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Valuation Report

Business Valuation Trends and Strategies

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Litigation Outlook

The Ins and Outs of Using a Neutral Appraiser

One of the most interesting trends in business valuation today is the use of a neutral valuation professional — one appraiser retained by both parties in a dispute. The most obvious benefit of this approach is financial: Hiring one valuation expert saves money for both sides.

However, using one appraiser also saves time and — at least theoretically — diminishes the likelihood of both parties fighting over whose valuation is most worthy.

How It Works

There are several different ways a neutral valuation professional can be retained, including these:

Pendulum arbitration: This arrangement involves hiring a neutral valuation professional to select which of two valuations is more valid. The neutral valuator reviews the valuations produced by other appraisers for each side and picks a winner. Both sides agree to go with this decision.

Final opinion: Here, the neutral valuation professional is asked to determine a value and all parties agree to move forward with what he or she decides. In disputes like these — which might involve several shareholders, for example — at least one party is usually unhappy with the outcome, though.

Therefore, it's common for the valuator to ask for "quasi-judicial immunity" — this means he or she can't be sued by any of the parties. Quasi-judicial immunity can be granted by the judge overseeing the case, or it can be agreed upon in the engagement letter.

Negotiable opinion: Sometimes both parties will hire one neutral professional to arrive at an opinion of value. But unlike the "final opinion" arrangement above, the parties reserve the right to criticize the valuator's conclusion. They are allowed to offer feedback and try to sway the analyst's opinion.

This arrangement doesn't feel quite so risky to the parties involved. They have some sense of control and feel like they have some recourse if the valuation isn't what they expected.

Yes or no: In this arrangement, the neutral valuator arrives at an opinion and both parties examine it and decide whether to accept it or not. The valuation professional is often providing a starting point for negotiation and sometimes can even help facilitate the discussion and decision between the parties.

A neutral valuation professional can be appointed by the court or

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Industry Outlook

Key Factors Influencing Physician Practice Valuations

The Affordable Care Act (ACA) has had numerous ramifications on the healthcare industry since it became law. One has been the sale of more physician practices to hospitals. Many self-employed doctors, faced with uncertainty about their future, have chosen to let hospitals handle the headaches of running their practices.

This trend has created a boom in physician practice valuations. Healthcare consultant Robert James Cimasi has identified four "pillars" of healthcare that impact the value of a practice. The more uncertainty in these areas, the more risk is involved in the transaction — and more risk means lower practice value.

Here's a look at these four pillars:

1. Reimbursement — Medicare and Medicaid reimbursement rates drive reimbursement rates for all insurance companies. Generally, reimbursement rates are declining for specialty services, but are expected to rise for primary care. Reimbursement based on volume of care is being supplanted by reimbursement based on quality and outcomes.

A practice's payer mix — Medicare/Medicaid versus commercial insurance — is an important factor in value. However, changes in the healthcare climate make it difficult to predict future cash flows based on past performance.

2. Competition — One goal of healthcare reform was to create more cost-conscious consumers. This created a new competitive environment in healthcare, as patients are now more likely to look for reasonable costs and favorable outcomes — especially if insurance is covering only part of the bill.

Also, it is now more common for patients to see nurse practitioners and physician assistants instead of physicians. While these alternatives have created competition, they've also created a value-building opportunity for physician practices. Indeed, a common way to build practice value is to use "physician extenders," since they create revenue at a lower cost.

3. Regulation — When it comes to transactions between 501(c)(3)s, which many hospitals are, and private practices, there are two regulatory standards that must be met. One is that every element of the transaction must be at fair market value (FMV).

Interestingly, there are several regulatory definitions of FMV. To comply with the definition in the Stark law (which prohibits physician self-referral), the present value of the income stream must be assessed with the assumption that the selling physician is free to stop referring patients to the practice once it is bought by the hospital.

The second standard is "commercial reasonableness," which requires both qualitative and quantitative analysis of the anticipated transaction to ensure that it represents a "prudent business decision."

4. Technology — At a time when cost-containment is paramount in healthcare, attractive and expensive new technology is being developed at an unprecedented pace. Patients always want the latest and greatest — however, even behind the scenes, certain technology is mandated for compliance.

For example, the ACA requires practices to use an electronic medical record (EMR) for Medicare and Medicaid reimbursement. While keeping up with technology increases the value of a practice, it also creates intense capital requirements.

Of course, there are many more factors influencing the value of a medical practice. But practice valuations have become more complex in light of healthcare reform, which reinforces the need for expert assistance. ■

Our valuation analysts are highly experienced in the healthcare arena. Contact us to discuss your valuation needs.

Buying and Selling

Buyer Beware: How to Perform Proper Due Diligence

You think you've found it — the right company to buy. You've made a bid, signed a letter of intent and have the seller's financial statements. They look good, but is the seller telling the whole story?

Caveat emptor. This is where due diligence comes in.

Due diligence is perhaps the most important part of the deal. If done properly, due diligence provides you with an in-depth understanding of the quality of earnings of the target company. Armed with this knowledge, you are better equipped to establish pricing, determine the best deal structure and proceed with post-purchase planning.

What to Look For

Below are some typical areas on which to focus your due diligence:

Revenue recognition: Revenues should be recognized in the proper period, along with costs related to generating those revenues. Generally accepted accounting principles (GAAP) should be consistently applied.

Normalization adjustments: Non-recurring income and expenses must be normalized to reflect realistic earnings. These adjustments might include seller discretionary items that are not anticipated to impact future earnings, such as compensation in excess of fair market value, one-time legal fees, the loss of a big customer or a particularly large debt expense.

Quality of revenues: Due diligence in this area entails a comprehensive assessment of revenues and margins by customer, product line and channel. The goal is to assess the quality and sustainability of the revenue stream.

Accounting adjustments impacting earnings: It's important to analyze the nature of activity within reserves and accruals, such as allowance for doubtful accounts, inventory reserves, warranty reserves and accrued liabilities.

Inventory valuation: Capitalization of costs into inventory should be closely assessed to determine the appropriateness of valuation.

Pro forma cost adjustments: Pro forma costs might include expenses such as restructuring or financing costs. These must be carefully analyzed, both qualitatively and quantitatively, to determine whether the adjustments were in an appropriate amount and manner.

In addition to these categories, due diligence should include a look at value drivers such as the scalability of the business, depth of the management team, adequacy of information systems and equipment, and the customer/supplier base.

Also, it's wise to double-check the working capital requirements and thresholds established in the letter of intent or purchase agreement and assess capital expenditures, both past and future.

How to Proceed

Warning: Attempting to perform due diligence on your own is not prudent. This is an area in which the services and expertise of a trusted CPA can be extremely valuable.

Your CPA is likely to see areas of concern that you may not notice. He or she can then steer you away from questionable transactions or companies that aren't as financially healthy as they might appear at first glance.

A CPA will typically issue a comprehensive report that analyzes and shares observations about the business. While the intent of the report is to confirm what the CPA has seen, the report can also be useful in negotiations moving forward. ■

Neutral Appraiser

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hired by the parties involved. Payment of his or her fee is typically split between the parties.

Letters of Engagement Are Key

The success of using a neutral valuation professional often hinges on the agreements spelled out in the letter of engagement. This document should detail every part of the arrangement, including:

Scope of work: What exactly is the neutral expert expected to produce? For example, is he or she going to issue a formal report or just a calculation of value?

Fees: How much will the valuation analyst be paid, by whom and by what date? One party might be upset with the outcome of the valuation and balk at paying the expert. The letter of engagement must be explicit about what's expected.

Communication: Interaction with both parties is expected, but there are still communication issues to work out. For example, the letter should clarify whether the analyst can speak to the parties without their lawyers present and, if so, under what circumstances.

Process: The letter of engagement should outline the process the analyst will use to gather information and provide a timeline for analysis and issuance of an opinion.

The popularity of using a neutral appraiser is likely to increase given the cost and time savings involved. Be sure you look for a valuation professional with the temperament and experience to work with opposing parties simultaneously. ■

Interested in using a neutral appraiser? Ask our valuation team for more information.

Valuation or Calculation: Which Do You Need?

As members of the American Institute of Certified Public Accountants (AICPA), CPAs are bound by the valuation standards issued by that organization. According to the AICPA's Statements on Standards for Valuation Services (SSVS1), there are two types of engagements to estimate value — a valuation engagement and a calculation engagement.

Which you need depends on several factors, including how the assessment of value will ultimately be used. In a proceeding that will likely involve litigation, such as a shareholder dispute or divorce, a full-blown valuation is warranted. The same is true for tax matters, such as estate and gift tax returns. Also, if you are selling your business, potential buyers will likely want to see a formal valuation.

For less-formal circumstances in which the value is less likely to be challenged, a calculation might be the answer. For example, if a business owner is conducting retirement planning and wants a good idea of what his or her business is worth, a calculation of value would probably serve the purpose.

The scope of the two types of engagement is clearly defined in SSVS1. In valuation engagements, the valuation professional can apply whichever valuation approaches and methods he or she believes are appropriate based on the circumstances. The result — a *conclusion* of value — can be expressed either as a single amount or as a range of values.

In calculation engagements, the valuation professional and the client agree on the valuation approaches and methods to be used, as well as the procedures the analyst will perform to calculate value. The result — a *calculation* of value — can be expressed either as a single amount or as a range of values.

Because a calculation engagement doesn't include all of the procedures of a full valuation, it doesn't include a conclusion of value. Therefore, it is less expensive and typically proceeds faster. ■