

Valuation of radiation oncology practice is a moving target

– Greg Koonsman, CFA and Ron DiGiaino, MBA, BSHA

This year's proposed rules for 2010 have caused quite a stir in the health-care sector. Radiation oncology is no exception. If the proposed rules of 2010 were to be finalized, numerous free-standing facilities throughout the country – especially those in certificate of need states – have given notice that they may be forced to close their doors. While that news is not exciting to the authors of this article or to the cancer patients and communities served by those facilities, the closing of one door might actually open another.

Opportunity to collaborate

This could be the “opportunity” to collaborate with those that may have been one time or current competitors. Hospitals around the country appear to be having a softer landing in store for the reimbursement changes than freestanding clinics if the proposed rules are any indication of the actual final rules. Of course, this is based on the 2010 proposed rule information available at the time of this article being written. A follow-up article next month will complete this two-part series by analyzing the implications of the *final* rules. Nonetheless, it is certainly a time to give consideration to what the possible routes that owners/partners in freestanding cancer centers may take. A short list is provided below and is by no means all inclusive:

1. Actually close doors and cease providing life-saving treatments (not the favorite choice)
2. Partner with that hospital down the road or across the street to allow for hospital-based therapy
3. Sell to larger outfits that can operate on lower margins due to economies of scale
4. Sell to the hospital outright and become physician professional providers or employees
5. Stick it out to see what happens next year
6. Grow market share by adding physicians or creating a multi-specialty group
7. Hybrids of the above

Of course, each of the above has a common theme: *before* any route is chosen you need to make sure you have data on your side. Reimbursement has been a highly volatile target in recent years and certainly appears to be the same going forward. In this year's “proposed” rules for Medicare Physician Fee Schedule (MPFS) for 2010, a Prostate IMRT patient that would get approximately \$39,737 per course in 2009 Medicare

Global national average dollars would be *reduced* in 2010 to \$18,231. That is a negative variance of \$18,566 *per patient* or a little more than 50 percent assuming proposed RVUs and the conversion factor is set at 21.5 percent reduction. Using the same data but substituting breast 3D treatment, the 2009 Global Average is approximately \$13,673 with a “proposed” reduction to \$9,151 or \$4,522 *per patient*. As you can imagine, these types of changes can have a dramatic effect on valuations. This may or may not be horrible news depending on which side of the negotiating table you are sitting. It may just be an opportune time to go on a shopping spree much like some did when the stock market took a nose-dive over the last year. Do not guess at the worth of your practice and worse yet, do not count on the valuation or the same multiples you had three years ago. With the changes we have seen in reimbursement, and the draconian proposed rules this year, a material financial impact can happen in a single year as illustrated above, and current information is critical. Knowledge is leverage and power in negotiations. Ideally, you would get an independent valuation at a time when you aren't under pressure to make a change and, of course, when you *are* under pressure it is an absolute requirement. Please take note of a few of the experiences shared in this article where appropriate and apply this information to your particular setting.

Data collection

The pure blocking and tackle aspects of data collection are not surprising, you will need to have numerous things available in order to effectively carry out a timely and well organized valuation, among them are:

- ▶ Partnership agreement
- ▶ Listing of owners and their percentage ownership
- ▶ Financial statements
- ▶ Volume reports
- ▶ Actual collections by course of treatment
- ▶ Managed care contractual rates
- ▶ Accurate payer mix
- ▶ Diagnosis mix
- ▶ Source of referrals (summary information)
- ▶ Same market current and future planned competitors
- ▶ Staffing detail, including salary by position and benefits level
- ▶ Facility detail, summary of lease terms



- ▶ Age and type of equipment, leased owned, depreciation status etc.
- ▶ Maintenance agreements
- ▶ Summary of debt

Future Earnings and Risk

Simply stated, the valuation of health-care-services businesses – radiation centers included – are dependent upon two major inputs: future earnings and risk. Any input that affects future earnings or risk related to the realization of the projected earnings is an important aspect to the valuation of a radiation center.

Many mistakenly believe that a “multiple” of historical earnings is the primary method to value a radiation center. This could not be further from the truth. It is true that multiples are utilized as a discussion point to simplify a valuation of a center (aka, rules of thumb for value).

The value of a radiation center, if performed appropriately, is based upon the assessment of the expected future earnings or cash flow of a center on a present value basis with consideration of the relative risk associated with attaining those projected earnings. The higher the risk associated with future cash flows yields a lower present value. High risk=lower value and visa versa. The methodology related to the valuation of future earnings is called a discounted cash flow analysis or DCF. Some of the major factors that should be considered in the DCF related to a radiation center include:

- ▶ Volume: where do the centers’ patients originate and how sustainable is that referral base;
- ▶ Utilization: over utilization of IMRT can create an unsustainable level of high reimbursement volume. Properly considering the reduction of that utilization is very important in developing reasonable values;
- ▶ Reimbursement: Very important to understand both Medicare and Commercial reimbursement trends;
- ▶ Growth: What is a reasonable estimate of future volume growth and why/where does it originate;
- ▶ Competition: What other competitors exist in the market and what are their strengths and weaknesses;
- ▶ Certificate of Need (CON): Are there any barriers to entry;
- ▶ Cost structure: How well are staffing, supplies, facility, and other operating expenses being managed. Are there any expense improvement or efficiency opportunities;

- ▶ Capital Investment: In a capital intensive business that requires high tech equipment, it is important to reasonably project ongoing cost of reinvestment in new technology. This is a direct reduction from the cash flow of the business, but necessary to stay competitive in a technology-driven service;
- ▶ Consideration of the overall relative scale of conservatism or aggressiveness of the projections of future cash flow. The more aggressive the projections that are utilized the higher the risk rate that should be applied.

It is important that one who is both knowledgeable in the area of business valuation, but also in the specific segment of health-care services being valued, perform the valuation. The health-care market is unique in terms of both business and regulatory matters. First and foremost, physicians and physician referrals are central to the success or failure of any healthcare business, this simple fact must be considered in any valuation. Knowledge regarding the source of the referral base and the sustainability of the referral base is critical in the determination of future volume and risk.

Government influence on valuation

The federal government has a significant amount of influence on radiation businesses in terms of both reimbursement and regulatory matters. As discussed previously, the reimbursement of radiation for freestanding centers is projected to decrease. This must be factored into a reasonable projection of future cash flows and as might be expected will have a negative impact on value. The Stark laws and federal anti-kickback statutes have great deal of impact on how radiation center partnerships are structured and how they conduct business. Without a full understanding of how these laws impact the structure and operations of radiation centers, a reasonable valuation cannot be performed. As required by both Stark and the Anti Kickback Statutes, all transactions in the radiation center business must be at “fair market value.” Fair market value is a legal term that is defined as “the price at which a business or asset would transact if both buyers and sellers had reasonable possession of the relevant information and facts, and neither were under any compulsion to buy or sell.” The fair market value standard requires the need for someone with focus and expertise in the area of business valuation. However, without very specific knowledge and experience with radiation centers and their operation, the

valuation results could be suspect. For example, if a valuation were performed on a center with an abnormally high level of IMRT utilization without consideration of the sustainability of that IMRT volume and the proposed reimbursement reductions, an appraiser could reasonably miss the valuation by significant dollar amounts.

As providers consider participation in acquisitions, joint ventures, and divestitures of radiation businesses it is vital that all parties understand what is required of them by both state and federal regulatory guidelines. It is also important to involve parties that have expertise in the operations and valuation of radiation centers. Success or failure in valuing, structuring, and completing a transaction are, in many cases, determined by the expertise of the third parties (legal, operational, and valuation) that assist in the completion of a transaction. The valuations of radiation centers in our current environment are truly moving targets. The uncertainty regarding regulatory changes, reimbursement changes, healthcare insurance reform, and other factors that impact value is significant. Proper consideration of the risk and reward of future earnings will dictate whether the moving target has been properly identified and hit. **H**



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