

Fair Market Value and Commercial Reasonableness in Healthcare: Documenting and Ensuring Compliance, Part II

Christine Bachrach, MS
Vice President - Compliance
HealthSouth
One HealthSouth Parkway
Birmingham, AL 35243
(205) 970-5853
christine.bachrach@healthsouth.com

John R. Boettiger, Jr., ASA, CFA, CMC
Principal
Deloitte Financial Advisory Services LLP
333 Clay St Ste 2300
Houston, TX 77002-4196
(713) 982-2374
jboettiger@deloitte.com

Robert A. Wade, Esq.
Partner
Baker & Daniels LLP
Suite 250, First Bank Bldg
205 West Jefferson Blvd
South Bend, Indiana 46601
(574) 239-1906
bob.wade@bakerd.com



Topics

The Valuation Process

Complex physician compensation

Physician Recruitment

On-call coverage

Time share arrangements – Real Estate

Equipment Leasing

Honoraria – Speakers, Services, and Data

Stark Regulations – non-monetary gifts and incidental benefits

Business Combinations and Transactions

- Intangibles, covenants not to compete

- Joint ventures, acquisitions, divestitures

The Value of Valuations

- Part of the Basics of Business Planning:
 - Business Enterprises (Assets/Liabilities/Equity)
 - Contractual Services
 - Mission and Business Plan of Organization
 - Negotiation Tool
- Financial Reporting
- Increasingly as part of Governance and Compliance
- Crucial issue in a wide range of legal matters

Legal Opinions

- Law firms work with providers to establish a process to develop FMV/commercial reasonableness information, and then opine that providers followed established process
 - Most law firms do not provide legal opinions on fair market value or commercial reasonableness.

Valuation Opinions

- Process as important as the Outcome
 - Process (Facts + Analysis) + Documentation = Support.
- When do you need an independent appraisal?
 - Are there circumstances and market factors that limit the usefulness of benchmarks and other historical data?
 - Consider the likelihood the transaction or arrangement will receive close scrutiny – an independent valuation will be given more weight.
 - If transaction so novel – participants themselves may object
- When do you not need?
 - Don't need for every arrangement – Do the facts and circumstances lend themselves to 3rd party benchmarks and/or accessible comparables?

Complex Compensation Arrangements

- Compensation arrangements can have a variety of formats. The following are possible compensation structures:
 - Equal compensation.
 - Fixed salary.
 - Productivity – based compensation.
 - Point system (a/k/a relative value unit [RVU] method).
 - Combination of guaranteed salary and productivity based compensation.

Complex Compensation Arrangements

- There are three (3) basic types of productivity compensation arrangements:
 - Percentage of collections.
 - Compensation per RVU.
 - Percentage of gross charges.

Complex Compensation Arrangements

Pros vs. Cons

Gross Charges

- Pro:

- Compensation is not based upon patient's payor.

- Con:

- Charges may not be aligned with collections.
- Compensation can be influenced by employer's increase/ decrease of charges.

Complex Compensation Arrangements

Pros vs. Cons

Collections

- Pro:

- Compensation is aligned with the amount employer collects for professional services.
- Good documentation, better behavior

- Con:

- Great incentive for physician to see patients with higher paying payors (disincentive to see Medicare, Medicaid or indigent patients).

Complex Compensation Arrangements

Pros vs. Cons

Relative Value Unit

- Pro:

- Compensation is based upon physician's productivity.
- Value of RVU is assigned by Medicare.
- Physician is compensated for work effort regardless of payor/collections.

- Con:

- Compensation based upon RVUs may not be aligned with collections.
- Confusion btw work and total

Example 1:

- Single Tier Model with a Guaranteed Cash Compensation of \$175,000 with additional incentive compensation of \$40 per RVU above 4,500 RVUs work.
- Base Compensation, RVU production and compensation per RVU all benchmarked at 50th percentile.

Percentile	Cash Compensation	RVUs	Compensation per RVUs
25	125,000	3,500	\$35
50	175,000	4,500	\$40
75	225,000	5,500	\$41
90	300,000	6,500	\$46

Example 2:

- Multiple Tiered Model
- 100% RVU Production

RVUs worked	Compensation per RVU
4,500 and below	\$35
4,501 – 5,500	\$40
5,501 – 6,500	\$45
6,501 and above	\$50

Physician Recruitment Fraud & Abuse

- Anti-Kickback Statute – 42 U.S.C. 1320a-7b
- Stark Act – 42 U.S.C. 1395nn

Physician Recruitment

OIG Factors to Consider

- The OIG, where a safe harbor cannot be achieved, considers the following when evaluating a recruitment arrangement:
 - The benefit is reasonable necessary to recruit or retain the physician recruit
 - The total pay-out is less than three years
 - The recruit does not have an existing stream of referrals that he or she could divert to the hospital/healthcare entity
 - There is an existing community need for the physician recruit

Physician Recruitment

Types of Arrangements

- Forgiveable Loans

- More Conservative Approach
- Amount Considerations
 - Recoupment of Start-up Costs
 - Expected Salary
- Required Responsibilities
 - Medical Director
 - Other Provider Needs
- Payback Period

- Income Guarantees

- Less Conservative Approach
- Amount Considerations
 - Expected Salary
 - Collections Calculations
- Required Responsibilities

Physician Recruitment

Other Factors

- Recruitment into Existing Practice
 - incremental costs
 - Use of non-compete agreements

Physician Recruitment Compliance Contract Elements

- **Arm's-Length Negotiation** - The hospital/healthcare provider searches for the best price on a good or service (i.e., not in collusion to share profits with the physician).
- **Commercially Reasonable** - The remuneration provided in agreement is commercially reasonable even if no referrals were made to the purchaser (rates consistent with risk and return).
- **Fair Market Value** - This is the result of *bona fide* bargaining between well informed buyers and sellers who are not otherwise in a position to generate business for the other party.

Physician Recruitment

Compliance Contract Elements: How to Document

- Consistent Processes & Approvals - necessary for different types of arrangements
 - Benchmark Data
 - Compensation Structures
 - Third Party Surveys or Advisors
 - Legal Assistance/Review
 - Approvals from the top of the organization exec/board
- Annual Audit of process should also take place

2005 Physician On-Call Pay Survey Report

Sullivan Cotter and Associates, Inc.

April, 2005

Introduction

- Sullivan, Cotter and Associates, Inc. conducted a survey of the on-call pay practices and rates paid to physicians across the U.S. during the months of December, 2004 and January, 2005.
- 167 Organizations participated in this survey.

Significant Findings

- Majority of participants (81%) were from hospitals/health systems. 19% were from physician group practices.
- 45% of the hospitals were trauma centers.
- Majority (86%) of participants require physicians to provide on-call coverage.
 - 46% of this amount pay independent physicians to be on call,
 - and 43% pay employed physicians to take call.

Significant Findings

- 16% of participants state that they are planning to implement additional on-call arrangements. Reasons are as follows:
 - Declining reimbursement rates for physicians combined with the increased number of uninsured patients has resulted in physicians demanding compensation for providing call services.
 - Compliance with EMTALA has created increased staff obligations for on-call coverage and trauma related areas such as neurosurgery, orthopedic surgery, trauma surgery, plastic surgery, and oral maxillofacial surgery.
 - Difficulty in recruiting or retaining physicians without a specific provision for on-call pay.

Pay Practices

- The table below summarizes the methods used by survey participants to determine physician on-call pay rates:

Method for Determining On-Call Pay Rates	Percent ^(a)
Rate varies by specialty	51%
Individually negotiated	44%
Percent of market rate, by specialty	12%
Same rate for all specialties	7%
Other	5%
On-call paid when a pre-determined number of events or shifts are exceeded in a given period of time	4%
Formula which takes into account factors such as rate of pay for each specialty, frequency of call, E/M and CPT codes or RVUs	3%

(a) Percentages add to more than 100% due to multiple response categories

Pay Practices

- The table below summarizes the methods used by survey participants to compensate on-call physicians who are called in to work:

Method for Compensating On-Call Physicians Who Are Called into Work	Percent ^(a)
Physician receives professional fees	36%
Individually negotiated	33%
Market rate for the specialty	26%
No additional compensation	18%
Flat rate for all	16%
Other	6%

(a) Percentages add to more than 100% due to multiple response categories

Pay Practices

- On-call rates were reported based upon whether the physician provided restricted or unrestricted call coverage
 - Restricted call indicates that the physician is required to stay on the premises
 - Unrestricted call indicates that the physician is not required to stay on the premises

Pay Practices

- On-call pay is provided in various forms such as hourly, daily (24 hours), weekly (168 hours) and annually (8,760 hours)
- All amounts paid were calculated to an hourly rate

Pay Practices

	Restricted On-Call					Unrestricted On-Call			
	No. of Respon- dents	25th %	Median	75th %		No. of Respon- dents	25th %	Median	75th %
Anesthesiology	12	\$52.61	\$ 66.25	\$ 91.17		6	\$15.03	\$21.38	\$43.60
Cardiology	5	\$69.49	\$104.17	\$112.50		7	\$ 7.64	\$16.67	\$28.54
Cardiothoracic Surgery	3	isd	isd	isd		9	\$ 6.46	\$12.15	\$18.75
Critical Care	7	\$55.00	\$ 65.00	\$ 91.58		4	isd	isd	isd
Family Practice	4	isd	isd	isd		6	\$ 5.28	\$13.21	\$50.00
Gastroenterology	1	isd	isd	isd		5	\$ 4.69	\$ 9.38	\$19.10
General Surgery	3	isd	isd	isd		9	\$18.75	\$33.33	\$35.67
Internal Medicine	6	\$60.88	\$ 65.52	\$ 71.25		7	\$10.42	\$16.00	\$45.00

isd = insufficient data (reported only for 5 or more respondents)

Pay Practices

	Restricted On-Call					Unrestricted On-Call			
	No. of Respondents	25th %	Median	75th %		No. of Respondents	25th %	Median	75th %
Maternal Fetal Medicine	7	\$85.00	\$95.00	\$106.00		3	isd	isd	isd
Neonatology	4	isd	isd	isd		5	\$10.78	\$17.35	\$30.72
Neurology	1	isd	isd	isd		5	\$ 5.87	\$ 9.38	\$22.45
Neurosurgery	7	\$83.33	\$93.75	\$104.17		30	\$17.58	\$32.29	\$41.67
Obstetrics/Gynecology	34	\$53.35	\$70.00	\$ 82.97		15	\$ 9.38	\$14.84	\$34.25
Ophthalmology	0	isd	isd	isd		9	\$ 5.89	\$ 9.38	\$17.09
Oral Maxillofacial Surgery	0	isd	isd	isd		7	\$ 4.17	\$ 8.93	\$14.88
Orthopedic Surgery	8	\$53.13	\$72.91	\$155.79		30	\$18.03	\$26.04	\$41.67

isd = insufficient data (reported only for 5 or more respondents)

Pay Practices

	Restricted On-Call					Unrestricted On-Call			
	No. of Respondents	25th %	Median	75th %		No. of Respondents	25th %	Median	75th %
Orthopedic Surgery-Hand	0	isd	isd	isd		6	\$10.86	\$14.47	\$19.15
Otolaryngology	0	isd	isd	isd		15	\$ 4.21	\$ 9.38	\$14.88
Pediatrics	4	isd	isd	isd		6	\$ 4.85	\$10.21	\$22.42
Pediatric Surgery	0	isd	isd	isd		4	isd	isd	isd
Plastic Surgery	0	isd	isd	isd		14	\$ 8.19	\$13.63	\$34.37
Psychiatry	5	\$60.42	\$82.16	\$ 91.67		12	\$ 6.03	\$ 9.52	\$16.06
Radiology	5	\$54.69	\$62.50	\$141.60		0	isd	isd	isd
Trauma Surgery	15	\$59.04	\$70.00	\$ 83.33		18	\$25.24	\$41.73	\$55.37
Urology	0	isd	isd	isd		9	\$ 5.06	\$ 8.33	\$13.69

isd = insufficient data (reported only for 5 or more respondents)

On-call Coverage

- Need to determine if on-call physician is required to be: a) at the hospital while on call (restricted); b) or is merely available by pager/phone (unrestricted).
 - Blurry lines regarding definitions?

On-call Coverage

- If on call physician needs to be available by pager/phone, and no third party survey is available, either of the following two approaches may be used:
- Find a specialty that does have a third party survey.
Determine on call hourly rate and determine percentage of normal hourly rate.
 - Example: Third Party Survey \$150 FMV hourly rate and \$20 on-call rate = 13.3%
Your on-call issue: \$200 FMV hourly rate x 13.3% = 27/hour
 - Determine what market typically pay nurses as a percentage of normal hourly rate to be on-call.
 - If nurses in market are typically paid \$2 to be available by pager and normal hourly rate is \$16, nurses are paid 12.5% of their normal hourly rate to be on call.
 - If a physician's normal hourly rate is \$150, then it may be commercially reasonable to pay the physician \$18.75 to be on call (12.5% of \$150).

Time-Share Arrangements

Real Estate

- Must allocate all costs.
- Rental of space (Half or Full Day Slots)
- Vacancy Rate (Project 20% vacancy?)
- Supplies
- Utilities
- Staff (Registration, Nursing, etc.)
- Equipment

Time-Share Arrangements

Real Estate

Example:

- Assume the following:
 - \$18 gross per square foot rental (exclusive use)
 - 30% projected vacancy
 - 1,000 square feet in suite
 - Building has 6,000 square feet, with 1,000 square feet for common area (5,000 square feet usable space)
 - Suite capable of being leased in half day increments (8:00 A.M. – Noon; 1:00 P.M. – 5:00 P.M.)

Time-Share Arrangements

Real Estate

Example:

- Furniture and equipment in suite determined to be leaseable at \$2,000 per year using independent third party leasing company.
- Miscellaneous medical/office supplies projected to be used in suite is approximately \$5,000 annually if suite leased 70% of the time.

Time-Share Arrangements

Real Estate

Example:

- What is the fair market value/commercially reasonable rate for one half day?

Time-Share Arrangements

Real Estate

Example:

- \$18 (exclusive use rate) + 30% (vacancy) = \$25.71 per square foot
($\$18 \div .7 = \25.71)
- 1,000 square feet (suite) \div 5,000 square feet (building not including common area) = 20% (percentage of suite's usable space in building's usable space)
- 1,000 square feet (common area) \times 20% (suite to building)
- = 200 square feet (common area allocated to suite)

Time-Share Arrangements

Real Estate

Example:

- 1,200 square feet (suite plus allocated common area) x \$25.71 = \$30,852
- \$30,852 + \$2,000 (furniture and equipment) + \$5,000 (medical/office supplies) = \$37,852
- \$37,852 ÷ 52 (weeks) = \$728 (weekly rate)
- \$728 ÷ 5 (business days in week) = \$146 (daily rate)
- \$146 ÷ 2 = \$73 (half day rate)

Time-Share Arrangements

Real Estate

Answer:

- \$73 for each $\frac{1}{2}$ day use of shared space
 - Consider some profit margin?

Time-Share Arrangements Real Estate

- Example becomes more complicated if:
- Part of suite is leased (as opposed to full suite)
- Staff is provided by landlord/hospital
- Specialized equipment is used
- Non-standardized supplies are used by a tenant

Time-Share Arrangements

Equipment Leasing

- First, it must be determined whether the equipment will be used exclusively by lessee or shared between multiple providers.

Time-Share Arrangements Equipment Leasing

- If leased exclusively, comparables from third party leasing companies should be obtained.
- Call and receive quote
- If unable to obtain a quote from a third party leasing company, lessor could determine the useful life of the equipment and reasonable rate of return for lessors of equipment.

Time-Share Arrangements

Equipment Leasing

- Example:
- Equipment valued at \$100,000, with a useful life of 7 years, and a commercially reasonable rate of return of 15%, produces an annual lease rate of \$16,428.

What is the formula for above calculation?
 $(\$100,000/7 \times 1.15)$

Reasonable Rate of Return: Determined by lessors who are not dependant upon referrals from lessees.

Time-Share Arrangements

Equipment Leasing

- If the equipment is not going to be used exclusively by the lessee, either a daily, hourly or per click lease rate should be developed.
 - Quote from third party leasing company
 - If unable to receive third party quote, using the same methodology as used in the exclusive use example may be appropriate.
- \$16,428 (annual rate including 15% rate of return) divided by 260 days = \$63 daily rental rate.
- **Caution:** This does not include any additional services lessor needs to provide to transport equipment or to make equipment available to lessee (i.e., films, technician, etc.).

Physician Honoraria

- Increasing scrutiny of payments from life sciences sectors for services from physicians:
 - Consulting payments and speaker fees
 - Sponsorships of continuing medical education
 - Marketing and educational services by healthcare providers
- Both sides of arrangement at risk.
- OIG Guidance for Pharmaceutical Manufacturers – must compensate speakers and consultants at “FMV”.
 - Life Science companies need insights from providers
 - Physicians want objective information – often the best source is the company that developed the drug or device
 - Patients require providers deliver unbiased recommendations

Physician Honoraria: Determining FMV

- Perform industry-wide speaker and consultant compensation survey.
 - Not at arms length (are existing rates at FMV?)
 - Difficult to compare
- Utilize national salary surveys and determine hourly base rate (by specialty, geography, experience, type of practice).
- Utilize internal information to consider unique characteristics of service and skill being provided (should a premium be added?).
- Develop FMV formula based on survey data and internal information.

Data and Related Services

- Data purchases becoming part of mix for payments to providers
- Data and data driven services life science manufacturers purchase from health plans, PBMs, and providers
 - Retrospective and prospective data studies
 - Patient-level data that can be aggregated and disaggregated
 - Utilization data, inventory, claims, script, chart information
 - Stand alone data or packaged with analyses, presentations
- Concerns: Price concessions and other remuneration to induce purchase of products; a condition for discount arrangements or provided at no charge or at different rates
 - Charging less than FMV to a referral source
 - Paying above FMV to a referral source

Data and Related Services: Determining FMV

- Perform industry-wide data survey
 - Data vendors
 - Other life sciences manufacturers (purchase and sell)
 - Other similar providers (purchase and sell)
- Cost analysis – Labor costs required to collect and technical and analytical support to warehouse the data

Non-Monetary Compensation / Incidental Benefits

2 Exceptions under Stark:

- i. Non-Monetary Compensation up to \$322 and*
- ii. Medical Staff Incidental Benefits*
- Benefits (meaning anything of value) can be given to a physician if either of the two exceptions are met.
 - See, § 411.357(k) and (m)

Non-Monetary Compensation

These benefits can include:

- free meals
- cookies
- golf outing (including charity golf)
- flowers
- sporting tickets
- CME
- Mugs
- Jackets
- Hats

Non-Monetary Compensation

- Although the maximum amount of the benefit is known (\$27 per benefit or \$322 annually), determining the value of each benefit can be challenging.

Non-Monetary Compensation

Example: Cookies

- What is the value of two dozen cookies baked in the hospital's kitchen?
 - Cost of materials to bake the cookies is \$1.50

Non-Monetary Compensation

Example: Cookies

- In this example, the value is not the cost to the hospital to bake the cookies. The value will be determined based upon the cost of two dozen cookies baked by a supermarket or bakery. If a bakery charges \$6.00 for two dozen cookies, then \$6.00 must be tracked under either exception even though the cost to the hospital was \$1.50.

Non-Monetary Compensation

Example: Charity golf outing

- Hospital donates \$2,000 to have a foursome participate in a charity golf outing. The CEO desires to ask a physician to be a part of the foursome.

Non-Monetary Compensation

Example: Charity golf outing

- Is the value assessed to the physician \$500 ($\$2000 \div 4$)?

Non-Monetary Compensation

Example: Charity golf outing

- Part of the \$2000 payment by the hospital is a donation to the charity. Thus, the value assessed to the physician will be the normal cost for 18 holes and a golf cart (i.e., \$100).

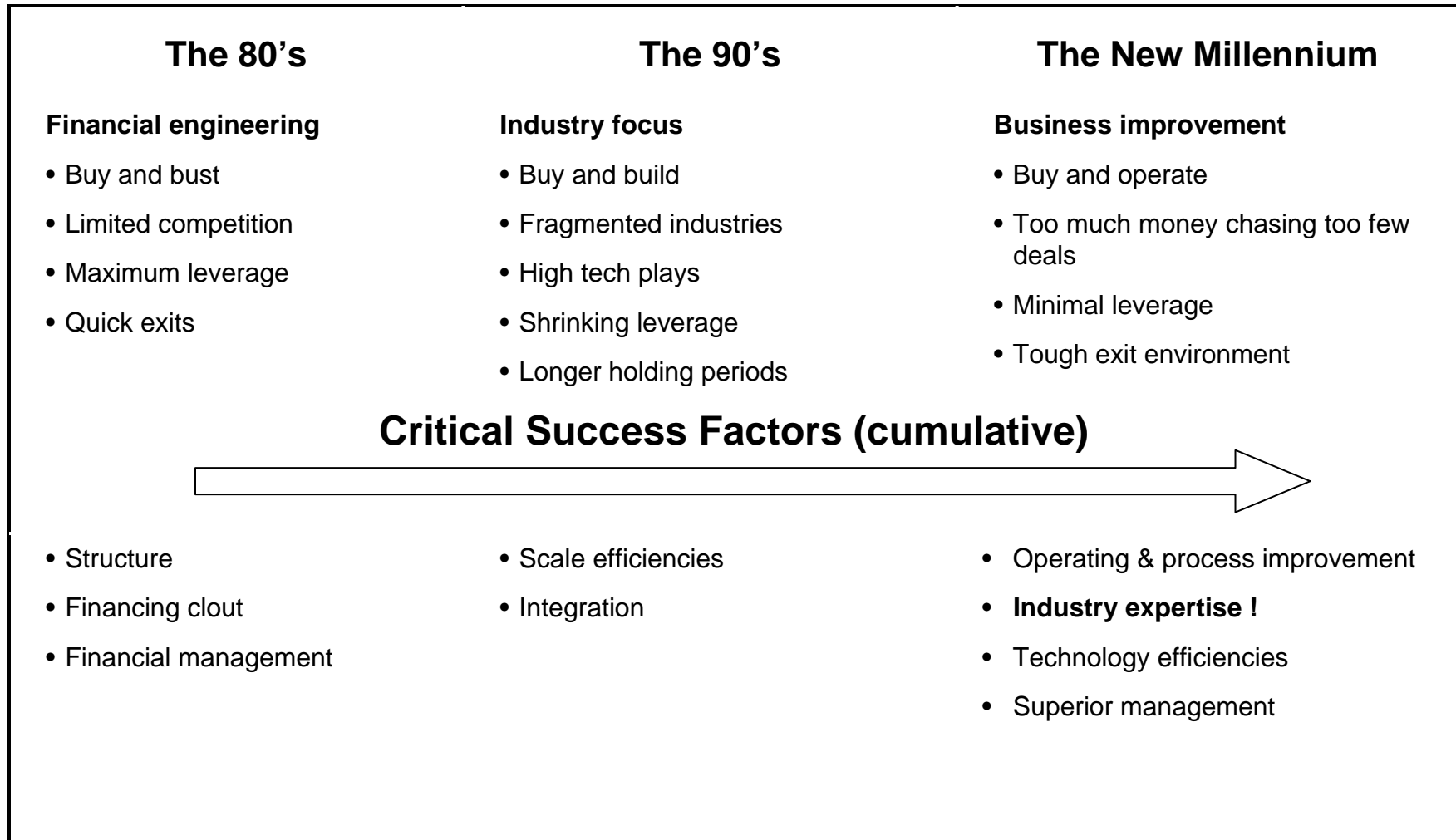
Non-Monetary Compensation

- Especially under the non-monetary compensation up to \$322, it is important to document each benefit given and to track all benefits to insure that the amount given each year does not exceed \$322 in one year.
- See Exhibits 1 and 2 for a model form to document each benefit given and an example of how to track the benefits.

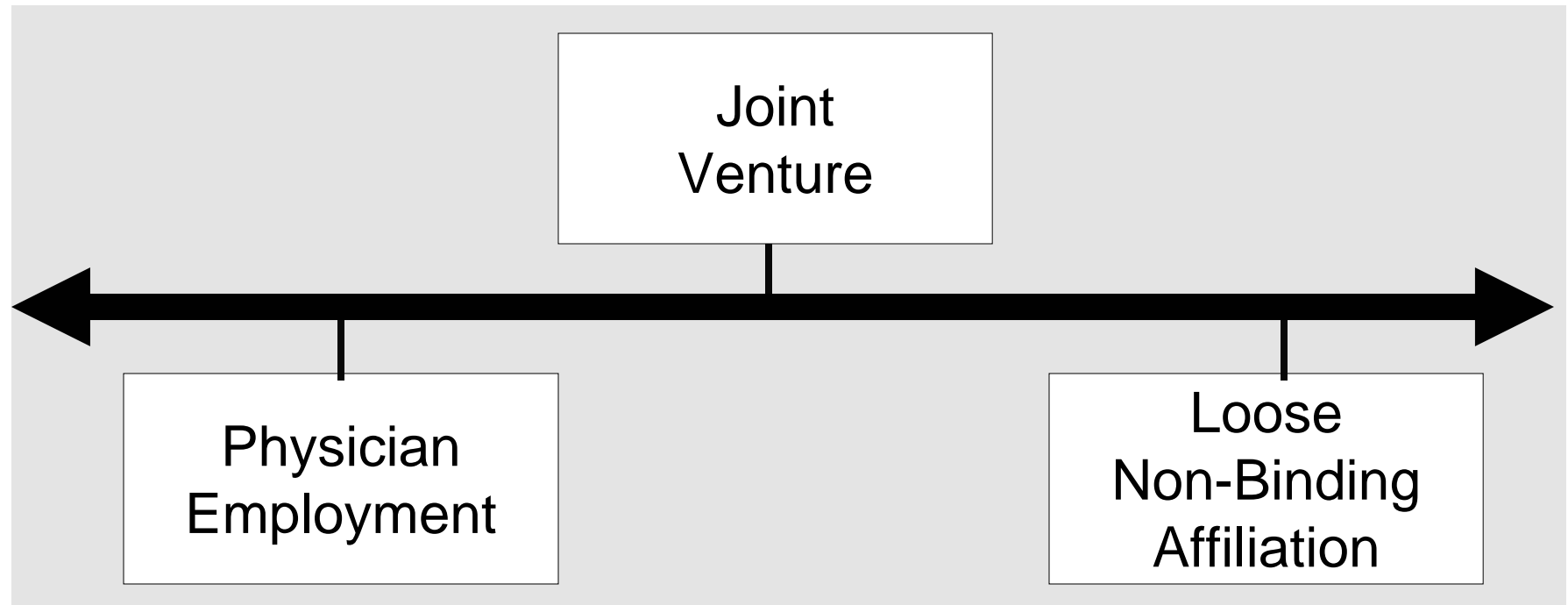
Business Combinations and Transactions

- Tangible v. intangible assets
 - Enterprise Goodwill (location, brand name, etc.)
 - Covenants not to compete
- Equity v. asset value
- Partial interests
- Amount of control and marketability
- Scope of services
- Risk elements
- Business and legal considerations

Private Equity Trends: The Landscape Has Changed



Continuum of Physician/Hospital Relationships: Business Enterprises



May have resulted from

- Recruitment
- Practice Acquisition

Typical MD/Hospital Transactions

	Purchase / From Physician	Sell / To Physician	Create a New Company (JV)
	Business, Business Interests, or Business Assets		
Candidates	Professional Practice Ancillary Businesses Real Estate	Syndication of Partial Interests in MOBs, ASC, & Imaging Centers	Consolidation of Labs, ASC, Imaging & Creation of Cath Labs
Focus for Appraiser	Tangible & Intangible Assets Being Purchased	Marketability & Control Issues	Tangible & Intangible Assets Being Contributed
Consideration of all 3 Approaches to Value	Yes	Increased Focus on Income and Market Approaches	Yes
Impact on Hospital Operations Risk	Increases; as Physicians have Less Financial Exposure	Decreases; as Physicians have More Financial Exposure	Typically lowers both party's risk
Impact on Compliance Risk	Largest Increase	Increase	Increase

Acquisitions/Divestitures

- Estimated range of fair market value used for decision making purposes related to Hospital's potential acquisition of a Practice.
- Rely primarily on the income and market approaches; however, we can apply cost approach to test the reasonableness of the FMV estimate.
- Transaction Negotiations
 - Determine compensation levels for physicians
 - Consider base/incentive compensation models
 - Is Hospital interested in all the physicians?
 - Term of employment; without cause termination?
 - How do we treat fees for ancillary services ordered, but not performed by physician?

Joint Ventures

Initial Agreements that may need FMV support

- Joint Venture Agreements
- Management Agreements
- Real Estate Transactions and Leases
- Employee Leases
- Equipment Leases
- Amount of buy-in and buy-out
- Syndications – requires per unit valuation

Joint Venture Considerations

- Income and market approaches usually the most relevant for profitable businesses
 - Cost approach can be utilized where value of contributed business is readily measurable and there is minimal intangible value
- Challenges
 - Valuing all components at FMV
 - Projected capital requirements (including value of “contributed” hospital business)
 - Reimbursement assumptions: hospital rates v. freestanding (low net revenue per case is a major risk factor)

Valuation Theory & Applications

In terms of general approaches to valuation, the business valuation community, as well as the American Society of Appraisers, categorize commonly accepted valuation methods into three broadly defined approaches:

I. Market Approach	<p><i>A general way of determining a value indication of a business, business ownership interest, or security using one or more methods that compare the subject to similar businesses, business ownership interests, or securities that have been sold.</i></p> <p>Application of the market approach was utilized through the guideline transactions method. The <i>fair market value</i> of the Company is derived from applying selected valuation multiples (such as MVIC to Revenue) to the Company.</p>
II. Income Approach	<p><i>A general way of determining a value indication of a business, business ownership interest, or security using one or more methods wherein value is determined by converting anticipated benefits into a present single amount.</i></p> <p>The income approach is a technique by which <i>fair market value</i> is estimated based on the future available cash flows that the Company can be expected to generate over its remaining useful life.</p>
III. Asset-Based (Cost) Approach	<p><i>A general way of determining a value indication of a business's assets and/or equity interest using one or more methods based directly on the value of the assets of the business less liabilities.</i></p> <p>The cost approach is a technique that uses the concept of replacement cost as an indicator of value. After careful consideration, it was determined that the cost approach was not applicable in the valuation of the Company.</p>

Market Approach Analysis

The market approach is a general way of determining a value indication of a business, business ownership interest, or security using one or more methods that compare the subject to similar businesses, business ownership interests, or securities that have been sold.

The guideline public company method estimates the FMV of the business enterprise by comparing the subject company to guideline firms that are publicly traded on an organized exchange.

The guideline transactions method estimates the FMV of the business enterprise by comparing the subject company to recent transactions of similar companies.

Income Approach Analysis

The single period capitalization method of the income approach estimates the FMV of the business enterprise by projecting a normalized level of available cash flow to the company during the next year and then using a capitalization multiple to convert a single year's cash flow into an estimate of value of the company.

One of the critical components of the single period capitalization method is the development of a pro forma income statement for the base year

Asset Accumulation Method

Identify the specific tangible and intangible assets associated with a proposed transaction.

Tangible Assets

Estimate Net working capital. This includes inventory and contractual reserves that are retained on the balance sheet for the Clinics.

Intangible Assets

Identify key intangible assets that have a value separate from and in addition to the tangible assets of the Clinics.

Valuation of Partnership Interests

- Discounted Cash Flows
 - Dependent upon a large number of assumptions such as
 - Volume
 - Revenue per unit (case, visit, day, etc.)
 - Payer mix
 - Growth rate
 - Operating costs
 - Salaries
 - Supplies
 - % Variable Cost vs. Fixed Expense
 - Fixed Assets beginning balance
 - Capital needs
 - Age, mix of equipment
 - Source of financing for capital (i.e. available cash or new loans)
 - Average Depreciation Life for capital equipment
 - Working Capital Requirements

Valuation of Partnership Interests

- Discounted Cash Flows (continued)
 - Fixed Assets beginning balance
 - Capital needs
 - Age, mix of equipment
 - Source of financing for capital (i.e. available cash or new loans)
 - Average Depreciation Life for capital equipment
 - Working Capital Requirements

Valuation of Partnership Interests

- Discounted Cash Flows (continued)
 - **Discount Rate** – Commercially reasonable rate of return
 - Opportunities to increase if certain unfavorable factors are present
 - Decision as to when required to outsource valuation
 - Inflation Rate
 - Tax rate
 - If CON state, status of CON activity and competition
 - Other factors
 - Longevity of partners, enforceable non-compete provisions

Valuation of Partnership Interests

- Market
 - EBITDA times market multiple less debt
 - Market Multiple –
 - Low risk of variation of future earnings equals greater multiple
- Cost
 - Net Tangible Assets minus Total Liabilities
 - Doesn't factor Intangible Assets

Contractual Joint Ventures

April 2003 HHS-OIG Special Advisory Bulletin

- Provider in one line of business (i.e., hospital or physician or Owner) expands into related business by contracting with an existing supplier of the related business (i.e., Manager/Supplier)
- Provides services to existing patients of Owner
- Manager/Supplier manages, provides inventory, space, billing etc.
- Manager/Supplier is otherwise potential competitor
- Owner receives profits for federal program referrals

QUESTIONS?