Buying or Selling Imaging Operations

If it’s just about the money, don’t do it!

Presented By

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President
Regents Health Resources
Conflict Statement

President
Regents Health Resources, Inc.
A national medical imaging consulting firm that delivers services directly related to the topic.

Board of Advisors
AIM Specialty Health
Benefits management corporation serving medical imaging, pharma, oncology.
Outline

• Transaction Drivers
• Documenting and Establishing Value
• Regulatory Considerations
• Post Transaction Considerations
• Discussion
Healthcare’s Future

- Moving from Fee for Service to P4P
  - ACO – Quality, Accountability
  - Exam Bundling
  - PPACA, PQRS, Muse, HCAHPS etc.
- Consolidation
  - Hospitals, Physicians, Payers, Services
- Transparency
  - Quality, Outcomes, Cost
- Utilization Management
  - Medicare, Medicaid
  - Services automation
- Exclusive Capitated Contracting
- Interconnected Healthcare Data; Data; Information
CMS announces over 100 new ACO contracts

Modern Healthcare Posted: January 10, 2013

Medicare nearly doubled the size of one accountable care program as of Jan. 1 with 106 new ACO contracts that offer hospitals and doctors financial incentives to improve quality and slow health spending.
How ACOs are Transforming Health Care

- Hospital Systems are acquiring physician practices at an unprecedented rate
- Systems are employing physicians including Radiologists and Cardiologists
- Physician practices are merging and/or forming virtual coalitions
- Hospitals are buying up clinics and imaging services
- Commercial Insurers are forming relationships for ACO development in numerous markets

Selected Physician Practices are taking the lead in implementing ACOs
Aging Marketplace
The imaging centers across the US are showing signs of age and wear. Similarly, the smaller owners are looking at mature businesses and considering exit strategies.

Reimbursement Future
MEDPAC continues to recommend reimbursement reductions maintaining the trend that started with The Deficit Reduction Act. All imaging operators will see continued impacts to varying degrees.

Utilization Controls
70% of the 130 million US lives covered under commercial health plans are subject to pre-authorization review and steerage by RBM’s. Lacking market leverage, capital for improvement, and struggling to stay afloat, smaller operators are challenged in finding ways to offset the RBM impact.

Payer Leverage
Small networks and “One of one’s” lack the leverage with strong payers to affect or offset downward reimbursement pressure placed on them. Larger networks offering full service imaging in multiple locations combined with strong market-share of available procedures have access to data and the bargaining power to negotiate competitive reimbursement.
“One of One” Centers Stressed (not part of a network)
Single Center and or Single modality, Single centers are not able to leverage the marketplace to create opportunity with payers or referring MD’s. Their ranks continue to decrease. As these fold or are rolled into larger operations via acquisition, competition decreases, volume shifts.

Private Equity and Venture Capital Have $ Looking for a Home...
...and good partners. As a result of the declines on Wall Street, significant investors are looking for smart long term plays in stable industries. Healthcare is one of the most stable with growth forecast long term. Interest is increasing by PE / VC firms.

Nationally, Imaging has Replaced Surgery as the #1 Contribution Margin for Hospitals

Provider Based (hospital) Reimbursement is More Lucrative than Centers Operated as Physician Practices or IDTF’s ...for the moment
4% increase per year in FFS volume per Medicare Beneficiary 2004-2010

Hospital Medicare margins improved from -7.1% in 2008 to -4.5% in 2010

Hospital Medicare Margins Expected at -7% in 2012

Recommending 1% increase in payment rates for OP services – 2013

Considering Payment equalization between HOPD’s and Freestanding

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**TABLE 3-3**

Cost growth slowed in 2010

<table>
<thead>
<tr>
<th>Cost measure</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inpatient costs per discharge</td>
<td>4.3%</td>
<td>5.5%</td>
<td>2.9%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Outpatient costs per service</td>
<td>5.6</td>
<td>5.1</td>
<td>4.8</td>
<td>0.1*</td>
</tr>
<tr>
<td>Weighted average</td>
<td>4.5</td>
<td>5.4</td>
<td>3.3</td>
<td>1.6</td>
</tr>
<tr>
<td>Input price inflation</td>
<td>3.4</td>
<td>4.3</td>
<td>2.6</td>
<td>2.1</td>
</tr>
</tbody>
</table>

Note: Cost growth numbers are not adjusted for reported changes in case mix. Analysis excludes critical access hospitals and Maryland hospitals. The weighted average is based on services provided to Medicare patients in hospitals, including costs for inpatient, outpatient, skilled nursing facility, inpatient rehabilitation, and home health services.

*Cost growth was 1.7 percent if adjusted for complexity of services provided.

Source: MedPAC analysis of Medicare Cost Report and claims files from CMS.
Credit Radiation Exposure Concerns for Utilization Decreases

- Overall 2.5% Decrease in 2010 was 1/30th of Previous Decade of Growth
- Appropriateness Still a Concern – Must be Addressed
- ECG’s and CV Stress grew at over 85% from 2000-2009 – Faster than Imaging

**FIGURE 4-3**

Growth in the volume of practitioner services, 2000-2010

**FIGURE 4-4**

Disparities in physician compensation are widest when primary care is compared with nonsurgical proceduralists and radiologists, 2010

Source: MedPAC analysis of claims data for 100 percent of Medicare fee-for-service beneficiaries.
HealthCare Challenges...

Medicare
$565.3 billion spent in 2011 ($455 in 2010)
Projected to be $1.058 trillion in 2022

Source: CBO March 13, 2012

Medicaid
$275 billion in 2011
Projected to be $622 billion in 2022

Source: CBO March 13, 2012

Projected Medicare Spending Growth

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>7.40%</td>
<td>2.60%</td>
<td>4.10%</td>
<td>4.40%</td>
<td>5.70%</td>
<td>6.00%</td>
<td>6.70%</td>
<td>6.60%</td>
<td>6.90%</td>
</tr>
</tbody>
</table>

Source: CBO March 13, 2012
Medicare payment differences across ambulatory settings

There is increased urgency to address payment variations across settings because many services have been migrating from physicians’ offices to the usually higher paid OPD setting as hospital employment of physicians has grown. This shift toward OPDs has resulted in higher program spending and beneficiary cost sharing without significant changes in patient care.

“If the same service can be safely provided in different settings, a prudent purchaser should not pay more for that service in one setting than in another.”
Transaction Drivers

Globalization/geographical expansion
Corporate growth and expansion/diversification
Product/service line acquisitions
Access to improved technology or other
Intellectual property acquisitions
Corporate cash balances
Private equity influence
Corporate divestitures
Public to private transactions
Private company buyouts/management buyouts
Defensive deals
Regulatory Influence
Tax strategy

Red = Related to Medical Imaging
The Radiology Value Chain

Traditional Radiology QA

Order
1. Timely
2. Appropriate

Imaging
1. Protocols
2. Technique
3. Clinical Hx
4. Timely

Interpretation
1. Accurate
2. TAT

Report
1. Clinically useful
2. Complete
   a) clinically
   b) billing
3. Communicated
4. Patient gets result on time

Follow-up
1. Patient gets appropriate procedure

Courtesy: VRad, Pat Basu M.D.
Sustainability and Survivability

Strategic Thinking

✓ Imaging settling on volume to reduce per service unit costs

✓ Payers are more likely to contract with a radiology partner that has market strength for imaging services and lower costs

✓ Unified operational processes and support present a strong entity to clinically integrate capturing advanced imaging and driving quality in sufficient volume that allows reduced costs, competitive pricing and payer leverage
Documenting and Establishing Value

1. Getting to the Truth: BPR= $K_t$
2. Valuation Methodology
3. Valuation Examples
4. Preparing for a Valuation
Important Pre-Requisite #1

No amount of belief makes something a fact. - James Randi
Important Pre-Requisite #2

Your **PERCEPTION** of a situation will drive your decisions and actions.

*PERCEPTION*
It works better if your eyes are open
Reality is the state of things as they actually exist, rather than as they may appear or might be imagined.
Reality
Perception
Belief
Truth
Define today’s cash flow & business model

Clearly define all metrics of today’s business

Develop future earnings model

Consider market, competition, reimbursement changes
Consider business changes and their effects
Valuation Methodology

Market Approach – A general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.
Valuation Methodology

1. Determine future earnings with 5 year & terminal value

2. Determine projected EBITDA by year for 5 future years
   
   Apply Discount Factor (Risk) = Current Purchase Value

3. Current Purchase Value / Current Year EBITDA

4. Equals valuation multiple of current year EBITDA
Determining Value

Question of the Day

Current Purchase Value
\[ \frac{\text{Divided by current year EBITDA}}{\text{Equals valuation multiple of current year EBITDA}} \]

Current Purchase Value $2.5m
Current year EBIDTA $0.8m
Multiple 3.125

What additional multiple should be applied in the case of a CON?
## Valuation Differences

<table>
<thead>
<tr>
<th></th>
<th>Exam Volume</th>
<th>Modalities</th>
<th>Average Collections per Exam</th>
<th>Avg. Population 5 yr Growth</th>
<th>Competition</th>
<th>Marketing Program</th>
<th>Revenue</th>
<th>Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>Center A1</td>
<td>15,500</td>
<td>CT, XR, MA, Dexa, US, FL, NM, IR</td>
<td>$140</td>
<td>17.1%</td>
<td>1 hosp. 1 OIC</td>
<td>No</td>
<td>$2.2 M</td>
<td>($0.6 M)</td>
</tr>
<tr>
<td>Center A2</td>
<td>33,800</td>
<td>3 MR, 2 CT, NM, US, 2 XR, C-Arm, MA</td>
<td>$308</td>
<td>1.5%</td>
<td>2 hosp. 3 OIC</td>
<td>Yes</td>
<td>$11.2 M</td>
<td>$2.3 M</td>
</tr>
<tr>
<td>Center B1</td>
<td>41,200</td>
<td>6 MR, 5 CT, 2 FL, 4 US, 2 XR, 5 MA</td>
<td>$192</td>
<td>27.0%</td>
<td>2 hosp. 5 OIC</td>
<td>Yes</td>
<td>$7.9 M</td>
<td>$1.2 M</td>
</tr>
<tr>
<td>Center B2</td>
<td>3,200</td>
<td>MR, CT</td>
<td>$219</td>
<td>29.6%</td>
<td>1 hosp. 4 OIC</td>
<td>Yes</td>
<td>$0.7 M</td>
<td>$0.1 M</td>
</tr>
<tr>
<td>Center C</td>
<td>39,000</td>
<td>2 MR, CT, 2 US, 3 MA, NM, Dexa, CR, IR, PET</td>
<td>$198</td>
<td>6.7%</td>
<td>2 hosp. 1 OIC</td>
<td>Limited</td>
<td>$7.5 M</td>
<td>$1.1 M</td>
</tr>
</tbody>
</table>
Valuation models use NFCF to Invested Capital, which is the cash flow available to all stakeholders of the business, including both debt and equity holders. Accordingly, we must use a discount rate encompassing both the cost of equity and debt capital. This rate is known as the weighted average cost of capital (“WACC”), and is calculated by estimating the cost of equity and cost of debt separately, then averaging the two rates using the relative market value weightings of each in the overall capital structure.
1. Determine future earnings with 5 year & terminal value

2. Determine projected EBITDA by year for 5 future years

   Apply Discount Factor (Risk)

   = Current Purchase Value

3. Current Purchase Value / Current Year EBITDA

4. Equals valuation multiple of current year EBITDA
## Regulatory

### Seller

- Internal Buy / Sell Agreements
- Stock or Asset Sale
- UCC discrepancies
- Lease Transfers
- Debt Satisfaction
- Liability: Operations, M.D.(s)
- Stark
- Litigation
- Accreditation
- Rights & IP Transfer
- Etc.

### Buyer

- IDTF or Physician Practice
- HOPD or MPFS
- State Notifications for Licensing
- Asset or Stock purchase
- UCC search
- Complete or partial purchase
- JV or under arrangement
- CON Transfer
- Liability tail: Operations, M.D.’s
- Stark
- Litigation
- HR Transition
- Etc.
An important goal for Hospital Buyers is to keep debt of the balance sheet while still enabling a provider based delivery model and minimizing the infusion of capital, one option could look like this:

1. **Imaging Partner - Investor Company**
2. **Finance Company**
3. **NewCo Imaging Partnership**
4. **Imaging Center Acquisitions**
   - Not a standalone entity post acquisition
5. **Hospital Company**
6. **Hospital Company**
   - Imaging Operations

**Key Responsibilities:****
- Financing
- Lease(s)
- Ownership
- Operations & Management

Example:

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Preparing for Sale or Acquisition

**Success Factors**

- Efficient Operations
- Understanding your market
- Working knowledge of financials
- Great Customer Service
- Engaged Radiologists
- Business Differentiation
- Great Marketing

**Failure Factors**

- Work Flow? Staff? Supplies?
- Market? What Market?
- I don’t have those numbers
- They NEED us, we’re the best.
- In-definitive Interpretations
- We do that too!
- No Strategy
Preparing for Sale or Acquisition

What’s the strategy?

Formulate a clear direction
Create your elevator speech

Defining strengths & weaknesses

What’s your plan to build on what’s great & fix what’s not?

“A well run business is a tidy business!”
Barriers to Successful Sales & Acquisitions

Valuation Expectations
Lack of Viable Targets
Private Equity / Other Buyer Competition
Legal Issues
Shareholder Concerns
Market Issues – Competition, Payers, Saturation
Suitable Capital

Other

Integration Challenges
Lack of Resources
Buyer Hesitance
Regulatory Issues
Risk / Market Uncertainty
Process & Control Concerns
Process Summary

The Seller

Desire to Sell

- Confidentiality
- Due Diligence
- Set a Schedule
- Develop Relationships
- Communicate

Prepare for Promotion

- Identify Your Representative
- Perform a Valuation
- Tune up the Business Plan
- Get Your Market Data
- Know your History

Identify Targets

- Marketing
- Networking
- Selling

Engage w/ Potential Buyers

- Price
- Terms
- Schedule
- Financing

LOI

Final Diligence

- Regulatory
- Licensure
- Lease transfers
- Billing
- Professional services
- Staff
- Plan for potholes

Closing

Identify Targets

- Marketing
- Networking
- Selling

Prepare for Promotion

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Closing
Process Summary

The Buyer

Target Identification
- Geography
- Population Demographics
- CON
- Strategy

Preliminary Investigation
- Center Summary
- Volumes
- Modalities
- Payor Mix
- Market

Pursue?

Due Diligence
- Valuation
- Market Study
- Organization
- Payor Contracts
- Staff
- Professional Services Model

Buy?

LOI
- Price
- Terms
- Schedule
- Financing

Closing

Final Diligence
- Sale Lease Back
- Financing
- Legal
- Billing
- Lease Transfers
- Regulatory
- Professional Services
Conventional
- $ available, but require risk mitigation plan
- Rates vary widely by source & type of financing
- Sources like a strong banking relationship & collateral

Joint Venture
- JV options exist with Imaging Corp’s willing to invest
- Options to create Operating / Management JV’s
- Creates opportunity to raise significant capital for project

Non- Conventional
- Capital consortium formation to create sale lease back options
- Terms, position vary by market & ownership opportunity
Potholes in the Road
Plan for imperfections in your path

Price
Realistic Expectations

Terms
What’s Included, What’s Not

Legal
Liability Tails, Escrow & Agreements

Financing
Lack of Planning ....
Who

- Buyer’s & Seller’s Agent
- Buyer & Seller
- Accounting
- Legal

What

- State Requirements
- Lease Transfers & Assignments
- Service Transfers & Assignments
- Billing Transfer
- Officers’ Documentation
- Proprietary Rights Transfer
- Final Bill of Sale
- Escrow Agreements
- Closing Statement
- $$$$
Fear is "an unpleasant and often strong emotion caused by anticipation or awareness of danger."
Post Transaction Considerations

- Culture Differences / Impact
- Financial
- Market
- Professional
Post Transaction Considerations

Culture

Best Practices - Seller

- Re-communicate confidentiality
- Communicate Intentions early
- Inform: employees, vendors, large accounts
- Share new owner insights, position
- Estimated Timeline
- Impact on personnel
- Set $ aside for retention bonuses
Post Transaction Considerations

Culture

Best Practices - Buyer

- Maintain confidentiality
- Communicate Plan for integration and operations
- Maintain confidentiality
- Provide Estimated Timeline and Responsibilities
- Maintain confidentiality
Post Transaction Considerations

Financial & Market

- Infrastructure impact on staff benefits
- Operational changes and impact
- Revenue sources
- Pricing changes and competitive effect
- Reinvestment
- Effect on payers and contracts
- Brand Impact
Post Transaction Considerations

- PSA’s
- Other compensation vehicles
- Loss of perceived control
- Referring physician loyalty
- Indirect ancillary services effect
The unstoppable force meets the immovable object...

**High Deductible Health Plans**
- Direct Consumer Impact as employers move to HDHP’s
- Could slow consumer use of provider services
- Will drive consumer desire for transparency

**Health Insurance Exchanges – “Marketplaces”**
- Will likely pay less for provider services
- Slow movement = time to adjust
- Prepare to run lean

**Healthcare Consolidation**
- Desire to remain independent remains
- Must be dominant, financially efficient, top rated

**Independent Practices**
- Dominate or be at risk
- Get efficient, less $ in the near future
- Specialized and specific – stand out
Discussion & Questions
Thank You!

Follow-up Questions?

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