

Proven Methods for Boosting the Value of Pathology Group Practices

2002 Executive War College
on Lab and Pathology Management

Sponsored by *The Dark Report*

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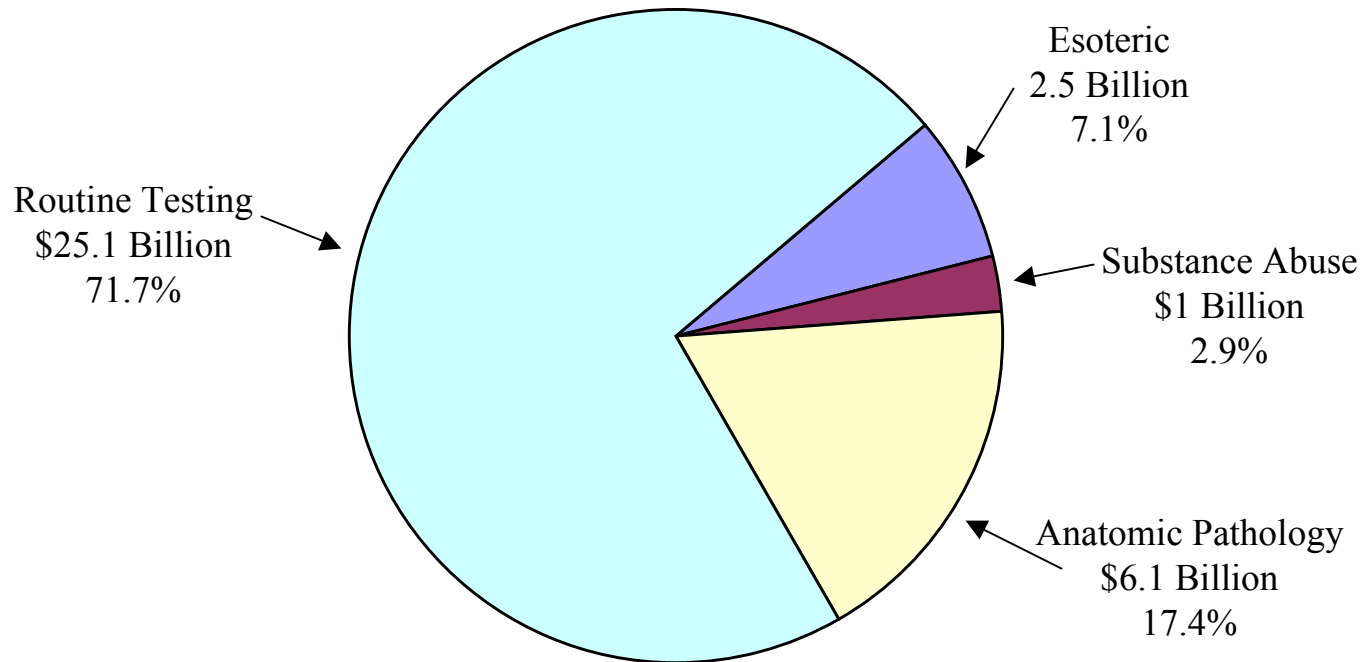
Overview

- I. Dynamics of the Pathology Industry Segment
- II. Why Value a Pathology Practice Anyway?
- III. Valuation Theory
- IV. Valuation Illustration (Controlling Interest Valuation)
- V. Primary Factors that Influence the Value of a Pathology Practice

I. Dynamics of the Pathology Industry Segment

The Anatomic Pathology market is projected to grow at an annual rate of 5% to 10% per year over the next 2 to 3 years.

Breakdown of U.S. Clinical Laboratory Industry by Segment - 2001



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I. Dynamics of the Pathology Industry Segment

Despite the efforts of a few consolidators,
the anatomic pathology segment remains highly fragmented.

Number of Pathologists in the Group	Percentage of Independent Pathologists	Number of Pathology Practices	Percentage of Total Practices
Solo	7.3%	857	26.8%
2 to 3	11.5%	673	21.0%
3 to 4	26.0%	874	27.3%
5 to 6	18.8%	401	12.5%
7 to 10	13.5%	187	5.8%
11 to 20	15.6%	175	5.5%
21 or greater	<u>7.3%</u>	<u>34</u>	<u>1.1%</u>
Total	100.0%	3,201	100.0%

Source: College of American Pathologists and Haverford Healthcare Advisors' estimates

II. Why Value a Pathology Practice Anyway?

- Admission of new pathologist partner
- Buy out of retiring pathologist partner
- Merger with another practice
- Outright sale of the practice
- Litigation (involuntary termination of partner, divorce, etc.)

III. Valuation Theory

- Present value of future cash flows
- Capitalization rates
- Cash flow vs. pathologist compensation
- Controlling interest value vs. Minority interest value

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IV. Valuation Illustration (Controlling Interest Valuation)

Valuation Calculation	<u>Status Quo</u>	<u>Adjusted</u>
Net Revenue	\$ 3,000,000	\$ 3,000,000
Physicians' Compensation	2,300,000 (a)	1,100,000 (a)
Non-Physician Operating Costs	<u>700,000</u>	<u>700,000</u>
Total Expenses	\$ <u>3,000,000</u>	\$ <u>1,800,000</u>
EBIT (Earnings Before Interest & Taxes)	\$ 0	\$ 1,200,000
Purchase Price: EBIT		\$ 1,200,000
Purchase Multiple		<u>x 6.0</u>
Total Purchase Price		\$ 7,200,000

(a) Analysis of compensation

per pathologist	Partners (4)	\$ 500,000	\$ 200,000
	Associates (2)	\$ 150,000	\$ 150,000

V. Primary Factors that Influence the Value of a Pathology Practice

Internal Factors:

- Growth Potential / Historical Growth Rate
- Size (revenue, EBIT, number of pathologists)
- Profitability
- Stability / Reputation
- C-Corporation vs. S-Corporation vs. Partnership vs. LLC
 - Objective is to achieve capital gain treatment for sellers
 - Buyers prefer to buy assets

V. Primary Factors that Influence the Value of a Pathology Practice

Internal Factors (cont'd):

- Composition of Revenue
 - Part A vs. Part B
 - Hospital vs. Non-Hospital sources of revenue
 - Client Bill vs. Third Party Billing
 - General AP vs. Sub-specialty
 - Professional Only vs. Global
- Billing Compliance
- Verifiability of Financial and Operating Data

V. Primary Factors that Influence the Value of a Pathology Practice

Internal Factors (cont'd):

- Hospital Contract Terms
 - Exclusivity
 - Term and termination provisions
 - Compensation
 - Change of control
 - Quality of relationship with administration
- Depth / Composition of Staff
 - Age and number of pathologists
 - Sub-specialty pathologists
 - Quality of management personnel

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V. Primary Factors that Influence the Value of a Pathology Practice

External Factors:

- Opportunities for the Buyer, (i.e. “Synergies”)
- Timing - Seller’s Market

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Haverford Healthcare Advisors

Haverford Healthcare Advisors specializes in providing valuation, merger and acquisition, and corporate finance advisory services to healthcare companies, with a specific focus on pathology practices and clinical laboratories. We represent and assist physicians and other healthcare company owners during the process of selling their practices, during the process of merging or partnering with other practices or companies, or during the process of growing through acquisition. We also provide practice valuation services, typically in connection with practice transition issues such as admitting new partners, retiring existing partners, and related matters.

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