor reviews the sales agreement and treats the ASC as a “brand new supplier” if new owner is not accepting assets and liabilities of prior owner.
The CHOW Process

- ASCs may submit CMS-855B CHOW applications up to 90 calendar days before the transaction, but CMS will not process prior to the effective date
- Time for processing varies based on completeness of application, current agency workload, and other factors
Transferring the Provider Agreement

- 42 CFR §489.18(c): “When there is a change of ownership . . . the existing provider agreement will automatically be assigned to the new owner.”

- Assigned agreement subject to all existing terms and conditions, including any plan of correction in force.
Why Assume the Provider Agreement?

- New assignees assume the ASC’s current liabilities
- New owners also benefit from the ASC’s ongoing cash flow
- If buyer does not assume existing provider agreement, certification as a “new” ASC can take time and requires a new survey, and cash flow crunch will ensue
Dos and Don’ts

- **Do** have a collegial relationship with regulators
- Some court cases and settlements have held a new owner responsible for prior owner’s civil monetary penalties, False Claims Act (FCA) liabilities and Medicare overpayments
- **Don’t** purchase an ASC without ample due diligence
Buyer Beware: Due Diligence

- Buyers should learn whether the ASC has been subject to any fraud/abuse allegations
- Buyers should negotiate for indemnity protection under purchase agreement for assumption of Medicare liabilities
The Anti-Kickback Statute

- 42 U.S.C. § 1320a-7b prohibits:
  - the exchange (or offer to exchange)
  - of anything of value
  - to induce or reward the referral of federal health care program business
Navigating the Data Room

- Buyers should carefully review ASC’s existing business practices for Anti-Kickback Statute violations
- Though harder to prove than Stark violations, AKS violations can occur anywhere in the delivery system
Navigating the Data Room
(continued)

- The ASC purchase *itself* may raise risk (example: hospital and referring physicians as partners)
- Ask: is any person or entity in the deal in a position to make referrals to any other person or entity in the deal?
Navigating the Data Room
(continued)

- Buyers and their counsel should carefully examine seller’s records for signs of FCA violations or billing irregularities
- Warning signs of fraud: up-coding, unbundling, ghost patients, lack of medical necessity
Navigating the Data Room
(continued)

- All arrangements between providers (e.g., medical director, equipment leases, facility leases, anesthesia PSAs, lithotripsy provider agreements, etc.) must be fair market value

- Stark is of lesser concern because it only targets designated health services, which ASCs generally do not provide
Questions?
Speaker Bios
SPEAKER BIOGRAPHIES

Speakers listed in alphabetical order

Gregory Cochran  
Partner, Nossaman LLP  
Gregory Cochran is a physician/healthcare attorney with broad experience in transactions, regulatory counseling, facility licensing law and in legal issues unique to hospitals, foundations, surgery centers, clinics and physicians. His work is informed by more than a decade of experience as an emergency medicine physician, allowing Mr. Cochran the opportunity to offer a deep understanding of the legal issues impacting his clients through first-hand industry experience.

Ron Grace - Moderator  
Partner, Nossaman LLP  
Ron Grace is Chair of the Corporate Practice Group at Nossaman LLP and represents emerging and established companies as transactional and general corporate counsel with respect to a wide variety of business transactions. His work includes mergers and acquisitions, financings, private placements of debt and equity securities, general contract, securities and healthcare law. A significant portion of Mr. Grace’s clients are involved in the healthcare industry. Mr. Grace has extensive experience in representing management companies, physicians and health systems in all aspects of ambulatory surgery center transactions, including syndications, due diligence, advising on transaction structure, drafting and negotiating transaction documents, joint ventures and compliance issues.

James Jackson  
Senior vice President, United Surgical Partners International  
James Jackson currently serves as Senior Vice President, Development for United Surgical Partners International. From 2003 through 2006 Mr. Jackson served as Senior Vice President, Operations for USPI’s Pacific Division. Prior to 2003, Mr. Jackson was responsible for de novo developments and physician partnerships within USPI’s development organization. He joined the company in September 1998 as Vice President of Sales, where he developed sales and marketing programs for ambulatory surgery centers. From 2000 to 2002 he served as Vice President of Operations with operational responsibility for ambulatory surgery centers within USPI’s Eastern Division.

Dr. Paul Lynch  
Co-Founder, Pain Doctor  
Dr. Paul Lynch is a Double-Board Certified and Fellowship Trained Interventional Pain Physician, who has dedicated his life to the eradication of pain. He is passionate about diagnosing the most complex pain conditions and treating those patients with the most innovative therapies, including Stem Cells Injections and spinal cord stimulation. He currently practices in Scottsdale, Arizona and is the cofounder of Arizona Pain, Nevada Pain, Colorado Pain, PainDoctor.com, Holistic Pain and Boost Medical. Dr. Lynch is a member of several professional societies including ASIPP, ISIS, and AAPM. Dr. Lynch is also passionate about passing on his knowledge about the business of medicine through Boost Medical. Boost Medical focuses on growing and developing practices through lead generation and surgery center development as well as practice acquisition.
Kevin McDonough  
Partner, VMG Health  
Kevin McDonough is a partner at VMG Health and is based out of the Dallas office. During his tenure at VMG, Mr. McDonough has provided valuation, transaction advisory, feasibility, and operational consulting services to the firm’s healthcare clients. His clients include acute care hospitals and health systems, ambulatory surgery centers, surgical hospitals, oncology centers, diagnostic imaging centers, dialysis centers, home health agencies, physicians groups, physical and occupational therapy centers, long term care facilities, and numerous other ancillary healthcare service businesses. In addition, Mr. McDonough has served as a consultant in the formation and development of numerous physician-hospital joint venture initiatives.

Robert Mosher  
Partner, Nossaman LLP  
Robert Mosher is experienced in healthcare law, mergers and acquisitions, partnerships, securities and business transactions. His clients include large managed care provider groups and facility-based companies. Mr. Mosher represents corporations, limited liability companies and partnerships in acquisition transactions and in raising capital by the issuance of securities in private placements.

Peggy Sanborn  
Vice President, Partnership Integration, Dignity Health  
Peggy M. Sanborn is the Vice President of Partnership Integration at Dignity Health (formerly Catholic Healthcare West). Ms. Sanborn is responsible for ensuring effective transitions from agreement to implementation related to new partnerships and acquisitions for Dignity Health. She supports the effective integration, where appropriate, of new affiliates. Ms. Sanborn also is actively involved in the identification of diversified growth opportunities, including negotiations, valuation and related activities. She leads the System activities related to acquisitions, divestitures, joint ventures, integrated service line programs, management agreements and other portfolio development opportunities.

Bill Simon  
Senior Vice President, The Bloom Organization  
Bill Simon has developed, managed and syndicated surgery centers on the West Coast for over 20 years and has earned the reputation of one of the leading surgery center experts. In addition to developing numerous physician joint venture surgery centers over this time, he is also nationally recognized authority on all aspects of the surgery center business and leads the Bloom Organization efforts for the Western US.

Jon Vick  
Founder and President, ASCs Inc.  
Jon Vick, the founder and President of ASCs Inc., has assisted in development, merger, strategic acquisition and real estate sales transactions for over 250 physician-owned ambulatory surgery (ASCs), endoscopy centers (ECs) and surgical hospitals since 1984. He has extensive experience in ASC and EC sales, development, business planning, operations, valuations, and strategic mergers & acquisitions. He has 30 years of experience in healthcare facility development, business planning, operations, valuations, and mergers, sales & acquisitions, and sale of ASC/MOB real estate. Since 1998 ASCs Inc. has assisted and advised owners of over 100 ASCs and ECs to value their businesses and in structuring beneficial strategic partnerships.