Healthcare tax checkups

Podcast transcripts

Episode 2: Physician valuation issues

Announcer

Hello, and welcome to Healthcare Tax Checkups, the KPMG podcast series, featuring KPMG tax leaders on emerging and perennial tax issues impacting the healthcare industry.

Announcer

Today's episode explores the significance of proper valuations of physician practices for both pricing and regulatory purposes.

Lori Robbins

Hello everyone. And thank you for tuning into this podcast episode. I'm Lori Robbins, deputy tax industry leader for KPMG's healthcare tax practice. I'm based in Washington, DC in our firm's Washington national tax practice. And with me today is Chris Ober. Chris co-leads KPMG's national healthcare valuation practice, and has nearly 20 years of experience specializing in valuation and analysis of businesses and intangible assets for financial reporting, M&A, fairness opinions, shareholder disputes, and for a variety of other purposes, Chris focuses on healthcare and has performed valuations in many different fields, including acute care hospitals, surgery centers, physician practices, behavioral health, pharmaceuticals, laboratories, medical devices, healthcare payers, and so on. Chris, thanks for joining us. We have a number of physician practices being acquired by hospitals and other healthcare providers and your services have been in great demand in that time. So much of what you do is fining the fair market value of businesses and assets. We hear the phrase fair market value used in many contexts. What is that? And does it have a special meaning in the healthcare setting?

Chris Ober

Well, thanks Lori for having me and yeah, so respect to fair market value. It really has a meaning across the valuation world in particular, across all industries really, and is formally defined by revenue ruling 59, 60 and fair market value in a traditional setting is really for tax related valuations or anything, maybe management planning, anything that's not related to financial valuation. And when you get to financial reporting and then the standard switches to fair value, which is then defined by the AICPA, the definitions are similar, right. But the AICPA definition is more specific to market participants and just different accounting type circumstances. But as it relates to healthcare, it does have a definitely a special meaning in the healthcare setting. It relates more to compliance with the Stark law and anti-kickback statute.

Chris Ober

And the specific definition for FNB within the healthcare setting is defined by the code of federal regulations. It's sort of a long definition, but, generally it's the price that would result after a bonafide bargaining agreement between two well-informed parties that are not in a position to generate business from the other party, right? So it's... The price and compensation cannot be determined in any manner that considers volume or value for patient referrals. So it's uniquely defined in the healthcare space to avoid the perception of reality of paying for patient referrals.

And the regulations were put in place in the healthcare industry to prevent incentives paid to provider, to direct patients to their own facilities.

Chris Ober

So a health system cannot overpay a physician if in any way, shape or form to convince that physician or a group of physicians to stop sending their patients to other centers and send them to within their own healthcare facility. So in that context, FNBB you hear it all the time outside of just the healthcare space, but you're right. It is uniquely defined within healthcare to help abide by those Stark and anti-kickback regulations.

Lori Robbins

So determining fair market value is important, not just to going to the pricing of the business, but to the Stark and anti-kickback rules that you mentioned.

Chris Ober

Yeah, exactly. I mean, I think it has a dual purpose. And if you look at the... Anytime you're at the front end of a transaction of any kind with a provider, whether it's acquiring a physician practice or a group of physicians, or any type of other arrangements with providers such as joint ventures or anything like that, it's definitely highly recommended to have an analysis performed that demonstrates that you're paying within the fair market value realm.

Chris Ober

The risk, I guess, is if the OIG or AG or any other governing body comes around and investigates some of these transactions that you're, that are taking place with other providers. You'll want to have something in your file that shows that you've done the diligence around the payments to that provider, whether it's a purchase price or a compensation paid to a physician that you're going to be acquiring and demonstrates that you thought this through and you believe that it is within fair market value, this kind of avoids... If you seen out there, a lot of over the past few years, a lot of settlements, like large settlements, right.

Chris Ober

And sanctions that have come down on certain health systems for Stark and anti-kickback violations, while maybe not all related to fair market value, there's definitely some components. And there were, they've identified what they perceive as overpayments to physicians that cannot be explained and don't have any documentation or support. So that why we get called in usually on the front end of transactions, to help them, have that diligence performed, have something in their files that shows that a third party came in and did this fair market value analysis. And what they're paying coincides with that. Usually if you have that, if one of the governing body comes and starts to investigate, that will help them get comfortable with what you're paying. But that said outside of the compliance perspective, it does have a purpose for management planning and that it does help the client understand the value premise of what they're looking at.

Chris Ober

Right. We've had a number of circumstances where some of our health systems are acquiring physician practices, and they'll hire us in to do the valuation work, the FNB work from a compliance perspective, but also to help them in their negotiation process. And there's always, there's like, I can remember several circumstances where we'll put that in front of the client and they'll kind of stare at it for a little bit and think we were planning on paying a lot more than this. Right. And so it helps them kind of fine tune their perspective of what that practice might be worth after they see that analysis. So it does kind of serve that dual purpose from that perspective.

Lori Robbins

Interesting. So, it's good to keep those fair market valuation documents handy so that if a regulator does come calling you, you have that at your disposal.

Chris Ober

Correct.

Lori Robbins

So, generally, how is fair market value determined? And I'm not asking you to give up your trade secrets in this space, but are there different ways of calculating fair market value?

Chris Ober

Yeah, there are no trade secrets. And it's funny you say that because every time we get on the phone to talk through methodology, I always say that especially if the auditors are on the line, that we're not going to pioneer anything new here, what you're going to see is what you see generally across all valuation providers. It's just where we provide the most value is in our expertise from an industry perspective, but in general, for physician practices or other, just any other kind of entity acquisitions, right. We start with a discount of cashflow analysis and, and a market approach. And the sense is that for an investor always wants to kind of understand what the return on investments going to be from a cashflow perspective. But in addition, what others market participants out there are paying for certain assets or liability or equity interests.

Chris Ober

So that, that just kind of cash flow method we'll work with the clients to understand what that proforma will look like on a standalone basis, not including any synergies from the buyer and then do a risk assessment on those cash flows and discount that back to present that methodology's been around for, since the dinosaurs, right? So everybody knows that the discount of cash flow method and the market approach will look at what we'll call guideline company analysis, where we'll try to find comparable publicly traded companies and, and, and look at pricing multiples based on the stock prices, or we'll look at transactions of similar entities. So we know we may have skilled nursing facilities, or we may have urgent care centers, ambulatory surgery centers. We'll try to find transactions specific to those types of entities and look at the pricing multiples in those transactions.

Chris Ober

So usually with the smaller physician practices and other types of smaller deals, we'll usually focus more on the transactions because you won't find many public traded comp companies that are uniquely similar to a physician practice, right? I think there are maybe just one or two that just went public, but even they're too new on the market. So a lot of the market approach stuff is transaction oriented. Having said all that, oftentimes, with physician practices, there's little to no profitability left in the business. If you think about how a physician practice works, especially the smaller ones, right. They're not saving to expand into other markets. They don't have a lot of capital and investments that are needed outside of maybe some new equip meant here and there. So if you think of maybe a primary care practice they're just seeing patients, they're billing insurance, they're getting collections and then they're paying their expenses.

Chris Ober

And hopefully there's something left over at the end of the day for salary. But whatever that is, is usually what they take home, leaving very little on the bottom line. So when you start to look at a discounted cash flow method, there's not an up there for materiality from a value perspective. And there's no earnings, there's nothing really to hang a multiple on, unless you're looking at a multiple of revenue, which doesn't make a lot of sense in that space. So in ad instance, we'll, we'll actually look at the value of the assets underlying the business. So, it's usually all of the equipment, that they have the computers, desk, chairs, beds, and any type of medical equipment x-ray machines, those types of things. And then the intangibles, right. I mean, we'll look at the workforce, we'll look at the patient records, we'll look at supplies that they have on hand. And that really becomes the supplement of, of value from that perspective when there's less profitability.

Lori Robbins

That makes sense. So even though they may not be highly profitable businesses, you can still go into a great amount of detail to find the value of that business.

Chris Ober

That's correct. Because just because there's no cash flow coming out, doesn't mean there's no value to the business. And, and so you look at saying, okay, well, I'm going to employ this physician. I'm going to pay them for all of the investments that they made in their underlying infrastructure at the end of the day. Right. So there's some value there, but it, you're not going to be able to see it from looking at negative cash flows. You know what I mean.

Lori Robbins

Right.

Chris Ober

So yeah, you look to alternative methods, but for physician I'll hit one last thing on the question around how FNB has determined. When you look at physician compensation, it looks a lot different, right? It's not the type of analysis that I just described while it technically is a form of the market approach.

Chris Ober

It's really more of a benchmarking exercise. So, we'll gather all the information that the have on a physician that they want us to, to run an FMV on or commercial reasonableness test on and that includes looking at their collections, their work RVUs, patient volume and just other metrics, right? Maybe they're teaching, maybe they have a medical directorships. Some maybe there's some unique in noninvasive surgery that they've created in their world, renowned all other aspects outside of just the productivity. But we'll take all that information and then go to several of the subscription, third party survey databases that we have. And we'll start to look at, okay, what specialty as this physician in, and then we'll drill down to that specialty and try to find information about what other physicians that are, that have similar productivity in terms of collections and work RVUs in similar regions what they're being paid and then kind of compare that to the proposed compensation for the physician we're looking at, right.

Chris Ober

And then we'll look at the facts and circumstances underlying it. And at the end of the day, making certain adjustments within the benchmarking data, come up with what we feel like a fair market value range for that physician should be our group of physicians. So it's a little bit, it's a little bit different. It is part of the market approach. And we're using publicly available survey information and trying to compare and contrast what similar character, similar physicians are make, are being compensated, I should say, for doing similar types of services. And services. Right. So that's kind of what the, where we end up with compensation. So I wanted to make sure I hit on both entity acquisitions and in physician compensation. Cause I think that's kind of the crux of the question that you asked.

Lori Robbins

Yeah, that's great. That makes sense. And thanks for those insights. In wrapping up, are there any other special considerations that those who are party to these physician practice deals should consider in the valuation context? You mentioned obviously physician comp is sort of its own unique animal. Any other closing thoughts for those listening?

Chris Ober

Yeah, I guess I would say from aside from physician compensation, a lot of times it's overlooked that there should be an FNB framework around other provider arrangements. Oftentimes when, when we're talking with our clients will ask is there a management agreement put in place where, you'll see a lot of health systems that are acquiring physician practices set up an MSA, so to provide back office support, but really taking the pressure off of the physicians to, to have to focus on that. And then instead give freeing up their time to look at just the clinical side and just treat patients right. But there's being, there's a fee being paid for those services. And often it's overlooked that that fee also needs to be within fair market value range. So it's not perceived that you're charging below market fees, right.

Chris Ober

Which could be saying, Hey, we won't charge you full price for the management fees, if you just pay to promised to send patients into our facilities. So oftentimes we'll recommend that gets, that gets looked at. Rental arrangements are similar. There's been circumstances where a health system may buy a physician practice and the physician just operates out of one office building, right. And they own that building and they want to sell that building to the health system as well. And then the health system will charge them rent to operate that. It's easy to forget that that fair, that rent also needs to be at fair valley because that's also more just, it's money transacting between the provider and the health system. So it also needs to be looked at from a fair market value perspective.

Chris Ober

And I think last, I had a client reach out to me in the HR department that handles physician compensation and asks me a question about why third party providers don't look at billing and coding audits during the diligence process, because oftentimes, deal's close, right. And that doesn't get looked at. And then the physician contracting gets handed over to HR and they realize that the, the physician's been and maybe billing the wrong codes over a period of time. Right. And if you alleviate that, then the compensation definitely looks different. Right.

Lori Robbins

Right.

Chris Ober

And the difficult decision discussions need to be made post transactions that probably should have happened during the diligence process. And so we often when we're talking in the beginning of transactions with our clients recommend that somebody at least do a sampling of the billing and coding of the physicians to make sure that all that's being done accordingly, such that the appropriately rep or reflects the compensation being paid. I think that's pretty much from an FNB perspective, those are the few different areas that sometimes do get overlooked that I think is important to highlight.

Lori Robbins

Great. Great. Thanks Chris, for shutting some light on various significant valuation issues that healthcare organizations are facing. And for those of you listening, if you have any questions or wish to discuss your business's valuation issues further, please feel free to contact Chris Ober or myself or your local KPMG representative. Thank you very much.

Announcer

Thank you for listening to KPMG's healthcare tax checkup podcast. For more information, visit the healthcare and life sciences homepage. See you next time.

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