



2011 CANCER CENTER BUSINESS SUMMIT



Achieving Accountable Cancer Care

October 13 – 14, 2011

Palmer House Hotel • Chicago, Illinois



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Achieving Accountable Cancer Care

Buying and Selling Oncology

Practices: A Valuation

Overview

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October 13 – 14, 2011

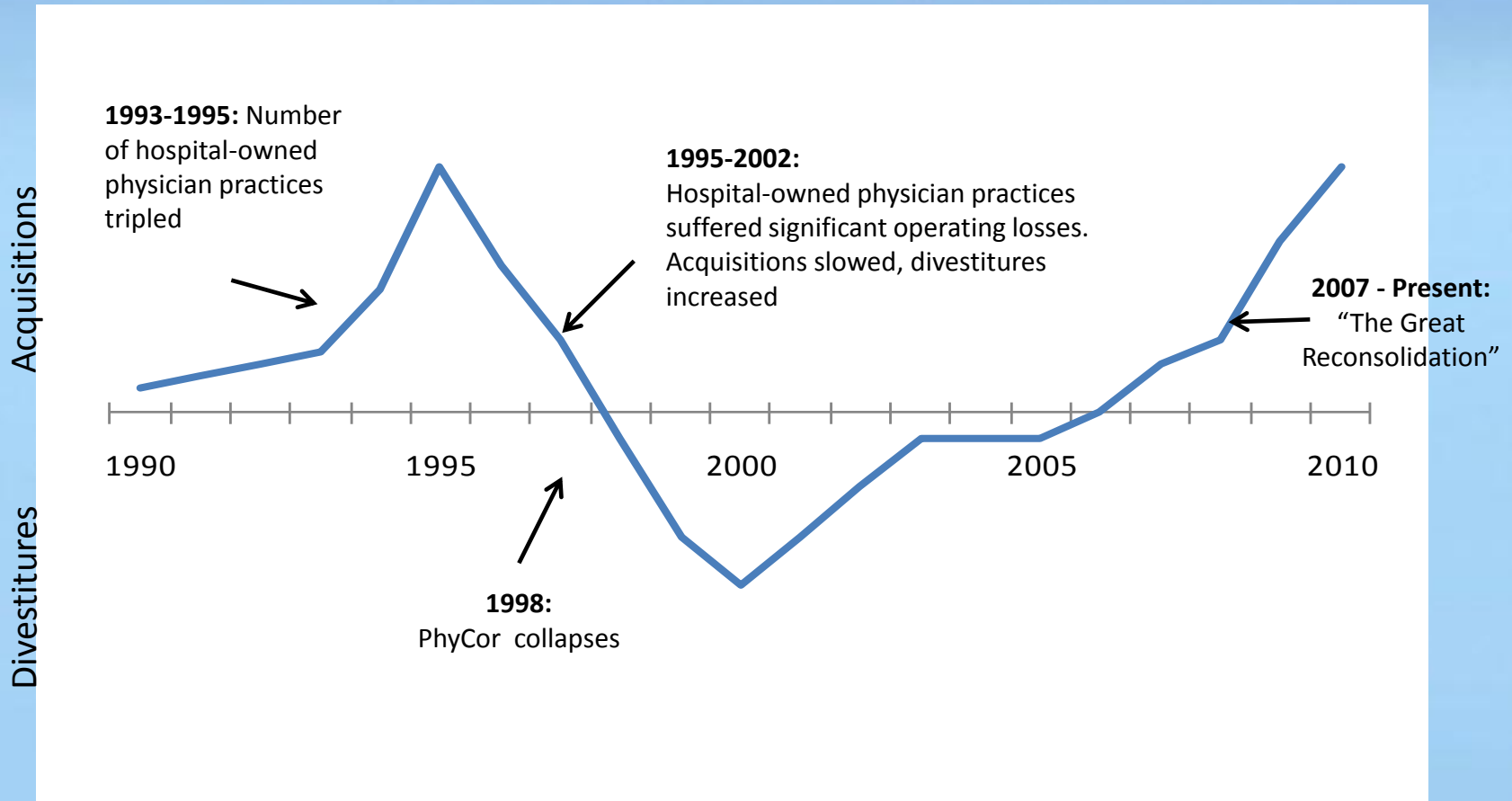
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Session Overview

My focus today will be on:

- History of Physician Employment by Hospitals
- Current Drivers
- Valuation Approaches
- Professional Practice
- Technical Practice
- Selling Both Professional & Tech
- Considerations
- Questions

Physician Transaction History



History of Physician- Hospital Relationships

- 1995 to 2002: What Went Wrong
 - Hospitals reacted defensively to perceived threats – PPMs
 - Economic incentives were not aligned
 - Physicians became frustrated with how hospitals ran practice
 - Physicians felt they had lost control of their practice
 - Significant operating losses
 - Valuations were not sound

History of Physician- Hospital Relationships

- 2007 to Present: The Great Reconsolidation
 - Physician Consolidation Motivation
 - Physician desires to be shielded from market forces
 - Access to Capital constrained
 - Reimbursement Cuts (Drastic in some cases)
 - Difficult to Grow
 - Healthcare Reform

History of Physician- Hospital Relationships

- 2007 to Present: The Great Reconsolidation
 - Hospital Consolidation Motivation
 - Addressing staffing shortages
 - Call coverage
 - Increase market share and reduce the threat of competition
 - Additional reimbursement from physicians' ancillary services
 - Higher reimbursement under OPPS
 - Need to improve quality

Valuation – Type of Value

- Fair Market Value-
- The only premise of value to meet the Anti-Kickback Statue and Private Inurement Regulations
 - *Definition* – The price, expressed in terms of cash equivalents, at which a property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms length in an open and unrestricted market, when neither is under compulsion to buy nor to sell, and when both have reasonable knowledge of the relevant facts.
 - FMV can consider revenue increases or cost savings to the Practice that any hypothetical willing buyer would be able to influence but not specific downstream referrals the Practice drives to a health system

Valuation – Type of Value

- Investment Value or Strategic Value
 - Premise of value used everyday in merger and acquisitions which are not required to meet Fair Market Value standards
 - *Definition* – The price, at which a property would exchange hands between a specific buyer and able seller; it is the value of a property to a particular investor
- Examples of FMV / Investment Value:
 - Investment Value: Adjusting the reimbursement rates for the sellers freestanding business up to Hospital based (Provider Based)
 - Fair Market Value: Adjusting the reimbursement rates for the sellers freestanding business up to freestanding market averages

Valuation Approaches - Professional vs. Technical

- Valuation – Three Approaches

Primary Approach
By Type of Business

Professional
Practice
(Pro Fee)

Radiation
Therapy
(Tech Fee)

– Income Approach

- Discounted Cash Flow Method



– Cost Approach

- Tangible Assets
- Intangible Assets



– Market Approach

- Guideline Public Company Method
- Similar Transactions Method



Professional Practice – Valuation

- 2 Valuations – Professional Practice and Compensation
 - Value upfront = Acquisition Price
 - Value ongoing = Employment Agreement
- Most of the time Fixed Assets / Little Intangible (Goodwill) Value
 - Why?
- Exceptions
 - Profitable employment relationships with physicians and mid-levels
 - High levels of ancillaries – Discussed in Rad Therapy
 - Requires sacrificing earnings

Professional Practice - Compensation

- What will the employment agreement look like?
- Compensation
 - Typically guaranteed for 2 years at historical levels or in some cases more, with upside
 - Productivity based after initial guarantee period
 - Work RVUs
 - Net Professional Collections
 - % of Earnings / Profitability (Virtual Private Practice)
- Other key terms
 - Term
 - Typically include outs without cause
 - Buy-back provisions
 - Non-competes

Radiation Therapy (Technical) - Valuation

- Value of Rad Therapy's Equity is Dependent on:
 - Value is dependent upon Future Earnings and Risk
 - Highly Dependent upon Actual Facts and Circumstances
 - Historical Earnings May Not Be Representative of Future
 - Many Risk Factors Must Be Incorporated into Valuation
 - Partnership Risks
 - External Risks
- Key Items driving profitability and risk
 - Referral source – ability to maintain
 - Level of dependence on IMRT/IGRT
 - IMRT/IGRT = Higher profitability = Higher Risk
 - Technology – relative to market (overall & local)
 - Competition

Radiation Therapy (Technical) - Valuation

- Control or Majority Equity Level Value:
 - Typical for hospital or management company buy-in
 - Higher valuation (think EBITDA @ 5.0X – 7.0X)
 - Premium value related to rights and privileges of majority owner
 - (management control, distributing level & timing, capital structure decisions, admission of new investors, etc.)
 - Buyer establishes new operating agreement with terms desired by the buyer
- Hospital/Provider Reimbursement for IMRT/IGRT for Medicare is lower than Freestanding

Radiation Therapy (Technical)– Items to Discuss

- A few key items not to “leave off the table”
 - Co-Management Agreements
 - Can create future earnings to providers
 - Assist hospital with ongoing management
 - Sale Lease Back
 - Can sell business with lease backs on equipment and or facility
 - Creates low risk future earnings stream for providers
 - Assists hospital with upfront cash
 - Potentially will not help with Balance Sheet Issues

Selling Both Professional & Technical

- Consider deal in Totality
 - 3 Distinct Valuations
 - Radiation Therapy Business
 - Professional Practice
 - Provider Compensation
 - Reality – “Can not pay twice”
 - Historical Compensation – Total Compensation
 - Professional earnings + Ancillary Earnings
 - Selling Ancillary Earnings = Monetizing portion of total compensation
 - Hospitals have greater flexibility in setting provider compensation versus acquiring a business
 - Focus on deal in Totality and cash flow in Totality

Considerations

- Key Question: Can employment do something for me that I cannot accomplish without the hospital?
 - Economic
 - Increased compensation
 - Replace potential loss of ancillary earnings
 - Alleviate the need to make substantial investment in new technology
 - EMR
 - New Linear Accelerators
 - May be best or even only way to participate in risk-based contracting, global billing arrangements, ACOs or other quality initiatives.
 - Caution: How long is the employer going to be willing to lose money?
 - Non-economic
 - Security
 - Quality of Life

Questions / Contact

- Questions?

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