Engagement Guide to Understanding and Valuing Medical Practice Specialties

Mark O. Dietrich

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By Mark O. Dietrich

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Goal of the Guide

The overriding goal of this guide is to help an experienced generalist in business valuation, compensation valuation, or divorce litigation develop a specialty in valuing specific types of medical practices.

This guide is not designed as a basic business valuation text, such as those of the late Shannon Pratt, Gary Trugman, or Jim Hitchner. Nor is it designed as a basic valuation text for medical practices, which is the purpose of my *BVR's Guide to Physician Practice Valuation.* This guide—as a companion to those basic guides—enables the valuation expert to zero in on the type of analysis necessary for a specific type of medical practice. Invest the time to read one of the specialty chapters in this guide, and you will know more about that physician specialty than you could learn in a week of internet searches.[1]

For Business Valuation

Understanding the services different physician specialties provide is no different than understanding what a given business of any sort is selling. As is the case with different types of retail stores, for example, different physician specialties sell different things, and the profitability of the services varies among specialties. It wouldn't be appropriate to think of a convenience store as a department store, and it is not appropriate to think of an orthopaedic surgeon as a primary care doctor. The orthopaedic surgeon can exploit profit opportunities for durable medical equipment, physical therapy services, and X-ray and other imaging services, to name a few, that are unrelated to personal productivity and, therefore, create value.

For Compensation Valuation

Compensation valuation for other than business valuation is a distinct discipline, but critical to both disciplines is understanding productivity, both in terms of services or procedures of a given specialty as well as the relative value units (RVUs) associated with those services and procedures. RVU values, of course, are the primary driver of physician revenue from payers, and work RVUs are the primary measure of productivity in many practice settings. The guide provides precisely the kind of background knowledge required to prepare an appropriate analysis before reaching a conclusion as to reasonable compensation.

For Litigation Experts

For the expert in a divorce or civil litigation setting, much of the detail herein might strike you as unnecessary and/or over the head of the trier of fact. That may well be the case, depending upon who the opposing expert is, who the opposing counsel is, and how clever the marital litigant is, if you are opposite the physician. The guide enables the recognition of the types of temporary income reduction strategies that may occur with a change in procedure coding, delayed billing, shifting cases to another member of the practice, and many others, besides just simply describing the valuation aspects. My own experience with hundreds of litigation engagements settled without a trial suggests that, while a little knowledge is dangerous, a lot of knowledge can settle cases.

1 Having spent many such weeks, I can assure you this is the case.

For Litigators

One of the most important decisions legal counsel makes is the choice of an expert witness—and the same is true of opposing counsel, of course. Physician divorces, in particular, often involve significant income and significant assets, especially in the higher-income procedural or surgical specialties such as dermatology, gastroenterology, OB-GYN, ophthalmology, and orthopaedics, with the question of whether the practice has goodwill value beyond its tangible assets—equipment, furniture, accounts receivable—being critical in many cases. When evaluating an expert for a medical practice case, the guide provides the background of what you should expect your expert to be familiar with. Further, if you believe income is being hidden, each chapter in the guide demonstrates how to obtain all the Medicare claims data for a given physician, a particularly important forensic tool.

For Staff Training

As I indicated above, this guide is aimed at those who already understand how to value a business or professional practice. That said, a firm looking to develop specialized physician practice expertise in a younger member of the firm who has an interest in medical terminology and procedures will find precisely the kind of data necessary herein.

No other text provides this level of integration between the description of the clinical services physicians provide and the business valuation conclusion. I hope readers of this new guide will find the kind of detailed, but practical, technical knowledge that has characterized my previous BVR guides[2] and articles.

2 *BVR/AHLA Guide to Healthcare Industry Finance and Valuation, BVR's Guide to Physician Practice Valuation,* Business Valuation Resources.

Using the Guide

This guide consists of individual chapters, each devoted to a specific medical specialty. Where appropriate, those chapters also look at subspecialties, such as retina in the chapter on ophthalmology. Importantly, each chapter is designed to stand alone, such that the valuator can find all the relevant information in one place, without flipping to various other places in the book. As a result, certain information appears in each of the chapters, e.g., a description of the history of the Medicare conversion factor, an overview of value-based care, including accountable care organizations and capitation, where relevant, and an explanation of relative value units (RVUs).

SPECIAL FEATURE	Many of the topics common to each chapter are supplemented with "Author's Insights" specific to that chapter's specialty, where I speak to the reader in the first person with examples from my own engagements highlighting a specific issue.

How the Specialties Were Chosen

The three chapters covering primary care—internal medicine, pediatrics, and OB-GYN—rank first, third, and fifth in number of practitioners, according to the Association of American Medical Colleges. Family medicine is second (a virtual tie with internal medicine), and, given the nature of the chapters on internal medicine and pediatrics, another primary care chapter would be redundant. These practices are common targets of private equity consolidators, making them likely valuation candidates as well as a complicating factor in divorce litigation.

Other specialties with a high count of practitioners such as emergency medicine, anesthesiology, and radiology[1] are hospital-based specialties and are excluded for that reason.

In the medical specialties that are subsets of post-internal medicine residency training or fellowships, gastroenterology and dermatology are included because these are widely owned by physicians as opposed to health systems or private equity and, as a result, are also current targets of private equity for consolidation.

Perhaps the most notable full-chapter exclusion is that of cardiology practices. I have valued many of them, but it is estimated that 70% of cardiologists are now employed by hospitals or health systems, with ongoing growth in that number, making the specialty an unlikely business valuation subject. The nature of these transactions nowadays is typically limited to enhanced employment compensation, and, thus, a valuation engagement would involve fair market compensation. The *BVR/AHLA Guide to Valuing Physician Compensation and Healthcare Service Arrangements* covers those

1 There is an excellent chapter (No. 34) on imaging by industry consultant Doug Smith in the *BVR/AHLA Guide to Healthcare Industry Finance and Valuation,* 4th edition, Business Valuation Resources.

compensation engagements in great detail. Nonetheless, a summary of cardiology practices is included in this guide's final chapter on other specialties for those readers who encounter one.

Hematology/oncology is excluded because of the complexity and types of cancers. Valuing such a practice is likely to require knowledge of numerous chemotherapy drugs and ongoing scientific breakthroughs, making it a challenge even for someone who has focused his or her entire career in healthcare.

As is the case with cardiology, a summary of both neurology and nephrology is included in the final chapter on other specialties. Neurology is a fairly common specialty, and many neurologists remain in private practice, making them a potential target for private equity.

After hematology/oncology, nephrology is one of the most complicated specialties to attempt to value. It is included primarily to demonstrate to readers that it is likely best to find someone with deep expertise in this area rather than undertake an engagement with many pitfalls and challenges.[2]

For the surgical specialties, the focus was on both the number of private practitioners and the interest of private equity in consolidating them. Ophthalmology and orthopaedic surgery are the second and third most common surgical specialties after general surgery. The latter is excluded because of the broad nature of procedures done, which range from the head and neck, to the breasts, the gastrointestinal system, and the skin, resulting in many different subspecialties within general surgery. Urology has recently caught the attention of private equity and, thus, again, is included in the guide.

Specialty-Specific Elements

Each chapter opens with a discussion of the specialty and any subspecialties that it includes. The nature of residencies and fellowships is discussed. Next, there is a review of the most common procedures using CPT®[3] codes, in terms of: (1) dollars billed; and (2) total units billed, from the Medicare claims database.

SPECIAL FEATURE	A "Research Tip" is included about where to locate these data and how to customize them for download.

For those specialties with other sources of income, such as cosmetic procedures for dermatology or eyeglass sales for ophthalmology, a description is provided of how those sources of income can be analyzed. More significant, perhaps, is the explanation of "J" codes for in-office drug treatments that are critically important in gastroenterology, retina, and urology practices, for example.

Having laid the foundation of common sources of revenue for the specialty, a comprehensive example of the chapter's practice specialty is presented and explained, comparing the valuation subject's CPT© codes to the Medicare data and offering insights as to similarities and differences. Some chapters include data for a group practice with multiple subspecialties, as in the case of orthopaedics, where I evaluate differences in: (1) individual coding of office visits; (2) productivity; and (3) use of physician assistants. Where physician assistants or nurse practitioners are present, coding

2 As I am retired, this is not an attempt to get referrals!

3 CPT© codes, descriptions, and other data only are copyright 2021 American Medica Association. All rights reserved. Applicable FARS/HHSARS apply. Fee schedules, relative value units, conversion factors, and/or related components aren't assigned by the AMA, aren't part of CPT, and the AMA isn't recommending their use. The AMA doesn't directly or indirectly practice medicine or dispense medical services. The AMA assumes no liability for data contained or not contained herein.

and productivity data are included as well, such as in the pediatric, dermatology, internal medicine, OB-GYN, and orthopaedics chapters.

SPECIAL FEATURE	In addition to "Author's Insights," there are "Report Tips" that detail how to approach report writing. There are also custom "Management Interview Techniques."

Payer Mix

Each chapter includes a discussion of the sample practice's payer mix, or what portion of its revenues come from various insurers as well as directly from patients. These data are used later in the chapter to measure collectible accounts receivable, a critical measurement in a transaction valuation as well as in divorce litigation.

Relative Value Unit (RVU) Calculation and Reasonable Compensation

Probably the most readily recognized challenge confronting the valuator in a medical practice is to differentiate distributions on ownership from reasonable compensation for labor/services. Relative value units from the Resource-Based Relative Value Scale (RBRVS) offer a uniform national measure of physician labor, which can be adjusted for local market rates insurers and patients pay. RBRVS eliminates the debunked technique of looking at physician compensation surveys, which consist of 70% of hospital and health system-employed physicians or more and are completely irrelevant to private practices that are the subject of most business valuation engagements. At the same time, the import of local market conditions is emphasized, as reflected in existing employment contracts with nonowners or in the recruitment of new physicians.

Each chapter includes a comprehensive calculation of reasonable compensation for one or more providers using an RVU calculator. For those specialties where imaging or other testing is performed—orthopaedics, OB-GYN, ophthalmology, and urology—the text demonstrates how to isolate the revenue and expense from those services, which have a distinct technical component (TC) revenue stream. Summary commentary on the TC revenue also appears in the cardiology and neurology segments of the "Other Specialties" chapter. In the gastroenterology chapter, in particular, the need to determine the service location where procedures are done is emphasized—in the office, an ambulatory surgery center, or hospital outpatient department—in order to generate the correct calculation of practice expense RVUs.

Cost of Capital

In this section of each chapter, there are observations about the kind of factors that should be taken into account in developing a subjective risk premium. However, the broader cost of capital issues are left to existing textbooks, including *BVR's Guide to Physician Practice Valuation*,[4] as well as BVR's *Cost of Capital Professional.*

Profit and Loss and Cash-Flow Analysis

Each chapter includes a sample P&L for the practice. For practices with income other than from CPT© codes, the P&L is broken down into lines of business, e.g., in the chapter on orthopaedics, accountable care organization profit distributions, technical component profits, and excess profits from RVUs beyond the value of physician work.

4 Chapter 14, section 4.0.

Normalization Adjustment

Many commonly encountered normalization adjustments are present in physician practices, but two in particular are described that are specific to physicians: federal stimulus payments and call pay.

Capitalization of Cash Flow (CCF)

A simple CCF is used as the basis of the valuation in each chapter. As stated in the Introduction, the reader is assumed to have experience in business valuation and, for those who are new to business valuation, there are other texts designed for that.

Perhaps unique to the valuation conclusion presentation is breaking down the market value of invested capital/business enterprise value into the three primary asset categories: working capital, fixed assets, and intangible value. A basic example of how to calculate the collectible amount of accounts receivable is presented in each chapter based upon the amount due from each different insurer and what percentage of the practice's charges they pay. Among the many reasons for doing this is that accounts receivable are never part of intangible value or goodwill.

The Medical Practice Management Interview

The guide's final chapter is an engagement aid on how to conduct the management interview, complete with detailed explanations for each interview item. This is one of the most useful and practical aspects of this undertaking.

About the Author

Mark Dietrich is a summa cum laude, Beta Gamma Sigma graduate of Boston University, where he also earned an MBA with high honors. He started his career in 1977 as the outside auditor for what was then the largest of the Harvard Medical School's Faculty Group Practices, a task that included several months each year studying medical charts and how procedures were coded and billed to insurance. As such, he was studying anatomy, medical terminology, procedure codes, and diagnosis codes during the more than four decades before sitting down to write this guide and continued to do so throughout his career. These *clinical* aspects of medical practices are important because, if you are going to understand the *financial* aspects of a medical practice, you need to understand the nature of the services the physician offers. It can be a challenging task to understand a physician practice, just as it is in many other complex businesses, but the primary goal of this book is to enable the valuation expert to meet that challenge.

In the early 1990s, Mark and a CPA colleague were the two consultants who put together the first independent physician network in Massachusetts, encompassing most of the communities south of Boston. Mark's role was negotiating risk-based contracts with insurers. As a result, he had the unusual opportunity to attend Medicare Advantage Medical Director training for that physician network to assist him in understanding the actuarial dynamics of the health insurance business as well as giving financial advice that was more consistent with desired clinical outcomes.

Using this knowledge of clinical and insurance matters was the foundation of a career in valuing more than 500 medical practices of just about every conceivable specialty. Mark's first book in more than five years, this guide represents the culmination of some 45 years of studying the financial and clinical aspects of specific physician practice specialties. Mark attempts to roll all that knowledge into this guide so that the user can gain the benefits of his experience and insights, without investing in a second career (humor intended).

Other books written/co-written/edited/co-edited by Mark Dietrich:

- *BVR/AHLA Guide to Healthcare Industry Finance and Valuation*, 4th edition (primary author, editor);
- *BVR/AHLA Guide to Valuing Physician Compensation and Healthcare Service Arrangements*, 2nd edition (contributor, co-editor);
- *BVR's Guide to Physician Practice Valuation*, 3rd edition (author);
- *BVR Guide to Ancillary Healthcare Services Valuation* (contributor, editor);
- *The Financial Professional's Guide to Healthcare Reform* (co-author); and
- *PPC's Guide to Healthcare Consulting*, 24th edition (co-author).

Acknowledgements

In writing these acknowledgements, I looked back over my career to consider how fortunate I was to have the support of many individuals. I retired in January 2022 after a nearly 50-year career in accounting that started as a college sophomore with part-time work for a sole practitioner CPA. I remained in small firms my entire career, starting my own firm in 1990 with Kathie Wilson, who remained in practice with me right through my final trial. I am especially indebted to Kathie for her review skills and testimony-preparation skills, without which I would have been far less successful and not have developed the knowledge to write this book.

I am also indebted to a host of colleagues, many of whom will go unmentioned here because of the scale of the list. Reed Tinsley inspired me to write my first book after we met in 1995. The late Jim Rigby put that book in front of the late Shannon Pratt, who endorsed it on the inside front cover. The late Bob Cimasi gave the book a shoutout at an ASA Conference in New Orleans. Rigby later introduced me to the folks at Business Valuation Resources, who have published dozens of my articles and all my books since. At BVR, I am particularly indebted to Andy Dzamba, who is a fine editor with an unparalleled ability to grasp concepts those of us in valuation train for decades to understand. Finally, I am indebted to the many colleagues who reviewed my numerous articles prior to publication.

I fell a few states short of having valuation or litigation engagements in all 50. That never would have occurred without referrals from other CPAs and valuation professionals, who gave up work they could have kept for themselves and, in turn, expanded the range of practice specialties I encountered. This may not have happened if I started out 10 years later, but it is a plus of getting "old in the tooth" in this business, I suppose. Doug Smith—a radiology and imaging consultant—and I worked on many engagements all over the country, using his client base and unique insights into different modalities, to enable me to develop cash-flow forecasts and risk profiles. Jay Fishman gave my work on personal goodwill several shoutouts at conferences—and referred me one of the biggest cases of my career. Many of these engagements also came from being invited to speak at various valuation and healthcare industry conferences around the country, including the FICPA conference, where Sheri Schultz gave me many opportunities to speak, and the VSCPA conference, where Harold Martin also afforded me many speaking opportunities. And, during their time as AICPA staff on the Business Valuation and Healthcare Conferences, Tracey Kenney and Christine Cutti-Fox were very supportive.

As a linear thinker who believes algebra is the most important mathematical discipline, I am also indebted to two great statistics minds, Frank Cohen and Dr. Mike Crain. Frank made the complex simple in his many appearances at the AICPA Healthcare Industry Conference in the many years I served on that committee. Mike always gave me pointed advice and provided great assistance in my understanding of the many scientific papers I had to study to prepare and teach numerous webinars on the COVID-19 pandemic. My partially complete book on that topic is my next challenge.

I had two great writing collaborations in my career. After we met at a healthcare conference in Lake Las Vegas in 2004, Carol Carden and I worked on many papers, book chapters, and speaking appearances. Carol reviewed a number of the chapters in this guide, making important contributions, as was always the case in our work together. In particular, I dedicate the guide's deliberately brief discussion of nephrology practices to Carol, as she knows more about them

than anyone I ever met—which is why I only wrote a summary discussion, lacking the nerve to attempt a full chapter. Anecdotally, I once was contacted to serve as a consulting expert in a major litigation matter involving nephrology but suggested to the potential client that Carol would be the better choice. They retained me anyway, and, years later, I realized that Carol had already been engaged as the *lead* consulting expert.

Finally, there's my good friend and research partner, Tim Smith. We spent more than a decade challenging the statistical validity of the various physician compensation surveys and the healthcare industry's reliance on them, despite the initial negative impact on our careers. Aside from the simple bad math of it, we recognized those surveys contributed to inflated salaries for health system-employed physicians and, in turn, contributed to healthcare cost inflation as ancillaries were moved from private office settings to much more expensive hospital outpatient settings. In an effort Tim led, I think we can declare victory based upon our joint commentary to CMS and the final December 2020 revisions to the Stark regulations, which, among other results, forever ended the mistaken belief that regulators favored these surveys. Tim was also instrumental in debunking the sole use of the cost approach to *invent* intangible value where no income was available to support the value,[1] equal in my "pet peeves" ranking to compensation surveys. And, of course, he was an important reviewer of this guide.

And, thank you to Kevin Yeanoplos, Stacey Udell, and Don DeGrazia for their review of chapters.

Outside the profession, I thank my constant companion for more than 50 years and spouse for 45 of those. While I wrote stuff and talked a lot, she built stuff, like decks, bathrooms, kitchens—and an entire suite complete with kitchen, bath, game room, and theater. She never got in my way; I wish I could say the same—but we have a legacy of accomplishment to share in our retirement.

Mark Dietrich
March 2023

1 See Smith, Chapter 21, "Resolving the Debate About the Value of Physician Practices: A Comprehensive Analysis," *BVR's Guide to Physician Practice Valuation, Third Edition*, published by Business Valuation Resources..

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