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10 Things to Know About Financing for ASCs

Written by Laura Miller | October 31, 2012

Whether ambulatory surgery centers are looking into expansion projects or want to sell their ownership outright, refinancing is a very viable, and potentially lucrative, option for the future.

"The next two years may be good years to refinance because ambulatory surgery centers will be in demand," says Doug Fenstermaker, executive vice president of healthcare at Warbird Consulting Partners. "The demand will increase because of reform and that will push prices up. If the owners believe they are doing fine and continue to run the surgery center on their own, selling them might not be as attractive as refinancing at the lowest rate possible; that's clearly an option on the spectrum."

Here are 10 things to know about refinancing for ambulatory surgery centers.

1. Make the center attractive to financiers. Single and multispecialty surgery centers are seeing the opportunity for growth in the future, which could mean seeking alternative financing. Financiers are looking for good opportunities in every market to help surgery centers grow, but ASCs must present these opportunities as viable ventures for the future.

"We are looking for facilities with good track records, are run properly, in certain healthcare populations and with diverse payor mixes," says Tom Aronson of Monroe Capital. "We want to make sure they are getting paid."

Diverse payor mix is arguably the most important element to ensure you continue to receive payment because if one payor significantly decreases coverage, the surgery center won't be hit too hard.

2. Private equity is interested in acquiring centers. Private investors are interested in ambulatory surgery centers because they are very profitable and represent the future of

healthcare delivery as more efficient and affordable alternatives to the inpatient hospital setting. Some hospitals are already considering private equity options in the face of Medicare cuts, and physician-owned ASCs could be next in line.

"As hospitals start to face cash flow crunches going forward because of Medicare cuts and healthcare reform, they will need more days cash on hand and as a consequence they may need to sell a portion of their assets," says Mr. Fenstermaker. "That might mean selling the physical facility and/or the business inside the center. Private investors have their ears perked up about acquiring these from hospitals."

If done well, these transactions will give the hospitals some economic return. Physician-owned or joint venture ASCs traditionally seek financing from local banks, but they may find a better deal in the private equity market.

"Investors may be bidding ASCs up in order to amass them," says Mr. Fenstermaker. "They might be able to get their money out of these investments. ASCs are relatively low risk healthcare investments, so banks may continue their willingness to loan money if there is a good relationship between them. Otherwise, financing in private equity might make more sense."

3. Investment bankers can help struggling centers. When surgery center owners don't want to use local banks or private equity options, they should consider investment bankers with a specialization in bonds.

There are a lot of companies willing to lend money or loan money out as debt, and taxable bonds could be used to refinance the center. There isn't much interest rate difference between taxable and tax-exempt bonds; however there are some advantages to using taxable bonds.

"You need an investment banker for taxable bonds, and national or regional investment banks can help with the taxable bonds deals," says Mr. Fenstermaker. "There are new financing options emerging, so owners can start to think more creatively about how to gain access to capital."

An advantage of non-traditional financing, such as taxable bonds or leveraging assets, is that owners may be able to move past more the more restrictive tax-exempt bond covenants.

"The thing to do is not just borrow the money, but think about the 'strategy of' borrowing the money," says Mr. Fenstermaker. "The less restrictive rules the better in order to preserve future flexibility."

4. Calculate financial performance and return on investment opportunities. Before moving forward with refinancing options, surgery center owners should conduct a thorough financial forecast based on historical information and return on investment opportunities. If the surgery center is well managed it should have positive cash flow and ROI, which would make it a prime candidate for financing.

"They need to do a competent job of financial forecasting and conduct an analysis of where they stand and where they would like to be," says Mr. Fenstermaker. "They should have a clean

balance sheet as the lenders/investors will conduct a thorough due diligence and ask a lot of questions."

5. Financial information must be organized. It will be important for ASC owners to organize their financial information and present it logically to lenders in a language non-healthcare people will understand. This means the books and records must be in good shape, but they must also have a clear summary of the payor mix, types of services provided at the center and the ASC's financial performance.

"If they are going to look towards growth, they have to have a good sound business plan and business model put together," says Mr. Aronson. "Many times that falls outside what inherently a surgeon does best and that's not their expertise. It might be beneficial to them to hire and contract out a third party debt placement advisor that speaks the financial language and can tell a story in a way that a financial source can understand."

6. Focus on growth opportunities. Many financiers today are looking for growth opportunities, and there are several within the healthcare sector. Look at your own market and find potential for your ASC to grow (a focused market and demographics analysis). If possible, present this information to potential financiers along with the center's financial information.

"I think financial buyers in general are looking for growth opportunities, and today the healthcare space is deemed a growth sector," says Mr. Aronson. "ASCs are a more efficient way to perform medical procedures. Financiers are looking for strong management and a good payor mix."

Financiers will also consider your location to make sure growth won't saturate the market or dry up after a few years.

7. Beware of taking on too much risk from investors. In some cases investors or lenders trying to minimize the risk of the transaction may ask ASC owners to take on too much risk, a dangerous prospect if the surgery center fails. Beware of signing personal guarantees, which could ruin the surgeon's personal financial records.

"Lenders might want surgeons to sign personal guarantees on the loan, and I would avoid that like the plague," says Mr. Fenstermaker. "If one of the businesses doesn't work, lenders could go to the individual for the money and it could impact their personal finances. It's not a good idea to sign a personal guarantee on any financing deal because it could lead to trouble if something goes wrong."

Make sure the buy/sell agreements are clear, especially for surgeon succession. Surgeons with equity interest will eventually leave the practice — whether by retiring or for other reasons — and need a pathway to sell their shares and transition out of the center. This will be part of the due diligence for any transaction, so have the work done ahead of time.

8. If you are selling the center, create a managed service organization. One model gaining popularity among surgeon groups selling their surgery center to private equity or other investors is the managed service organization model. Under this model, surgeons form a management organization and contract with the private equity firm that purchased their center for

management services.

"In the sale, surgeons might say this is time to get out so they sell their interest but they negotiate an MSO to run it for the private equity firm," says Mr. Fenstermaker. "They not only get the capital from the sale, but they also get ongoing income to run the center."

This is particularly helpful if the private equity firm doesn't have experience operating a surgery center. The surgeons can continue to operate with their expertise and profit from the success of the center. However, surgeons should remember they no longer have control over all aspects of the center after a sale.

"This model means they could have an ongoing annuity of income if they run the clinic properly, but they have bosses (the people they just sold the clinic to) so they should go into that with their eyes wide open," says Mr. Fenstermaker.

9. Financing transactions could impact Medicare coverage. ASC owners must understand how financing impacts the center's ability to receive Medicare coverage. This is particularly important if a non-profit entity is financing with a for-profit entity.

"Whatever the transaction, owners need to understand the impact it will have on CMS reimbursement if they execute the deal," says Mr. Fenstermaker. "There might be regulations impacting the kind of transaction they have. If the ASC is part of a health system and the sale is to a for-profit company, know what the requirements are for the for-profit company so the ASC can continue with Medicare patients."

The surgery centers will need approval from Medicare to continue reimbursement and receive a new Medicare number. "The contract with the hospital won't automatically carry over from the hospital to the new owners," says Mr. Fenstermaker. "You need to get a new contract under the for-profit deal."

10. It takes time to complete the transaction. Surgery center owners can't simply go to the bank, ask for financing, and receive a check the next day. It normally takes a few months to complete the transaction, and that doesn't include pre-planning.

"There are local financial institutions or bank owners you can go to, and there is a whole world of finance companies that can provide growth capital for surgery centers that cannot obtain conventional bank financing," says Mr. Aronson. "Owners should allow at least 60 to 90 days, and it could take up to 180 days if owners are not prepared with the proper financial information."

After you receive the financing, it will take time to draw up the legal documents and perform due diligence. Be prepared for a long process.