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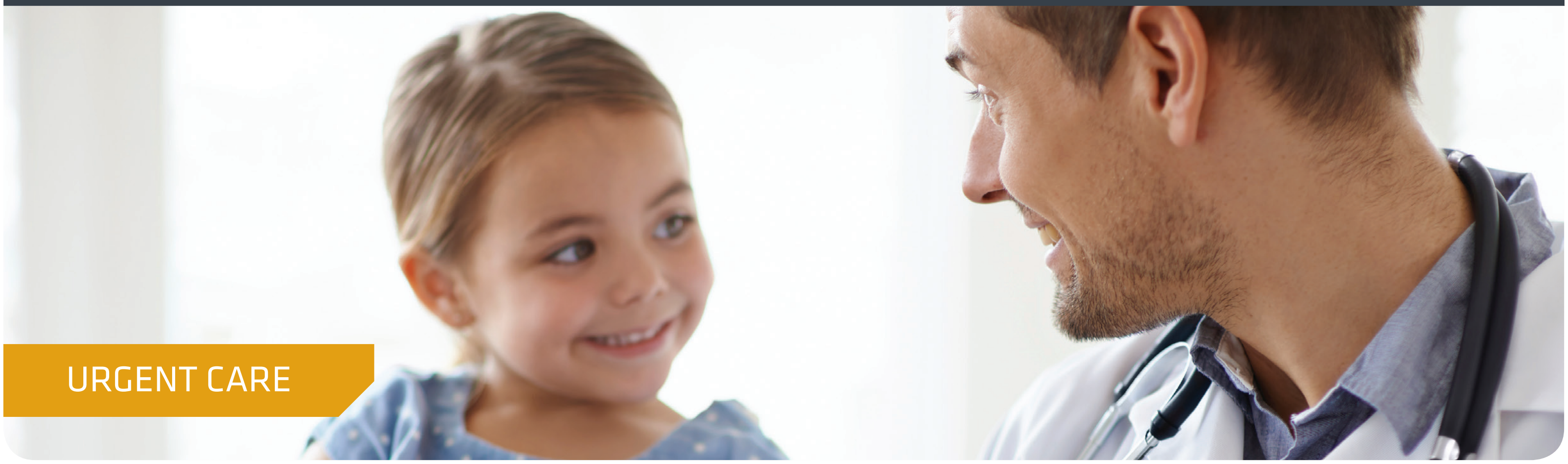

URGENT CARE

SPECIAL EDITION

HOW TO INCREASE THE VALUE OF YOUR URGENT CARE CENTER

At their very core, all valuations are a function of INCOME, GROWTH, and RISK.

Those multiples you hear about, that are whispered in board rooms choked with cigar smoke and coffee stained spread-sheets? They're merely a reflection of risk and growth: the lower the risk that the business may deteriorate, or the greater its growth potential, the higher the multiple. And since you apply that multiple to income (typically earnings before interest, taxes, depreciation, and amortization – EBITDA), the greater the income, the greater the value.

Tweak any of these levers, you're likely to generate a higher purchase price.

Strategies to Increase EBITDA

This one is fairly self-evident – increase revenues and/or reduce costs, you increase EBITDA.

On the revenue side of the ledger you can add locations; increase visits per day; optimize coding (appropriately); develop niche services such as occupational medicine, pediatrics, allergy therapy, performance coaching, nutrition and weight loss, mental health crisis intervention, medical spa services, clinical trials, concussion care, travel medicine, and alternative treatments (i.e. acupuncture, massage therapy).

As for expenses, you can deploy cost-saving technologies; optimize the mix of physicians and advanced care practitioners; offer telemedicine to refine staffing levels and flex up capacity as needed; evaluate group purchasing options and more.

When it comes to building income in urgent care, there are many ways to skin a CAT scan.

That said, it's important to bear in mind that, from a mergers and acquisitions perspective, all revenues and earnings are not created equally. For example, if you added a retail drug operation to your center, you may very well increase revenues and profits. But with most buyers targeting more "pure play" urgent care or occupational medicine, the product extension would add little value.

The trick then is to increase EBITDA without wandering too far from the core value proposition of urgent care – fast, convenient, consumer-friendly, extended hours access to high quality medical care at a lower cost, and far greater patient satisfaction than a visit to an emergency room.

Strategies to Increase Sustainable Growth

First, don't overlook the word sustainable. A one-time surge in volume and revenues, that is not clearly a result of (a) specific, (b) repeatable, and (c) institutionalized initiatives, will add little to value.

So in evaluating growth, what are the kinds of things urgent care buyers are looking for?

- A track record of successful **de novo start-ups.**
- A "portfolio" of centers that include **early stage, revenue producing units,** as well as mature operations that give buyers a glimpse into the growth path likely to follow.
- Experience in identifying, acquiring, and integrating **acquisitions** – particularly underperforming providers that management has successfully turned around.
- Locations with **attractive and growing demographics** – particularly young families or newly covered health care insurance beneficiaries that may not have established relationships with primary care physicians.
- Revenue producing **specialty products and services** (see strategies to increase EBITDA above) that not only produce growth on their own, but could potentially be rolled out across a buyer's centers.
- **Innovative partnerships and contract relationships** with payors, employers, ancillary health care providers, schools, and others that can be expanded and mined to generate additional revenue sources.
- A multi-faceted marketing program that includes **"executive sales"** efforts to explore and develop these types of relationships.

Growth and timing. While you want to leave buyers room to grow, the question is how much? After all, if you capture much of the growth yourself, you may not receive as high a multiple, but with greater income to multiply, you may still come out ahead.

To tackle this question, we break down growth trends into three blocks: Hyper-Growth, Market Growth, and Growth.

When your business is in **hyper-growth,** it's generally growing more than 25-30% or more per year. While quite attractive to buyers, they rarely juice their multiples high enough to reflect adequately the upside. So you may be better off capturing some of this potential before going to market.

At the other end of the spectrum is market growth. In this phase, you're growing (or not growing) at the same rate as the market, but you are not increasing your share. Generally, we peg this rate at plus/minus 10% annual growth. Good, certainly – but not enough to warrant a bump above a "base" multiple.

As you may have guessed, the "best" time to capture an optimal blend of high multiple and high income is when your business is in the growth phase between hyper and market growth (15-20% per year). At this rate, buyers can more confidently boost their multiples. What's more, you've captured a meaningful amount of increased income that ultimately gets multiplied.

Strategies to Reduce Risk

While growth is important, the greatest determinant of value is risk. Lower your risk, increase your multiple of earnings.

Let's examine the relationship between risk and multiples.

Risk can be expressed as a required rate of return – the return an investor would expect to invest in a particular asset. If an asset has little risk, such as a 20 year US Treasury bond (smirk duly noted), an investor wouldn't demand a high rate of return (it has recently been hovering around 2.5%).

But as risk increases, so does the required rate of return. For example, compared to a Treasury bond, an investor would expect a higher rate of return to buy stock in a small cap manufacturer (say 10%). So if the stock price is $10.00 a share, she would be looking for an annual return of at least $1.00 ($1.00 / $10.00 = 10%).

Said another way, in order to generate a 10% return on an asset in this risk class, you would be willing to pay $10.00 in anticipation of earning a buck – or, more simply, a multiple of 10.0 x the expected return (which is also the reciprocal of the required rate of return; 1/.10 = 10.0).

In a highly competitive health care service business that is in the midst of systemic change in the who, how, and how much of reimbursement, you would need an even higher rate of return; perhaps 14% - 20%. So, before any considerations for growth, you might be willing to pay approximately 5.0 -7.0 x EBITDA.[1]

Sound familiar?

Two further points.

1 Required rates of return (a.k.a. assessments of risk) are conceptually based on (a) historical returns on like assets (i.e. similar businesses or related investment opportunities), which (b) are then adjusted for company specific factors.

2 These required rates of return (a.k.a. multiples) are then adjusted for growth before being applied to EBITDA.[2]

So how can an urgent care provider reduce risk, and thereby drive up their valuation multiple?[3]

- Assemble a skilled **management team** so that the go-forward success of the business is not dependent on you.

- Develop **additional locations** to spread performance risk across multiple entities.

- In fact, **size alone is considered a risk mitigating factor,** the theory being that you can't operate a sizeable urgent care business without strong middle management, well established and communicated clinical and customer service protocols, a comprehensive EMR and other business attributes that bolster success.

- In such a consumer oriented business as urgent care, it is difficult to develop a "sticky" (i.e. loyal) – and hence more predictable – patient base. However, if you can create strong institutional **referral relationships,** you can produce more steady revenue streams. So call on schools, employers, independent drug stores, hotels, college residential life departments – any entity that is likely to interact with people that are innately a good fit for the services and convenience urgent care can offer.

- Seek out opportunities that create **barriers to entry.** Any product or service you can provide on an exclusive or semi-exclusive basis restricts competition and creates more income stability. So, where strategically appropriate, work with payors to become an "in-network" provider; look for opportunities to partner in an accountable care organization (ACO) or other coordinated care initiative; seek out preferred provider agreements with employers, schools, or other institutions; become an exclusive provider of a new product or service.

- While strong referral, partnership, and contract relationships are attractive, you'll want to guard against them accounting for a disproportionately large component of your business. Then the upside of revenue stability can turn into a downside of **concentration risk.**

- Where practical, choose an **"industry standard" electronic medical record and billing system.** By doing so, you not only reduce the risk of improper (or sub-optimal) billing, you boost an experienced buyer's confidence that they can seamlessly integrate an acquisition into their own operations.

- Devote resources to proactively improve and monitor **compliance** as it tends to be a go/no-go assessment. Shortcomings rarely result in a price reduction. Rather, they will derail the deal entirely.

- Devote resources to **accurate financial reporting.** It's the first place buyers go to evaluate an acquisition opportunity. If your numbers are a mess, the assumption is that the business may be as well.

- Proactively strive to **minimize turnover.** Urgent care providers that have long-tenured caregivers project stability.

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[1] 1.0/.20 (required rate of return) = 5.00; 1.0/.14 (required rate of return) = 7.14.

[2] This can get a tad complicated. First, in many cases, the initially required rate of return already has expectations of sector growth built into it. So it would only be adjusted for anticipated growth above this level. Second, as growth typically slows over time, the adjustment factor should reflect a long-term horizon. In classic "valuation-speak," this is referred to as "growth in perpetuity," and is frequently pegged to plus/minus 3%. For illustration purposes, if the required rate of return for an investment is 25% (which, before growth, corresponds to a multiple of 4.0), and long term growth is 5%, you would subtract this from the required rate of return (conceptually lowering risk) to get a growth adjusted figure of 20%. This then converts to a higher growth adjusted multiple of 5.0.

[3] Note that in managing risk, we are referring only to areas that are potentially under your control. There are many industry and non-industry risk factors that can impact valuation but are not under your control such as reductions in reimbursement, economic slowdowns, changes in health care delivery patterns, to name a few.

Theory in Practice

While it is certainly possible to synthesize required rates of return and growth expectations into well-informed – and defensible – valuation multiples, this rarely occurs. Except for private equity, that goes through spreadsheets like you go through tongue depressors, the majority of buyers begin with industry rules of thumb (that loosely reflect required rates of return for the sector) and then tweak them up or down to account for growth and risk to divine an unfettered multiple. And the key here is "unfettered."

Nothing draws out a more **refined** assessment of risk vs. return than a divestiture process that is rigorously **considered**, strategically **orchestrated**, and **competitive.**

So, if you want to increase the price of your urgent care business, you've got to work the **math** (income, growth, and risk) – **and**, the **method**.

Call it M&A M&Ms.

Sweet.

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[4] Source: Thomson Reuters, based on number of deals between 2008 and 2014.

FOR MORE INSIGHT INTO THE M&A MARKET FOR URGENT CARE AND WHAT IT MAY MEAN TO YOU, CONTACT OUR URGENT CARE TEAM:

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