

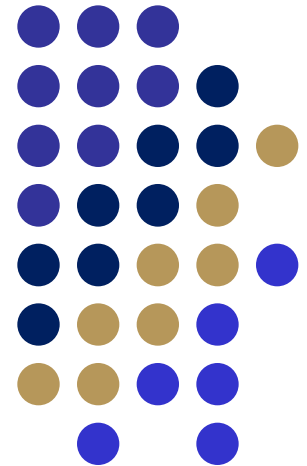
Valuing Physician Practices and Ancillary Service Lines

A Unique Perspective on Orthopaedic Practice Transactions

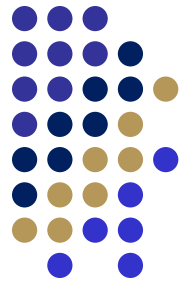
Presented by:

Stuart A. Neiberg, MAcc, CPA, CFA


HealthCare Appraisers
INCORPORATED

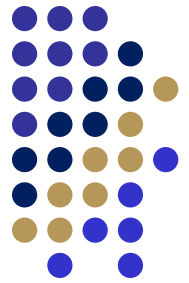


Physician Practice Acquisition Overview



- 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



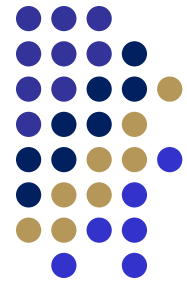
- Practice acquisition/employment transactions are occurring at a feverish pace.
- Valuers are polarized with respect to certain valuation approaches for practices.
- To establish FMV, you must first consider the proposed terms of the arrangement.
- Employment agreements can have many different features...and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

Physician Employment/ Practice Acquisition

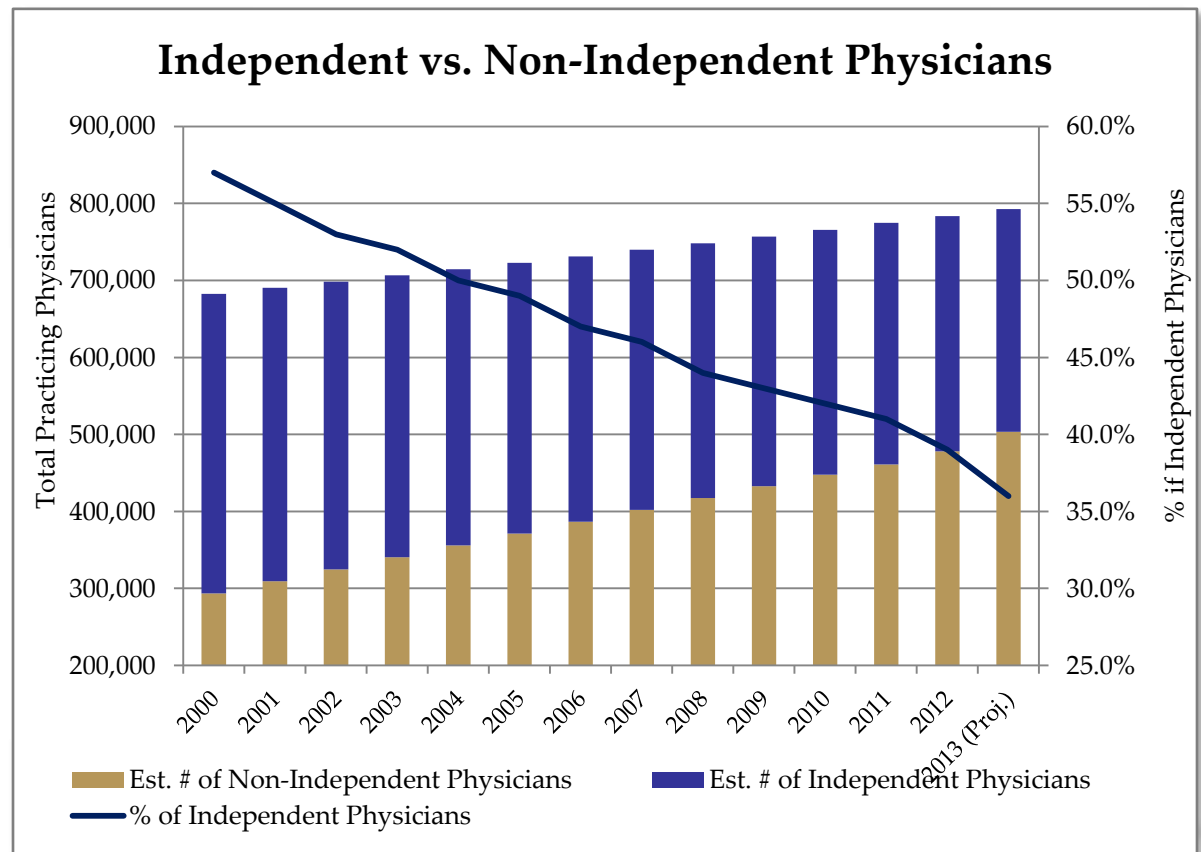


- Not only hospitals and health systems making acquisitions.
- Significant acquisition activity from insurance companies and managed care administrators to expand their network.
- Are these acquisitions subject to FMV standard?

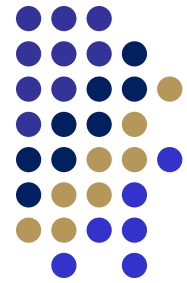
History of Physician Practice Acquisitions



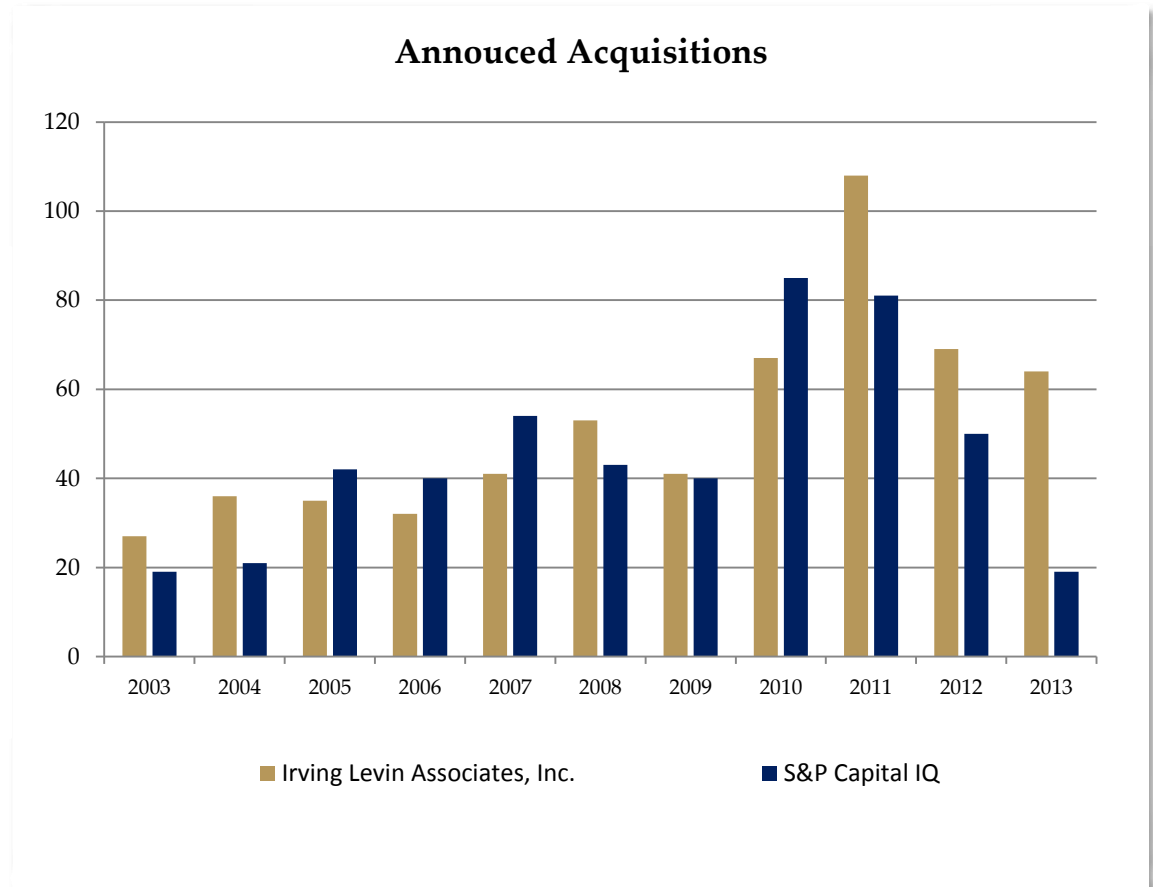
- The chart illustrates the physician employment trend over the past decade, primarily driven by reimbursement pressure and PPACA.



History of Physician Practice Acquisitions



- The chart illustrates the physician practice acquisition trend over the past decade.
- These two databases report only a small percentage of the total acquisition activity in the US, but the data confirms HAI's experience of heightened acquisition activity following the passage of PPACA.

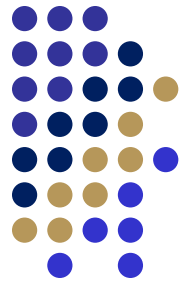


Acquisition Structure & Compensation Models



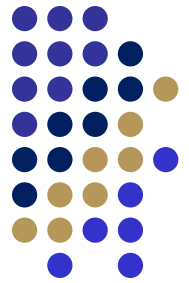
- Over 95% of transactions are structured as an asset purchase and subsequent employment of physicians, with the buyer acquiring
 - Inventory
 - Tangible Assets (equipment, etc.)
 - Identified Intangible Assets
- Post-Acquisition compensation must be factored into purchase agreement. The majority of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

Acquisition Structure & Compensation Models



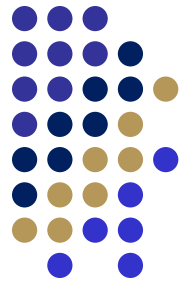
- Alternative structure considerations
 - Synthetic employment (PSA, etc.)
 - Carve out of department or select physician specialties
 - Lease of practice's tangible assets and employees
 - Ancillary carve-outs

Overview – FMV Standard



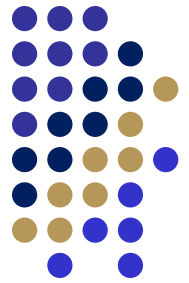
- Healthcare regulations stipulate **fair market value** as the applicable standard of value.
- The definition of **fair market value** in healthcare is slightly different than the standard valuation definition.
 - the price at which property would change hands between a hypothetical willing and able 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.



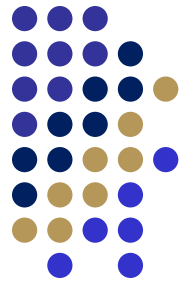
Physician Practice Valuations



- 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.**

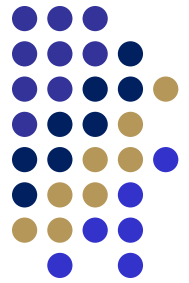


Physician Practice Acquisitions



- 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 DME).
 - 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

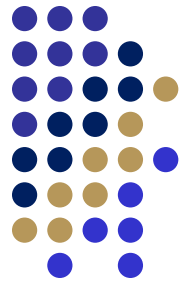
Physician Employment/ Practice Acquisition



HAI's positions on practice valuation

- No one valuation methodology is appropriate in all cases.
- In order for intangible value to exist there, we do not need to fully support value by an income approach. (*Cost approach can be used, but must be based on a valuation of a legitimate contractual obligation*).
- Post-acquisition compensation must be incorporated into the valuation analysis under all valuation methodologies.

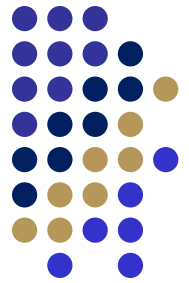
Physician Employment/ Practice Acquisition



HAI's positions on practice valuation

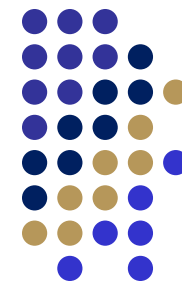
- “Make believe” DCF assumptions are not a justifiable methodology to support intangible value.
- Increases in compensation relative to historical levels will result in a “compensation offset”.
- Some compensation models will result in the purchase price being limited to that of the fixed assets only.

Physician Employment/ Practice Acquisition



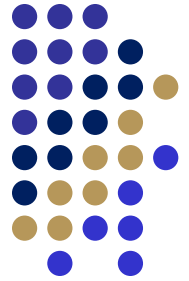
HAI's positions on practice valuation

- Is there value in connection with most MD practices?
Typically value created over time is manifested in MD compensation (*i.e.*, compensation to owners likely exceeds what can be earned as an employee within another practice setting.)
- Practices typically less concerned with liquidity event than locking in compensation as long as possible and partnering with viable long-term partner



QUESTIONS?

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