

INSIDE

Health Care Management News

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Special points of interest:

- Value varies dramatically based upon the "Standard of Value".
- Appraisers provide objective assessment of practice value.
- There are different Approaches to measuring value.
- Goodwill is a measurable asset.
- The Ricardo Group specializes in health care valuations and forensic analysis.

YOUR PRACTICE WHAT'S IT WORTH?

Often value is not solely measured through the eyes of the owner, but instead dictated by the willingness of the buyer or the legal circumstance. Ever hear that a medical practice is only worth what someone is willing to pay for it? Sometimes the worth is pre-defined in a partnership agreement, interpreted by case law, or a judge's decree, such as in divorce.

When valuing a medical practice the appraiser will identify the appropriate standard of "value" for that particular engagement. Using appraisal industry standards and terms, value can be defined as "fair", "investment", "intrinsic", "going concern", "forced liquidation", "assemblage of assets", "orderly disposition", or more commonly "fair market". In many situations, the standard of value is legally mandated. However, in some circumstances it can also be a function of the wishes of the parties involved.

While virtually any business or professional practice may be appraised using any of these premises of value, the resulting value may be dramatically different.

definitions of value on page 2



AVOIDING THE PITFALLS

FORENSIC ACCOUNTING CAN OPEN YOUR EYES TO VALUE

Practices are bought and sold on a handshake, deals are consummated by a third party with deep pockets, purchases are agreed upon for political reasons and worth is driven by the emotions of divorce.

Whatever your situation, make sure you know the value before you commit. Following is an example of how the full knowledge and complete information of an independent appraisal and forensic analysis can save you headaches and heartaches down the road.

This practice may look strong and profitable by the numbers, but look closer.

A physician, who claimed principal loyalty to a local non-profit hospital, approached the hospital to purchase his practice. The physician was tired of managing the practice, was agreeable to a salary, and wanted to be part of the hospital's

forming foundation model. Looking at the practice numbers, the physician looked like a good prospect. Upon further investigation, it was found that the revenue figures included director fees paid by three different hospitals and a "loan" listed under revenue. The practice rent and equipment was underwritten by one of the hospitals and various vendors.

Most of the revenue came from assisting in surgery as payment for referrals; physical therapy was performed by an unqualified assistant; and the physician required patients to make cash pre-payments of deductibles. Two liens were filed against the practice, it had a maxed out credit line, various overdue credit card accounts and the problems didn't stop there.

In the end, the hospital decided not to purchase the practice or hire the physician.

APPRAISING THE APPRAISER SELECTING THE RIGHT EXPERT

There are many different reasons to have a medical practice valued.

Perhaps you are planning to retire, and you're beginning to think about selling your practice.

You're considering inviting a new physician to join you or are splitting from your partner.

Maybe you plan to merge with a group of physicians or you need to know the value of your practice for a divorce settlement.

A hospital or HMO that is considering purchasing a practice is requiring an appraisal of value.

The following checklist should help you evaluate and select a qualified appraiser:

- Does the Appraiser specialize in Health Care or Professional Practice Appraisals?
- Does the Appraiser have the background and training that support understanding physician practices and the valuation process?
- Has the Appraiser worked with practices of your size, specialty, and character?
- Is the Appraiser a member of the ASA, IBA or other related specialty societies? Does he/she have other appropriate credentials?
- Does the Appraiser understand reimbursement, health care trends, practice characteristics as well as the financial situation?
- Does the valuation process include more than one Approach?
- Can the Appraiser clearly explain the valuation approaches and associated methods of appraisal?
- Does the Appraiser explain the required standards and ethics he/she follows? Does the appraiser sound objective?

Ask for an engagement letter, references, and credentials.



*The Ricardo
Group specializes
in Health Care
with over 25 years
of experience!*

WHAT'S IT WORTH?

DEFINITIONS FROM PAGE 1

Fair Market Value: This is the most widely recognized standard of value used in a business valuation. As defined by the American Society of Appraisers, it is "the amount at which property would change hands between a willing seller and a willing buyer when neither is acting under compulsion and when both have reasonable knowledge of the relevant facts."

Fair Value: Typically this value applies to specific business transactions. In most states, it is applicable in cases of dissenting stockholders' appraisal rights, if a corporation merges, sells out, or is involved in certain major actions and is challenged by a minority shareholder, often the consideration for the stock is at a pre-transaction rate.

Investment Value: In the context of a dissenting shareholder suit, Investment Value is the expected return on the earnings.

Intrinsic Value: This value measures perceived characteristics inherent in an investment as interpreted by one analyst versus another. Intrinsic Value may eventually equal Market Value as the market of investors reach the same conclusion

Going Concern Value: Measures income producing assets in an on-going business.

Assemblage of Assets Value: Measures the value of the assembled business assets even though they may or may not be currently in use for the production of income.

Orderly Disposition Value: Reflects the piecemeal value as assets are sold individually with normal exposure to a secondary market.

Forced Liquidation Value: Is the piecemeal sale of assets as they are forced into the secondary market, either individually or grouped, with less than normal exposure time.

MEASURING BUSINESS VALUE THREE RECOGNIZED VALUATION METHODS

Over the years various appraisal methods have survived the reasonableness test and survived the test of time for measuring the value of a professional practice.

Following is an explanation of some of the approaches with their respective methods.

Income Approach

This approach incorporates specific operating characteristics and conditions of the physician practice into a cash flow analysis. It takes into account the future benefits of growth or expansion that can be projected from the current situation and then discounts those future earnings into current dollars.

Often the question the buyer will ask themselves

is "What is the difference between the cash flow from buying this practice versus cash flow if I just start a practice from scratch?"



Cost Approach

Using this approach, the practice is assumed to be worth the Fair Market Value of the assembled assets. The approach values debt-free assets, and places a premium on goodwill when the earnings are sufficiently high.

Both tangible and intangible assets are isolated and valued. Goodwill is measured using weighted excess earnings and reflects the practice's profitability and performance.

Market Approach

Similar to the real estate market, this approach compares similar practices sold to the subject practice.

Factors affecting comparability can include geographic markets served, competitive position, profitability, growth prospects, risk perceptions, and capital structure.

All three approaches are considered and may be weighted by the Appraiser when determining value.

WHAT IS THE VALUE OF GOODWILL? UNDERSTANDING GOODWILL AS AN INTANGIBLE ASSET

The recognition of the intangible assets is an important consideration in a medical practice valuation. This identification of goodwill and intangible assets are an integral part of the valuation in a sale of a medical practice and often considered in marital dissolutions.

In the case of marital dissolutions, the value or incremental value of the family owned business is part of the marital estate but value associated with employment agreements and non-compete agreements may be excluded depending on the jurisdiction.

Some of the reasons to conduct an intangible asset appraisal include:

- Sales Transaction Pricing and Structuring
- Tax Planning and Compliance
- Management Information and Planning
- Securing Cash Flow or Asset Financing
- Bankruptcy and Reorganization Assessment
- Litigation Support and Shareholder Dispute Resolution
- Marital Dissolution

Categories of Intangible Assets can be related to:

- Patients (Lists, Charts)
- Contracts (Vendor, Insurance, Hospital)
- Data Processing (Data bases, Computers, Automated Systems)
- Employees (Trained and Assembled Workforce, Employment Agreements)
- Marketing (Trademarks, Referrals, Network, Relationships)
- Location (Leaseholds, Certificate of Need)
- Goodwill (Reputation, Going-Concern)

The Ricardo Group has Valued Virtually Every Type of Medical Specialty and Practice Model!

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Let us hear from you

We are working hard to make *Insides* an informative resource for you. Your comments and input help us provide comprehensive information on a variety of health care management topics. If you would like to be added to our email version of *Insides*, please let us know.

Ralph Wolf
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THE RICARDO GROUP, INC.

DID YOU KNOW.....

The Ricardo Group, Inc. is a nationally recognized and respected health care management consulting firm that continues to stay abreast of leading edge issues and changes. As healthcare management specialists one of our traditional strengths have been our ability to offer a full spectrum of healthcare business consulting, litigation support, and valuation services.

The Ricardo Group, Inc.'s pioneering approach to resolving the fiscal dilemma facing many of today's Physicians and Associated Organizations continues to gain widespread acceptance.

TRG Services include:

- Forensic Accounting and Litigation Support.
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