



Valuation Overview of Physician Practice Acquisitions and Post- Transaction Compensation







Introduction

VMG Health - Overview

- Valuation and transaction advisory firm focused in the healthcare industry since 1995.
- More than 50 professionals and two offices in Dallas, TX and Nashville, TN.
- Clients located in all 50 states
- Services provided include:
 - Business valuation (800+ valuations per year)
 - Professional service agreement valuation (300+ valuations per year)
 - Tangible asset valuation
 - Transaction advisory
 - Real estate valuation



Overview




Presentation Overview

Physician Practice Acquisition
Trends and Valuation
Techniques

Post-Transaction Compensation
Trends and Valuation
Techniques

Questions



Physician Practice Acquisition Trends and Valuation Techniques



Overview (A Primer on Valuation)

- I. Practice Acquisitions – A Look Back in History
- II. Practice Acquisitions – Current Observations & Trends
- III. Valuation 101: Practices & Ancillary Services



Practice Acquisitions – Past & Present



Physician Transaction History

Physician Acquisition & Employment – A Look Back in History

- Physician Practice Management Companies (PPMCs)
 - ❖ PhyCor (1998)
 - ❖ Typically purchased equipment, A/R, real estate
 - ❖ Provided management services for fee (% of revenue)
 - ❖ Physicians were not employees
- Hospitals Defensive Response: Integrated Delivery Network (IDN)
 - ❖ Hospital-owned
 - ❖ Typically purchased equipment, A/R, real estate, goodwill
 - ❖ Physician was gatekeeper
 - ❖ Ancillary services often included
 - ❖ Physicians were employed



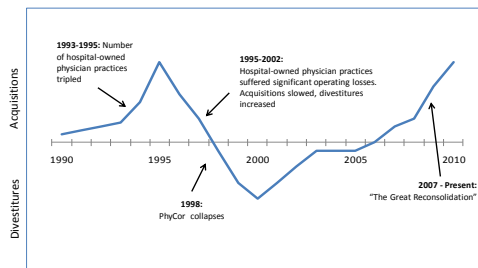
Physician Transaction History

- The PPMC / IDN Bust – late 1990s / early 2000s
- Physicians frustrated with how hospitals managed practices
 - ❖ Hospital's lack of experience in billing for physician services
 - ❖ Grew too large too quickly
 - ❖ Lack of Physician involvement in decision-making
- Hospitals frustrated with Physicians' lack of motivation and declining productivity
 - ❖ Prices paid for practices were too high to earn adequate ROI
 - ❖ Often caused by guaranteeing Physician salaries with no recourse
 - ❖ Resulted in significant losses to hospitals
- Many PPMCs / IDNs dissolved and physicians re-entered private practice



Physician Transaction History

Physician Practice Transaction Timeline





Physician Transaction History

2007 to Present: The Great Reconsolidation

Driving Forces for Physicians:

- ❖ Physician desire to be shielded from market forces
- ❖ Reimbursement cuts – in some cases these have been drastic
- ❖ Increasing costs – particularly malpractice
- ❖ Increased in costly IT requirements (EMR)
- ❖ Reaction to Healthcare Reform
- ❖ Shifting physician demographics
- ❖ Shifting desire for work/life balance



Physician Transaction History

2007 to Present: The Great Reconsolidation

Driving Forces for Hospitals:

- ❖ Herd Mentality
- ❖ Secure/expand referral network – defensive strategy
- ❖ Advantageous reimbursement – particularly for ancillaries (imaging)
- ❖ Addressing staffing shortages
- ❖ Need for call coverage
- ❖ Healthcare Reform – ACOs
- ❖ Need to improve and exhibit quality of care



Fair Market Value from a Regulatory Perspective



Regulatory Guidance

Regulatory Overview

- Fair Market Value ("FMV") – the only premise of value to meet the Anti-Kickback Statute and Private Inurement Regulations
- Both for-profit and not-for-profit health care providers that accept payments from government programs (i.e., Medicare) must ensure that exchanges between them and other providers are at FMV.
- Definition
 - ❖ The price, expressed in terms of cash equivalents, at which a property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms length in an open and unrestricted market, when neither is under compulsion to buy nor to sell, and when both have reasonable knowledge of the relevant facts
 - ❖ FMV can consider revenue increases or cost savings to the Practice that any hypothetical willing buyer would be able to influence but not specific downstream referrals the Practice drives to a health system



Regulatory Guidance

Regulatory Overview

- Stark Law
 - ❖ Prohibits physicians from referring a patient to an entity with which the physician (or an immediate family member) has a financial relationship, when the referral is for the furnishing of certain designated health services (DHS).
- Anti-Kickback Statute
 - ❖ Prohibits the payment or remuneration in exchange for, or in order to induce, the referral of patients or other businesses which are reimbursed under the Medicare program.
- Private Inurement
 - ❖ Deals with Tax-exempt entities providing excess benefits to non tax-exempt individuals or entities



Valuation Approach

Fair Market Value vs. Strategic Value

- Investment Value or Strategic Value
 - ❖ Premise of value used everyday in merger and acquisitions which are not required to meet Fair Market Value standards
 - ❖ Definition – The price, at which a property would exchange hands between a specific buyer and able seller; it is the value of a property to a particular investor
- Examples of FMV / Investment Value
 - ❖ Investment Value:
 - Adjusting the reimbursement rates for the sellers to Hospital-based (Provider-based)
 - Adjusting the cost structure to account for efficiencies or economies of scale that only a specific buyer could realize
 - ❖ Fair Market Value:
 - Adjusting reimbursement rates up to freestanding market averages
 - Adjusting the cost structure to reflect market norms for similar businesses



Valuation Primer - Practices



Valuation Primer

Types of Practice Transactions...

- Purchase in context of entire practice
 - ❖ Ancillaries may be "carved out" in valuation
 - ❖ Physician employed
 - Carved out ancillary cash flows excluded from post transaction compensation calculation
- Ancillary only Purchase
 - ❖ Physician may not want to give up control
 - Physician not employed
 - ❖ Method to Integrate with Hospital without outright sale
 - ❖ Method of liquidation/risk mitigation



Valuation Primer

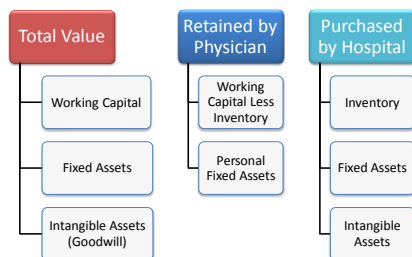
Practice Valuation versus Ancillary Services

- Professional Practice Valuation
 - ❖ Hospital will buy Fixed Assets – very little intangible value
 - ❖ Acquisition Value versus Ongoing Comp Structure
- Ancillary Valuation
 - ❖ Physician is giving up Income Stream
 - ❖ Buyer will compensate Physician for this Lost Income Stream
 - ❖ Many Ancillary Businesses are still Quite Profitable
 - ❖ Acquisition Market is Quite Active



Valuation Primer

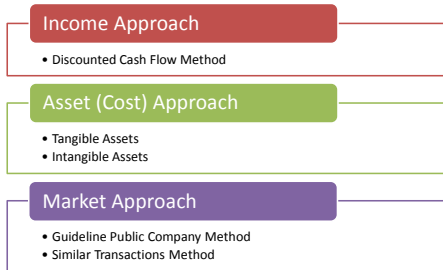
Components of Value...





Valuation Primer

There are three accepted business valuation methods...





Valuation Primer

Valuation – Three Approaches

	Professional Practice (Pro Fee)	Ancillary Business (Tech Fee)
Income Approach Discounted Cash Flow Method	←	←
Asset (Cost) Approach Tangible Assets Intangible Assets	←	←
Market Approach Guideline Public Company Method Similar Transactions Method	✗	←



Valuation Primer

The Income Approach...

- Examines historical financial and production information to estimate the future level of cash flows.
 - ❖ Projection of future revenues and expenses
 - ❖ Projection of future capital expenditures and working capital requirements
- Discount future after tax debt free discretionary cash flows
- Discounted or capitalized cash flow methods are commonly utilized for healthcare entities.

Present Value of Cash Flows = Value Indication



Valuation Primer

The Asset (Cost) Approach...

- Takes into consideration the cost of replicating a comparable asset, security or service with the same level of utility.
- Typically used when the entity has historical losses or nominal projected cash flow.
- Typical Components...
 - ❖ Tangible Assets
 - Working capital
 - Fixed assets
 - Real estate (if applicable)



Valuation Primer

The Asset (Cost) Approach...

- Intangible Assets
 - ❖ Legal title, protectable, separately marketable
 - Trade name
 - Phone number
 - Medical Chart
 - Non-Physician Trained Workforce
 - ❖ Also generate an economic return (typically based on positive Income Approach)
 - Covenants not to compete
 - Physician workforce

Tangible Assets + Intangible Assets = Value Indication



Valuation Primer

The Market Approach...

- Estimates value by comparing the value of similar assets, securities or services traded in a free and open market to the subject asset, security or service.
 - ❖ Similar publicly-traded companies are not comparable from a size or growth standpoint and often include practices with a variety of management services agreements.
 - ❖ Similar transaction information in the public domain is rarely useful because details on transaction structure (including post-transaction compensation and employment terms) are not included.
 - ❖ Market Approach rarely used alone as a determinant of FMV for a physician practice.

Selected Multiple(s) x Subject Metric(s) = Value Indication

Post-Transaction Compensation Trends and Valuation Techniques

Physician Service Agreements (PSAs)

May be a result of joint ventures, acquisitions, employment or independent contractor arrangements

- Traditional Employment
- Physician Lease Model
- Administrative Services
- Call Coverage
- Clinical Co-management (fixed + variable)
- Management

- Professional/technical splits
- Development
- Billing and Collection
- Leasing Arrangements
- All of the above combined

Often a combination of several valuations is required for one agreement.
Choose the right data / analysis to reflect each of the services.

PSA Valuation Basics

- Select a valuation expert with care – does the valuation expert have:
 - ❖ Credentials from recognized organizations (AICPA, ASA, NACVA)?
 - ❖ Experience with healthcare industry regulations and guidance?
 - ❖ Expertise on the impact of the regulations on a valuation?
 - ❖ Knowledge of relevant market survey data and its limitations?
- There are no published standards for valuing physician services and compensation.
 - ❖ Stark law indicates that fair market value is based on the facts and circumstances and reasonable methodologies should be used.
 - ❖ Most valuers start with traditional business valuation approaches (Cost, Market, and Income Approaches)
- The PSA terms must be understood prior to valuation:
 - ❖ What services will be provided?
 - ❖ How will the parties be compensated?
 - ❖ The valuation should match the agreement.

Common Misconceptions of FMV Compensation

- Compensation data point from a single survey constitutes FMV.
 - ❖ Per Stark, reference to multiple, objective survey remains a prudent practice in evaluating FMV.
 - ❖ One survey alone may not provide enough support for FMV compensation.
- Any compensation rate that falls below the 75th percentile is FMV.
 - ❖ Broad statement that does not consider specific facts and circumstances.
 - ❖ May raise a red flag if productivity is not considered (i.e., paid 70th percentile while productivity falls at 25th percentile).
- Compensation offers from local competing hospitals determine FMV.
 - ❖ Compensation offer may not be arms-length or consistent with FMV.
 - ❖ Per Stark, market data utilized in determining FMV should exclude referral relationships.

Takeaway: Each of the above may be considered as part of the entire FMV analysis, but should not be the sole basis for FMV.

Valuation of Clinical Compensation

- Clinical compensation models vary widely:
 - ❖ Fixed salary model
 - ❖ Revenue minus expense model
 - ❖ Percentage of collections model
 - ❖ Compensation per work RVU model
- Cost and Market Approaches (blended Cost-Market Approach):
 - ❖ Cost to employ/contract with a physician based on market data
 - ❖ Most commonly utilized method among valuers
 - ❖ Benchmarking analysis that aligns compensation and productivity
 - ❖ Published surveys include:
 - MGMA Physician Compensation and Production Survey
 - AMGA Medical Group Compensation and Financial Survey
 - SCA Physician Compensation and Productivity Survey
- Common productivity metrics include:
 - ❖ Work RVUs or Total RVUs
 - ❖ Professional collections or gross charges
 - ❖ Patient encounters

Note: MGMA = Medical Group Management Association, AMGA = American Medical Group Association, and SCA = Sullivan, Citter and Associates, Inc.

Valuation of Clinical Compensation

- Benchmarking example (using the MGMA survey):
 - ❖ Solo practitioner specialized in general orthopedic surgery
 - ❖ No in-office ancillaries or mid-level providers
 - ❖ 2011 annual work RVU volume of 13,867

MGMA Physician Compensation and Production Survey				
	Physician Work RVUs			
	25th	Median	75th	90th
Orthopedic Surgery: General	6,239	8,250	11,021	13,867
Subject Physician's Annual Work RVUs				13,867
Conclusion: Physician productivity falls at the 90th percentile				
	Physician Compensation			
	25th	Median	75th	90th
Orthopedic Surgery: General	\$372,437	\$497,088	\$658,842	\$825,044
Selected Compensation (based on work RVUs)				\$825,044

Takeaway: Valuers commonly benchmark *multiple* productivity metrics to *multiple* surveys.

Valuation of Clinical Compensation

- Common benchmarking mistakes include:
 - ❖ Including mid-level provider productivity
 - ❖ Benchmarking total RVUs to reported *work RVUs*
 - ❖ Benchmarking total collections to reported *professional collections*
 - ❖ Miscalculation of patient encounters (read the data definition of each survey!)
- Common misunderstandings of survey data:
 - ❖ Reported compensation is a definitive snapshot of current market compensation
 - ❖ Reported compensation reflects only clinical services
- Common mistakes in using the reported compensation per work RVU:
 - ❖ Per MGMA, an inverse relationship exists between work RVU volume and compensation per work RVU
 - ❖ Paying a highly productive physician the 75th to 90th percentile compensation per work RVU may result in compensation outside of FMV.
 - ❖ See illustration on the following page.

Valuation of Clinical Compensation

- Misuse of reported compensation per work RVU data
 - ❖ Solo practitioner specialized in general orthopedic surgery
 - ❖ 2011 annual work RVU volume of 13,867
 - ❖ Hospital employer proposed MGMA 90th percentile compensation per work RVU

MGMA Physician Compensation and Production Survey				
	Compensation per Work RVU			
	25th	Median	75th	90th
Compensation per work RVU - Orthopedic Surgery: General	\$47.74	\$60.39	\$77.39	\$95.49
Times: Physician's Annual Work RVU Volume (equal to MGMA 90th)	13,867			
Equals: Annual Physician Compensation	\$1,324,021			
	Physician Compensation			
	25th	Median	75th	90th
Total Compensation - Orthopedic Surgery: General	\$372,437	\$497,088	\$658,642	\$825,044
Annual Physician Compensation is more than 160% of the 90th percentile!!	\$1,324,021			

Takeaway: Always test productivity models to ensure the selected metric and expected productivity result in FMV compensation.

Valuation of Clinical Compensation

- Income Approach:
 - ❖ Another standard valuation approach
 - ❖ Considers normalized historical compensation
 - ❖ Considers normalized physician practice revenues less expenses and a reasonable rate of return to the employer.
 - ❖ Considers specific economic factors of a physician's practice such as:
 - Local reimbursement
 - Payor mix
 - Procedure mix
 - Practice expense profile

Takeaway: The Income Approach often serves as a reasonableness check to the results of the Cost-Market Approach.
