Owner, Partner, Employee: Navigating and Negotiating the Medical Maze

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Agenda

- Describe various practice settings and how the physician’s role can vary within each system
- Identify key physician contract variables for each practice setting
- Understand how to accurately assess the value of an allergy practice, including the impact of assets, liabilities and “good will”
- List steps a physician nearing retirement needs to take to close/sell their practice

Practice Setting

- SINGLE SPECIALTY (Solo, Small Group, Large Group)
- MULTISPECIALTY (Private, Healthcare Organization)
- ACADEMIC (Research, Clinical)
Physician Roles

- **Single Specialty**: Employer/Owner, Employee, Partner/Shareholder, (Volunteer Faculty)
- **Multispecialty**: Shareholder, Employee, (Volunteer Faculty)
- **Academic**: Faculty appointment/tenured (commensurate with experience and training,) Non-tenured, Clinical, Physician-Scientist, Teacher, Advocacy

Medscape Allergist Compensation Report 2016

- Multispecialty: $244K
- Single Specialty Group: $238K
- Healthcare Organization: $233K
- Solo Practice: $211K
- Academic: $184K
- Self-employed: $251K (m), $211K (f)
- Employed: $209K (m), $188K (f)

n=192

Hours per Week Spent on Paperwork & Administration: Employed vs. Self-employed

- Prime cause of physician burn-out
- No difference employed vs self-employed
- 51% in each group spent > 10 hours

n=192
dark= self-employed
DISCUSSION

- Will work force shortages impact practice settings?
- Is solo practice facing extinction due to regulatory/financial pressures?
- How will newly trained allergists (student loan debt, work-life balance concerns) alter the practice landscape?
- Are allergists changing practice settings to improve their quality of life?
- Other?
Disclaimer:
I’m about to try to jam two years of masters level finance into 10 minutes. Should remind some of you of medical school.

What are some things that are considered when valuing a medical practice?

- Revenues (total collections)
- Cash flow (why not profitability?)
- Assets
- Accounts Receivables
- Debts
- Goodwill
- Property (owned)
Let’s start this off right...

“Come on come on, love me for the money
Come on, come on, listen to the money talk”

- BC/BC

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Audience Participation Scenario -
How much is the following practice worth?

- 30-year practice, solo allergist, one location
- MD is ready to retire and wants to sell her practice to an aspiring young allergist
- Works 4 days a week, 37 hours
- $1,100,000 in revenue, take home pay $450,000
- Profit each year between $2000-$5000
- 600 active shot patients
- No allergist within 6 miles in a major metropolitan city

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WARNING

Medical practices are NOT worth what they once were!

- Declining reimbursements
- Increasing expenses
- High deductible plans
- Rising uncertainty in reimbursement schemes
At the end of the day, the practice is only worth what someone is willing to pay.

Valuation Methods:

- Discounted Cash Flow
- Multiple of Earnings
- Comparable Companies Analysis
- Leveraged Buyout Analysis
- Asset Based (book value)

Throughout this discussion please remember, what an allergist earns above and beyond a normal and customary salary, goes to the profitability of the practice - and hence to its valuation.
Stock vs. Asset Purchase

A painful but necessary slide because the structure of the transaction can and will affect the price.

- There are tax advantages to the buyer and seller depending on how the deal is structured.
- A CPA is VITAL to understanding these implications to your personal tax situation.
- As a rule, sellers generally want a stock transaction and buyers want an asset transaction.
- Stock purchases can be risky for a buyer because of the liabilities of the former owner.
- A good lawyer is needed to de-risk this type of transaction and ensure the reps and warranties are tight.
- Asset purchases give the buyer a fresh start without encumbering the buyer with potential liability landmines that may or may not have been known to the seller.
- A good lawyer is STILL needed because we really should have at least a few that we can keep off the personal injury billboards.

Valuation Methods - Discounted Cash Flow

DCF analysis uses future free cash flow projections and discounts them to arrive at a present value.

Discounted Cash Flows at Work
Valuation Methods

Multiple of Earnings

You must determine the CASH available from a business after all expenses are paid including a normal and customary allergist salary.

Example:
Cash flow = $25,000
Allergist is taking home $400,000 in an area where most are making $325,000.

Valuation Methods

Comparable Companies Analysis

Few medical practices are comparable. The comparable companies analysis has severe limitations and should only be used in conjunction with another valuation analysis.

Brokers will try to use this method so buyer beware!!

Valuation Methods

Leveraged Buyout Analysis

…or how to make money with OPP

- Purchase Price $500,000
- You put down 20% ~ $100,000
- Finance $400,000 from a bank
- You earn a 15% return on that $500,000
  - ~$575,000 in returns
  - Repay the bank $400,000 + interest*
- You are left with $175,000 - interest* on your $100,000

*Interest expense excluded for simplicity

That’s a 75% return on your investment!
Valuation Methods
Leveraged Buyout Analysis
...or how to make money with OPP

Another way to look at LBOs and cash is used

Valuation Methods
Asset Based
Book Value / Adjusted Book Value

Book Value is simply the value of the company's assets (net of depreciation, depletion and amortization) and total liabilities -- as carried on the company's balance sheet.

Adjusted Book Value takes the book value and adjusts it to more accurately reflect fair market value through either its replacement value or salvage value.

Goodwill

Goodwill is an accounting concept that values intangible assets that are not separately identifiable from the assets you used to value a business.

More easily said: anything you pay for a company in excess of book value is booked as goodwill and can usually be amortized over 10 years.
Differences between DCF and LBO

- LBO analysis is similar to DCF analysis in its use of cash flows, terminal value, present value, and discount rate.
- DCF looks for the present value of the company (enterprise value) while LBO looks for the internal rate of return (IRR*).
- LBO analysis considers whether there is enough projected cash flow to operate the company and also cover debt principal and interest payments.

*IRR - is the rate of return required to make the net present values of all cashflows zero
Put another way, the IRR of an investment is the discount rate at which the net present value of costs (negative cash flows) of the investment equals the net present value of the benefits (positive cash flows) of the investment.

Valuation Comparison Methods

**EV / EBITDA**

- Capital Structure Neutral
- Increased Complexity

In a nutshell, it values the company, free of debt, to earnings before interest. It also removes non-cash accounting items like depreciation/amortization.

Best way to compare to practices you may be considering

Brief Summary of Valuation Methods
Key Pieces - Physician Contract
John Milewski, MHA, FACMPE

Depending what side of fence you are on?

Employer – Employee Relationship
Current Contract
Partnership
Understand the Culture and Governance.

History of employee
Churn and Burn
Longevity
Partnership levels

Key points in the contract

- Non Compete
- Disability Provision
- Tail – Nose Coverage
- Compensation structure –
- Termination provision

Conclusion

- Non Compete
- Disability Provision
- Tail – Nose Coverage
- Compensation structure –
- Termination provision
Non Compete
Restrictions
State by State the statute varies
Examples -

Disability
• Does it fall under the group employee policy
• Being an employee falls under ADA
• Coverage – Group - Individual

Tail – Nose Coverage
• Historically "Tail Coverage" is an extended reporting period endorsement, offered by a physician's current malpractice insurance carrier, which allows an insured physician the option to extend coverage after the cancellation or termination of a claims-made policy.
Compensation Structure

• Production Based Income
• How is Net Income Calculate?
  • Net Income = Income - Total Cost
• Questions:
  • Income Determined?

Compensation

• Total Cost
• Expenses
  • Direct Cost
    • Are those cost directly attributable to the office cost: (labor, supplies, rent, repairs, etc. etc.)
  • Indirect Cost
    • Health Insurance, Malpractice, payroll taxes, T & E, Professional dues, Phone, Retirement contributions and etc. etc.
  • Administrative Expenses – Allocation

Termination

1. “At-will” state
2. How much advance warning is noted.
3. Does a reason need to be given
Why do Physicians Close or Sell Practice?

- **Retirement**
  - Relieve burden of running a business
  - Stabilize income
  - Improve quality of life

Physician Status in Practice & Exit Strategy

- **Employee:**
  - Review contract time frame for termination
- **Partner/Shareholder:**
  - Contract, buyout provisions, or valuation formula (amount & duration of payments)
- **Solo Practice:**
  - Sell v. Dissolve (most states have articles of dissolution-date of closure, conclusion of business)
  - Asset Purchase Agreement - places value on practice, describes rights, responsibilities, legal & business liabilities of seller & buyer

Finding & Choosing a Buyer

- **Buyer with a stake in the area**
- **In many areas, purchases go for about 1.5X dividends (dividend=practice income-salaries and overhead costs)**
- **Hospital v. Large Group v. Equity Firm**
  - Hospital quick exit
  - Equity firm less available, can consolidate back office operations, increase profitability
Steps to Closing or Selling Practice: Exit Strategy

• Plan in advance: avoid forced sale, achieve accurate valuation
• Assemble team: attorney, accountant, appraiser
• Create check lists
• Maximize practice appeal
  • Eliminate debt
  • Enhance services likely to be reimbursed going forward, i.e., chronic care mgmt.

Boosting Practice Value

• Value determined by:
  • Tangible assets, i.e., equipment, accounts receivable,
  • Goodwill (hardest to assess)
    • Reputation, history & location, patient base and records, staff support
• ADD VALUE:
  • Keep credentials current
  • Keep working - keep revenue up
  • Maintain curb appeal: aesthetics, website, financial reports
  • Maintain relationships with referring sources to
    • show patient base consistency & growth

Boosting Practice Value

• HOLD OFF major “tech” investments (may lose productivity, buyer may have their own system)
• Add ancillary services
Practice Value

• Health Care Group:
  Publishes Goodwill Registry, practice transactions across the country, values paid.

Healthcaregroup.com

Steps to Closing Practice

• Review of all documents - if not solo, employment agreement; shareholders agreement (Corp); operating agreement (LLC); if deferred compensation exists
• Contract review - employees, vendors, managed care
• Develop plan for patient notification
• Review advance notice provisions (to avoid contract breach)
• Review retirement plans - vesting schedules, benefit eligibility timing

Steps to Closing Practice

• Cover your TAIL
• Medical Record arrangements
  • Assure safety, access with signed release, at least 30 days advance notice,
  • Custodian of records (Dr/hospital/document mgt co.), some HMO requirements where records kept
  • Records usually kept for about 7 years
  • Understand who owns patient charts - if employed, are property of the practice
• Financial - close after bills paid, receivables
• Final step if solo: dissolution form with state
Contracts Review

- Service and vendor contracts
  - Managed care agreements, notice requirements
- Employee agreements
  - Notification
  - Compensation if owed
  - Retirement plan obligations
  - Allow adequate time to handle transition and find other position

Notifications

- Patients
- Staff: average 90 days!
- Insurance-malpractice, property
- Others: Hospitals, DEA, Payers, Referrers, Medical Boards, State & Local Societies, Dept. of Health (License), Vendors, Health Plans

Patient Notification

- First step: Develop mechanisms to provide notice of the closing to your patients
- Once there is established physician-patient relationship: Avoid claims of abandonment & assure continuity of care
- Abandonment - unilateral termination of the relationship without giving the patient adequate notice of such termination & without giving the patient sufficient time to establish a relationship with new physician
How Much Notice to Patients

- Depends on:
  - Type of practice
  - Health status of patients
  - Needs for continuing care
    - whether there are other physicians in area who can continue care...time in urban area may be shorter than in rural.
  - General rule: 45-60 days notice, at least 30 days to avoid claim of abandonment and assure continuity of care; varies by state law

Notice of Closure

- Letters to active patients (within 1-2 years), copy of notification in each patient’s chart
- Ad in local paper for period of two weeks
- Letter should include: date of closure, how to obtain copies of records, or how to transfer records to another physician; name person if someone taking over, note not obligated to use this physician; note office can assist in finding new physician; include authorization form to release records and note where records will be stored
- Post notice in waiting area
- For special needs patients, specialized notice
- Chronically ill patients, certified letters

Following Patient Notification

- Accept no new patients
- Limit non urgent visits
- Be sure to notify patients requiring continuous care at least 60 days prior to closure
Storage & Maintenance of Records

- Legal minimum varies by state, typically 7 years after the last visit
- For minors, until age 21 + 7 yrs following last visit
- Patient has right to access their stored medical records with signed authorization
- Never release an original record, only copies with signed authorization (you may charge)

Practice Closure Notifications

- State Board of Medical Examiners
- DEA
- Malpractice carrier
- Other insurance carriers covering building or practice
- Medicare
- Medicaid
- Managed care companies (check contracts for termination guidelines)
- Other business contracts
- State Medical society & other professional associations

Malpractice Insurance Notification

- Occurrence policy - notify in writing, request premium refund if due
- Claims made policy - COVER YOUR TAIL for claims filed after you leave practice
  - If not solo, review contract to determine who pays for this supplemental insurance
Accounts Receivable

• If exiting a group: based on buyout formula ex.
  Collection of accts receivable - operating cost
  divided by # physicians

• If solo:
  • Sell to outside agency
  • Transfer to collection agency for stated period

Information Resources

• State Medical Societies
• Medical Economics: July 2011, June 2013, Feb 2016
• AMA