

The Valuation of Medical Practices



Overview

- Industry Trends
- Factors Affecting Medical Practice Values
- Valuation Considerations
- The Valuation Process
- Selecting an Appraiser
- Our Experience in the Healthcare Industry

Industry Trends

- The traditional model of healthcare delivery has changed over the past decade
- Younger physicians are opting out of private practices, choosing hospitals and medical groups instead
- Older physicians, faced with rising operating costs, reimbursement pressure, and a lack of recruits to hire, are selling their practices and switching to salaried positions

Industry Trends (Continued)

- Only about 33 percent of U.S. physicians are currently unaffiliated with any group, down from 57 percent in 2000¹
- Medical practices owned by hospital systems have increased from 14 percent in 2012 to 29 percent as of July 2016²
- Physicians working for hospital systems have increased from 26 percent to 42 percent over the same period³
- A recent survey indicated that independent physicians expect this trend to continue⁴
- 44 percent of the independent physicians surveyed expect to sell their practice within the next 10 years⁵

Industry Trends (Continued)

- These shifts stem from U.S. government incentives and private health insurer policies
- Increased Medicare payments for procedures performed at outpatient facilities owned by a hospital system have led to increased vertical integration⁶
- Independent physicians are open to being acquired due to lower reimbursement when operating alone, combined with the costs associated with increased administrative burdens⁷
- Independent physicians recognize the benefits of being associated with well-known healthcare systems⁸

Factors Affecting Medical Practice Values

Physicians
are
Integral to
Critical
Decision
Making

- Performing medical procedures
- Referring patients to other healthcare providers
- Ordering medical equipment

Factors Affecting Medical Practice Values (Continued)

Medical Practice Characteristics

- Competition within local area
- Number of physicians
- Physician specialties
- Revenue distribution among physicians
- Ability to replace a physician

Factors Affecting Medical Practice Values (Continued)

- Medical practices are subject to industry-specific federal and state laws, such as anti-kickback laws and Stark laws
 - Anti-kickback laws prohibit physicians from soliciting payment for the referral of, or arranging the referral of, items, services, or patients reimbursed by any federal or state healthcare program
 - Stark laws generally prohibit physicians referrals for certain designated health services payable by Medicare or Medicaid to an entity with which the physician or an immediate family member has a financial relationship

Factors Affecting Medical Practice Values (Continued)

- Due to the tax-exempt status of many healthcare organizations, certain guidelines by the Internal Revenue Service and other government agencies must be followed

Valuation Considerations

- Market and economic factors related to the healthcare industry
- Local market and how it influences the volume of patients and the insurance mix
- Healthcare laws and regulations

Valuation Considerations (Continued)

- Goodwill is comprised of professional/personal goodwill and practice/commercial goodwill
- Practice goodwill is included, but in certain instances, such as marital dissolution, professional goodwill is excluded

Valuation Considerations (Continued)

Professional goodwill arises from personal attributes of a specific doctor

- Education
- Personality
- Board certifications
- Personal reputation and bedside manner

Valuation Considerations (Continued)

Practice goodwill arises from attributes of the medical practice

- Location
- Staff
- Protocols
- Practice reputation

Valuation Process

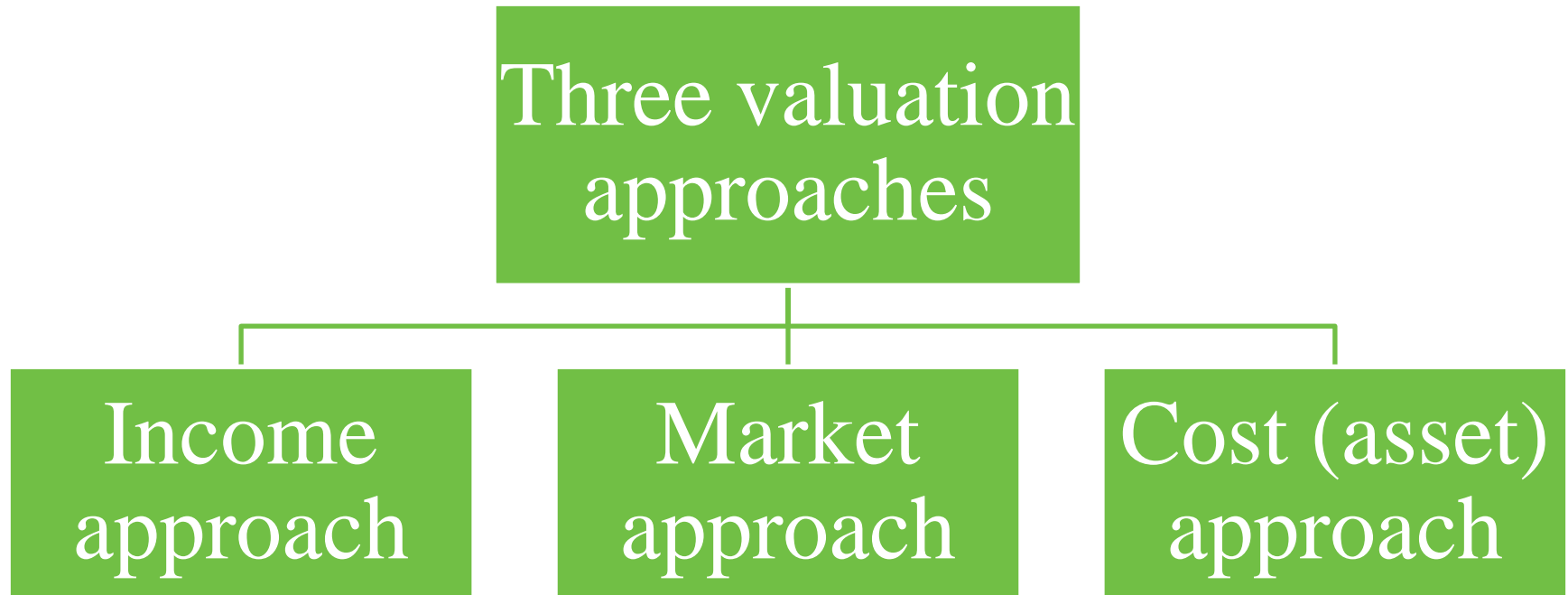
Determine the valuation date

Specify the interest to be valued

Identify the purpose of the valuation

- Different purposes require different standards of value (for example, fair market value vs. fair value vs. investment value)

Valuation Process (Continued)



Income Approach

- Reduce expected future economic benefits to present value
- Discounted cash flow method is the most widely used method of the income approach
- Determine key assumptions regarding revenue, expenses, taxes, working capital, and capital expenditures
 - An appraiser needs to understand the revenue stream
 - Salaries and wages of physicians need to be considered when determining operating expenses
 - Supply costs vary based on procedures performed
 - Capital expenditures vary widely by type of medical practices
 - Technological innovations must be considered when determining levels of capital expenditures and the frequency of replacing equipment

Market Approach

- Determine valuation multiples to apply to the fundamentals of the company
- Two common methods
 - Guideline transaction method
 - Valuation multiples based on the transaction prices of recently acquired medical practices
 - Guideline company method
 - Valuation multiples based on the stock prices of reasonably similar publicly traded companies

Market Approach (Continued)

- Limitations exist for both methods
- The facts and circumstances surrounding observed transactions may cause the reported price to misrepresent the true value
- Guideline companies tend to be much larger (higher revenue, more offices, etc.) and may not be appropriate when valuing an individual practice or a small group of practices

Cost Approach

- Based on the principle of substitution, assumes that a buyer would pay no more than it would cost to produce a similar substitute
- Requires identification and appraisal of each tangible and intangible asset
- Values are combined to determine the aggregate value of the company

Adjustments

- Once a value has been determined for the medical practice, adjustments may be applicable depending on the specific interest being valued
- A minority interest may require a discount for lack of control
- A discount for lack of marketability should also be considered

Selecting an Appraiser

- Certifications and experience enhance credibility if needed as an expert witness
- Members at Appraisal Economics hold designations and credentials from organizations such as the American Society of Appraisers, the American Institute of CPAs, the CFA Institute, and various real estate licensing boards
- Appraisal Economics also has experience providing expert witness testimony in federal, state, and tax courts, at arbitration hearings, and at Federal Communication Commission hearings

Our Experience in the Healthcare Industry

- Some of our assignments have included valuations of:
 - Individual assets of a first-aid supply company, for financial reporting purposes
 - Intangible and tangible assets including customer relationships, technology, tradenames, and inventory, for a purchase price allocation in accordance with ASC 805
 - Equity in a provider of medical services to nursing facilities, for estate tax purposes
 - Equity in a medical device company for the Internal Revenue Service, related to a tax dispute
 - Preferred equity of a biotech company in Phase 2 of FDA clinical trials, for tax purposes

For More Information

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Endnotes

1. “IBISWorld Industry Report 0D6029: Medical Group Practice Management in the U.S.”, April 2018.
2. “Updated Physician Practice Acquisition Study: National and Regional Employment Changes in Physician Employment” March 2018, Physicians Advocacy Institute.
3. Ibid.
4. Ibid.
5. “2015 Independent Physician Outlook Survey”, Procure Systems.
6. “Medicare Payment Differentials Across Outpatient Settings of Care”, February 2016, Avalere Health.
7. “2015 Independent Physician Outlook Survey”, Procure Systems.
8. “10 Emerging Healthcare Trends for 2016”, Julie Bird, FierceHealthcare.