

Valuing Accountable Care Organizations (ACOs)

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*Providing Solutions in an Era of
Healthcare Reform for 30 Years*

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Presenter Bio

Todd A. Zigrang, MBA, MHA, FACHE, CVA, ASA, ABV, is the President of Health Capital Consultants (HCC), where he focuses on the areas of valuation and financial analysis for hospitals, physician practices, and other healthcare enterprises. Mr. Zigrang has over 28 years of experience providing valuation, financial, transaction and strategic advisory services nationwide in over 3,000 transactions and joint ventures involving acute care hospitals and health systems; physician practices; ambulatory surgery centers; diagnostic imaging centers; accountable care organizations, managed care organizations, and other third-party payors; dialysis centers; home health agencies; long-term care facilities; and, numerous other ancillary healthcare service businesses. Mr. Zigrang is also considered an expert in the field of healthcare compensation for physicians, executives and other professionals.



Mr. Zigrang is the co-author of “The Adviser’s Guide to Healthcare - 2nd Edition” [AICPA - 2015], numerous chapters in legal treatises and anthologies, and peer-reviewed and industry articles such as: The Guide to Valuing Physician Compensation and Healthcare Service Arrangements (BVR/AHLA); The Accountant’s Business Manual (AICPA); Valuing Professional Practices and Licenses (Aspen Publishers); Valuation Strategies; Business Appraisal Practice; and, NACVA QuickRead. Additionally, Mr. Zigrang has served as faculty before professional and trade associations such as the American Society of Appraisers (ASA); the National Association of Certified Valuators and Analysts (NACVA); the American Health Lawyers Association (AHLA); the American Bar Association (ABA); the Association of International Certified Professional Accountants (AICPA); the Physician Hospitals of America (PHA); the Institute of Business Appraisers (IBA); the Healthcare Financial Management Association (HFMA); and, the CPA Leadership Institute. He also serves on the Editorial Board of The Value Examiner and QuickRead, both of which are published by NACVA.

Mr. Zigrang holds a Master of Science in Health Administration (MHA) and a Master of Business Administration (MBA) from the University of Missouri at Columbia. He is a Fellow of the American College of Healthcare Executives (FACHE) and holds the Certified Valuation Analyst (CVA) designation from NACVA. Mr. Zigrang also holds the Accredited Senior Appraiser (ASA) designation from the American Society of Appraisers, where he has served as President of the St. Louis Chapter. He is also a member of the American Association of Provider Compensation Professionals (AAPCP), AHLA, AICPA, NACVA, NSCHBC, and, the Society of OMS Administrators (SOMSA).

Introduction

- Overview of ACOs
- Current and Future Trends
 - Regulatory
 - Reimbursement
 - Competition
 - Technology
- Valuation Methodology
- Value Drivers of ACOs
- Conclusion

ACO Overview

What is an Accountable Care Organization (ACO)?

- Established via the Patient Protection and Affordable Care Act (ACA)
- “groups of doctors, hospitals, and other health care providers, who come together voluntarily to give coordinated high quality care to the...patients they serve.”
- Entities controlled by the provider members, who work together to control costs, improve quality, and coordinate care
- ACOs that achieve spending and quality targets designated by payors receive a share of the savings
- Organized in a variety of manners legally and in governance and can have varied contracts depending on size, with payors, and with members of the ACO

ACO Overview

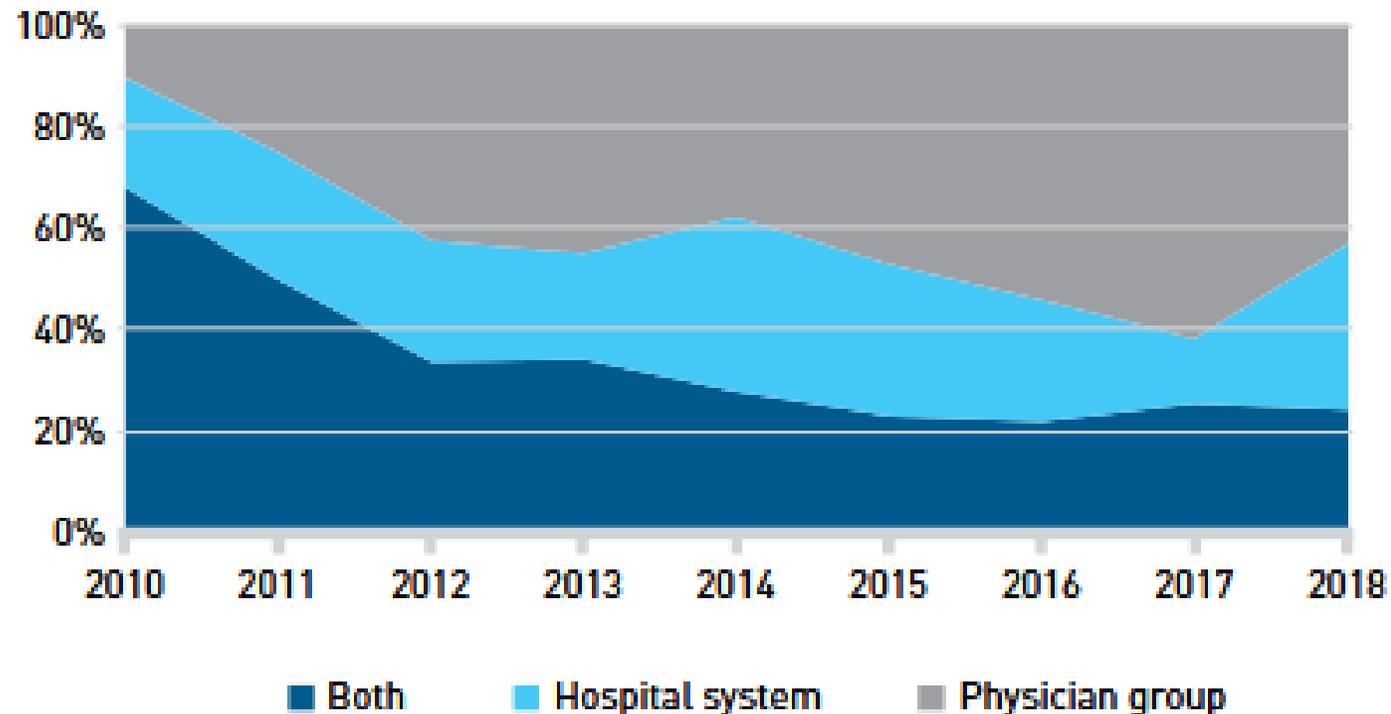
Classification of ACOs:

- **Full Spectrum Integrated** – directly provide all aspects of healthcare to their patients. ACOs in this classification are often dominated by a large integrated delivery network. **(15% of ACOs / 27% of Lives)**
- **Independent Physician Group** – have a single physician group owner and do not contract with other providers to offer additional services. **(24% of ACOs / 20% of Lives)**
- **Physician Group Alliance** – may have multiple physician group owners – often including multi-specialty groups – but do not contract with other providers to offer additional services. **(16% of ACOs / 9% of Lives)**
- **Expanded Physician Group** – only directly provide outpatient services, but will contract with other providers to offer hospital or subspecialty services. **(23% of ACOs / 24% of Lives)**
- **Independent Hospital** – have a single owner that directly provides inpatient services but do not provide subspecialty care. Outpatient services could also be directly provided by this type of ACO if the owner is an integrated health system. **(11% of ACOs / 9% of Lives)**
- **Hospital Alliance** – have multiple owners with at least one of those owners directly providing inpatient services. **(12% of ACOs / 11% of Lives)**

ACO Overview

Who is Starting ACOs?

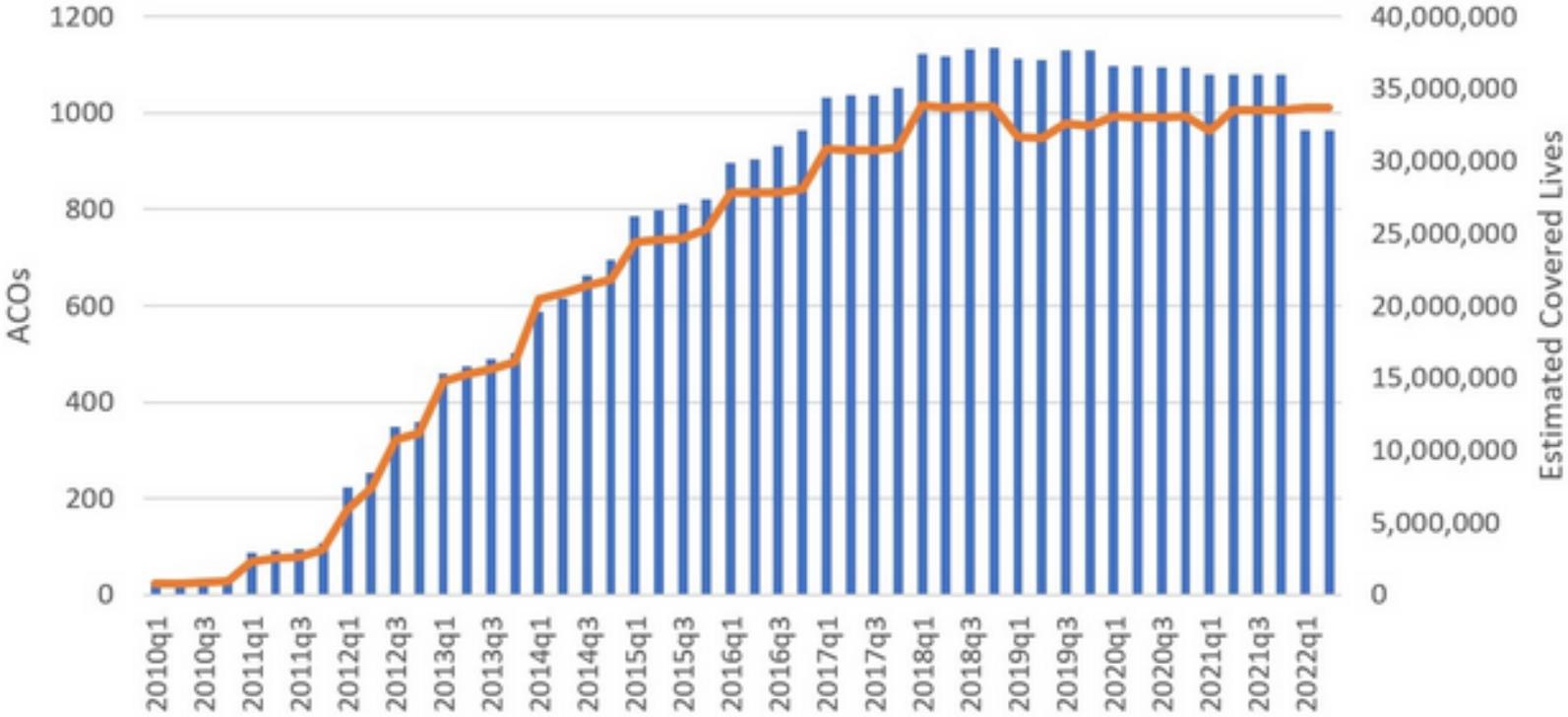
- New accountable care organizations (ACOs) are increasingly led by physician groups rather than hospital systems



ACO Overview

ACO Growth

- Across all payers, ACO participation has continued, but growth in the number of new ACOs, new ACO contracts, and ACO-covered lives has slowed

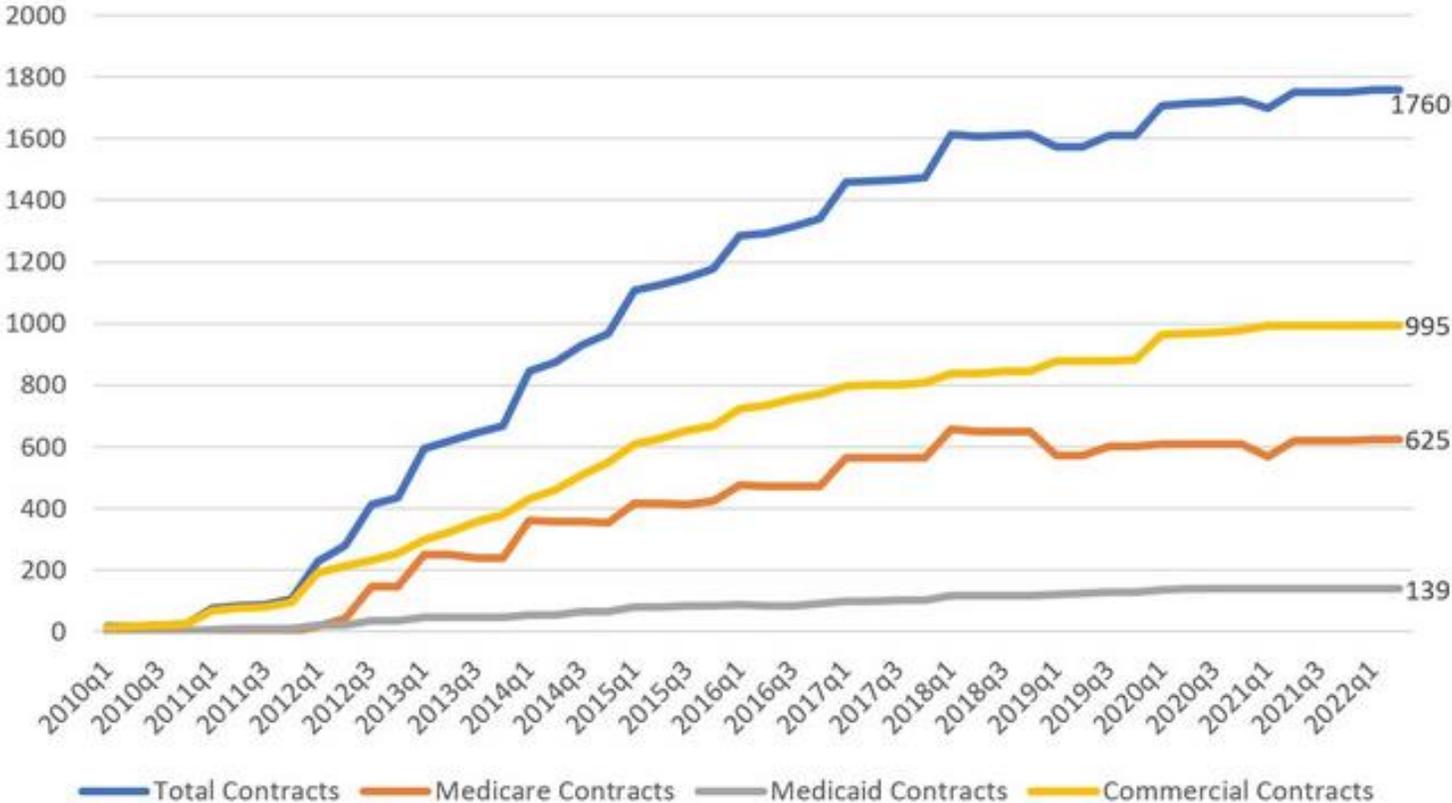


Source: Milliman Torch Insight

ACO Overview

ACO Growth

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Source: Milliman Torch Insight

MSSP ACO Overview

- Most ACOs are participants in government programs such as the MSSP
- As of 2023, 456 MSSP ACOs, serving 10.9 million Medicare fee-for-service beneficiaries, participate across various participation options (tracks):
 - BASIC Track
 - Level A & Level B (one-sided risk)
 - Level C (two-sided risk)
 - Level D (two-sided risk)
 - Level E (two-sided risk)
 - Enhanced Track (two-sided risk)

Non-MSSP ACO Overview

- Medicare has historically offered several other ACO Models:
 - ACO Investment Model
 - Next Generation ACO Model
 - Pioneer ACO Model
 - Vermont All-Payer ACO Model
 - Advance Payment ACO Model
 - Comprehensive ESRD Care Initiative
- These models have functioned as pilot programs, for CMS to run for a defined amount of time, and then apply lessons learned to the next ACO iteration
- In 2022, CMS announced the next iteration – ACO REACH (Realizing Equity, Access, and Community Health)
 - 132 began participating in the model in 2023 (first performance year)
 - Designed to inform the MSSP and future models

Current and Future Trends

Regulatory

- Anti-Kickback Statute
 - Felony for any person to “knowingly and willfully” solicit or receive, or to offer or pay, any “remuneration,” directly or indirectly, in exchange for the referral of a patient for a healthcare service paid for by a federal healthcare program
 - Carries both criminal penalties (up to a 5-year prison term per violation) and civil penalties.
 - Safe harbors specific to ACOs:
 - Value-Based Arrangements: Protects certain arrangements wherein participants take on varying levels of financial risk
 - CMS-Sponsored Model Arrangements and CMS-Sponsored Model Patient Incentives: Exempts providers in a CMS-sponsored model (such as ACOs) from the law provided certain factors are met

Current and Future Trends

Regulatory

- Stark Law
 - Prohibits physicians from referring Medicare or Medicaid patients to entities with which the physicians or their family members have a financial relationship for the provision of designated health services (DHS)
 - Carries only civil penalties
 - Exceptions specific to ACOs:
 - Arrangements that facilitate value-based health care delivery and payment
- ACO Fraud and Abuse Waivers
 - Pre-Participation Waiver
 - Participation Waiver
 - Shared Savings Waiver
 - Compliance with Stark Law Waiver
 - Patient Incentive Waiver

Current and Future Trends

Reimbursement

- Medicare Reimbursement
 - MSSP ACO providers continue to receive FFS rates from Medicare (under the Physician Fee Schedule)
 - Shared Savings/Losses
 - If the ACO's assigned beneficiary spending is less than the benchmark target at the end of the year, the ACO shares the savings with Medicare
 - If the ACO's assigned beneficiary spending is more than the benchmark target, the ACO shares the losses with Medicare
 - Quality is also factored into the calculation of shared savings and losses

Current and Future Trends

Reimbursement

- Medicare Reimbursement
 - For performance year 2021, MSSP ACOs realized net savings of \$1.66 billion (5th consecutive year of savings)
 - Gross savings of \$3.6 billion
 - 58% of MSSP ACOs achieved savings
 - 99% of MSSP ACOs met the program's quality standards

Current and Future Trends

Competition (Supply)

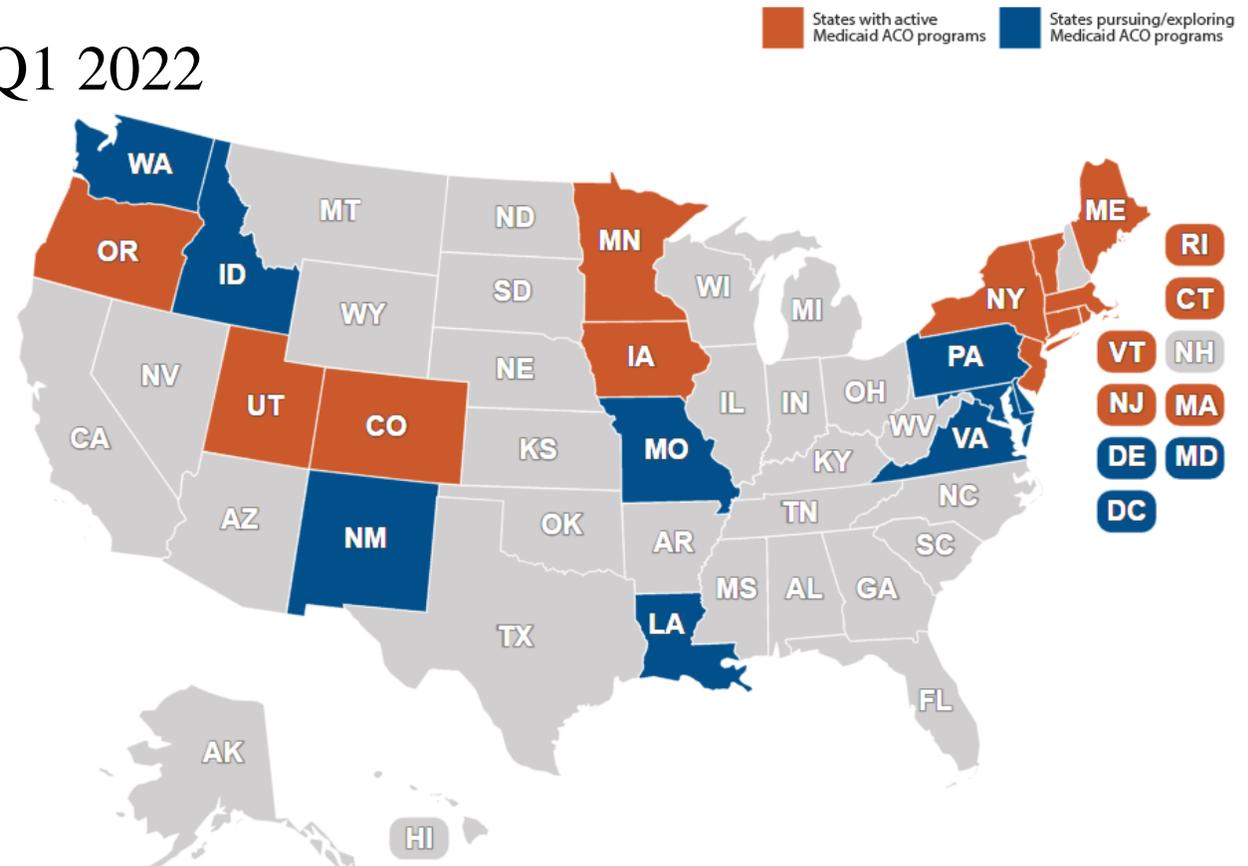
- Medicare ACOs
 - Number of MSSP ACOs has declined somewhat in the last few years, partly due to the pause in new participants due to COVID-19
 - MSSP ACOs currently serve approximately 10.9 million beneficiaries
 - REACH ACO – commenced January 1, 2023, serves 2.1 million beneficiaries

Current and Future Trends

Competition (Supply)

- Medicaid ACOs
 - 139 Medicaid contracts in Q1 2022

- Growing number of states implementing accountable care models, but significant variability across states



Current and Future Trends

Competition (Supply)

- Commercial ACOs
 - 995 commercial contracts in Q1 2022
 - Lower adoption of ACO models by commercial plans as compared to Medicare (could be due to patient population)
 - Although commercial insurers have instituted ACO models, the level and growth of these models has plateaued since the start of the COVID-19 pandemic
 - Studies have indicated that commercial ACOs may moderately reduce costs

Current and Future Trends

Competition (Demand)

- In general, the demand for healthcare services is expected to rise, due to the aging American population
- Due to the variety of participants in a given ACO (hospitals, specialists, post-acute providers, pharmacies, etc.), the demand for ACO services is correlated to the healthcare service industry overall
- ACOs are uniquely positioned, especially under new CMS rules, to rewrite the traditional rules of supply and demand in healthcare services because the conventional analysis of physician demand cannot be utilized
- However, primary care physicians still play a significant role

Current and Future Trends

Technology

- Healthcare information technology (HIT)
 - May lead to improved efficiency and quality management, especially in rural areas
 - “Uses technology to store, secure, retrieve, and transfer protected health information electronically”
 - Includes a variety of software applications:
 - Electronic health records (EHR)
 - Digital networks to electronically transmit medical test results and patient records
 - Electronic communication between providers and with patients
 - Electronic prescribing/ordering
 - Digital support systems
 - Billing software
 - Staffing models

Current and Future Trends

Technology

- Healthcare information technology (HIT)
 - A hallmark to a successful ACO is care coordination between providers, often achieved by leveraging EHR capabilities
 - However, interoperability issues have been significant problems in achieving success for ACOs because care coordination and interoperability are fundamentally intertwined
 - ACOs leveraging patient portals can significantly increase patient engagement

Current and Future Trends

Technology

- Data Analytics
 - Involves extracting insights from sets of patient data from various sources, but primarily EHRs
 - ACOs utilize data analytics to:
 - Manage patient populations
 - Manage financial risk
 - Monitor performance
 - Data sources used:
 - CMS claims data
 - Pharmacy data
 - Disease registry data
 - Patient-reported data
 - Administrative data
 - Financial data

Standards of Value

- Fair Market Value
- Fair Value
- Investment Value
- Intrinsic or Fundamental Value

Valuation Methodology Considerations

- Income Approach
- Market Approach
- Asset Approach

Valuation Methodology Considerations

Income Approach

- Measures the present value of anticipated future economic benefits that will accrue to the owner of the property interest to be appraised.
- Economic benefit of ownership has several potential measures, including:
 - Net operating income
 - Net Income
 - Cash Flow
- A risk-adjusted required rate of return, matched to the level of economic benefit employed (e.g., pre-tax/after-tax), by which the benefits are discounted, must be developed.
- Income Approach based methods return a value of all assets (both tangible and intangible) of the ACO.
- It assumes that the assets are sold in an assemblage of assets and as part of a going-concern, income producing business (i.e., profitable).

Valuation Methodology Considerations

Income Approach

Forecast of Economic Benefits of Ownership

(1) Revenue

- Membership Fees
- Care Coordination Fees
- Shared Savings (MSSP Model)

(2) Expenses

- Administrative and Operating Expenses
- Distributions of Shared Savings to Participated Providers

(3) Working Capital and Cash Flows

- Timing of Shared Savings Distributions

(4) Discreet Period Cash Flows vs. Residual Period Cash Flows

(5) Multiple Scenarios?

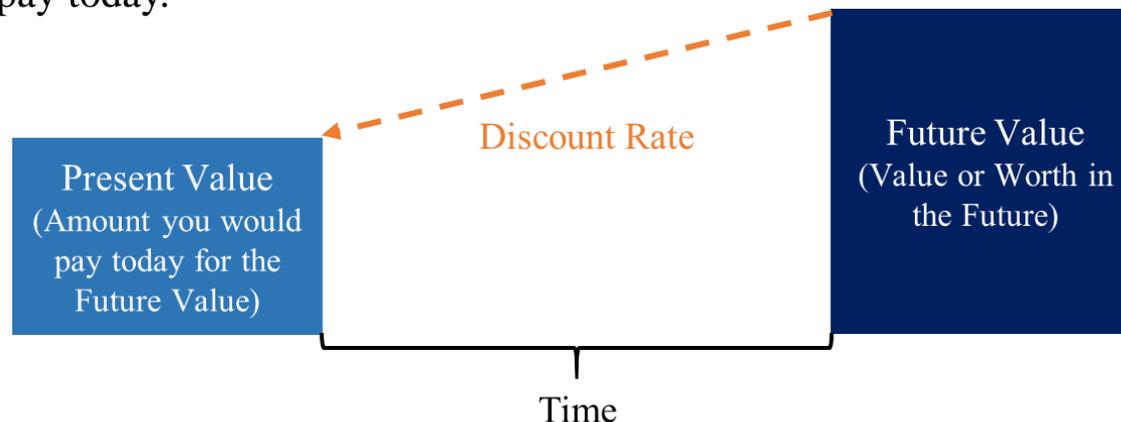
- Best case, pessimistic, and optimistic scenarios

Valuation Methodology Considerations

Income Approach

Risk-adjusted Required Rate of Return

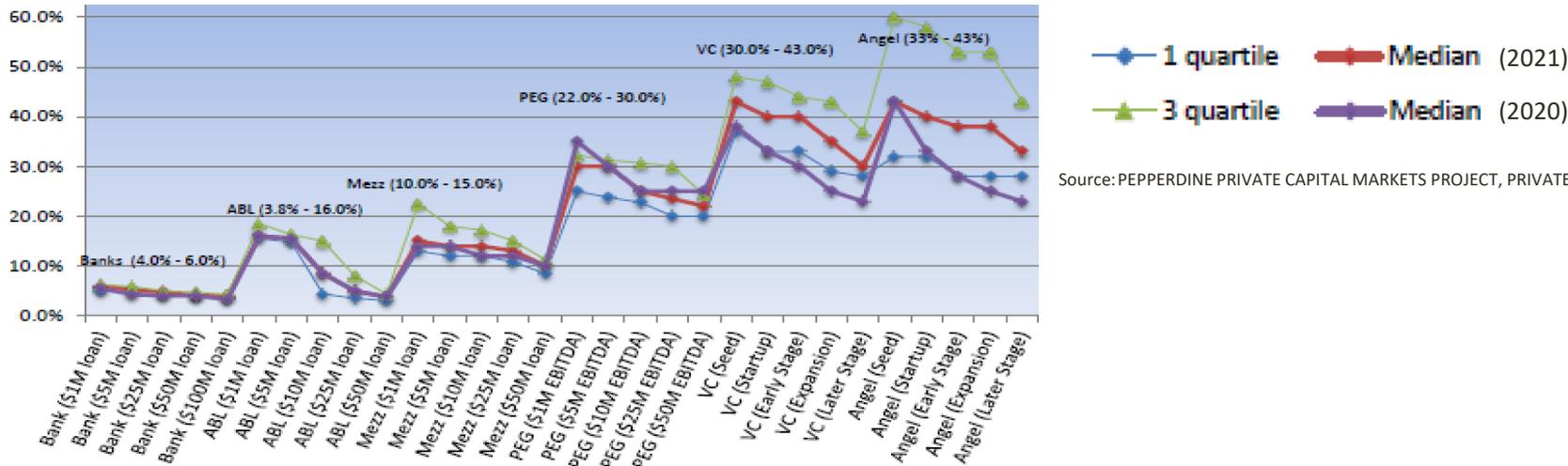
- A discount rate is the rate of return used to discount future cash flows and exit value back to their present value. This rate is often an investor's required rate of return they expect to earn relative to the risk of the investment. The discount rate:
 - Accounts for the time value of money
 - Accounts for the riskiness/uncertainty of an investment
 - Represents the opportunity cost for an investor
 - Acts as a hurdle rate for investment decisions
- The more uncertain the future value (increased risk of investment), the higher the discount rate, and the less you would be willing to pay today.



Valuation Methodology Considerations

Income Approach

Risk-adjusted Required Rate of Return – Cost of Equity



Risk-adjusted Required Rate of Return – Weighted Average Cost of Capital

	Capital Structure	After Tax Cost of Capital	Weighted Average Cost of Capital
Debt	10.0%	8.00%	0.80%
Equity	90.0%	30.00%	27.00%
Total	100.0%		27.80%

Valuation Methodology Considerations

Income Approach

Discounted Cash Flow Method

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Cash Distributions to Owners (Addnt'l Paid in Capital Req.)	(\$1,000,000)	\$1,500,000	\$1,750,000	\$2,250,000	\$3,500,000	\$8,000,000	\$1,000,000
Time Factor (Midpoint)	0.50	1.50	2.50	3.50	4.50	5.50	6.50
Discount Factor Based on WACC @ 27.8%	0.8846	0.6922	0.5416	0.4238	0.3316	0.2595	0.2030
Present Value of Forecasted Cash Flow s	(\$884,575)	\$1,038,233	\$947,787	\$953,508	\$1,160,591	\$2,075,727	\$203,025
Total Present Value of Discreet Period Cash Flow s	\$5,494,298 ← Component of Value Attributable to Discreet Period Cash Flow s (Years 1-7)						
Residual Period Cash Flow s							
Year 1 of Residual Period	\$1,030,000						
Capitalization Rate @	24.8% (WACC reduced for long-term growth of 3% per year)						
Value of Residual Cash Flow s at 12/31/2021	\$4,153,226						
Time Factor	6.50						
Discount Factor	0.2030						
Total Present Value of Residual Period Cash Flow s	\$843,209 ← Component of Value Attributable to Residual Period Cash Flow s (Years 8+)						
Total Present Value of Future Cash Flow s	\$6,337,506 (sum of Present Value of both Discreet Period Cash Flow s and Residual Period Cash Flow s)						

Valuation Methodology Considerations

Market Approach

- Market Approach computes value by comparing the value of similar businesses or assets trading in the open market.
- Value may be established using:
 - Prices at which companies have changed hands (the Guideline Merged and Acquired Company Method)
 - Valuation multiples based on prices at which stocks of similar companies in a public market (Guideline Public Company Method)
 - Prices paid for equity in company in the past (Prior Transactions Method) – Revenue Ruling 59-60
- A significant challenge of utilizing Market Approach based methods is the difficulty in obtaining reliable transactions data from a sufficient number of reliably reported private transactions of closely-held enterprises, offering similar services, as well as identifying publicly traded companies providing similar services.

Valuation Methodology Considerations

Market Approach

Comparable Transaction Summary						
	Size Characteristics			Benchmarks		
	Price (EV)	Revenue	EBITDA	EBITDA Margins	Revenue Multiple	EBITDA Multiple
10th Percentile	\$ 2,625,000	\$ 2,250,000	\$ (8,043,104)	11.1%	0.7	4.0
25th Percentile	\$ 4,800,000	\$ 4,011,217	\$ (4,765,865)	15.3%	0.8	4.8
Median	\$ 21,302,469	\$ 6,170,709	\$ 10,771	22.2%	1.4	6.0
75th Percentile	\$ 61,262,250	\$ 29,044,925	\$ 500,000	22.2%	2.7	6.9
90th Percentile	\$ 100,350,000	\$ 103,199,391	\$ 9,000,000	22.2%	3.4	7.4
Average	\$ 40,804,742	\$ 38,556,426	\$ 322,556	17.6%	1.9	5.7

Source: Scope Research Healthcare M&A Valuation Database

Valuation Methodology Considerations

Asset Approach

- Separately identify and appraise each tangible and intangible asset of the ACO, then aggregate (sum) the separately appraised values into an accumulated value of the ACO in its entirety
- Asset approach based methods focus on the value of the ACO's assets under hypothetical sale conditions instead of its earning potential. Thus, Asset approach based methods are generally used in one of the following situations:
 - The ACO has no established, or future likelihood, of earnings (i.e., the ACO is “worth more dead than alive”); and/or,
 - The ACO's value depends heavily on the value of its tangible assets, and there is little or no value added to its services from labor or intangible assets.
- An ACO that fails to produce sufficient evidence to indicate a reasonable likelihood that it would be able to generate sufficient profit in the reasonably foreseeable future, a valuation premise of Value-in-Use as a Going Concern cannot be supported. In that event, the adoption of the “Value-in-Exchange” premise of value is indicated, and an Asset/Cost approach based valuation method may result in an indication of the “highest and best use” of the assets controlled by the ACO.

Valuation Methodology Considerations

Asset Approach

The value of the ACO resulting from the employment of the Asset Approach are reflective of the costs to establish the functional utility of the tangible and identifiable intangible assets that support the operation of the ACO, i.e., cost to replace or replicate the assets of the ASO.

- (1) Organizational Startup Costs
 - Legal
 - Accounting
 - Consulting
 - Management expenses
- (2) Development Costs
 - Technology
 - Provider Network
 - ACO Contract(s)
- (3) Tangible Assets (typically minimal)
- (4) Other Intangible Assets
 - Trained and Assembled Workforce
 - Data

Value Drivers

- The Structure
- Groups and Providers Involved
- Data Infrastructure
- Location and Type
- Shared Savings Model

Conclusion

- Healthcare is a continually changing marketplace, but the ACO market is, quite possibly, evolving the quickest
- ACO transaction activity will substantially increase in the near term
- ACOs are in competition with other value-based payment models – it is important to consistently identify areas to create and maintain value for your organization and your patients.

Thank You!

*For questions for information please do not
hesitate to contact us.*

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