

Healthcare Compensation Valuation: “In-Depth Case Studies Highlighting Common Healthcare Compensation Valuation Considerations”

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Presentation Outline

Case Study 1 – Hospital/Physician Joint Venture & Lease

- JV formation
 - Parties
 - Form of contributions
- Ongoing Lease
 - Equipment/Facility/Services
 - Per Click/Flat

Case Study 2 – Practice Acquisition/Physician Employment

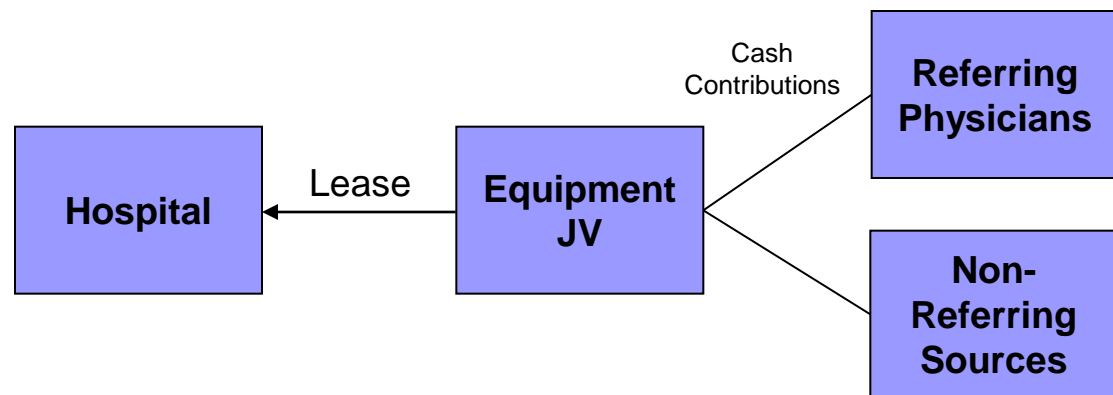
- Staffing Composition
- Profitability
- Ancillary Income

Question and Answer Session

CASE STUDY 1(a) – Hospital/Physician Joint Venture

Valuation issues focus on amount and structure of lease payment, JV investment

- Lease rate
 flat
 per
 click
- Commercial reasonableness
- Allocation of risk

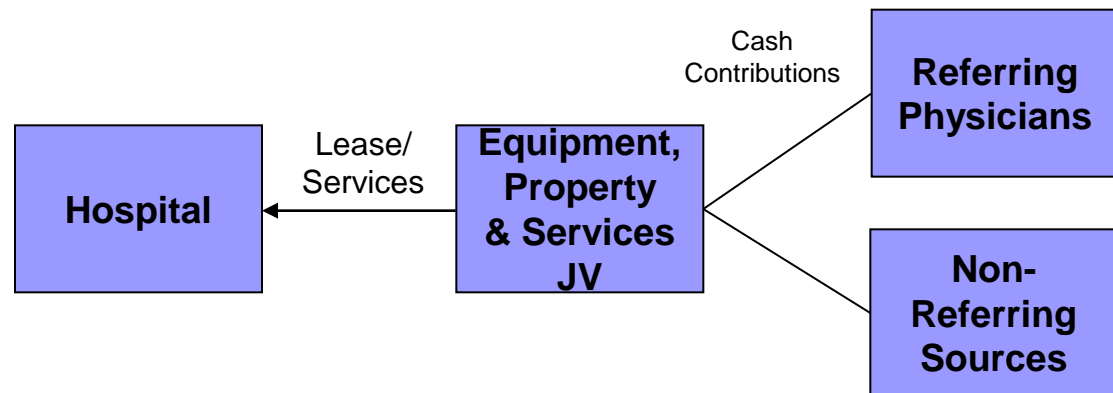


- Valuation of (1) lease payment and (2) investment in the JV
- Are these items that the hospital can't obtain itself?
- Is there a business reason for doing this as a JV? For involving these particular investors?
- Per-click/flat fee – off balance sheet financing?
- Would the JV be commercially reasonable with a flat fee lease?

CASE STUDY 1(b) – Hospital/Physician Joint Venture

Addition of services provided by the joint venture

- Commercial reasonableness
- Allocation of risk

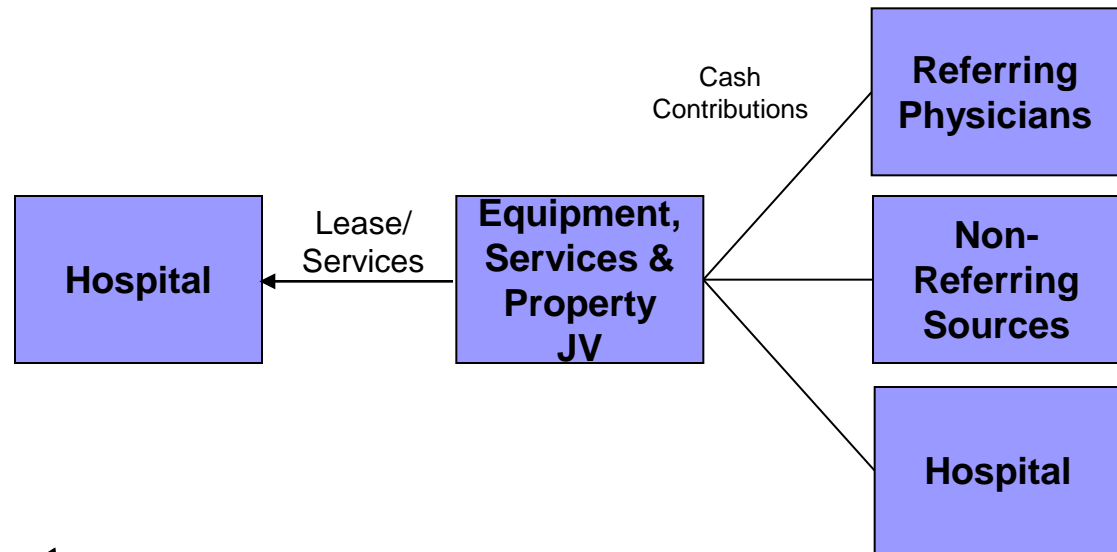


- How does the addition of services provided by the JV change the valuation analysis?

CASE STUDY 1(c) – Hospital/Physician Joint Venture

Addition of hospital as an investor in the joint venture

- Commercial reasonableness
- Allocation of risk



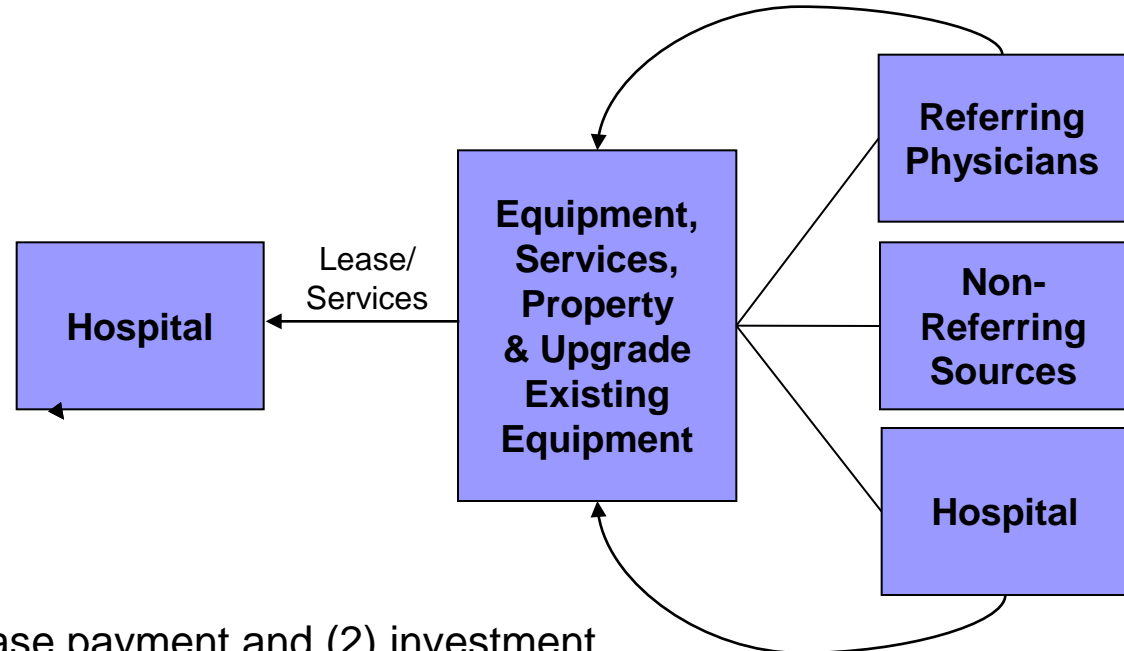
- Valuation analysis to consider potential financial outcome to hospital both as end user and as supplier – does this analysis change with increased ownership interest by hospital?
- Does the hospital's investment undermine the commercial reasonableness analysis?
- Balance of risk is a key factor

CASE STUDY 1(d) – Hospital/Physician Joint Venture

Investment consideration = cash + non-cash assets

Contribution of Non-Cash Assets

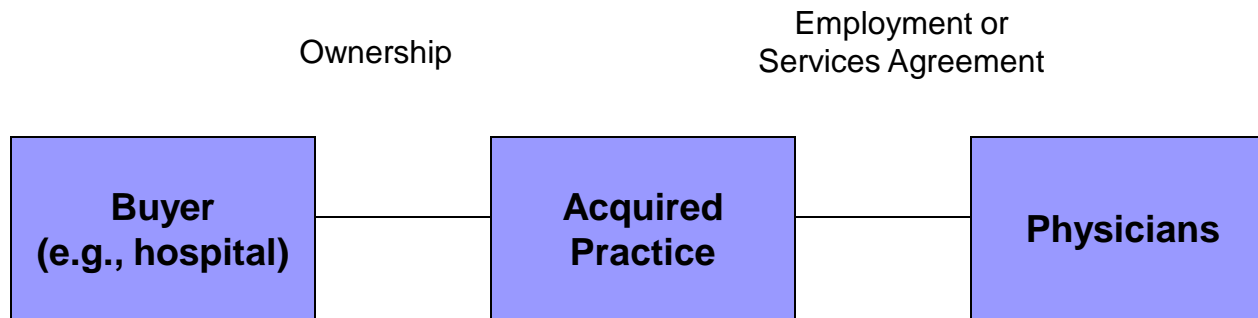
- Cash contributions vs. non-cash contributions
- Consideration for investment interest or a lease discount?
- Commercial reasonableness
- Allocation of risk



- Look at valuation of (1) lease payment and (2) investment
- How to value the non-cash contribution?
- Once valued, where to apply the non-cash contribution?
- Who's contributing non-cash assets: the hospital or another investor?

CASE STUDY 2 – Physician Practice Acquisition & Post Acquisition Employment

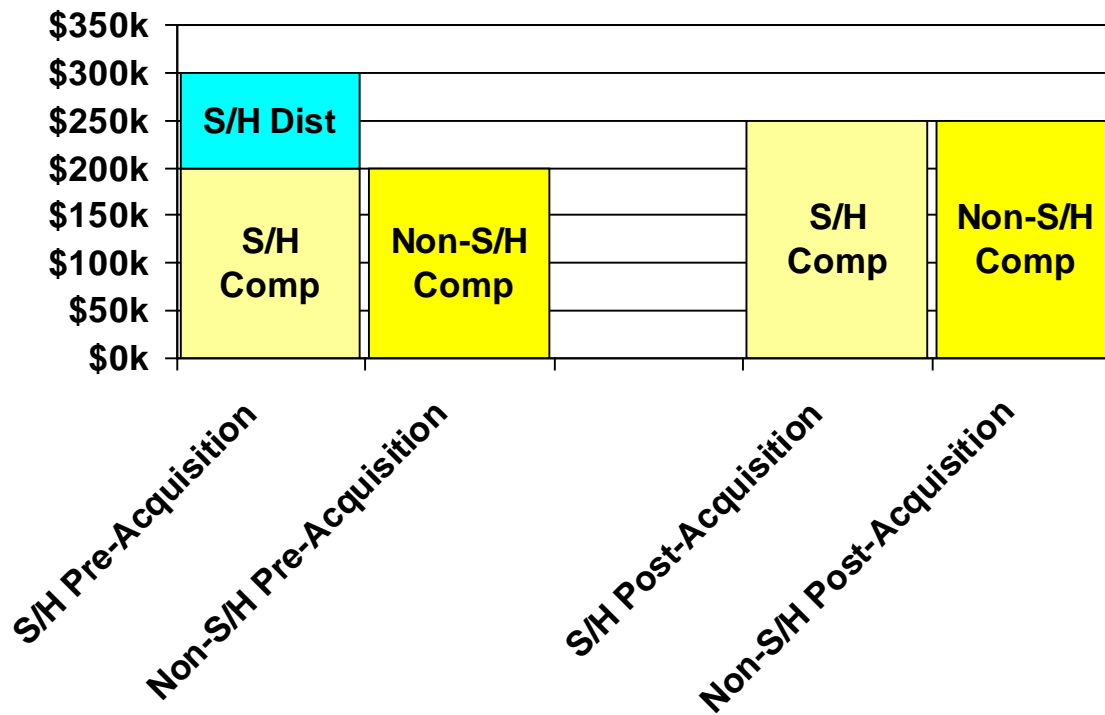
OVERVIEW



Relevant Practice Characteristics that impact value (of Practice or Shareholder Employment Agreement)

1. Staffing composition
2. Profitability of practice
3. Existence of ancillary income
4. Qualitative factors

CASE STUDY 2(a) – Staffing Composition - Physician Practice Acquisition – Owner and Non- owner Physicians



- Assume FMV comp = \$250k
- Employed doc accepts \$200k in anticipation of becoming owner
- Shareholder gets owner's distribution, total comp = \$300k
- Should shareholder get pay cut while non-shareholder gets pay raise?

2a. Staffing Composition

- Owner physicians employing other physicians and mid-level providers can leverage their productivity to increase income, but are at risk for payroll, malpractice, etc.
- Similar to ancillaries, hospital may wish to compensate for loss of this income post-transaction in the form of value paid for the practice
- Additional complexities arise if even after mid-level provider income is excluded, practice value is minimal to non-existent
 - Bifurcate practice valuation between medical services provided by the doctors and the mid-level providers
- Shareholder versus non-shareholder physicians

CASE STUDY 2(b) – Profitability of Practice

	Pre-Transaction	Post-Transaction Scenario B	Post-Transaction Scenario B
Revenues	\$1,400k	\$1,400	\$1,600k
Non-Physician Expenses	\$800k	\$1,000	\$800k
Available for Physician/Owner	\$600k	\$400k	\$800k

- Increase in value not specific to a particular buyer
- Value can be transferred in purchase price or within terms of PSA
- How should acquisition be treated if marked-to-market value is a net decrease? Net increase?

2b. Profitability of Practice

- Revenue of practice a function of
 - Clinical productivity
 - Payer mix / Payer contracts
 - Service mix (e.g., ancillaries, level of care, mid-levels' revenue, etc.)
- Revenue realized by prospective buyer may differ as a result of
 - Reduced (or increased) incentive toward clinical productivity
 - Differences in payer mix or contracted rates
 - Factors related to clinical protocols, patient population, etc.
- Current profitability versus projected profitability
 - go-forward adjustments to revenues and expenses must reflect what an arm's length buyer could reasonably expect to achieve
- Trade-off between compensation to former physician-owners and acquisition price
 - In any event compensation must be FMV

2b. Profitability of Practice (continued)

- Physician Compensation
 - Arrangements may include per wRVU or flat salary plus per wRVU payment over certain pre-defined “tiers”
 - If compensation is at FMV, practice will likely have little or no value without ancillaries or mid-level providers.
 - Consideration of post-transaction compensation adjustment as a result of higher expected revenue from better hospital contracts
 - Inherent mismatch between revenue and associated expenses present additional challenge for acquisition valuations.
- Post-Transaction Compensation Structure
 - Guaranteed salary
 - Productivity bonuses
 - Differences in compensation between former shareholders and non-shareholders
 - Quantifying the business risk former shareholders no longer take post-transaction

CASE STUDY 2(c) – Ancillary Income

	Pre-Acquisition Status Quo	Post-Acquisition Pro Forma
Revenues		
Physician Fees	\$1,000k	\$1,000k
Ancillaries	\$300k	
Total Revenues	<u>\$1,300k</u>	<u>\$1,000k</u>
Expenses		
Physician Wages	\$800k	\$800k
Ancillary Costs	\$100k	
Other Expenses	\$200k	\$200k
Total Expenses	<u>\$1,100k</u>	<u>\$1,000k</u>
Profits	\$200k	\$0k

- Physician owners received income not only from own professional services; also from ancillaries
- Owners wish to sell clinic to hospital, work for hospital in new clinic under PSA
- Clinic only has positive earnings because of ancillaries
- What acquisition value can be ascribed to the clinic?

2c. Ancillary Income

- Owner physicians have the ability to leverage their capital to increase their income
 - Ancillary services can increase the bottom line for shareholders, but offering them may also result in a net operating loss
- Hospitals may wish to compensate for loss of this income post-transaction in the form of value paid for the practice
 - Does hospital need or want ancillaries being purchased?
- Additional complexities arise if even after ancillaries, practice value is minimal to non-existent
 - Bifurcate practice valuation between ancillary services and medical services provided by the doctor

Questions & Answers

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