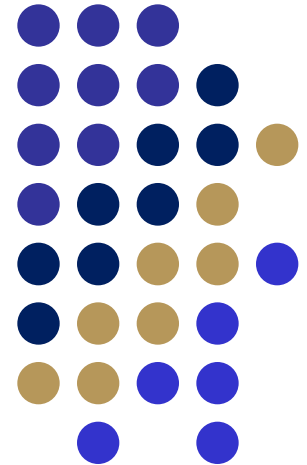


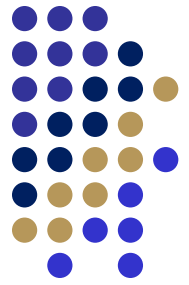
Valuing Physician Practices and Ancillary Service Lines: *A Unique Perspective on Orthopaedic Practice Transactions*

Presented by:

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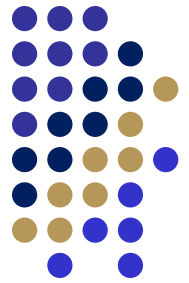


Physician Practice Acquisition Overview



- Significant Consolidation / Acquisition Activity for Healthcare Providers
 - These transactions began in 2009, shortly prior to the signing of PPACA (March 2010).
 - Driven largely by changing reimbursement models and costs associated with PPACA compliance
 - Formation of Accountable Care Organizations
 - Buyers initially focused on cardiology, but now focused on acquiring primary care physicians and large multi-specialty physician practices

Physician Employment/ Practice Acquisition



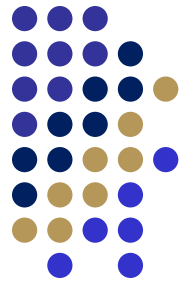
- Practice acquisition/employment transactions are occurring at a feverish pace.
- Valuers are polarized with respect to certain valuation approaches for practices.
- To establish FMV, you must first consider the proposed terms of the arrangement.
- Employment agreements can have many different features...and all must be considered when establishing FMV.

Physician Employment/ Practice Acquisition



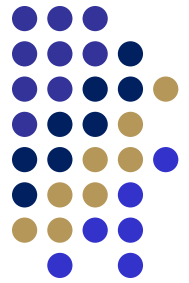
- Not only hospitals and health systems making acquisitions
- Significant acquisition activity from insurance companies and managed care administrators to expand their network
- Are these acquisitions subject to FMV standard?

Acquisition Structure & Compensation Models



- Over 95% of transactions are structured as an asset purchase and subsequent employment of physicians, with the buyer acquiring
 - Inventory
 - Tangible Assets (equipment, etc.)
 - Identified Intangible Assets
- Post-Acquisition compensation must be factored into purchase agreement. The majority of clinical compensation models are driven by productivity.
 - wRVUs x Conversion Factor
 - % of Professional Collections or Pre-Compensation Earnings
 - Hours or shifts worked

Overview – FMV Standard



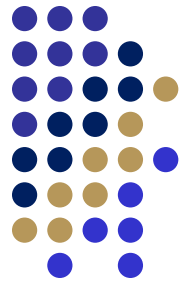
- Healthcare regulations stipulate **fair market value** as the applicable standard of value.
- The definition of **fair market value** in healthcare is slightly different than the standard valuation definition.
 - the price at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm’s length in an open and unrestricted market, when neither is under compulsion to buy or sell ... *between well informed parties who are not otherwise in a position to generate business for the other party...*
 - *Implications of “hypothetical”*

Use of Valuation Approaches



- Three generally accepted valuation approaches:
 - Income Approach – A general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that convert anticipated future economic benefits into a single present amount.
 - Market Approach – A general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.
 - Asset (Cost) Approach – A general way of determining a value indication of a business, business ownership interest, or security using one or more methods based on the value of the assets net of liabilities.

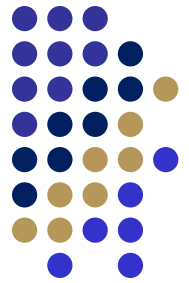
Physician Practice Acquisition Valuation Approaches



- Approaches to valuing physician practices (or any business entity) include Market, Cost and Income.
- A Market approach is generally of little value due to lack of comparability and/or reliable data for practice transactions.
- A Cost approach restates the entity's balance sheet, including specifically identified intangible assets (*e.g.*, workforce in place, etc.).
- An Income approach discounts (thru DCF) expected future cash flows to the buyer.



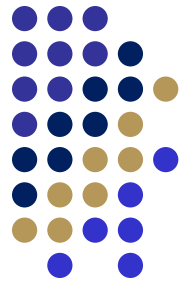
Physician Practice Valuations



- The central argument among appraisers regarding physician practice valuation is whether or not intangible value can exist in the absence of an income stream which *fully* supports the intangible value.
 - Certain respected appraisers espouse “Cash is king... income is the sole determinate of physician practice value.”
 - Other appraisers identify and value specific intangible assets with no consideration of the income of the practice.
- **Positions on either end of this spectrum are likely incorrect.**

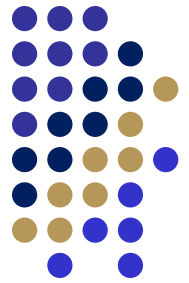


Physician Practice Acquisitions



- How is intangible value generated in physician practices?
 - Leverage off employed physicians or mid-level providers.
 - Provide ancillary services (*e.g.*, MRI, Physical Therapy or Durable Medical Equipment).
 - Perform allowed surgical procedures in-office (as opposed to hospital or ASC) and receive site-of-service differential.
 - MDs take pay cut (like old PPM deals); generally unpopular; most transactions involve a post-transaction compensation *increase*, further impacting potential intangible value.

Physician Practice Acquisitions



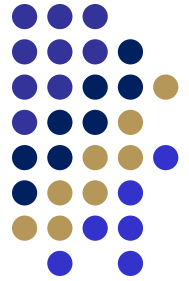
- How is intangible not derived in a physician practice?
 - By giving MDs credit for revenue enhancements or expense reductions generally unavailable in absence of a transaction
 - If a medical oncologist is employed by a hospital, the hospital likely will:
 - Bill for infusion services at a higher rate
 - Potentially benefit from 340b pricing (typically a savings of 30-35%)
 - Strategic /investment value vs. FMV

Ancillary Services Valuation



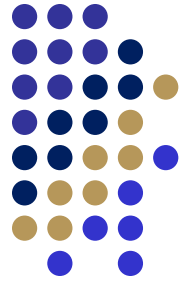
- Oftentimes we are asked to determine the value of an ancillary service within a physician practice for a potential sale.
- Is this ancillary service capable of being a stand-alone business?
- Valuation methods utilized:
 - **Income Approach;**
 - **Market Approach;** and
 - **Cost (Asset) Approach.**

Ancillary Services Valuation

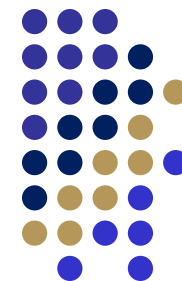


- Surgery Center:
 - Does it need a CON to operate as a stand-alone business?
 - Restricted use to physicians who are also owners/employees of related-party physician practice.
 - Should future compensation levels offset intangible value from the sale of this service line?

Ancillary Services Valuation



- MRI:
 - Referring Medicare patients if separate legal entity.
 - Would service need a CON to operate as a stand-alone business?
- Physical Therapy/Durable Medical Equipment:
 - Where do we get the majority of the referrals?
 - Proper allocation of clinical and administrative overhead when developing financial statements.



QUESTIONS?

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