

Valuing a Medical Practice *More complicated than you think*

A new wave of sales and purchases of physician practices is taking place around the country, with hospitals seemingly being the primary purchasers. Because of their numbers, size and purchasing power, hospitals are currently defining the standards for valuing (or determining the worth of) the practices they buy.

A practice's sale price is typically based on the value assigned to it by a professional appraiser when there's a strategic buyer. The value is made up of the practice's tangible assets, cash, accounts receivable (AR) and goodwill.

Tangible assets

Without cash, AR or goodwill, the calculable value of a medical practice is found primarily in its tangible assets — equipment, supplies, capital plant and furnishings. Hospitals that are purchasing group practices typically use a depreciated fair market value approach to pricing those items.

An asset issue that's emerged over the last few years, however, is the failure of a hospital's appraisers to appreciate the value of an electronic health record (EHR) system and its contribution to quality improvement and practice management. EHR systems must be seen as more than an electronic file cabinet for patient medical information. Although a traditional practice valuation would view an EHR system purely as a tangible asset, in reality it's a tangible asset with intangible benefits.

Cash and AR

Physician practices rarely retain any cash in the business. Traditionally, cash coming into the practice goes first toward overhead, with anything left over taken out as physician compensation. A practice up for sale is unlikely to include significant cash reserves.

With AR, however, practices often do carry substantial amounts that normally will have some value and pass to the new owner. However, many practice buyers don't want the headaches of collecting accumulated AR. Furthermore, if the buyer refuses to accept liabilities such as accounts payable and outstanding contracts and leases, the physician group may prefer to use AR to offset them.

Goodwill

This component, as a subjective measure of the practice as a going concern, usually reflects the surplus value after hard numbers have been assigned to assets, cash and AR.

Paying for goodwill at the time of purchase is paying in advance for future performance of the practice as a business. Some hospitals take the stance that there's no need to pay upfront for performance because they will employ the physicians and can use a variety of incentives to drive their achievements to desired levels. Another problem with a hospital paying for an intangible asset, such as goodwill, is that it may appear as if the hospital is paying for future referrals — a possible violation of the Stark and antikickback laws.

As a result, the goodwill value frequently isn't considered in the purchase price. When it is a factor, it typically will receive a lower value than it would have just five

or 10 years ago. There also are new factors that can and should influence the calculation of goodwill. While forward-looking practices are adopting new technologies and employing clinicians and staff with new competencies, others are still emphasizing traditional physician-focused values and attributes. The former practices will command higher goodwill valuations.

Examples of the prices paid for goodwill in recent physician practice sales or buy-in agreements can be found in the Goodwill Registry, which is maintained by the Health Care Group (thehealthcaregroup.com).

Keep in mind the limitations of the Registry. It doesn't include all practice transactions that have occurred nationwide, and it doesn't break out valuations by geographic region. In certain areas, the number of practices in a particular specialty will determine how many buyers are interested in such practices. And, if local hospitals are helping new doctors set up their practices or health plans are pushing down physician reimbursements, practice values will be lower.

Don't take it personally

One final reminder about appraisals: A valuation price set for your practice shouldn't be taken as a personal commentary on the physicians' worth. In fact, if the amount presented by the appraiser seems low, it may be that the selling physicians added considerable value to the business.