



How to Get at the Heart of Healthcare Company Valuations

Healthcare company valuations often seem as complex as brain surgery. In many cases, the main challenge is pinning down revenue forecasts, which can be a moving target in healthcare.

Government sources dictate a huge percentage of a healthcare company's revenue, and private insurance companies typically pay based on what Medicare and Medicaid pay. Whether the company being valued is a physician practice, an auxiliary care center or a major hospital, the current regulatory environment adds complexity to the assignment.

So, where does a healthcare valuation begin? Because of the volatility of healthcare revenues, historical activity isn't a reliable indication of future earnings. Many experts believe a focus on several key factors such as revenue drivers is the key to a successful engagement.

Factors To Consider

As with all business valuations, more risk equals less value. Here's a look at several factors to consider:

Regulatory Environment: The healthcare regulatory environment isn't getting any less complex. In fact, several recent regulatory changes have made it even more stringent, especially in the area of referral arrangements, which are potentially very valuable revenue drivers for physicians and hospitals.

For example, the Stark Law generally prohibits physicians from making referrals to organizations with which the physician has a financial relationship. Federal anti-kickback statutes also impact where referrals can be made. Other regulations vary by state. The bottom line? Stringent regulatory requirements can lower value.

Expenses: Facility and labor costs are the two largest expenses for healthcare entities. With revenues largely dictated by outside sources, cost-containment efforts become even more important.

A national nursing shortage is driving salaries sharply higher for qualified nurses. Innovative technology is expensive. Malpractice and other insurance costs continue to rise. Will the company's revenues grow enough to keep pace? Revenue growth comes in the form of more volume and/or higher prices — a difficult equation in healthcare.

Physicians: There's no shortage of physicians except in specific subspecialties and in rural areas. But physicians are key revenue drivers in the clinical setting. "Rock star" doctors who attract business or perfect new treatments add enormous value to a practice — but they don't practice forever. What's a practice worth without its most productive physicians?

Demand: Procedures are related to demographics. A nursing home is a good fit in a location where many elderly people live, while an OB/GYN practice is of more value in growing areas attractive to young families.

Our aging population will likely increase demand for all services over the next few decades. But competition also figures into the demand equation. One facility may have an advantage over another one with out-of-date equipment, for example.

FMV Is Required

Government regulations require fair market value (FMV) as the standard of value for almost all healthcare valuations. The challenge for business valuation professionals is to assess all the relevant facts in a market landscape that's continually changing.

For this reason, it is imperative to call upon a business valuation professional with deep experience in the healthcare arena — someone with access to and interest in the key value drivers affecting healthcare today.

Considering a healthcare company valuation? Please contact our firm to discuss the issues you'll want to address when choosing a valuation partner.