

National Urgent Care Convention



*Planning. Adapting. Succeeding:
New Strategies for Changing Times*

April 27-30, 2015
Hyatt Regency Chicago

Financial Modeling & Valuation

Stuart A. Neiberg, MAcc, CPA, CFA
Director | HealthCare Appraisers, Inc.

CHICAGO



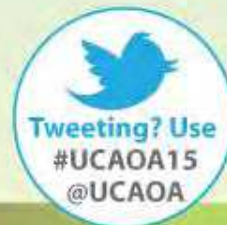
Presentation Outline

- Why is Financial Modeling and Valuation Important? Industry Overview and Trends in Acquisitions/ Divestitures
- What is Fair Market Value/Investment Value?
- Financial Modeling and Valuation 101: Approaches and Methods and Increasing Value within their Construct.



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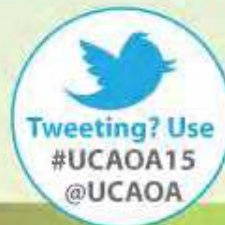
Urgent Care Industry Overview

- One of the fastest growing segments in healthcare
 - Approximately 9,000 centers in the U.S. providing urgent care services
 - Over 160 million visits annually
 - Average of 357 weekly patient visits per center
 - Almost 70% of the patients wait less than 20 minutes to see a physician, nurse practitioner or physicians assistant.
 - Majority of centers are owned by corporations (30.5%), physicians/groups of physicians (35.4%), or hospitals (25.2%)
 - Industry is expected to grow 40% by 2017.
- <http://www.hfma.org/Content.aspx?id=21849>



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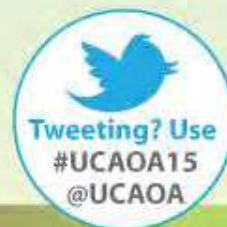
Trends in Urgent Care Acquisitions and Divestitures

- Significant acquisition activity from hospitals to expand their network
 - Generate referral volume from urgent care as opposed to primary care network
 - Not as important to employ primary care physicians if entering the urgent care market
 - If they have additional resources, can be used easily in an urgent care setting



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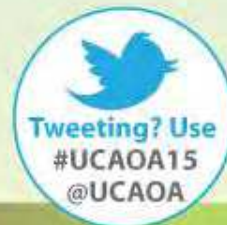
Trends in Urgent Care Acquisitions and Divestitures

- While large corporations have historically purchased urgent care centers in order to increase their market share in certain geographic locations, they now seem to employ more of a “*de novo*” strategy.
- (+)Advantages/(-)Disadvantages of *de novo* centers
 - (+)No renovation/relocation of existing facility
 - (+)No provider/staff turnover – no cultural change
 - (+)No systems migration
 - (-) No brand/location equity



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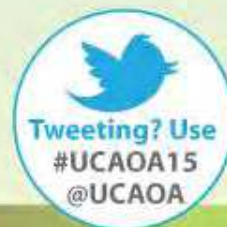
Trends in Urgent Care Acquisitions and Divestitures

- Urgent Care and the Affordable Care Act
 - Payor parity
 - Urgent care role with ACOs



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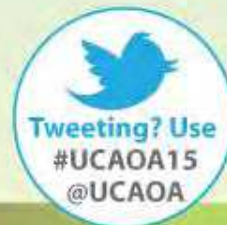
Standards of Value

- Valuation is **forward** looking
- Standard of value in most healthcare transactions is **Fair Market 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”*



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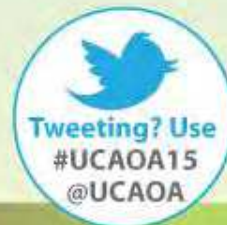
Standards of Value

- Investment value may also be an appropriate standard of value depending on the buyer.
- **Investment value:**
 - The value of a property to a *particular investor*.... It is equal to the specific value for the investor who has the capacity to put the property to good use—its highest-and-best-use, its most valuable use.
 - *Implications of “capacity to put to good use”*
 - *Hypothetical vs. Specific*



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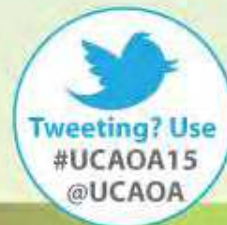
Valuation 101

- **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.
- Most common methods: Discounted Cash Flow Method and Capitalization of Earnings Method



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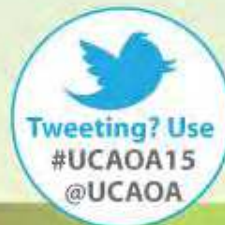
Future Economic Benefits = FCF

- Firm earnings + non-cash expenses – expected capital expenditures +/- increases/decreases in working capital = *Free Cash Flow*
- Free cash flows to the firm are *discounted* using WACC
- Free cash flows to equity are *discounted* using cost of equity



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Please see Chart 1 Handout

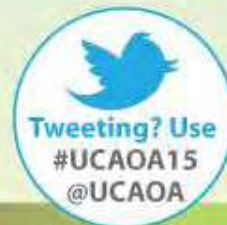
Example – Discount Rate Buildup

Cost of Equity Estimation		Source:
Risk Free Rate of Interest	2.47%	Federal Reserve Board - 20 Year Bond Yield as of 12/31/2014
+ Equity Risk Premium	6.21%	Implied equity risk premium as of 12/31/2014
= Market Return on Equity	8.68%	sum of above
+/- Industry Risk Premium	0.00%	Morningstar SBBI - SIC # 8011 - Offices and Clinics of Doctors of Medicine
+/- Size Risk Premium	5.99%	Duff & Phelps Valuation Handbook - Size Decile 10
+/- Company Specific Risk Premium	7.00%	Estimated by HealthCare Appraisers, Inc. on Exhibit E.2
= Required Return On Equity (K_e)	21.70%	sum of above, rounded
Cost of Debt Estimation		
Nominal Borrowing Rate	6.68%	Federal Reserve Board - Baa Interest Rate as of 12/31/2014 plus 2%
Effective Tax Rate	7.00%	See Exhibit H.3
After Tax Cost of Debt (K_d)	6.20%	nominal rate x (1-tax rate), rounded
Weighted Average Cost of Capital (WACC)		
% Equity In Capital Structure (W_e)	80.00%	Based upon discussions with Practice and our experience with similar entities.
% Debt In Capital Structure (W_d)	20.00%	
Weighted Average Cost of Capital	18.60%	$WACC = (K_e \times W_e) + (K_d \times W_d)$



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Please see Chart 2 Handout

Discounted Cash Flow Model

	Low Weighted Average Cost of Capital ("WACC")					Terminal Year
	2013	2014	2015	2016	2017	
Free Cash Flow	\$716,731	\$689,381	\$819,707	\$916,550	\$1,014,428	\$1,076,696
Partial Period Factor	0.25					
Discounting Periods (mid-point)	0.13	0.75	1.75	2.75	3.75	
Present Value Factor @ 14.0%	0.9838	0.9064	0.7951	0.6974	0.6118	
Present Value of Cash Flow	134,776	624,855	651,749	639,202	620,627	

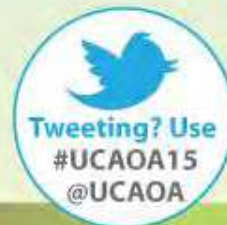
Present Value of Projected Cash Flows	2,671,209	
Present Value of Terminal Value Calculation	<u>5,489,355</u>	
Indicated Market Value of Total Capital	<u>\$8,160,564</u>	
Less: Debt	(1,529,861)	Exhibit B.2
Plus: Surplus Cash	<u>601,000</u>	Exhibit C.5
Indicated Market Value of Equity (Rounded)	<u>\$7,232,000</u>	
(control, marketable)		

<u>Terminal Value Calculation</u>	
Free Cash Flow in Terminal Year	1,076,696
Divided by Capitalization Rate (WACC - LTGR of 2.00%)	<u>12.00%</u>
Equals Terminal Value in 2017	8,972,466
Present Value Factor for 2017	<u>0.6118</u>
Present Value of Terminal Value	<u>\$5,489,355</u>



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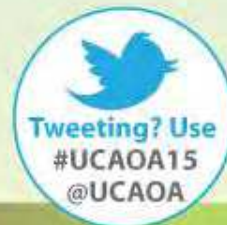
When and Why?

- Is the center cash positive (*i.e., are there positive earnings available to discount*)?
- Is the center expecting growth and/or material operational changes?
 - Discounted Cash Flow Method
- Is the center expecting minimal growth and/or stable operations?
 - Capitalization of Earnings Method



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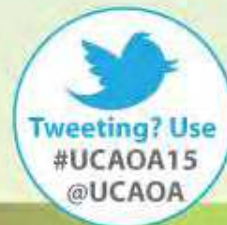
Valuation 101

- **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.
- Most common methods: Guideline Publicly Traded Method and Comparative Transactions Method



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Multiples

The Meaning Behind the Numbers

- The Finance Definition (a.k.a. Appraiser speak)
“A mathematical expression of risk and growth, which when applied to a perpetually recurring earnings stream results in an indication of value”
- A multiple is mathematically expressed as follows:

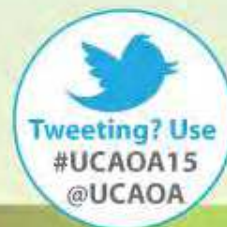
$$\frac{1}{(K - g)}$$

- Where, (K) represents the rate of return (risk), and
- (g) represents the growth rate of the earnings stream



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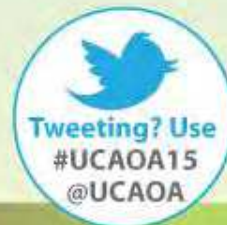
Scenario Analyses

	<u>Varying Growth</u>			<u>Varying Risk</u>		
	<u>Scen 1</u>	<u>Scen 2</u>	<u>Scen 3</u>	<u>Scen 1</u>	<u>Scen 2</u>	<u>Scen 3</u>
k	17.0%	17.0%	17.0%	17.0%	19.0%	22.0%
g	2.0%	3.0%	4.0%	2.0%	2.0%	2.0%
Multiple	6.67	7.14	7.69	6.67	5.88	5.00



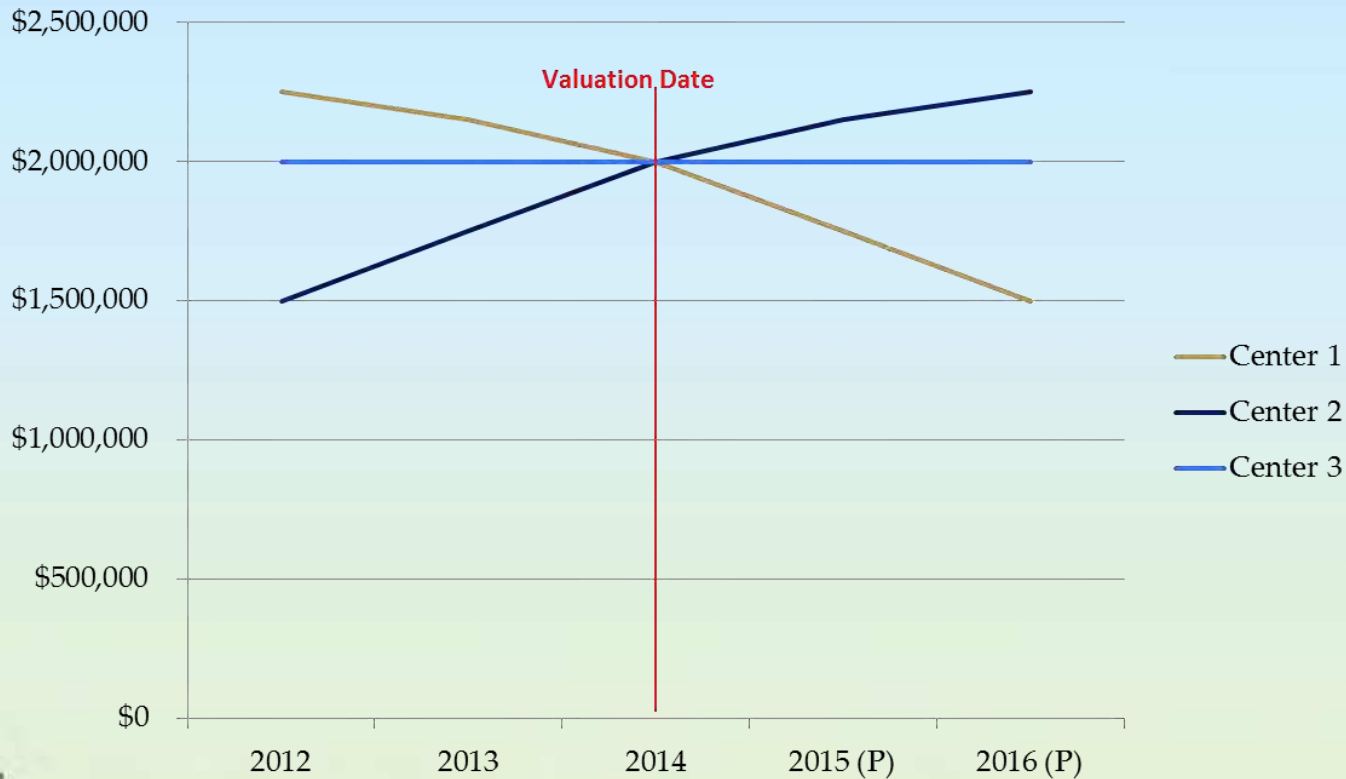
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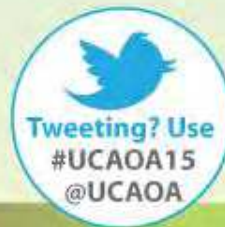
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Three Urgent Care Centers with \$2.0M EBITDA



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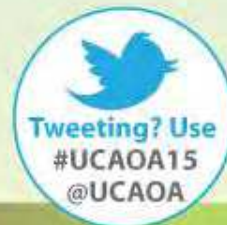
When and Why?

- Is the center cash positive? Multiples require a revenue/profits stream.
- Are there *comparable* entities? Are they *recent*?
- Are the transactions between two healthcare entities? (Anti-kickback Statute, Stark law)
- Adjustments to market multiple



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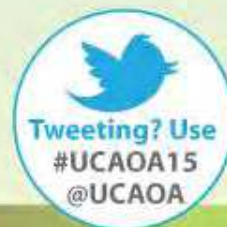
Valuation 101

- **Asset or 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.
- Cost to recreate



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Please see Chart 3 Handout

Example – Intangible Asset Value

Credentials Subspecialty	Hire Date	Tenure (years)	Pay Rate	Annualized Wages	Annualized Benefits	FTE	DOB	Age	Recruiting Fees	Advertising	Interview Expenses	Relocation	Signing Bonus	Training (months)	Training Costs	Adjustments
Physicians				(1)	(2)	(3)			(4)	(5)	(6)	(7)	(8)		(9)	(10)
Family Medicine	2/26/2003	11.1		\$147,000	\$22,050	0.2	7/10/1956	57.0	\$15,000	\$3,000	\$7,500	\$10,000	\$25,000	3.0	\$42,263	\$0
Emergency Medicine	12/1/2013	0.3		\$160,000	\$24,000	1.0	5/22/1955	58.9	\$25,000	\$3,000	\$7,500	\$10,000	\$25,000	3.0	\$46,000	\$0
General Surgery	8/16/2010	3.6		\$163,000	\$24,450	1.0	12/29/1969	44.3	\$25,000	\$3,000	\$7,500	\$10,000	\$25,000	3.0	\$46,863	\$0
Family Medicine	1/2/2013	1.2		\$163,200	\$24,480	1.0	4/12/1958	56.0	\$25,000	\$3,000	\$7,500	\$10,000	\$25,000	3.0	\$46,920	\$0
Emergency Medicine	10/1/2012	1.5		\$177,650	\$26,648	1.0	9/20/1952	61.5	\$25,000	\$3,000	\$7,500	\$10,000	\$25,000	3.0	\$51,074	(\$60,787)
Family Medicine	1/1/2008	6.3		\$178,248	\$26,737	1.0	1/12/1959	55.2	\$25,000	\$3,000	\$7,500	\$10,000	\$25,000	3.0	\$51,246	\$0
Subtotal Physicians				\$989,098	\$148,365	5.2			\$140,000	\$18,000	\$45,000	\$60,000	\$150,000		\$284,366	\$637,000
Midlevels				(1)					(2)				(3)		(4)	(5)
ARNP	7/7/2009	4.7	\$55.00	\$102,960	\$15,444	0.9	1/7/1973	41.2	\$15,444				\$7,000	2.0	\$19,734	\$0
PA	4/19/2008	6.0	\$50.00	\$52,000	\$7,800	0.5	3/21/1965	49.0	\$7,800				\$5,750	2.0	\$9,967	\$0
ARNP	2/26/2003	11.1	\$57.12	\$106,929	\$16,039	0.9	9/14/1949	64.5	\$16,039				\$7,000	2.0	\$20,495	(\$21,767)
Subtotal Midlevels				\$261,889	\$39,283	2.3			\$39,283				\$19,750		\$50,195	\$87,000
Clerical				(1)					(2)				(3)		(4)	(5)
Patient Service Rep	4/28/2010	3.9	\$11.11	\$11,554	\$1,733	0.5	11/7/1990	23.4	\$578					0.5	\$554	\$0
Patient Service Rep	11/20/2013	0.4	\$10.00	\$10,400	\$1,560	0.5	2/24/1992	22.1	\$520					0.5	\$498	\$0
Patient Service Rep	5/7/2013	0.9	\$10.00	\$20,800	\$3,120	1.0	4/25/1991	22.9	\$1,040					0.5	\$997	\$0
Patient Service Rep	11/3/2010	3.4	\$12.32	\$25,626	\$3,844	1.0	9/8/1970	43.6	\$1,281					0.5	\$1,228	\$0
Senior PSR	3/18/2009	5.0	\$14.34	\$29,827	\$4,474	1.0	2/3/1952	62.2	\$1,491					1.0	\$2,858	(\$2,175)
Subtotal Imaging				\$485,326	\$72,799	20.5			\$24,266						\$25,389	\$46,000
Clinical				(1)					(2)				(3)		(4)	(5)
MA/BMO	1/5/2009	5.2	\$16.12	\$33,530	\$5,029	1.0	4/30/1988	25.9	\$3,353					1.0	\$3,213	\$0
RT/MA	11/14/2013	0.4	\$14.00	\$29,120	\$4,368	1.0	12/5/1987	26.3	\$2,912					1.0	\$2,791	\$0
RT/MA	10/11/2012	1.5	\$14.50	\$30,160	\$4,524	1.0	7/3/1989	24.7	\$3,016					1.0	\$2,890	\$0
Paramedic	9/16/2008	5.5	\$16.00	\$16,640	\$2,496	0.5	12/15/1974	39.3	\$1,664					1.0	\$1,595	\$0
Paramedic/PT	7/17/2013	0.7	\$13.00	\$13,520	\$2,028	0.5	12/3/1986	27.3	\$1,352					1.0	\$1,296	\$0
Subtotal Clinical Support				\$752,024	\$112,804	25.5			\$75,202						\$72,069	\$144,000
Administration				(1)	(2)				(3)		(4)		(5)		(6)	(7)
CEO	2/26/2003	11.1	N/A	\$200,000	\$30,000	0.8	7/10/1956	57.7	\$20,000		\$5,000		\$10,000	2.0	\$38,333	\$0
Director Business Ops	2/24/2014	0.1	N/A	\$75,000	\$11,250	1.0	6/21/1969	44.8	\$7,500		\$5,000		\$3,750	2.0	\$14,375	\$0
Office Mgr	7/18/2011	2.7	N/A	\$33,370	\$5,006	1.0	9/9/1986	27.6	\$3,337		N/A		N/A	1.0	\$3,198	\$0
Administrator	1/21/2003	11.2	N/A	\$80,000	\$12,000	1.0	11/12/1965	48.4	\$8,000		\$5,000		\$4,000	2.0	\$15,333	\$0
Clinical Director	2/26/2003	11.1	N/A	\$72,000	\$10,800	1.0	7/4/1963	50.7	\$7,200		N/A		N/A	1.0	\$6,900	\$0
Business Development	1/24/2008	6.2	N/A	\$37,440	\$5,616	1.0	9/14/1982	31.5	\$3,744		N/A		N/A	1.0	\$3,588	\$0
Subtotal Administration				\$748,939	\$112,341	12.8			\$74,894		\$15,000		\$17,750		\$105,794	\$213,000
															Non-Physician Staff Total	\$490,000

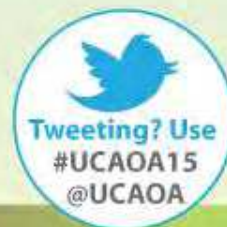
When and Why?

- If the center is not cash positive – it has limited economic benefits to discount and its value is in the assets it owns.
- If the center is cash positive – its future economic stream can support intangible asset value.
 - Examples of intangible assets: workforce-in-place, trade name and electronic medical records



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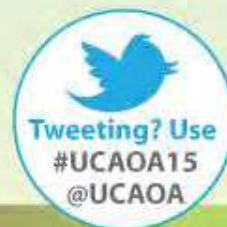
When to Apply Different Approaches?

- Does the subject urgent care facility operate more like an outpatient clinic or a physician practice?
- Are the owners also the primary clinicians?
- Highest and best use of center?
- Are there earnings in the business?



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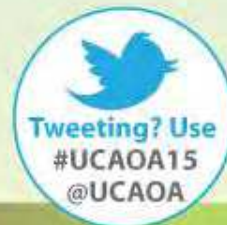
Acquisition Structure & Compensation Models

- Over 95% of majority interest transactions are structured as an asset purchase and subsequent employment of clinical staff. The assets include the following:
 - Inventory
 - Tangible Assets (equipment, etc.)
 - Identified Intangible Assets
- Post-Acquisition compensation may need to be factored into purchase agreement
 - Hours or shifts worked
 - % of Professional Collections or Pre-Compensation Earnings
 - wRVUs x Conversion Factor



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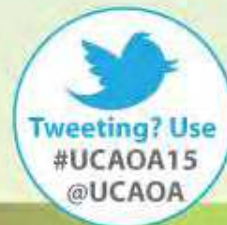
Minority vs. Majority Control

- Increasing value is not always the goal...
- Interests providing absolute control (*e.g.*, greater than a 50% interest) are worth more than interests which do not have the same control rights.
- Control granted by the governing documents
Examples include:
 - Major equipment purchases and investments
 - Debt signing authority
 - Admitting new owners



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QUESTIONS?



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