Objectives

Understanding the Approach to Practice Appraisals

Key Factors Impacting the Valuation

Information Needed for a Good Appraisal

Methods

The "strength" of the practice's income stream and what it produces for the owner(s) is what creates true value in an optometric practice.

The key to a successful valuation is deciding whether or not the practice's future income stream will mirror its present income stream.

Many optometrists have an idea in their head of what they THINK that their business is worth.

Often there is an emotional component that is factored into what the optometrist perceives their practice to be worth.
Understanding the Approach to Practice Appraisals

**Reasons of the Sale of a Practice**

- Retirement
- Relocation
- Maintaining the practice is too much of a burden/stress (Burnout)
- Physically unable to meet the demands
- Lower reimbursement rates
- Divorce
- Mergers
- Litigation
- Someone made them an offer they couldn’t refuse

**Regulatory Issues**

- **Anti-Kickback Statute**
  - Prohibits payments, offers, or inducements of any remuneration for referrals.
  - Issue: If acquisition price exceeds fair market value, transaction may be considered a remuneration for referrals.

- **Stark Law**
  - General Rule: Remuneration must be FMV and not determined, directly or indirectly, in a way that takes into account the volume or value of referrals (or other business) to the entity.

- "General market value" - Price that an asset would bring as the result of bona fide bargaining between well-informed parties to the agreement who are not otherwise in a position to generate business for the other party, on the date of the acquisition of the asset or at the time of the service agreement.
Understanding the Approach to Practice Appraisals

Regulatory Issues

- **Stark Law**

  - **Valuation Note:** Just because a transaction may be "fair market value" does not necessarily make it "commercially reasonable".

Different Appraisal Approaches

**Balance Sheet or Asset Approach**

- Adjusts the book value of the assets and liabilities to fair market value, or itemizes and values the individual items - which is often more accurate since abandoned items like old computers might still be on the Balance Sheet "books".

**Market Approach**

- Applied to professional practices compares the subject to other practices that have sold.
Understanding the Approach to Practice Appraisals

Different Appraisal Approaches

Income Statement Approach

Results in a value that includes ALL tangible and intangible assets, including that described as goodwill. It does not separately seek to break out goodwill value, but to include it.

Discounted Cash Flows: Focuses on the practice's projected future cash flows from operations, rather than assets and liabilities.

Capitalized Excess Earnings: Focuses on the practice’s historical earnings, as reported per its income statement.

Key Factors Impacting the Valuation Costs

When analyzing a practice’s financial statements, pay attention to:

- Salary costs
- Physician direct expenses (Travel, CME, insurance, etc.)
- Expiring leases
- One-time costs
- Adding costs to projected revenue growth
Key Factors Impacting the Valuation

Costs

Revenues:
- Where did they come from?
- Ongoing revenues?
- What happens to revenues if the owner stays/leaves?
- One-time revenues?

Expenses:
- Are they comparable to similar practices?
- Look for excess doctor-related costs that are disguised as compensation.
- Look for subsidies that will end and which will continue.
- Adjust to reasonable cost structure if necessary.
- Normalization adjustments.

Payer Mix

Primary vs. Tertiary Care

Identify common patients and related insurance structure (Vision vs. Medical)
- Obtain and analyze CPT Frequency Report.
- Will these same services continue if there is a change in practice ownership?

Which insurances have a direct effect on the practice's revenue stream?
- Impacts what the practice collects for the services it renders.
- Identify recent changes to practice payer mix (Growth in MVC, Medical & Medicare).
- Anticipate future changes in payer mix.
- Impacts reimbursement risk & revenue projections.
Key Factors Impacting the Valuation

PATIENT DEMOGRAPHICS

What is the breakdown in the practice?
- Percentage of males to females
- Identify new patient growth patterns by city or zip code
- Referral Patterns
- Economic Demographics of patients' buying patterns

Understanding communication / buying habits of each generation

Baby Boomers (1946-1964)
- 74.9 million Boomers - Ages 51 to 69
- 50% of the Population
- About half of baby boomers feel texts and emails are convenient
- May have patients who also still want a phone call
- Over the next 20 years, spending by people 50+ is expected to increase by 58% to $4.74 trillion

Generation X (1965-1980)
- Comprise 25% of the population & 31% of the total US income
- 48% listen to the radio, 62% still read newspapers and 85% watch traditional television
- Outspend all other generations when it comes to housing, clothing, eating out and entertainment

Millennials (1981-1996)
- Largest generation to ever exist in the United States.
- Want more technology in their healthcare
- Want to be able to text their doctor and driving expectations for healthcare
- Prefer access to goods and services over ownership of them
- Seek the best deal when making larger purchases, and rate price as very important when making a major purchase of $500 or more.
**Key Factors Impacting the Valuation**

**PATIENT DEMOGRAPHICS**

Understanding communication / buying habits of each generation

Generation Z (Post-Millennial) (1998-2016)
- 23 Million and make up 25% of the U.S. population
- Communicates with images and multi-task across 5 screens.
- Technology dependent.
- Has a sense of pride in ownership and not afraid to spend money.

---

**Key Factors Impacting the Valuation**

**COMPETITION**

Who are they?

Knowing what the practice is up against in the market will allow you to identify which practices will be the biggest competitions for patients.

What do they offer? Who are their patients?

Understanding what competitors offer gives you the opportunity to evaluate the practice's offerings to see how you stack up.

Put emphasis on ways that the practice can offer value where the competition cannot or does not.

What is the competition's strengths and weaknesses?

Objectively assess where competitors are both strong and weak and consider the practice's standing in comparison.
Key Factors Impacting the Valuation

COMPETITION

How do competitors market themselves?

- Is there something that’s working well for the competition that could inspire your own marketing efforts? What could perhaps be done better?
- Study how the competition are selling themselves so that you can improve and optimize your own marketing.

Key Factors Impacting the Valuation

COMPETITION

Do you know the practice’s growth potential?

- Assessing the outlook of the target can provide a signal to you how fierce the competition really is in your market.

Key Factors Impacting the Valuation

TRANSITIONING OWNERSHIP

Will the current owner(s) assist the transition to you?

- Establishing a succession plan is one of the most important business decisions the new owner can make.
- Generally want a transition period of 6 months.
- The structure of the succession plan will depend on the type of practice involved.

Key Factors Impacting the Valuation

TRANSITIONING OWNERSHIP

Will the current owner(s) assist the transition to you?

- Assemble a team of competent advisers who have in-depth knowledge and experience working with physicians, their practices, and their unique planning needs.
- Different structures have different tax consequences and create different demands on cash flow.
Information Needed for a Good Appraisal

FEDERAL TAX RETURNS

Income Tax Schedules

- Schedule C for Sole Proprietor & LLC
- Schedule K for Corporation S
- Practice’s federal income tax returns & accountant-prepared financial statements for the most recent 3 years & interim financial statements for the current year-to-date

Hard & Soft Assets

Hard Assets

- Tangible
- Furniture
- Fixtures
- Inventory
- Medical Supplies
- Working Capital
- Equipment
- Etc.

Soft Assets

- Copyrights
- Trademarks
- Medical Records
- Contracts
- Goodwill
- Trained Workforce

Fee Schedules & Volume Statistics

- Were fees in consideration of what the market generally charges?
- Were patients charged different fees or had different allowable discounts for self-pay vs. insurance?
- Comprehensives Examinations vs. Medical Examinations
Information Needed for a Good Appraisal

FEE SCHEDULES & VOLUME STATISTICS

- If fees are too low, plan to increase them incrementally until they’re where they need to be. Avoiding sudden changes in fees.
- For insurance, review codes where the practice is paid on the low end of what peers are paid.
- Review current insurance contracts

Information Needed for a Good Appraisal

APPOINTMENT SCHEDULING

Scheduling is the heartbeat of the practice
Scheduling represents the smoothness of the practice
Scheduling is the practice’s ability to provide excellent care of the patients
Scheduling is the practice’s ability to produce

- Percentage of Unfilled Appointments?
- Percentage of No Shows?
- Percentage of Last Minute Cancellations?
- What is the fill rate? Productivity of each OD/MD?

Information Needed for a Good Appraisal

GOODWILL REGISTRY

- Goodwill is one of the most elusive concepts and probably one of the most troublesome when valuing a medical practice
- The Goodwill of a practice is the remaining value after intangible and tangible assets are identified.
- Goodwill is evidenced by a source of cash flow for a practice that cannot be explained or attributed to other assets or is not a separable part of the practice.
- The Goodwill Registry cites:
  - Mean & median Goodwill values based on other optometry transactions
  - Where Goodwill value was included
  - Registry dates occurred during the years 1999 and 2017

Information Needed for a Good Appraisal

GOODWILL REGISTRY

- A practice’s true goodwill value depends upon various factors:
  - Overhead - A high overhead warrants a negative adjustment to the benchmark percentage, while a low overhead warrants a positive adjustment.
  - Competition - The more competitive the market, the greater a successful practice’s goodwill within the market; the less competitive the market, the lesser the goodwill value.
  - Specialty vs. Primary Care - The higher the degree of primary care, the greater the goodwill value; the higher the degree of specialty care, the lesser the goodwill value.
Information Needed for a Good Appraisal

GOODWILL REGISTRY

• A practice’s true goodwill value depends upon various factors:
  - Non-Compete Agreements: The existence of non-compete agreements provides security against the potential loss of patients due to the competition by a practice’s departing ODs.
  - Contracts: The smaller the payor mix, the less goodwill because risk of loss to the practice’s patient base.
  - Miscellaneous: Examples: Capitation, Litigation, NPS

• Every practice is different, each having its own characteristics and circumstances. So there may be other reasons warranting an adjustment to the average goodwill factor.

Methods

Balance Sheet or Asset Approach

Component Method

• The appraiser specifically identifies the practice’s assets and liabilities.
• The assets are individually valued, and the aggregate of such individual asset values constitutes the practice’s total asset value.
• Total liabilities are then subtracted from the total asset value, the result representing the practice’s resulting value.

Income Approach

Discounted Cash Flow Method

• This method focuses on a practice’s Income Statement (i.e., revenues & expenses).
• The practice’s projected future cash flows from operations, rather than assets and liabilities.
• Projected future cash flows are ascertained from historical cash flows (typically, the practice’s prior year’s cash flow) applying reasonable assumptions about future operations (including, for example, growth in revenues and expenses).
• The projected future cash flows are then discounted to present value by applying an appropriate discount rate.

Discount Rate

• The discount rate represents the total expected rate of return (%) that a buyer would demand on the purchase price of an ownership interest in an asset given the level of risk inherent in that ownership interest.
• Discount rate is used to derive present value factors which are used to discount a future benefit stream to a present value.
**Income Approach**

**Capitalized Excess Earnings Method**
- The easiest of the three methods.
- Focuses on the practice’s historical earnings, as reported per its income statements.
- An appropriate capitalization factor is applied to earnings to determine practice value.
- Appraisers will typically use a weighted average technique, whereby earnings for the prior three-year period are included and subjected to a weight factor that gives increasing consideration to the more recent year.

**Common Valuation Problems**
- Methodology Issues
- The doctors may not work hard
- Overcoding?
- There are no "profits"
- Tax affecting an C Corp, S corp, non-profit, or a partnership
- In a large group practice, some doctors create "earnings" while others do not.

Thank You!

Bryan M. Rogoff, OD, MBA, CPHM, FAAO
bmrogoff@eye-exec.com