Acquiring Cardiology Practices: Key Concepts on Price and Compensation

Becker's Hospital Review Annual Meeting

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Introduction

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Agenda

- Objectives
- Integration motivations; hospital and group
- Practice acquisition considerations
- Physician compensation considerations
- Leadership
- Clinical Co-Management
- Q&A

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Objectives for Presentation

- Cardiovascular integration is dynamic
- Current financial factors
- Future financial factors
- Importance of leadership, decision-making, alignment & communication
- Essential role of clinical co-management

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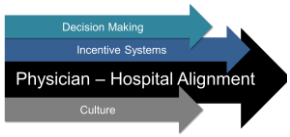

Understand the Motivations

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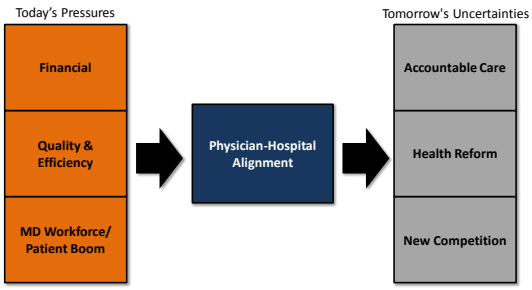
Drivers of Change



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The Spectrum of Integration

Degree of Alignment

Independent to Clinically Integrated

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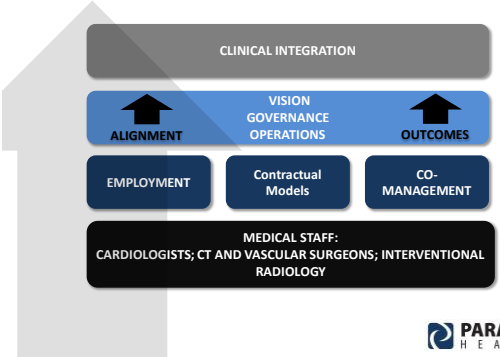
Sustainable Model



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Practice Acquisition

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Trends on the Deal

- **What is being bought or sold?**
  - **Specific tangible assets** – majority consideration
    - Hard assets (itemization of furniture, equipment and analysis of supplies on hand)
  - **Certain identifiable intangible assets** – organizational decision
    - Medical records (active patient records within previous 2/3 years – not including deceased patients)
    - Assembled workforce (those positions that have been trained and will transition to new employment)
  - **Leasehold improvements** - case by case basis
  - **Practice goodwill** – trend across the country is not to consider
  - **Leveraged income streams**
    - Ancillaries – "it depends"
    - Employed providers (physician associates and midlevel providers) – no consideration
  - **Liabilities and accounts receivable** – no consideration, typically stay within practice entity
  - **Patents and other intellectual property** – case by case basis
  - **Malpractice**
- **Note – most clients are focusing on compensation going forward and trying to minimize the cost and exposure to risk on the practice valuation.**

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Valuation Approaches - Cost

- **When to use**
  - Medical practice acquisitions
  - Low margin and unprofitable healthcare entities
  - Asset intensive entities (e.g., Hospitals, Diagnostic Imaging)
- **Common asset categories - tangible**
  - Accounts receivable
  - Inventory
  - Other current assets
  - Liabilities
  - Fixed assets
    - Leasehold improvements
- **Common asset categories – intangible (trends on organizational positions)**
  - Assembled workforce
  - Medical records
  - Non-compete agreements
  - Patient relationships – "Is the hospital paying for all the work we have done to help them in the past?"
  - Goodwill - trends and implications

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Valuation Approaches - Income

- **When (NOT) to use**
  - Many medical practice acquisitions
  - Low margin and unprofitable healthcare entities
- **When to use**
  - Profitable going concern entities – ASC, Dialysis, Imaging
  - Discussion on ancillary business lines
- **Identifying factors that contribute to risk**
  - Reimbursement - payer mix
  - Volume – competition and demographics
  - Expenses
    - Suppliers – drugs and medical supplies
    - Capital expenditures
    - Workforce
- **Cash flow considerations**
  - Physician compensation
  - Management services/ revenue cycle
  - Medical director services
  - Real estate issues
  - Global billing – professional vs. technical (ancillary) revenue
- **Auditing and Coding (revenue vs. compliance risk)**

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Valuation Approaches - Market

- **When to Use** – When you can identify good comparables; however, it is often difficult to find truly good comparables.
  - Public Companies
    - Too big
    - Too diversified
  - M&A Transactions
    - Pricing data not disclosed
    - Data unreliable
  - Issues to consider – leverage, cost structure, payor differences, productivity, etc.
- **When is it more appropriate to apply**
  - Cardiac catheterization labs
  - Ambulatory surgery centers
  - Dialysis centers
  - Hospitals/ LTAC's / SNF's
- **Possible Sources** – Pratts Stats, Levin Associates.

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Reconciliation

- Review outcomes of the approaches
- Consider the goodness of fit of each approach
- Evaluate the correlation of the approaches
- "Considered and included" vs. "considered and not selected"
- Weighting

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Key Considerations

- Consistency
- Be cautious on paying now ***and*** in the future
- Coordinate with other elements of the broader transaction

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Key Considerations

- Acquisition of Ancillaries
  - Revenue Stream Only

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Compensation

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Key Elements

- Base Clinical Pay
- Administrative Time
- Performance Incentive
  - Quality
  - Efficiency
  - Access/Program Development

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Key Legal/Valuation Issues

1. Fair Market Value ("FMV")
2. Not based on the volume or value of referrals or other business generated by the referring physician
3. Commercially Reasonable

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Employment Model Issues

- Fair Market Value
- Not based on the volume or value of referrals or other business generated
- Commercially Reasonable
- Subsidiary/Physician Integration Models—In-Office Ancillary Services Exception
- Impact of Subsidy

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Fair Market Value

- The value in arm's-length transactions, consistent with the general market value
- "General Market Value"—the price/compensation that would be included in an agreement as a result of *bona fide* bargaining between well-informed parties to the agreement who are not otherwise in a position to generate business for the other party, at the time of the agreement.

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Commercial Reasonableness

- An arrangement is a sensible, prudent business arrangement from the perspective of the parties involved, even in the absence of potential referrals.

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Employment Model: BV Considerations

- Will the existing physician practice or practice assets be purchased as part of the employment agreement?
- What will be purchased?
  - Specific assets
  - Leveraged income streams
  - Ancillary businesses
  - Liabilities
- Approach to value – cost vs. income
- Synergies?

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Employment Model: CV Considerations

- Another tried and true approach to integration
  - Compensation valuation models are well understood within the industry
  - Can result in significant alignment and integration
- How to influence behavior to achieve desired outcomes of high quality and low cost care?
  - "Behavior follows incentive" – use of physician compensation plans to achieve desired outcomes
  - Not always easy to design and implement, but physician input can help
  - How are quality and value recognized? Bonuses (still within FMV), withholds, etc.
- Non-physician services (e.g., leased employees, billing services), if present, need to be evaluated → FMV & commercial reasonableness

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Key Considerations

- Term of Employment Agreement
- Base Salary
- Productivity Component
- The Benchmarks: Sullivan Cotter; MGMA, etc...
- Quality and Efficiency (6 ACO Pillars)
- Focus on Clinical Co-Management

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Key Considerations

- Advanced Practice Clinician (APC) Implications
  - Use of Resources
  - Shared Services
- Renewal Strategies
- Emerging Models to Address
  - ACO/HCAHPS/VBP
- "Group" Model with Sub-Specialization
- Retirement, Retention and Deferred Income

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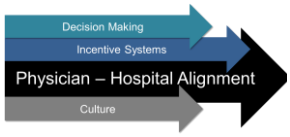

Implications on Alignment

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Decision Making: Leadership Role

- Governance
- Physician-Administrator Dyad
- Data Driven
- "Ownership"
- Compact: Clear Give and Get

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Clinical Co-Management

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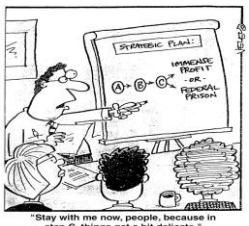

"Stay with me now, people, because in step C, things get a bit delicate."

Questions

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