The Importance of Operating Metrics in Running Your Practice

By Franklin J. Rooks Jr, PT, MBA, Esq.

At one point or another, many private practitioners have wondered how they will monetize the investment they have made in their practice. Some practitioners run through this exercise in contemplation of their exit as they approach retirement. For others, the sale of the practice may require them to grapple with the daunting challenges of competing in today's economic climate, where an outside infusion of capital is necessary to take the practice to the next level. Regardless of the reason for the sale, one of the private practitioner's chief concerns is whether he or she will be paid enough.

There are many factors a buyer considers in deciding what price to pay. The buyer usually conducts an extensive analysis of the private practice. This diligence process is usually cumbersome, because many private practitioners do not possess the operational sophistication to make the data analysis. Operational analysis is not a sophisticated process. It is fairly easy to assemble the data needed for a thorough analysis. The trick is having a billing system and data-capturing mechanism that compiles the necessary "operating metrics" of the private practice—and, of course, knowing which operating metrics are the important ones. The practice owner who knows how to assemble and capture these data may be able to parlay the information into an increased sale price.

Some Key Operating Metrics

Operating metrics are the functional indicators of the businesses performance level. Buyers analyze these metrics to assess the strength or weakness of the business. In addition, the very use of these statistics demonstrates the sophistication of the management team. Buyers feel great concern when the management team fails to recognize the importance of measuring and benchmarking these performance indicators. Private practices should be using these metrics during the routine operation of their business.

Clinical productivity is a measure of the efficiency of the clinical workforce. This measure is used in many industries. A manufacturer sets requirements for the production of finished products per hour, and quantifies efficiency based on the expected production relative to the actual production. Similarly, every practice should have its definition and expectations of physical therapist (and physical therapist assistant) productivity. The practice also should establish acceptable deviations from its productivity requirements. The productivity equation starts with the full-time equivalent (FTE) weight of a clinical employee. For a 40-hour-a-week staff person whose sole responsibility is to treat patients, the FTE weight is 1.0. The practice needs to establish how many patients per hour the clinician is required to treat. If the requirement of an FTE was 2 patients an hour during an 8-hour day, a physical therapist who treated 16 patients would yield 100% productivity. Productivity for the month would be reflected by the following formula:

(actual visits) / (required visits)

where required visits = FTE weight × patients per day requirement × number of working days per month.

This statistic is a very good indicator of the practice's staffing and management of human capital resources.

Units per visit is a metric that indicates how many CPT units, on average, the clinician bills for each visit. This is a particularly important indicator, and more significant than average charge per visit. If Practice A bills for 3 units and arrives at a $200 charge, and Practice B bills for 4 units and arrives at a $200 charge, it is more likely that Practice B will have a higher reimbursement for

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Employee Daily Productivity

	2/11/2010			2/13/2010			2/15/2010			2/16/2010			2/17/2010			2/18/2010		
Therapist Name	Possible Appts.	Active Patients	Effic. Rating	Possible Appts.	Active Patients	Effic. Rating	Possible Appts.	Active Patients	Effic. Rating	Possible Appts.	Active Patients	Effic. Rating	Possible Appts.	Active Patients	Effic. Rating	Possible Appts.	Active Patients	Effic. Rating
Bob	15	—	—	15	—	—	15	0	0.00	15	—	—	15	11	0.73	15	14	0.93
Carla	15	19	1.27	15	9	0.60	15	—	—	15	16	1.07	15	9	0.60	15	17	1.13
Chris	15	10	0.67	15	15	1.00	15	13	0.87	15	—	—	15	11	0.73	15	10	0.67
George	15	15	1.00	15	—	—	15	13	0.67	15	13	0.73	15	14	0.93	15	14	0.93
Eliot	15	12	0.80	15	14	0.93	15	14	0.93	15	13	0.87	15	—	—	15	10	0.67
Joe	15	8	0.53	15	7	0.47	15	16	1.07	15	13	0.87	15	14	0.93	15	8	0.53
John	15	14	0.93	15	1	0.07	15	11	0.73	15	11	0.73	15	8	0.53	15	15	1.00
Total	90	78	0.87	75	46	0.61	90	67	0.74	75	64	0.85	90	67	0.74	105	88	0.84

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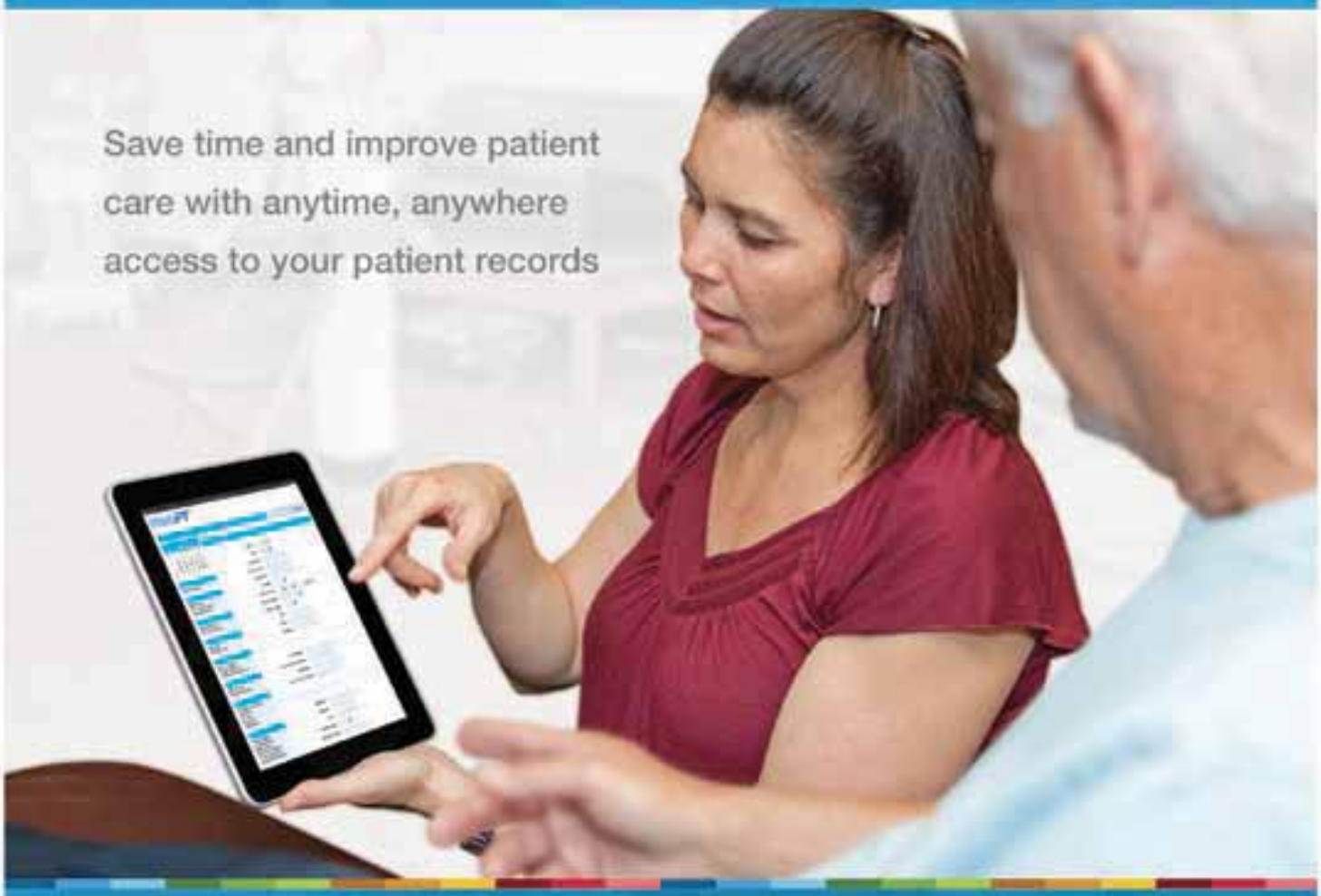

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the visit. This is because the insurance company pays based on units billed, not on the dollar value of charges billed.

The number of units billed per visit is a great indicator because it demonstrates the charging efficiency of the practice. It can send a red flag to potential buyers, too. The practice that bills an average of 5 or 6 units per visit may be inviting trouble. Also, the buyer may realize that the practice's earnings based on a 5–6 unit per visit average is not sustainable. In contrast, the practice that has 2–3 units per visit may present an opportunity to increase earnings because the clinicians may be undercharging for their services.

CPT Code Summary By Primary Ins.
Date Range: 11/10/2010 – 11/17/2010

Facility Name: TEST FACILITY

Blue Cross				
CPT CODE	DESCRIPTION	AMOUNT PAID	UNITS	AVG. REIMBUR./UNIT
97140	Joint Mobilization	$60.00	4	$15.00
Blue Cross of California				
CPT CODE	DESCRIPTION	AMOUNT PAID	UNITS	AVG. REIMBUR./UNIT
97001	Initial Evaluation	$50.01	1	$50.01
97110	Therapeutic Exercise	$47.00	1	$47.00
97140	Joint Mobilization	$60.00	4	$15.00
Blue Cross of California				
CPT CODE	DESCRIPTION	AMOUNT PAID	UNITS	AVG. REIMBUR./UNIT
97001	Initial Evaluation	$75.00	1	$75.00
97002	Re-Eval	$60.00	1	$60.00
97055	Ultrasound	$32.80	1	$32.80

Payer mix is an operating metric that indicates the percentage of the payer relative to all of the other various payers based on the number of patient visits per payer. Payer mix can also be measured by the number of dollars received from a payer relative to all the other payers. Not all payers reimburse the same. In general, auto claims and workers' compensation claims pay the best. Medicare is somewhere in the middle, and Medicaid and Blue Cross products round out the bottom of the payer continuum. If 1,000 visits were performed, and 300 of those visits were with patients insured by an auto insurer, the payer mix for the "auto" grouping would be 30%.

The payer mix can provide a weighted average of expected future reimbursement. By knowing the average reimbursement per payer, gross revenue can be forecasted. If the auto category reimburses $100 a visit and is 25% of the payer mix, 50% of the mix is commercial insurance reimbursing $75 a visit, and 25% of the mix is Blue Cross reimbursing $50 a visit, a monthly volume of 1,000 patients can be expected to reimburse $28,125. This number is achieved by performing a weighted average calculation such that (Auto = 250 patients × 25% × $100) + (Commercial = 500 patients × 50% × $75) + (Blue Cross = 250 patients × 25% × $50).

Trending is perhaps one of the most important statistical tools used in business valuation analysis. Earnings of $5 million look great. However, earnings are not evaluated in a vacuum; they are evaluated against a backdrop of prior period earnings. Suddenly, $5 million does not look great if the earnings in the prior period were $6 million. Some trends must be evaluated concurrently to see their true impact on the business. One example is the annual patient visit trend simultaneously analyzed with the annual earnings trend. Generally, increased visits yield increased charges through a greater number of patients/units billed in aggregate. But, ideally, the bottom line should demonstrate growth as well. Increasing patient visits and flat earnings growth generally indicate that the practice expenses outpaced the revenue growth from the increased patient volume, that insurance reimbursement decreased, or both. Of course, average number of units billed per visit could decrease, which could also produce flat earnings growth.

Visits per referral is a year-to-year comparison of the number of visits that each physician referral produces. This statistic is obtained by taking the total number of annual visits and dividing by the total number of annual new referrals. The number reflects the number of visits the average new referral produces. Even if patient visits decrease because the clinician is incredibly effective in returning patients to function, the reality is that decreased visits per referral may be caused by the ominous changes in insurance benefits. The significance of this metric is that decreasing visits per referral mean that the practice must dedicate more resources to increase the number of new referrals to achieve the same or greater number of patient visits. For example, the average patient at Practice A came 3 times a week for 4 weeks (average referral per visit = 12). Then, owing to increased co-payments and deductibles, the average patient now comes twice a week for 4 weeks (average referral per visit = 8). If the practice had 10 new weekly referrals, it would be performing 30 visits (10 new patients × 3 times a week). Then, after the insurance changes, those same 10 new weekly referrals translate to 20 visits (10 new patients × 2 times a week). To regain those 30 patient visits per week, the practice now needs to see 15 new weekly referrals, an increase of 50%.

The Valuation Process

The typical sale to a private equity firm is based on a multiple of the practice's earnings. The earnings are expressed as EBITDA (earnings before interest, taxes, depreciation, and amortization). EBITDA eliminates the effect of accounting and financial decisions, which many businesses use to minimize their tax burden. This term is used as a proxy for the company's general profitability, cash flow, and performance. In addition to taxes, depreciation, and amortization, other add-backs are used in the normalization of the EBITDA number. For example, if the practice owner has a salary and benefits that are out of line with the industry, the salary will be "normalized," with the difference being added back to the EBITDA number. After arriving at an EBITDA figure, that value is multiplied by a factor that is con-

sistent with the industry and earnings. If a practice has EBITDA of $700,000, a multiplier of 5 would yield an enterprise valuation of $3,500,000. Many times, the private equity firm will purchase 70% of the enterprise value, with the owners "rolling back" 30% of the equity into the practice.

The valuation process looks not only at earnings, but at what value can be leveraged from the business through the infusion of new capital. When a private equity firm or other buyer purchases a controlling interest in a private practice, the investment does not end there. To maximize the return on the investment, the buyer pumps in additional capital to grow the practice, either through new growth or acquisition of smaller practices to complement the purchased platform practice. Careful analysis of the operating metrics, in addition to the EBITDA, determines the opportunity. Sean Sullivan, an investment banker at Duff & Phelps Securities LLC, believes that valuations for physical therapy companies are at an all-time high. According to Sullivan, "While some private equity firms will consider investing in a physical therapy company with as little as $1 million of annual EBITDA, the universe of potential investors expands significantly when a company reaches $2 million of EBITDA."

Mike Cooper, vice president at Shore Capital Partners, a health care-focused private equity firm based in Chicago, shared his thoughts on the importance of operating metrics. According to Cooper, "Analyzing a target's operating metrics is critical to our process and provides great insight into how the company has performed historically and what we can expect, or enhance under our leadership, in the future. 'Metric management,' as we like to call the tracking of operating and financial metrics, is one of the first things we institute after partnering with a company and often leads to improved operating efficiency, cost rationalization, and the identification of potential new business opportunities. To the extent a company is already utilizing metric management prior to our involvement, it certainly makes a good impression and also makes our job, as the buyer, a lot easier."

What Operating Metrics Reveal

The mere utilization of operating metrics reveals the management team's attention to detail and level of sophistication. In contrast, the absence of these operating metrics, in the eyes of a buyer, indicates that the practice management team does not have a firm grasp on the fundamentals that drive the profitability and operations of the business. Aside from management prowess, operating metrics reveal opportunity or the absence thereof. If a practice's productivity is less than 70%, this could mean that the clinic is overstaffed. On the other hand, from the "glass is half full" perspective, it could mean that the clinic is staffed for growth, and there is opportunity to increase visits utilizing the existing staffing structure rather than adding to the bottom line by reducing staff.

Payer mix analysis may reveal a similar opportunity to unlock value. In many areas, workers' compensation and automobile claims reimburse providers more than other payer sources. A practice that has 10% or less of either of these payer sources has an opportunity to grow visits and the average reimbursement per visit by increasing the percentage of auto and workers' compensation claims. The weighting of the respective payer types within the payer mix is a very telling statistic. For example, a practice that has 5% weighting in auto or workers' compensation may offer growth potential in exploiting the "underweighting" in that payer category. In contrast, a practice that has a high weighting of auto or workers' compensation in its payer mix may offer very limited potential for increasing the volume of these higher-paying patient categories. In addition to the aforementioned, Sullivan explains, "The primary quantitative determinants of a practice's value are (i) historical and projected (risk-adjusted) growth rates in net revenue and cash flow; and (ii) company size. However, the presence of a strong leadership team that understands the metrics that drive performance, and has implemented systems and processes to successfully manage those metrics, is often the factor that generates the most enthusiasm among potential investors."

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Conclusion

The practice owner should incorporate operating metrics into the monthly statistics used by the management team to have a firm grasp on the dynamics of the business. Through retrospective analysis, prospective changes can be made to maximize the value of the practice. Additionally, analysis of operating metrics will reveal the existence of growth opportunities. Much of the data can be manually assembled, though several billing and practice management systems can place the data at your fingertips. As part of the due diligence process, these data should be readily available. Detailed, intricate knowledge of your business may put you on better footing when the time comes to explore practice sale options. ■

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