



# Practice Valuation

*How to determine the value of a Pediatric practice*

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# Today is not a substitute for Legal or Accounting Advice

- PMI does not offer legal or accounting services. As such, all information shared should be reviewed with your attorney to ensure compliance with state and federal laws.
- Today's webinar focuses on the operational aspects of practice valuations, mergers and/or acquisitions as a guide to educate you on issues involved.

# Plan for the Future

- Merge with another practice
- Sell to hospital/network
- Retirement

# Plan for the Unexpected

- The “4 D’s”
  - Disability
  - Death
  - Divorce
  - Divestiture

# Valuation Objective

- Establish a fair and mutually agreed upon price to facilitate the transfer of ownership in the practice.
- Establish a concrete formula that can be referenced or updated as the need arises.
- Eliminate Uncertainty
  - Set the expectation in advance of the need.
  - If you wait until stressful time to establish a value, emotions get in the way of a fair deal for both sides.

# Goal of Valuation Formula?

Determine the added benefit of  
owning a practice.

Single largest asset is the  
Pediatrician's ability to generate  
income

# Traditional Valuation Methods

- Income Approach
  - Determining the value of the practice by converting future economic benefits into a single present amount
- Asset Approach
  - Determining the practice's value based on the assets net of liabilities.
- Market Approach
  - Comparable Sales- comparing the practice to similar businesses, business ownership interests, securities or intangible assets.

# Sell to Hospital

- Medicaid Fraud and Abuse
  - Known as the "anti-kickback law"
  - Prohibits payments, offers, or inducements of any remuneration for referrals
  - Issue: If acquisition price exceeds fair market value, transaction may be considered a inducement for referrals
  - "Commercially Reasonable"
- Private Inurement
  - Applies to tax exempt hospitals - section 501 (c) (3)
  - Defined: No part of a hospital's net earnings may inure to the benefit of any private individual

Just because a transaction may be "fair market value" does not necessarily make it "commercially reasonable"



# Sell to Hospital

- Usually Combination Offer
  - Purchase of Current Practice
    - Asset Driven
  - Future Compensation Package
    - Base Salary
    - Benefits
    - Production (wRVU Incentives)
    - Limited by “Fair Market Value”
- Office Building Lease

# Sell to Network

- Offers Access to Better Paying Contracts
  - Net effect is higher compensation for Pediatricians
    - Network has payment rates far greater than smaller practice can obtain
    - After allocating network expenses, could see net increase in “take home pay” & benefits
    - Usually burdened with higher employee benefit costs
    - Loss of autonomy (not as bad if sell to hospital)
    - Less headache for seller in the future (HR issues, payroll, etc)

# Key Factors Impacting the Valuation of a Pediatric Practice

- Continuation of Patient Volume
  - 2 Children per day at \$100 per encounter = \$40,000 swing in payments per provider
- Continuation of Current Payment Rates
- Shift in Payor Mix
- Local Economy
- Building/Rent Expenses along with future liabilities
  - Need to relocate to better location
  - Interior Updating

# Transition Issues

- Issue: Will the current owner(s) be available to assist in the transition to the new owner?
  - If yes, can expect to maintain revenues
  - If no, anticipate a drop in patient volumes or referrals
- Generally want a transition period of 6 – 12 mo.

# Year End Cash Bonus vs. Equity

- Not unheard of to offer equity in lieu of cash bonus
  - Production incentive converted to equity
  - Usually a premium above cash value
    - \$15k cash bonus or 20% equity
- Be careful of capital gains taxes for both parties

# Goodwill

- **Goodwill** is an intangible asset that arises as a result of the acquisition of one **company** by another for a premium value. The value of a **company's** brand name, solid customer base, good customer relations, good employee relations and any patents or proprietary technology represent **goodwill**.
- Hogwash...benefits of reputation is what drives practice revenue...
- Allocation of “Goodwill” is double-dipping

# Scenario

- Dr. Smith is a 65 year old Pediatrician wants to retire in 2 years
- Dr. Johnson is a 45 year old Pediatrician has been there for five years, is good fit, and wants to buy the practice
- 1 NP (Full Time)
- 1 NP (Part Time)

# Mindset



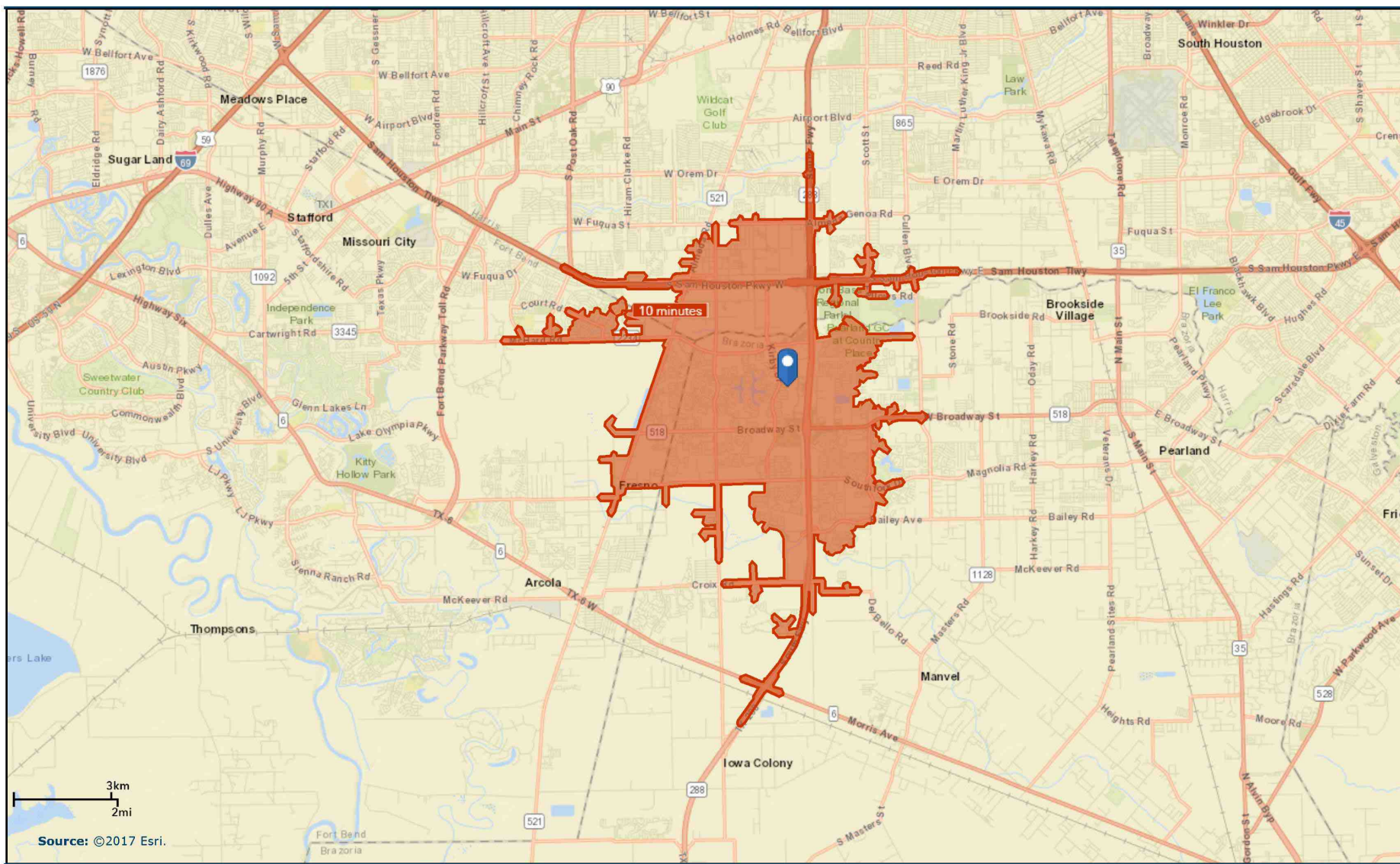


# Calculation

## Acme Pediatrics Practice Valuation

As of December 31, 2016

Part A			
Total Revenue	\$ 1,500,000		Actual 2016
Total Expenses	\$ 1,350,000		Actual 2016
Net Ordinary Income	\$ 150,000		Total Revenue - Total Expenses
Dr. Smith's Earnings	\$ 210,000		Actual 2016
Employed Physician Average Salary	\$ 175,000		
Variance	\$ 35,000		Estimated benefit of owning the practice
Multiple	2.00		Generally between 2 & 4 depending on practice outlook
<b>Total Part A Value</b>	<b>\$ 70,000</b>		
Part B			
Item	Amount	Effect	Note
Cash on Hand	\$ 25,000	Increase	Actual cash balance
Liabilities	\$ 15,000	Decrease	As reported on Balance Sheet
Accounts Payable	\$ 10,000	Decrease	Estimated
Vaccine Inventory	\$ 15,000	Increase	2016 Vaccine expense divided by 12 or Physical Count
Equipment Value (Estimate)	\$ 25,000	Increase	Refrigerators, Supply Inventory and other medical equipment
Collectable Accounts Receivable (Estimate)	\$ 125,000	Increase	Gross Collection Rate X Total A/R Balance as of Sale Date
<b>Part B Total</b>	<b>\$ 165,000</b>		
<b>Estimated Practice Valuation (Part A plus Part B)</b>	<b>\$ 235,000</b>		





## KEY FACTS

63,407

Population



3.0  
Average Household Size

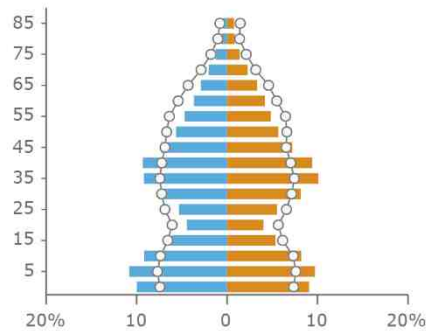
34.1

Median Age

\$102,864

Median Household Income

## Age Pyramid



The largest group:  
2017 Male Population  
Age 5-9 (Esri)

The smallest group:  
2017 Male Population  
Age 85+ (Esri)

Dots show comparison to  
Brazoria County

## EMPLOYMENT



79%

White Collar



11%

Blue Collar



10%

Services

5.1%

Unemployment Rate

## INCOME



\$102,864

Median Household Income



\$43,254

Per Capita Income



\$255,752

Median Net Worth

## Households By Income

The largest group: \$100,000 - \$149,999 (21.4)

The smallest group: \$15,000 - \$24,999 (3.7)

Indicator	Value	Difference	
<\$15,000	4.2	-3.1	
\$15,000 - \$24,999	3.7	-3.8	
\$25,000 - \$34,999	4.9	-2.5	
\$35,000 - \$49,999	9.0	-2.8	
\$50,000 - \$74,999	12.5	-5.3	
\$75,000 - \$99,999	13.8	+0.5	
\$100,000 - \$149,999	21.4	+2.8	
\$150,000 - \$199,999	14.0	+5.2	
\$200,000+	16.4	+9.1	

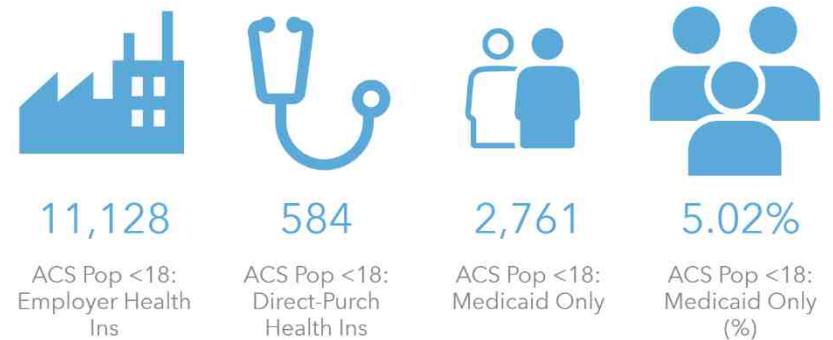
Bars show deviation from  
Brazoria County



## PEDIATRIC PATIENT POPULATION



## PEDIATRIC PATIENT INSURANCE COVERAGE



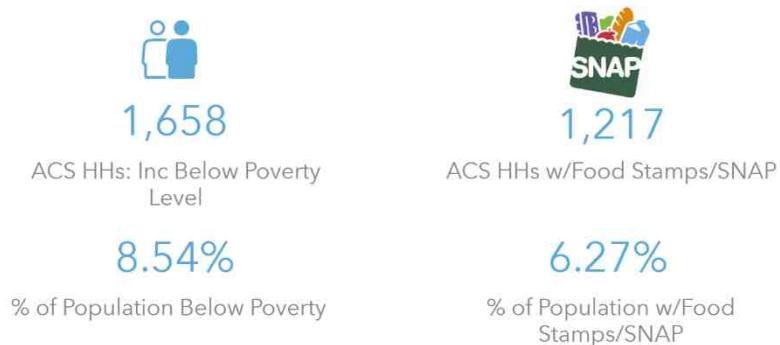
## HOUSEHOLD INCOME



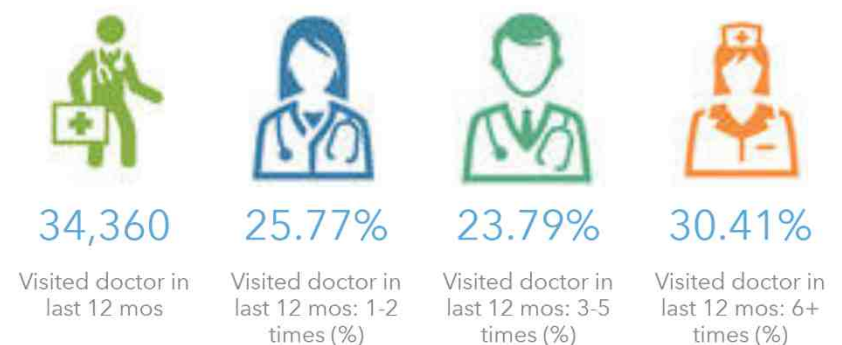
## HOUSEHOLD SIZE



## POPULATION AT RISK



## DOCTOR VISITS





## PMI Market Research Data

Acme Pediatrics  
11206 Sunlit Bay Dr, Pearland, Texas, 77584  
Drive Time: 10 minute radii

Latitude: 29.5674  
Longitude: -95.3940

### Population

2000 Population	14,740
2010 Population	46,464
2017 Population	63,407
2022 Population	74,413
2000-2010 Annual Rate	12.17%
2010-2017 Annual Rate	4.38%
2017-2022 Annual Rate	3.25%
2017 Male Population	48.6%
2017 Female Population	51.4%
2017 Median Age	34.1

In the identified area, the current year population is 63,407. In 2010, the Census count in the area was 46,464. The rate of change since 2010 was 4.38% annually. The five-year projection for the population in the area is 74,413 representing a change of 3.25% annually from 2017 to 2022. Currently, the population is [SCRIPT\_MALES\_CY\_P] male and [SCRIPT\_FEMALES\_CY\_P] female.

### Households

2000 Households	5,107
2010 Households	15,773
2017 Total Households	21,353
2022 Total Households	25,003
2000-2010 Annual Rate	11.94%
2010-2017 Annual Rate	4.27%
2017-2022 Annual Rate	3.21%
2017 Average Household Size	2.96

The household count in this area has changed from 15,773 in 2010 to 21,353 in the current year, a change of 4.27% annually. The five-year projection of households is 25,003, a change of 3.21% annually from the current year total. Average household size is currently 2.96, compared to 2.93 in the year 2010. The number of families in the current year is 16,547 in the specified area.

### Median Household Income

2017 Median Household Income	\$102,864
2022 Median Household Income	\$111,716
2017-2022 Annual Rate	1.66%

### Average Household Income

2017 Average Household Income	\$129,019
2022 Average Household Income	\$146,687
2017-2022 Annual Rate	2.60%

### Per Capita Income

2017 Per Capita Income	\$43,254
2022 Per Capita Income	\$49,056
2017-2022 Annual Rate	2.55%

### Households by Income

Current median household income is \$102,864 in the area, compared to \$56,124 for all U.S. households. Median household income is projected to be \$111,716 in five years, compared to \$62,316 for all U.S. households.

Current average household income is \$129,019 in this area, compared to \$80,675 for all U.S. households. Average household income is projected to be \$146,687 in five years, compared to \$91,585 for all U.S. households.

Current per capita income is \$43,254 in the area, compared to the U.S. per capita income of \$30,820. The per capita income is projected to be \$49,056 in five years, compared to \$34,828 for all U.S. households.



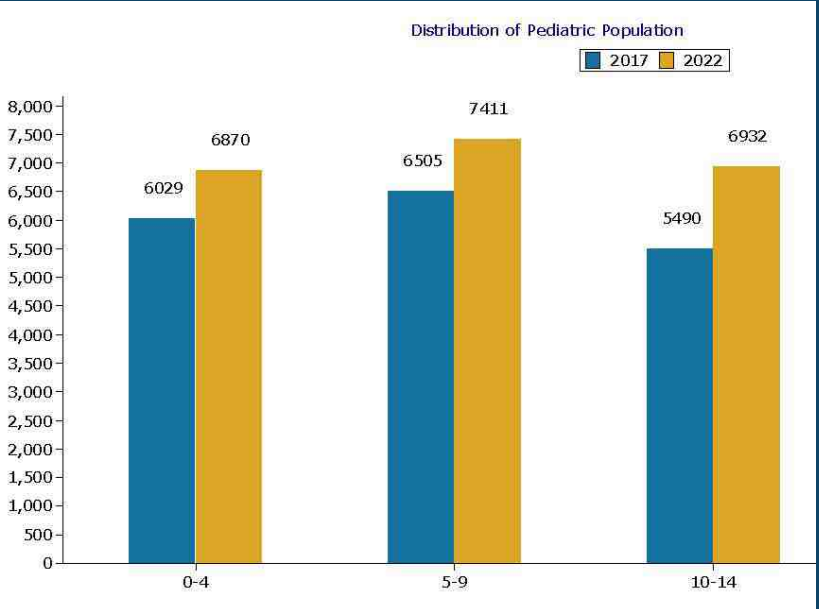
Helping Pediatricians Succeed

# Pediatric Population

Total Population by Detailed Age	Census 2010		2017		2022	
	Number	Percent	Number	Percent	Number	Percent
Total	46,464	100.0%	63,410	100.0%	74,413	100.0%
<1	990	2.1%	1,205	1.9%	1,389	1.9%
1	1,048	2.3%	1,276	2.0%	1,461	2.0%
2	1,004	2.2%	1,212	1.9%	1,383	1.9%
3	1,025	2.2%	1,227	1.9%	1,388	1.9%
4	935	2.0%	1,108	1.7%	1,250	1.7%
5	924	2.0%	1,378	2.2%	1,587	2.1%
6	939	2.0%	1,388	2.2%	1,590	2.1%
7	849	1.8%	1,270	2.0%	1,443	1.9%
8	886	1.9%	1,288	2.0%	1,461	2.0%
9	824	1.8%	1,181	1.9%	1,330	1.8%
<b>Total Under Age of 10 Years Old</b>	<b>9,424</b>		<b>12,533</b>		<b>14,282</b>	
10	747	1.6%	1,190	1.9%	1,505	2.0%
11	688	1.5%	1,111	1.8%	1,396	1.9%
12	649	1.4%	1,082	1.7%	1,359	1.8%
13	639	1.4%	1,060	1.7%	1,344	1.8%
14	647	1.4%	1,047	1.7%	1,329	1.8%
15	598	1.3%	847	1.3%	1,163	1.6%
16	569	1.2%	814	1.3%	1,133	1.5%
17	558	1.2%	757	1.2%	1,036	1.4%
18	459	1.0%	645	1.0%	879	1.2%
<b>Total Under Age of 18 Years Old</b>	<b>14,978</b>		<b>21,086</b>		<b>25,426</b>	

# Female Population of Child-Bearing Age

Female Population by Detailed Age	Census 2010		2017		2022	
	Number	Percent	Number	Percent	Number	Percent
Total	23,950	100.0%	32,596	100.0%	38,139	100.0%
<18	7,021	29.3%	9,951	30.5%	11,935	31.3%
18+	16,929	70.7%	22,641	69.5%	26,206	68.7%
21+	16,335	68.2%	21,806	66.9%	25,131	65.9%
15	280	1.2%	411	1.3%	570	1.5%
16	279	1.2%	399	1.2%	565	1.5%
17	257	1.1%	347	1.1%	478	1.3%
18	216	0.9%	310	1.0%	426	1.1%
19	190	0.8%	280	0.9%	380	1.0%
20 - 24	993	4.1%	1,308	4.0%	1,394	3.7%
25 - 29	1,866	7.8%	1,804	5.5%	1,883	4.9%
30 - 34	2,434	10.2%	2,657	8.2%	3,036	8.0%



# Earnings Surveys For Comparison Compensation

- Currently Employed Pediatricians
- MGMA Physician Compensation Survey
- MGMA Cost and Productivity Report
- American Medical Group Practice Association
- Modern Healthcare's Physician Compensation Report

# Adjustments

- Taking average shareholder salary for previous 2 or 3 years.
- Adjusting Average Shareholder Compensation based on whether or not meaningful use monies have already been received/recouped.
- Adjusting Average Shareholder Compensation based on whether or not the shareholders may have previously taken lower salaries to fund practice projects that are expected to generate additional earnings in the future.
- Adjusting for a variety of nuances in the shareholder compensation formula and other Shareholder Concerns



# Considerations

- Continued Employment for Dr. Smith
- Management Responsibilities
- Future Compensation
- Do Not Intermingle Buyout and Future Salary
  - Need two separate agreements (Buy/Sell and Employment)
- Internally Financed or Require Cash?
- Right of First Refusal to Repurchase Practice In Future
- Include Practice Real Estate
  - Not a good idea to do so
- Is it a fair deal for both sides?

# Considerations

- Ownership position immediate or when paid?
  - If financed, should be immediate since liability created between buyer and seller
  - If cash sale, immediate
  - If in lieu of bonus(es)- maybe deferred

# Internal Finance Options

2 Year Buyout					
Sale Price	\$ 235,000	\$235,000	\$235,000	\$235,000	\$235,000
Downpayment %age	10.00%	15.00%	20.00%	25.00%	30.00%
Downpayment \$	\$ 23,500	\$ 35,250	\$ 47,000	\$ 58,750	\$ 70,500
Balance to Finance	\$ 211,500	\$199,750	\$188,000	\$176,250	\$164,500
Years to Pay	2	2	2	2	2
WSJ Prime Rate	3.50%	3.50%	3.50%	3.50%	3.50%
Interest Premium	2.25%	2.00%	1.75%	1.50%	1.25%
Total Interest	5.75%	5.50%	5.25%	5.00%	4.75%
<b>Monthly Payment</b>	<b>\$9,350</b>	<b>\$8,808</b>	<b>\$8,269</b>	<b>\$7,732</b>	<b>\$7,198</b>
Annual Amount	\$112,200	\$105,697	\$99,227	\$92,788	\$86,381
3 Year Buyout					
Sale Price	\$ 235,000	\$235,000	\$235,000	\$235,000	\$235,000
Downpayment %age	10.00%	15.00%	20.00%	25.00%	30.00%
Downpayment \$	\$ 23,500	\$ 35,250	\$ 47,000	\$ 58,750	\$ 70,500
Balance to Finance	\$ 211,500	\$199,750	\$188,000	\$176,250	\$164,500
Years to Pay	3	3	3	3	3
WSJ Prime Rate	3.50%	3.50%	3.50%	3.50%	3.50%
Interest Premium	3.75%	3.50%	3.25%	3.00%	2.75%
Total Interest	7.25%	7.00%	6.75%	6.50%	6.25%
<b>Monthly Payment</b>	<b>\$6,555</b>	<b>\$6,168</b>	<b>\$5,783</b>	<b>\$5,402</b>	<b>\$5,023</b>
Annual Amount	\$78,657	\$74,012	\$69,401	\$64,823	\$60,277
4 Year Buyout					
Sale Price	\$ 235,000	\$235,000	\$235,000	\$235,000	\$235,000
Downpayment %age	10.00%	15.00%	20.00%	25.00%	30.00%
Downpayment \$	\$ 23,500	\$ 35,250	\$ 47,000	\$ 58,750	\$ 70,500
Balance to Finance	\$ 211,500	\$199,750	\$188,000	\$176,250	\$164,500
Years to Pay	4	4	4	4	4
WSJ Prime Rate	3.50%	3.50%	3.50%	3.50%	3.50%
Interest Premium	4.75%	4.50%	4.25%	4.00%	3.75%
Total Interest	8.25%	8.00%	7.75%	7.50%	7.25%
<b>Monthly Payment</b>	<b>\$5,188</b>	<b>\$4,876</b>	<b>\$4,568</b>	<b>\$4,262</b>	<b>\$3,958</b>
Annual Amount	\$62,258	\$58,518	\$54,811	\$51,138	\$47,499

# Shareholder Agreements

- Personal Responsibility for Coding
- Insurability for Life Insurance
- Spouse Signatures
- Personal Guarantees for Current Debt
- Consecutive Days Out of Office
- Disability- Continue to pay until insurance kicks in
- Failure to Plan Provision- Discounted if no notice
- Pledging of Assets- Prevent Collateralization
- Personal Bankruptcy- Allow practice to purchase before third party becomes owner
- Update Price Annually- If can't agree, old value stays in place
- Future Plans/Expansion- Finance expansions with cheap loan options



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