



Should You Sell Your Practice to a Hospital ?

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Overview

- History of Physician Employment by Hospitals
- Current Drivers
- Typical Transactions
- Considerations
- Question and Answer

History of Physician– Hospital Relationships

- 1981 – “Can Hospitals Survive?”
 - “Ultimately, hospitals that cannot support their capacity from market demand will be compelled to close, unless they are somehow subsidized by the government.”
- 1982 – “Cost Pressures and Health Policy Reform”
 - Health care costs are sustainable
 - “I know that many people have heard this line before from policymakers, yet the wolf has never appeared”
- 1985 – “Acquisition Strategies of Multihospital Systems”
 - Hospitals will focus on advertising insurance providers
 - Not focused on advertising care delivery
 - “25 to 50 very large health services organizations will soon dominate the health care industry”
 - “Health care will evolve from fee-for-services to fixed payment”
 - “DRG are transitory form that will be replaced by a more sophisticated prospective pricing system”
 - “Acquisition of teaching hospitals rising”
 - Increase acquisitions of nonhospital activities– acquiring insurance firms, developing PPOS, pre & post care capabilities, and forming joint ventures

History of Physician– Hospital Relationships

- 1985– “Cost Shifting and Care for the Uninsured”
 - Hospitals do not increase their markups from privately insured patients when revenues are squeezed from low remuneration of Medicare
- 1986– “How Many Doctors Are Enough?”
- 1989– “Physician Need”
 - Large surplus in number of physicians, but small shortage in primary care.
- 1990– “No Evidence of an emerging Physician Surplus”

History of Physician– Hospital Relationships

- “Ideas of March” (JAMA, 1993)
 - Residency graduates are increasingly staying in general internal medicine, up to 40% stayed in 1993
 - 22% increase in internal medicine graduates
 - There is an enhanced interest in general internal medicine that is expected to continue in the near future.

History of Physician– Hospital Relationships

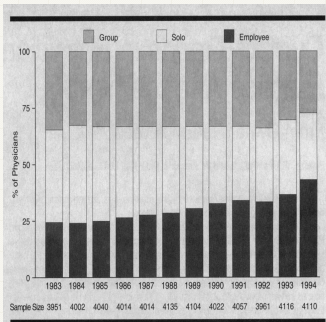
- “Current Trends in Physicians’ Practice Arrangements” (JAMA, 1996)
 - Between 1983 and 1994,
 - The proportion of patient care physicians practicing as employees rose from 24.2% to 42.3%
 - The proportion self-employed in solo practices fell from 40.5% to 29.3%
 - The proportion self-employed in group practices fell from 35.3% to 28.4%
 - The number of physicians employed rose 18% and the number in solo practices fell by 11%

History of Physician-Hospital Relationships

We've been through this before - Circa 1996

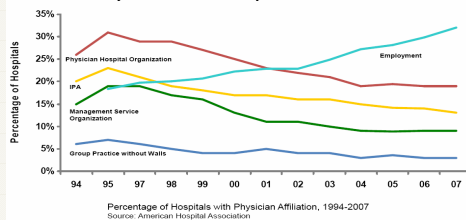
- "A majority of physicians will be employees in the very near future"
- "Many of these physicians will be in the employ of what has been called the 'new medical-industrial complex'"
- "Managed care has increased pressures on solo and small group practices"
- "Several recent workforce analyses have forecast a surplus of physicians in the near future"

Source: Philip Kletke, David Simmons, Kurt Gillis: Current Trends in Physicians' Practice Arrangements, JAMA August 21, 1996



History of Physician-Hospital Relationships

Physician-Hospital Trends



History of Physician-Hospital Relationships

- 2009 Center for Studying presentation to MedPac on hospital integration
- 1990s merger wave- 900+ deals from 1994- 2000
 - Proportion system members grew from 40% in 1995 to 60% in 2000
 - Integration between physicians and hospitals grew rapidly from 1980s until the mid-1990s, then declined

History of Physician–Hospital Relationships

What happened?

- Physicians joined arms with hospitals because of the initial high salary and uncertainty of future payment rates introduced by managed care
- Capitated/delegated model failed to become prevalent
- Hospitals divested and physicians were happy to leave

Source: Hospital- Physician Relations, Health Affairs, September/October 2008

History of Physician–Hospital Relationships

- As one of the largest industries in 2008, healthcare provided 14.3 million jobs for wage and salary workers. About **40%** were in **hospitals**; another **21%** were in nursing and residential care facilities; and **16%** were in **offices of physicians**.
- About **36%** of all healthcare establishments fall into **office based practices**. Physicians and surgeons are increasingly working as **salaried** employees of group medical practices, clinics, or integrated health systems.
- About 595,800 establishments make up the healthcare industry; they vary greatly in terms of size, staffing patterns, and organizational structures. About **76%** of healthcare establishments are offices of physicians, dentists, or other health practitioners. Although hospitals constitute only **1%** of all healthcare establishments, they employ **35%** of all workers.
- Wage and salary employment in the healthcare industry is projected to increase **22%** through 2018, compared with **11%** for all industries combined. Employment growth is expected to account for about **22%** of all wage and salary jobs added to the economy over the 2008–18 period. Projected rates of employment growth for the various segments of the industry range from **10%** in hospitals, the largest and slowest growing industry segment, to **46%** in the much smaller home healthcare services.

Source: Bureau of Labor and Statistics Occupational Outlook Handbook 2010–11, Healthcare/ Physicians and Surgeons

Current Drivers

• 2 Primary Drivers

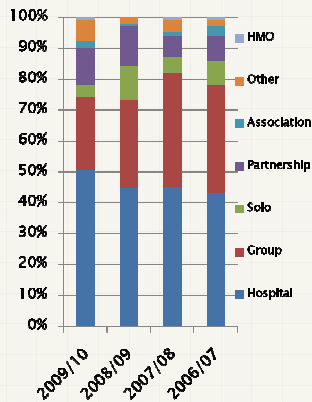
- Desire by medical school graduates to be employed
- Changes or anticipated changes in the delivery system
 - ACOs
 - Payment reductions in Medicare / Medicaid
 - Increased regulatory restrictions involving ancillaries

Current Drivers

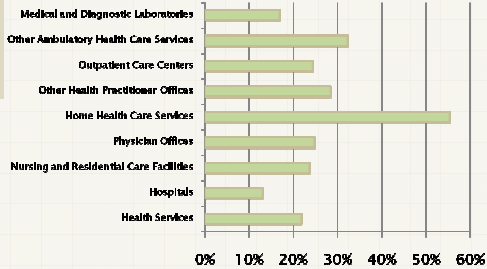
Where are the physician incentives today?

The current trend toward hospital employment of physicians is different from the 1990s, when hospitals typically approached physicians about employment opportunities rather than the reverse. Today, many physicians, specialists in particular, are seeking hospital employment to relieve them of the stress of high malpractice rates, the struggle for reimbursement, administrative duties and the general risks and hassles of private practice. Hospital employment is viewed favorably by many physicians today and, in our experience, hospitals offering employed positions may enjoy an advantage over those that do not.

Source: Merritt Hawkins 2010 Review of Physician Recruiting Interviews



Current Drivers



Source: Bureau of Labor and Statistics Occupational Outlook Handbook 2010-11, Healthcare/Physicians and Surgeons

Current Drivers

| Practice Setting | 2008 | 2006 | 2003 | 2001 |
|------------------------|------|------|------|------|
| Single Specialty Group | 23% | 91% | 30% | 24% |
| Partnership | 24% | 71% | 41% | 21% |
| Multi-specialty Group | 16% | 60% | 13% | 28% |
| Hospital employee | 22% | 52% | 4% | 3% |
| Outpatient Clinic | 8% | 17% | 2% | 8% |
| Association | 4% | 9% | 2% | 0% |
| Solo | 1% | 8% | 4% | 8% |

Source: 2008 Merritt Hawkins Final Year Medical Students Survey

* In 2006, resident surveyed had the option of choosing multiple responses.

Current Drivers

- Accountable Care Organization ("ACO")
 - To qualify for ACO status in PPACA a organization much have 5,000 or more beneficiaries managed by primary care
 - Hospitals are looking to build physician relationships to gain status
 - Primary care physicians are the target because they are the "gate-keepers" for the ACO patient base
 - Hospitals are expecting a shared savings model from Medicare and want to use employed physicians to get these payments
- Payment reductions in Medicare/Medicaid
 - Operating in a office-based environment may be less viable
 - Regulatory environment is more hostile with the expansion of fraud and abuse investigations

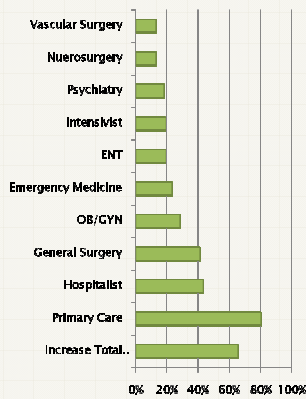
Current Drivers

What are hospitals looking for?

In a recent survey performed by the American Hospital Association ("AHA"), hospitals are looking to employ more physicians. Of the hospitals surveyed,

- 65% are making efforts to increase the number of employed physicians.
- 80% are seeking to grow the number of Primary Care physicians
- 42% are seeking more General Surgery physicians.

Source: AHA Rapid Response Survey, March 2010



Current Drivers

Top 5 specialties hospitals are acquiring

- Primary Care
 - Reason: Hospitals are driving towards an ACO or integrated environment. Primary care is the gate-keeper to referrals.
- Cardiology
 - Reason: A high revenue specialty for hospitals. 30% of surveyed cardiologists, according to the American College of Cardiology, are integrating their practices with a hospital
 - Survey of 300 cardiology practices, showed 60% of practices have already integrated with a hospital or are considering it.
 - Full integration: 14.3%
 - Co-Management agreement: 7.8%
 - Considering integration: 45.5%
- Neurosurgery
 - Reason: Significant revenue generator for larger-sized hospitals and a shortage of neurosurgeons is already prevalent in the physician pool.
- Orthopedics
 - Reason: As the population continues to age, orthopedics will become increasingly important. As well, revenue stream is strong
- Gastroenterology
 - Reason: Hospitals need GI specialists because of the continual patient movement to outpatient settings. GIs are making a shift away from being dependent on patient referrals from hospitals to self-referrals. GIs have seen the highest growth in the ASC setting from 2000-2009.

Source: Becker's Hospital Review: 3 Medical Specialties Most Pursued for Employment by Hospitals, Sept 27, 2010

Typical Transactions

- Valuation
 - Most of the time Fixed Assets / Little Intangible (Goodwill) Value
 - Why?
 - Exceptions
 - Profitable employment relationships with physicians and mid-levels
 - High levels of ancillaries
 - Requires sacrificing earnings
 - Physician Work-Force

Typical Transactions

- What will the agreement look like?
 - Compensation
 - Typically guaranteed for 2 years at historical levels or in some cases more, with upside
 - Productivity based after initial guarantee period
 - Work RVUs
 - Net Professional Collections
 - % of Earnings / Profitability (Virtual Private Practice)
 - Other key terms
 - Term
 - Typically include outs without cause
 - Buy-back provisions
 - Non-competes

Considerations

- Key Question: *Can employment do something for me that I cannot accomplish without the hospital?*
 - Economic
 - Increased compensation
 - Replace potential loss of ancillary earnings
 - Alleviate the need to make substantial investment in information technology
 - May be best or even only way to participate in risk-based contracting, global billing arrangements, ACOs or other quality initiatives
 - Caution: How long is the employer going to be willing to lose money?
 - Non-economic
 - Security
 - Quality of Life
