WHAT IS A PHYSICIAN PRACTICE WORTH IN TODAY'S CHAOTIC WORLD OF HEALTH CARE?

By Donald Parker

There are many reasons throughout a physician's career that may require the appraisal of his or her practice, such as changes in partnership structure, estate planning needs or the distribution of marital assets in divorce settlements. But, the most important need for the use of a professionally-credentialed valuation consultant is to ensure that when it comes time to sell, physicians receive full fair market value for their interest in the practice while ensuring that the transaction complies with all applicable regulations such as the Stark laws and anti-kickback regulations.

Planning a transition/exit strategy

The reasons for selling a physician practice vary. Some physicians would simply like to get back to the practice of practicing medicine and dispense with management of the practice. In this case, physicians may be willing to transition their practitioner status from employer to employee. For others, instead of a transition, their objective might be better defined as an exit strategy in which they wish to sell their practice (or an interest therein), receiving full fair market value for what they are leaving behind.

In any case, whether planning a transition or exit strategy, there are numerous complex issues that affect the value of all physician practices. As with any business, but especially in the case of physician practices, it is important to begin the planning process well ahead of the anticipated transaction.

The key to any successful transition or exit strategy is securing a team of trusted advisors, including a practice valuation consultant, very early in the process. Retaining professionals that specialize in health care transactions will help assure that any sale results in the receipt of the full fair market value of the practice.

Physician practice valuation

In today's ever shifting healthcare environment, there has been much discussion among valuation professionals, the courts and the IRS regarding to the most appropriate methodologies for valuing physician practices. At the end of the day, however, all parties agree that the most defensible valuation results from a balanced approach based on sound, informed judgment and logic, experienced statistical analysis and the economic realities of the marketplace.

Determining the value of a physician practice requires addressing a variety of complex issues including, but certainly not limited to: practice specialty; years in practice; patient base (new & recurring); charges & collections; physician production (encounters & procedures), reimbursement rates; referral sources; economic conditions; industry metrics; local demographics; and operational data such as coding conventions, payor mix, provider agreements (including capitation limits) and hospital privileges.

While the underlying fundamentals of valuation are generally the same for physician practices as those for most businesses, there are subtle differences in their level of applicability. The fair market value of a physician practice involves the identification of two distinct categories of assets: Tangible and Intangible.

- Tangible assets include equipment and furniture, leasehold improvements, cash on hand, accounts receivable and certain deposits and prepaid items. Accounts receivable often require special attention because, while they should only include the amount actually expected to be collected, many physician offices carry accounts receivable at the full amount of the original charges. Further, since most practices keep their books on a cash basis, accounts receivable may not even appear on the financial statements. Finally, very often, accounts receivable will not be included in the sale price of the practice.
- Intangible assets include the practice name and reputation, the assembled work force (physician and non-physician), developed processes and procedures (including technology systems), provider agreements, the established patient base and accompanying medical records, location and telephone numbers, any synergy created by multi-physician practices and goodwill. Of these intangible assets, goodwill typically comprises the greatest value and is also the most difficult to assess a value. The technical definition of goodwill is beyond the scope of this article, but suffice it to say that goodwill is defined by the amount of income not directly attributable to identifiable assets. Goodwill includes such intangible assets as reputation, trade name and work force.

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Valuation methodologies

In almost all cases of business appraisal, as with physician practices, there are three generally accepted valuation approaches that should be considered.

- The income approach estimates the value of the practice by determining the present value of the expected future economic benefits.
- The market approach entails comparing the practice to similar physician practices that have transacted in the marketplace, inferring value by relating the price of the practice to the level of collections or physician production.
- The asset approach determines value based on the level of net assets. In other words, the amount of assets minus all liabilities.

Coloring inside the lines: Determining fair market value

While the specific intricacies of physician practice valuation are well beyond the scope of this article, the following touches on some of the more important considerations in estimating value.

Federal regulations, such as the Stark Law and Anti-Kickback Statute, mandate that transactions involving physician practices must not only be priced at fair market value, but must also serve a "commercially reasonable" purpose. FMV is defined by these regulations in a manner that is more nuanced than the standard definition of FMV and may preclude consideration of economic benefits that might otherwise be priced into a transaction for other types of businesses.

Standard definitions of fair market value

- The IRS has defined FMV as: "The price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts." [Rev. Ruling 59-60]

Fair market value as it relates to physician practices

- Stark Law defines FMV as: "The value in arm's length transactions, consistent with the general market value, means the price that the assets would bring as the result of a bona fide bargaining between well-informed buyers and sellers who are not otherwise in a position to generate business for the other party."

- The Anti-Kickback Statute further refines the definition of FMV, introducing the following language: "Where the price or compensation has not been determined in any manner that takes into account the volume or value of anticipated or actual referrals."

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Commercially Reasonable

- Commercial Reasonableness is defined as "An arrangement…entered into by a reasonable entity of similar type and size and a reasonable physician (or a family member or group practice) of similar scope and specialty, even if there were not potential DHS [Designated Health Services] referrals." [69 Fed Reg p. 16093]

In addition to the above refined distinctions, most recently, the Patient Protection and Affordable Care Act (or Obamacare) is driving an increase in hospital and health system acquisitions of physician practices brought about by a push to align patient care across providers, changing reimbursement models and healthcare reform compliance.

This is sure to add to the ever-changing landscape of physician practice valuation even beyond the impact of current regulations and, as such, further demonstrates the need for valuation analysts with specific expertise in the healthcare industry.

It's not a "one-size-fits-all" proposition

Every valuation engagement has its own peculiarities. Business appraisal has always been an exercise of part art and part science that endeavors to reach an estimation of value within a reasonable range.

So, when you ask "What is my practice worth?" a definitive answer may be elusive, but common sense, professional judgment and applied statistical analysis can result in a valuation that is balanced, unbiased and defensible against the potential pitfalls created by ever increasing layers of regulation.

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