



2008 CANCER CENTER
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Valuation Issues Pertinent to Cancer Care

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Subject Transactions

- General FMV guideposts - FMV 101
- Employment arrangements
- Practice acquisitions
- Medical directorships/call coverage
- Chemo infusion under arrangements
- Co-management arrangements
- “Per click” arrangements (e.g., stereotactic radiosurgery JVs)
- Block leases (e.g., radiation therapy)

FMV 101 – Healthcare Deals and Transactions

- Don't do it if it's not legal
- Don't do it if it's not commercially reasonable
- Make sure that it is consistent with FMV
 - Healthcare regulations impose specific restrictions that directly impact FMV analysis
 - Avoid tainted market values
 - Avoid improper valuation methodologies

Commercial Reasonableness

- Commercial reasonableness and FMV must go hand in hand
- An independent valuator should opine with respect to FMV and commercial reasonableness

General FMV Issues

- Primary Valuation Approaches
- FMV vs. Investment Value
- Potential Valuation Pitfalls
 - “Tainted” Market Values
 - “Top Down” Approaches
 - Opportunity Cost Approach

Valuation Methodologies

The following generally accepted valuation approaches can be used for valuing businesses and business arrangements:

- Income Approach
- Cost Approach
- Market Approach

Cost Approach

The Cost Approach is defined according to the International Glossary as “a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset.” The Cost Approach is based upon the Principle of Substitution; *i.e.*, the premise that a prudent individual will pay no more for a property than he/she would pay to acquire a substitute property with the same utility.

Income Approach

The Income Approach is defined according to the International Glossary as “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 economic benefits into a present single amount.”

Market Approach

This approach is defined according to the International Glossary as “a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.” Similar to a Cost Approach, a Market Approach is based upon the Principle of Substitution.

FMV vs. Investment value

- The *fair market value standard* is a hypothetical willing buyer/willing seller scenario. No consideration is given to any unique attributes or synergies of either party in reaching a determination of value.
- The *investment value standard* takes into consideration the unique synergies or attributes that one or both parties may possess.
 - For example, a hospital's ability to bill for chemo at higher "provider based" rates is a value that cannot be passed along to physicians.

“Tainted” Market Values

- In addition to healthcare regulations, general valuation theory requires the use of “arms length” market transaction data. Healthcare transactions are frequently suspect.
- A market approach is the preferred valuation approach for many types of compensation arrangements.
- For certain types of arrangements, virtually no “non-tainted” data is available.
 - On-call arrangements
 - Medical directorships
- The valuator must consider alternate approaches.
 - Consider whether the arrangement can be “cross walked” to a non-healthcare setting; if the arrangement would make sense in a non-healthcare setting, it may make sense in healthcare (provided that referrals are never considered/valued)

“Top Down” Approaches

- “Non-traditional” *under arrangement* agreements are emerging related to outpatient surgical departments, cath labs, infusion services and other hospital services.
- A “top down” approach “passes through” all of the hospital's reimbursement, less a portion retained by hospital related to billing, collections, and other hospital services.
- This approach leaves open significant opportunity for challenge.
 - The *actual services* provided by the under arrangement entity must be FMV, and the valuation approach should primarily consider the value of such services
 - The level of reimbursement received by a hospital may have no bearing on the FMV of the services
 - Consider a “crosswalk” to non-healthcare scenarios

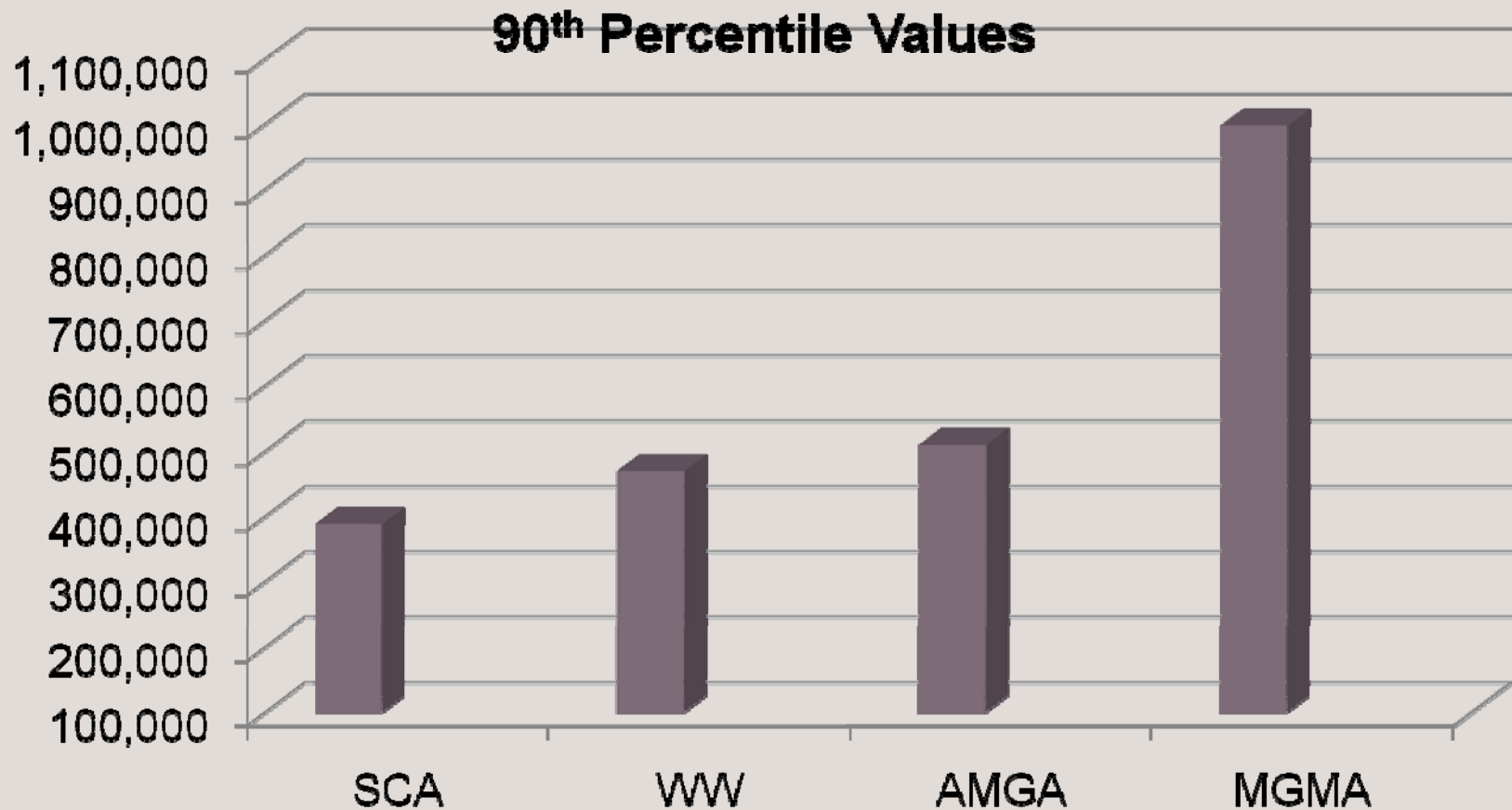
“Opportunity Cost” Approach

- Take caution. Stark III says opportunity cost (*i.e.*, the value of clinical services) *may not* be an indicator of the value of a physician’s administrative time.
- This position is logical and consistent with the general definition of FMV (*i.e.*, a willing buyer/willing scenario).
- RBRVS specifically identifies that certain physician duties carry a higher relative worth than others.
- Opportunity cost can be considered along with market data related to administrative services and informed judgment as to relevant worth of one activity compared to another.

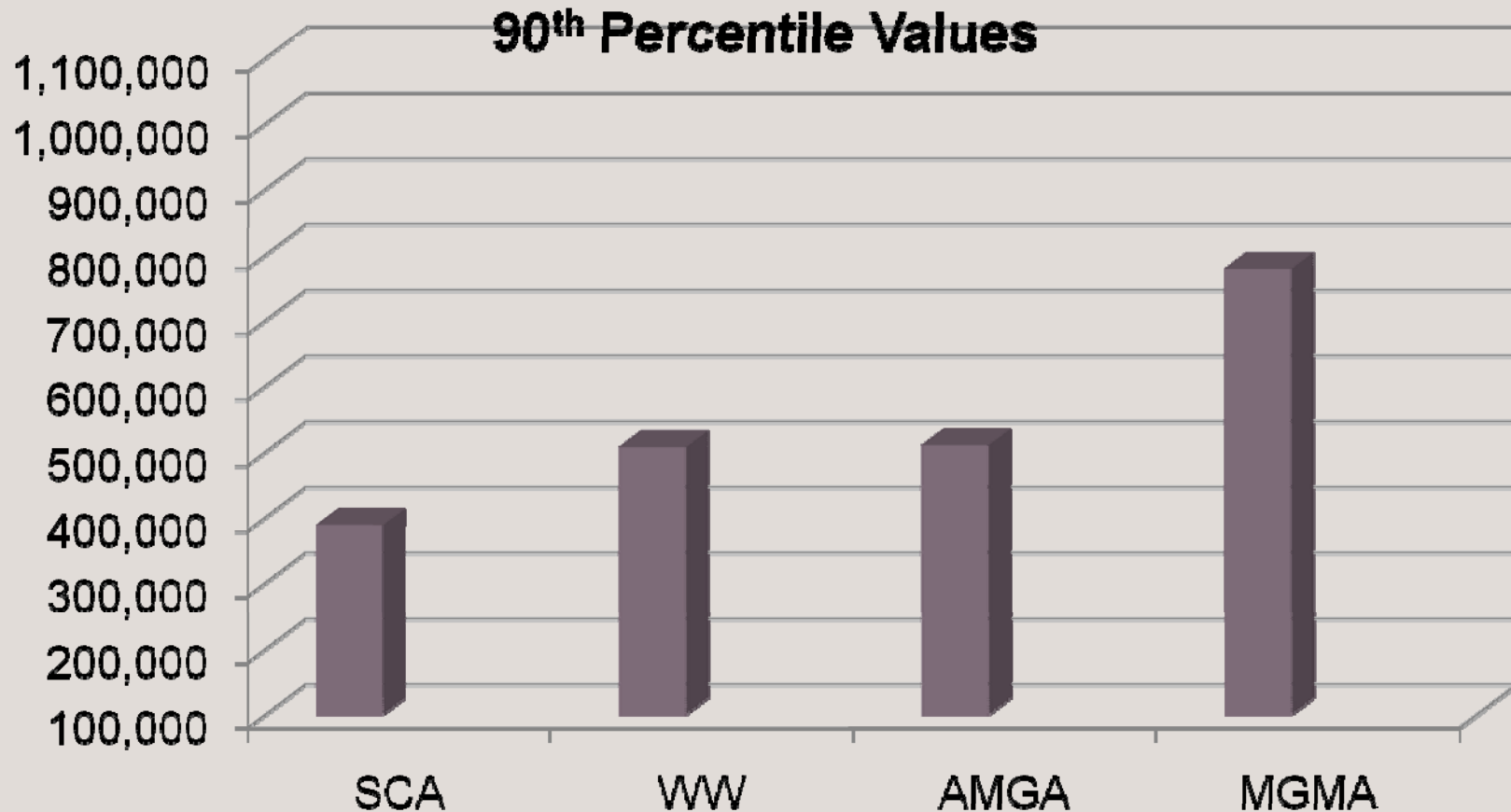
Employment Arrangements

- Sources of compensation survey data:
 - Medical Group Management Association
 - Sullivan & Cotter & Associates
 - Hospital & Healthcare Compensation Service
 - American Medical Group Association
 - Watson Wyatt Data Services

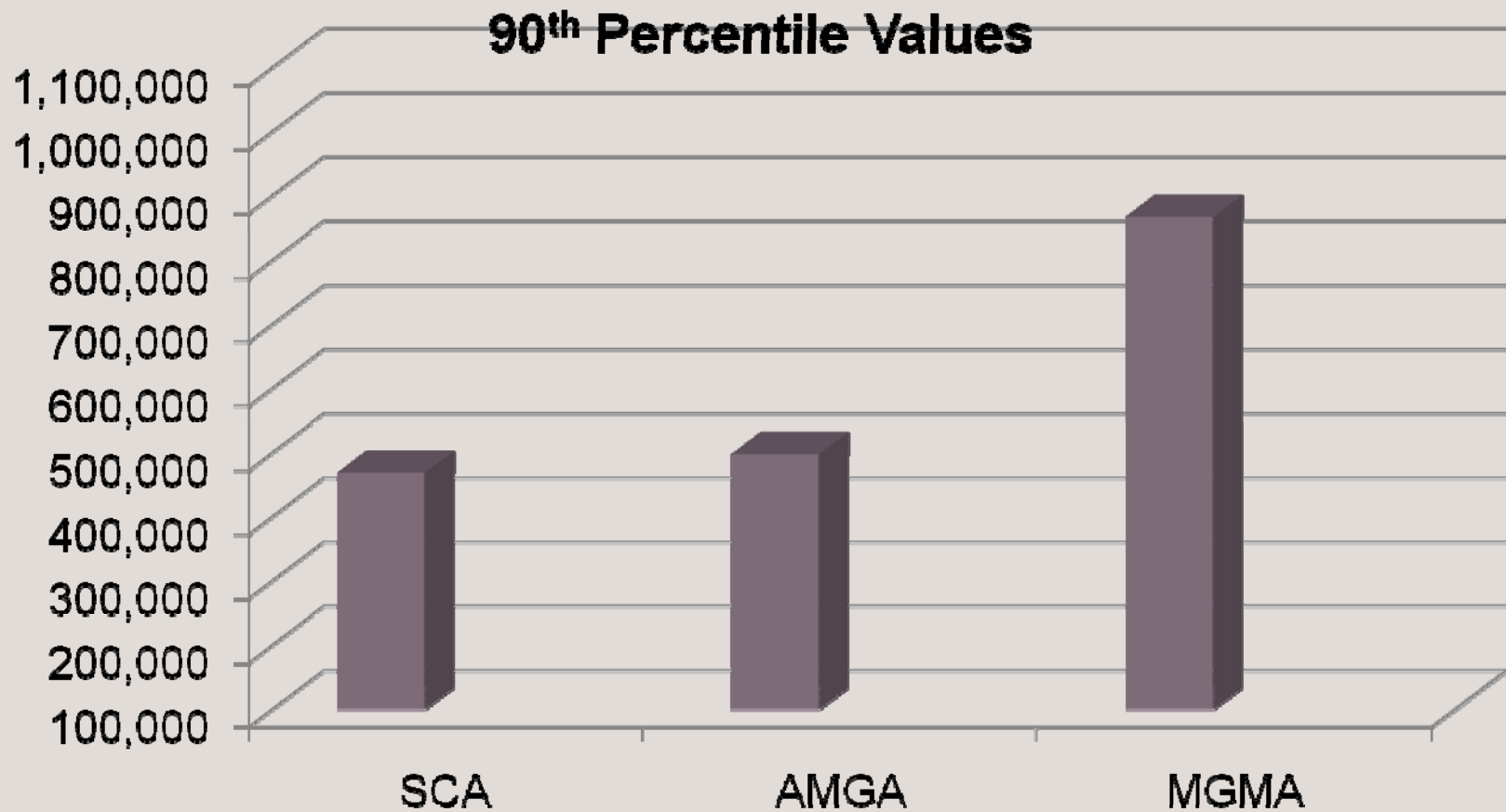
Salary Survey Data Hematology/Oncology - 2007



Salary Survey Data Hematology/Oncology - 2008



Salary Survey Data Radiation Oncology - 2008



Sales/Mergers of Practices

- Legal perspectives
- Current trends in the marketplace –
 - Frequently, only tangible assets are subject to purchase
 - Medical records are subject to purchase in certain instances, but establishing their value can be difficult
 - Receivables are rarely subject to purchase due to successor liability risks

Sales/Mergers of Practices

- Hospitals can't pay for value that they create
- Physicians' profits derived from a successful medical oncology practice may effectively preclude an acquisition/employment transaction with a hospital since non-professional fee revenue cannot be valued
- Ancillary profits can be shared with oncologists under a "group practice exception"; however, this option may not be desirable to the parties
- Practice mergers can be accomplished based upon relative values

Sales/Mergers of Practices

- Fallacies with an Income Approach –
 - Most practices pay out all earnings as W-2 compensation or owner distributions
 - A “bottom line” is created by “artificially” reducing the physicians’ compensation; if this approach is taken, the post-acquisition compensation to the physicians must mirror the assumptions used in the valuation analysis

Medical Director Rates

- Source: Integrated Healthcare Strategies
 - Medical Oncology
 - Radiation Oncology

Cancer Center/Oncology Medical Director Fees

	N	P25	MEAN	P50	P75	P90
Net Revenue (millions)	54	\$237.8	\$463.6	\$398.5	\$528.3	\$735.7
Number of Beds	54	276	554	432	661	1010
Hours Worked per Year	40	207	567	300	687	1,318
Hourly Rate	36	\$127.81	\$160.26	\$150.00	\$197.18	\$210.45

Radiation Oncology Medical Director Fees

	N	P25	MEAN	P50	P75	P90
Net Revenue (millions)	22	\$167.0	\$352.3	\$240.9	\$420.2	\$658.7
Number of Beds	22	266	443	382	511	694
Hours Worked per Year	17	144	453	240	416	1,092
Hourly Rate	17	\$115.00	\$178.56	\$179.49	\$208.00	\$281.14

Call Coverage

- Generally not applicable to medical or radiation oncologists
- SullivanCotter *Physician On-Call Pay Survey Report 2008* does not report on medical or radiation oncology

Infusion Under Arrangements

- Legal perspective – Dead, dying, or still alive?
- If permissible, an under arrangement maybe an alternative to an acquisition/employment arrangement

Infusion Under Arrangements

- Relatively new, and not too prevalent
- Hospital revenue may be much higher, but...
- Heed caution regarding the “Top Down” approach

Co-Management Arrangements

- These arrangements typically involve physician/hospital ventures to manage hospital service lines, with compensation consisting of base and incentive components.
- Oncology service lines seem very appropriate for co-management arrangements
- Pay for performance models seem to have broad support (including with regulators)

Co-Management Arrangements

- Compliance with FMV is critical for regulatory compliance, but also for the ultimate success of the project.
- Available valuation methodologies are limited and somewhat subjective.
- In considering the primary valuation approaches (cost, income and market), an income approach can likely be eliminated.
- Using a cost approach, FMV of the management fee can be established by assessing the required number of work hours needed to provide the management services multiplied by a fair market value hourly rate.
 - However, the exact number of required work hours cannot reasonably be determined in advance.
 - Further, a key ideal of most co-management arrangements is to reward results rather than time-based efforts.

Co-Management Arrangements

- A market approach recognizes that each co-management arrangement is unique, and reflects specific market and operational factors which are singular to the specific setting.
 - Break the specific services down into specific tasks and objectives, and then compare to other arrangements
 - On an item specific basis, assess the relative worth of each task/objective, and determine necessary adjustments to the comparable arrangements.
- The cost and market valuation methodologies described above must be reconciled to arrive at a final conclusion of value.
- The FMV of the *total management fee* must be established, as well as the *base* and *incentive* components.

“Per Click” Arrangements

e.g., Stereotactic JVs

- Legal perspective – What types of arrangements are permissible?
- Commercial reasonableness is paramount
- Iffy “per click” arrangements may cast a shadow on all “per clicks” transactions
- Uncertainty with respect to “normal” or projected volumes presents valuation challenges (particularly in the context of a new service)
- Consider the possibility of (i) a *descending* payment structure; (ii) a fixed fee plus a per click; and/or (iii) a payment “cap” to avoid windfall payments should volume escalate.
- Consider how FMV may be reassessed after the initial year(s)

Factors that Support the Commercial Reasonableness of Stereotactic JVs

- The technology is relatively new, expensive and complex.
- A limited number of procedures are expected to be performed each year.
- The parties to the JV each bear substantial risk.
- A hospital reasonably might be disinclined to offer these services without commitment from participating physicians.

Block Leases

- Legal perspective
- CMS concern re: IMRT block leases
- Structural requirements & FMV Implications