I. Course Description
   A. Private equity and other investment firms have focused their attention in optometry over recent years and practice appraisals are the most important factor for both buyers and sellers to determine their value. There are a variety of methods and pieces of information that play a role in the appraisal process which are NOT an exact science and are subject to an appraiser’s opinion. This course discusses the basics of different types of appraisals, needed information and the understanding goodwill to be able to understand THEIR value of their practice.

II. Course Objectives
   A. Understanding the Approach to Practice Appraisals
      1. Reasons of the sale of a practice
      2. Regulatory Issues
      3. Different Appraisal Approaches
   B. Key Factors Impacting the Valuation
      1. Costs
      2. Primary Care vs. Specialty (Tertiary Care) & Payer Mix
      3. Patient Demographics
      4. Competition
      5. Transitioning Ownership
   C. Information Needed for a Good Appraisal
      1. Federal Income Tax Returns
      2. Soft & Hard Assets
      3. Fee Schedules and Volume Statistics
      4. Appointment Scheduling
      5. Demographics of Marketing Area
      6. Goodwill Registry
   D. Component Method
   E. Discounted Cash Flow Method
   F. Capitalized Excess Earnings Method
   G. Common Valuation Problems

III. Understanding the Approach to Practice Appraisals - The "strength" of the practice's income stream and what it produces for the owner(s) is what creates true value in a medical practice. The key to a successful valuation is deciding whether or not the practice's future income stream will mirror its present income stream.
   A. Reasons of the sale of a practice
      1. Practice values come into play for various reasons
         a) Owner buy/sell arrangements
         b) Divorce
         c) Mergers
         d) Litigation
   B. Regulatory Issues¹

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

2. **Stark Law**
   a) 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
   b) “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.
   c) Valuation Note: Just because a transaction may be “fair market value” does not necessarily make it “commercially reasonable”

D. **Different Appraisal Approaches** - All methods, despite their heavy reliance on historical numbers, require appraiser discretion in determining revenue or earnings multipliers, discount and capitalization rates. Discretion should have some foundation whether based upon market comparables, appraiser experience or both.

1. **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”.

2. **Market Approach** - Applied to professional practices compares the subject to other practices that have sold.

3. **Income Statement Approach** - The income 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. The underlying concept is that when using income of the business as the approach for valuation, that income results from the value of both tangibles and intangibles together.
   a) **Discounted Cash Flows** - Focuses on the practice’s projected future cash flows from operations, rather than assets and liabilities.
   b) **Capitalized Excess Earnings** - Focuses on the practice’s historical earnings, as reported per its income statement.

IV. **Key Factors Impacting the Valuation**

A. **Costs**
   1. Costs to pay attention to: Salary costs, Physician direct expenses (Travel, CME), Expiring leases, One-time costs, Adding costs as projected revenues grow
   2. Revenues: Where did the revenues come from? Ongoing revenues?
      a) If owner(s) stays?
      b) If owner(s) leaves?
      c) One-time revenues?
   3. Costs: Comparable to similar practices
      a) Adjust to reasonable cost structure if necessary
      b) Look for subsidies that will end (continued)
      c) Look for excess doctor-related costs that are in reality disguised compensation
      d) Make using normalization adjustments

B. **Primary Care vs. Specialty (Tertiary Care) & Payer Mix**
   1. Identify common patients seen and their related insurance structure (Vision vs. Medical)
      a) Obtain and analyze CPT Frequency Report
      b) Will these same services continue if there is a change in practice ownership?
   2. Has direct impact on revenue stream
      a) Impacts what the practice collects for the services it renders

2 http://www.medicalpracticeappraisal.com/physical-therapy-practice-valuation-appraisal.html
b) Identify recent changes to practice payer mix
   1) Ex. Growth in MVC, Medical & Medicare
   c) Anticipate future changes in payer mix
   d) Impacts reimbursement risk & revenue projection

C. Patient Demographics\(^3\) - What is the breakdown in the practice?
1. Understanding the communications and buying habits of each generation.
   a) Baby Boomer 1946-1964
   b) Gen-X 1965-1980
   c) Millennials 1981-1996
   d) Gen-Z (Post - Millennial) 1982-2002

D. Competition
1. Are there, or will there be, competitors that will, or can, take patients away from the practice now and in the future?
2. Is a practice “risky” if it doesn’t have competition?

E. Transitioning Ownership\(^4\)
1. Will the current owner(s) be available to assist in the transition to the new owner?
2. Generally want a transition period of 6 months.
3. Establishing a succession plan is one of the most important business decisions the owner of a practice can make.
4. The structure of the succession plan will depend on the type of practice involved: solo or group.
5. Assemble a team of competent advisers (qualified tax advisor, attorney, and wealth adviser) who have in-depth knowledge and experience working with physicians, their practices, and their unique planning needs.
6. Different structures have different tax consequences and create different demands on cash flow.

V. Information Needed for a Good Appraisal
A. Federal Income Tax Returns
1. The practice’s federal income tax returns and accountant-prepared financial statements for the most recent three (3) years and interim financial statements for the current year-to-date.

B. Soft & Hard Assets
1. Tangible assets, such as furniture, fixtures, equipment and office and medical supplies, often referred to as “Hard Assets”
2. Accounts Receivable; and Goodwill.

C. Fee Schedules and Volume Statistics
1. Best Practices:\(^5\)
   a) Avoiding sudden changes in fees. If they’re too low, increase them incrementally until they’re where they need to be.
   b) Set fees in consideration of what your market generally charges.
   c) Make the fee schedule uniform for all physicians, or at least by specialty.
   d) Avoid charging different patients different fees, though you can allow for discounts for self-pay patients, and perhaps a deeper discount if they pay at the time of service.
   e) During contract negotiations, focus on codes for which you are paid on the low end of what peers are paid.
   f) Always read an insurer’s contract thoroughly before signing it and obtain a copy of your contract. If you do not have a current copy of your contract, I would recommend contacting your insurance carriers to obtain a copy for your records.

D. Appointment Scheduling

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1. Scheduling is the systems that may be the heartbeat of the practice. The smoothness of the practice, the practice’s ability to provide excellent care of the patients, and the practice’s ability to produce.
2. Unfilled appointments?
3. No shows?
4. Last minute cancellations?
5. Fill Rate?

E. Demographics of Marketing Area
1. Identify demographics of practice patients
2. Issue: Will these demographics change in the near future
3. Move to a different a payer class which pays more or less
   a) Ex. Patients moving into the Medicare program – Impacts discount/capitalization rate
4. Might impact revenue growth projection

F. Goodwill Registry
1. Goodwill is one of the most elusive concepts and probably one of the most troublesome when valuing a medical practice.
2. Goodwill can have a great deal of value or have very little value.
3. The Goodwill Registry cites mean and median goodwill values based on optometry transactions, where goodwill value was included, having occurred during the years 1999 and 2017.
4. However, a practice’s true goodwill value depends upon various factors:
   a) Overhead
   b) Competition
   c) Specialty vs. Primary Care
   d) Non-Compete Agreements
   e) Contracts
   f) Miscellaneous

VI. Component Method
A. 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.

VII. Discounted Cash Flow Method
A. This method focuses on a practice’s Income Statement (i.e., revenues and expenses).
B. The practice’s projected future cash flows from operations, rather than assets and liabilities.
C. 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).
D. The projected future cash flows are then discounted to present value by applying an appropriate discount rate.

VIII. Capitalized Excess Earnings Method
A. Perhaps the easiest of the three methods.
B. Focuses on the practice’s historical earnings, as reported per its income statement.
C. An appropriate capitalization factor is applied to earnings to determine practice value.
D. 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.

IX. Common Valuation Problems
1. Methodology Issues
2. The doctor that does not work hard
3. Overcoding?
4. There are no “earnings”
5. Tax affecting an C Corp, S corp, non-profit, or a partnership
6. In a large group practice, some doctors create “earnings” while others do not.