Best Practices for Assessing the Feasibility of New Business Opportunities

Andrew Maller, MBA, COE
BSM Consulting
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Financial Disclosure

I have the following financial interests or relationships to disclose:
BSM Consulting – C

BSM Consulting provides practice management solutions to specialty care providers.

Course Agenda

Explore common new business opportunities
Discuss key operational, strategic, and financial considerations when looking at new business opportunities
Introduction to key concepts that practice leaders must be aware of
Review practical case studies to aid in the decision making process
Common New Business Opportunities

- New equipment purchases
- Hire a new and/or replacement MD
- Hire an optometrist
- Open a new location
- Add a new service line such as optical or cosmetics
- Acquire or merge with another practice
- Add partners to an ambulatory surgery center

Key Considerations When Evaluating New Business Opportunities

- Strategic Considerations
  - Owner Philosophy
  - Differentiation in Marketplace
  - Growth Strategy
  - Provider Succession Planning
  - Improved Patient Outcomes

- New Service Line or Sub-Specialty
Operational Considerations

Physical Space and Facility Upgrades

Staff Hiring and Training

Provider Capacity

Impact on Patient Flow

Marketing the New Opportunity

Financial Considerations

Projecting Volume

Projecting Revenue and Reimbursement

Variable, Fixed, and Incremental Expenses

How are we going to pay for it?
  • Pay cash
  • Get a bank loan
  • Equipment loan

Important Terminology
Equipment Financing Options

- Most simple transaction since no loan is involved
- Often the least expensive option
- No interest expense
- Practice must have sufficient cash to cover the purchase
- Equipment can be replaced or upgraded more frequently
- Often includes an option to purchase at end of lease
- Can be more expensive if sales tax is included
- Practice still owns the equipment
- Requires less cash up front
- Buyer pays interest
- Bank will often require personal guarantee from the buyer

What is the best financing option?

It depends on numerous factors...

- Can the buyer meet current and future expense obligations?
- What is the practice’s level of comfort having debt?
- How does the sum of total payments compare over the life of the equipment?
- What is the most friendly tax option (check with your accountant)?
- How will the decision impact future plans for development?

Variable vs. Fixed Expenses

<table>
<thead>
<tr>
<th>Variable Expenses</th>
<th>Fixed Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proportional to level of business activity.</td>
<td>Do not vary with number of patients seen.</td>
</tr>
<tr>
<td>Relate to number of patients or units of service.</td>
<td>Categories include rent, some salary, insurance, and utilities.</td>
</tr>
<tr>
<td>Examples include medical and surgical supplies, some salaries.</td>
<td>Increases or decreases are more incremental.</td>
</tr>
</tbody>
</table>
Incremental Expenses

Expenses that vary upon reaching critical quantity of services.

Examples
- Clinical Personnel
- Office Space
- Data Processing Equipment

The Cost/Volume Relationship

Cost

Incremental Costs
Variable Costs
Fixed Costs

Volume

New Business Opportunity Case Studies
Case Study 1
New Equipment Feasibility

“Super Laser” Feasibility Analysis

Operating Assumptions
- Revenue per Procedure = $750
- Laser Acquisition Cost
  - Acquisition = $250,000
  - Financed for 60 Months
  - 5% Interest
- Maintenance of $10,000 annually beginning in Year 2
- Per Procedure Cost: $250
- Staffing Needs
  - 1-1.5 Additional Technicians
  - Average salary of $45K

Case Study 1 – Equipment Financing

- Practice has decided to get a bank loan for 100% of the cost of the laser
- 5 year loan at 5% interest
- Results in annual debt payment of approximately $56K per year
Case Study 1 – Operating Assumptions

- 250 estimated procedures in Year 1
- Procedure volume expected to grow by 25% in Year 2

What is the expected cash flow impact at this projected volume?

Case Study 1 – Cash Flow Statement

Case Study 1 – Operational Considerations

What assumptions should be modified?
- Projected volume
- Staffing

What other fixed or incremental expenses need to be considered?
BSM Eye Associates is contemplating hiring an optometrist for the first time. The practice feels that they have adequate space to hire a new optometrist, but will likely need to hire technicians to support this person.

Your research indicates that the OD will require a starting salary of $125K, plus a production bonus in the range of 20% of net collections above three times the base salary.

What would you estimate to be the “break even” for the new OD?
Case Study 2 – Break Even Analysis

<table>
<thead>
<tr>
<th>Patient Volumes</th>
<th>Revenue from Billed Cases</th>
<th>Practice Expenses</th>
<th>Wholesale Expenses</th>
<th>Total Expenses</th>
<th>Net Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>400</td>
<td>$140,000</td>
<td>$60,000</td>
<td>$20,000</td>
<td>$180,000</td>
<td>$100,000</td>
</tr>
<tr>
<td>450</td>
<td>$150,000</td>
<td>$70,000</td>
<td>$20,000</td>
<td>$200,000</td>
<td>$100,000</td>
</tr>
<tr>
<td>500</td>
<td>$160,000</td>
<td>$80,000</td>
<td>$20,000</td>
<td>$200,000</td>
<td>$100,000</td>
</tr>
<tr>
<td>550</td>
<td>$170,000</td>
<td>$90,000</td>
<td>$20,000</td>
<td>$200,000</td>
<td>$100,000</td>
</tr>
</tbody>
</table>

Case Study 3 – Admitting New Partners to an ASC

New surgeon is projected to bring 650 total cases to the facility:
- 500 Cataracts
- 150 YAGS

What is the potential net income impact to the existing partners?

Potential surgeon is interested, but demands at least a 10% ownership interest.
Case Study 3 - Illustrating the Financial Impact

Table 1: Financial Impact of Adding a New Partner to Existing ASC

<table>
<thead>
<tr>
<th></th>
<th>'As Is'</th>
<th>With New Partner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Cases</td>
<td>2,525</td>
<td>3,175</td>
</tr>
<tr>
<td>Operating Revenue</td>
<td>$1,908,130</td>
<td>$2,424,230</td>
</tr>
<tr>
<td>Cost of Goods (1)</td>
<td>$387,695</td>
<td>$496,866</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>$1,520,435</td>
<td>$1,927,364</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>$954,065</td>
<td>$1,083,060</td>
</tr>
<tr>
<td>Operating Net Income</td>
<td>$572,439</td>
<td>$506,294</td>
</tr>
<tr>
<td>Number of Partners</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Ownership Percentage</td>
<td>25%</td>
<td>22.5%</td>
</tr>
<tr>
<td>Net per Existing Partner</td>
<td>$143,110</td>
<td>$192,695</td>
</tr>
<tr>
<td>Net per New Partner</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 2: Incremental Case Volume and Revenue Forecast for New Partner

<table>
<thead>
<tr>
<th>Procedures</th>
<th>Est. Annual Volume</th>
<th>Estimated Facility Fees</th>
<th>Total Est. Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>80544 - Cataracts</td>
<td>500</td>
<td>$962</td>
<td>$481,000</td>
</tr>
<tr>
<td>80581 - YAGs</td>
<td>150</td>
<td>$234</td>
<td>$35,100</td>
</tr>
<tr>
<td>Total Operating Revenue</td>
<td>$516,100</td>
<td>$516,100</td>
<td></td>
</tr>
<tr>
<td>Cost of Goods (1)</td>
<td>$387,695</td>
<td>$387,695</td>
<td></td>
</tr>
<tr>
<td>Gross Profit</td>
<td>$128,405</td>
<td>$128,405</td>
<td></td>
</tr>
<tr>
<td>Operating Expenses (1)</td>
<td>$954,065</td>
<td>$954,065</td>
<td></td>
</tr>
<tr>
<td>Estimated Net Profit from New Partner Cases</td>
<td>$283,035</td>
<td>$283,035</td>
<td></td>
</tr>
</tbody>
</table>

Footnotes:
(1) Per Table Two, it is assumed case volume for the new partner will be 500 cataracts and 150 YAGs, and total revenue of $516,100.
(2) Cost of goods is estimated at 20% of operating revenue.
(3) Operating expenses are estimated at 50% of operating revenue in the "As Is" scenario and at 25% of the incremental revenue generated by the new partner.

Case Study 3 - Illustrating the Financial Impact

- In this example, although the existing center owners will "suffer" a dilutive effect on ownership percentages, the lower percentage ownership results in a higher distribution.
- This exercise can prove quite helpful in assisting center owners in determining the "right" number of shares to offer the prospective buyer.
- This is due to the contribution being made by the new surgeon and the accompanying improved operating margins achieved by the center.
Why do many new business ventures fail?

- Lack of planning and due diligence
- Relying on emotions to make decisions
- Inaccurate estimates
- Patient demand
- Inability to execute

What do top practices do differently than?

- Dedicated staff and physician leadership
- Focus on strategy first, then operations, and financial projections
- Set regular goals
- Monitor regularly
Thank You!

For templates and questions, please contact:

Andrew Maller, MBA, COE
amaller@bsmconsulting.com