

IVF Practice Valuation – A Ready Reckoner

Due to variations in laws across countries and differences in ownership interests, the methods to determine the final value of an IVF practice could vary greatly



By: Kapil Khandelwal

A couple of years ago, a doctor acquaintance came to me with an offer from a start-up chain of IVF to acquire his practice. The valuation offered for their IVF practice according to him did not justify the assets and the goodwill he and his wife had painfully created over the years in the community for which there was no premium being offered. Of course the deal did not go through.

Over the last year, there has been an increased investment

activity especially that of mergers and acquisitions of stand-alone IVF clinics or companies having a chain IVF clinics. There has been consolidation in the IVF sector outside India and there are signs of this occurring in India as well. One of the drivers for consolidation of IVF in India is the assisted reproductive technology (ART) (Regulation) Bill – 2010. The ART Bill calls for certain standards to be maintained by these IVF centres and small players need funds to meet those standards mandated by the Bill.

Recent transactions

HCG has invested in Dr. Kamini Rao's IVF clinics chain and plans to take it national. The valuation of the IVF business was not disclosed publically. Earlier, Manipal Hospitals invested growth capital in Ankur Healthcare, a speciality centre, focused in delivering comprehensive services in the areas of reproductive medicine like IVF, andrology and men's health. There has been a number of questions raised about whether the IVF clinics/company valuations were right.

Uniqueness of IVF clinic practice V/s IVF chain business

There are nine key parameters on which we consider the uniqueness of an IVF Practice while valuing it. These include:

Price sensitivity

IVF services are price insensitive. When we want to have a baby, we seek out the most qualified IVF professional, regardless of prices and not go by the brand

Doctor is the face

IVF specialists may hire technicians to perform services, but the specialist approves the diagnosis and work performed. Customer loyalty flows through to the individual doctor rather than the business (e.g. Kamini Rao, Gunasheela in Bangalore)

Customer trust

As long as trust is maintained, costumers to the IVF clinic will continue to return or refer other customers. It is this trust that build and sustains goodwill unlike a branded IVF chain of clinics

Individual IVF success rate

While IVF services would be fairly standardised across all the IVF clinics, it is the success rate and the individual skills of the team at the clinics that makes one clinic preferable from another
IVF clinic markets are geographically restricted
IVF clinics would serve a geographically restricted market unlike a chain that may serve an aggregation of multiple geographical markets

Customer referrals is the main source of new business

Unlike a brand, it is the referrals from satisfied customers that feeds the new business at an IVF clinic



However, the objective of this column is not to critique the value at which the transactions have taken place or fallen off but to guide on the parameters on which the valuation of an IVF business is based. It is intended as a general background information to assist practitioners in establishing the fair market value of an IVF practice.

Due to variations in laws across countries, underlying reasons for the valuation, and differences in ownership interests, the methods to determine the final value could vary greatly. For these reasons, it is highly recommended that the advice and assistance of a qualified valuation consultant be obtained in all matters relating to the sale or purchase of a practice. The word IVF clinic and IVF practice may have been used interchangeably in this article.

Why value an IVF practice?

There are several reasons to value an IVF practice, however the following four reasons are mainly why valuation is conducted:

Financial planning:

Expansion and equipment acquisition

- Tax planning
- Estate planning
- Debt financing and collateralisation
- Litigation and malpractice
- Unsolicited offer (hospital wanting to secure practice)

Management information:

- Buy/sell agreement in a chain of IVF/group practice
- Long range planning

Personal:

- Disability
- Death
- Divorce
- Relocation

Retirement:

- Continuity of clinical records with a good clinician
- Fund an annuity or other retirement income

Key determinants

Let us understand that there are several determinants on which the valuation of both an IVF clinic practice or a chain of clinics rests. Goodwill being one of them, without careful nurturing, customers/patients/clients would soon take their business to other IVF providers. Goodwill in IVF practices is developed and sustained by the specialised expertise of the doctors and other specialists. These valuation determinants try to encapsulate the basic values that the market may place on the quality of earnings of a particular IVF clinic practice/chain

Objective determinants:

- Number of cycles per month
- Success rate and cumulative

	Enterprise Value (EV)	Revenue	EBITDA	Multiple EV / EBITDA
RECENT DEALS				
Vivian IVF Care	3,000	350	~110	27x
Sterling	560	200	20	28x
CARE	475	~330	~32	15x
PUBLIC COMPANIES				
Apollo	6,142	2,027	324	18x
Fortis	7,330	1,467	498	14x

- success rate over cycles
- Patient flow from abroad and types of services provided to them
- Price points or premium over other IVF clinics
- Historical profitability
- Growth rate by different services
- Payment mix
- IVF Specialists' age/health and succession plan
- IVF Specialists' ownership/ utilisation and/versus non-owner utilisation

Subjective determinants:

- Nature and history of the practice/clinic
- Good obstetrics and gynaecology practice
- Practice type (sole practitioner, single group, multispecialty group)
- Specialty type (including consideration of average term of the patient/doctor relationship)
- Facilities (including the location, length of time, and surrounding demographics)
- IVF specialist's reputation
- Professional management: Experience and quality of management and staff
- Competition also tied with locational advantage
- Lab and equipment
- Batch IVF
- Quality: Consistent results comparable with the best in the world
- Counselling service offers and additional non-pregnancy IVF offers
- Good and experienced embryologist
- Good QA – QC facility
- System driven, leading to staff and supplies efficiency
- Central marketing
- Scouts, selects egg donors
- Maintains sperm and egg bank
- Selects and provides

- surrogates
- The clinic must be totally transparent in all its operations
- Must let the patient know what its success rates are in regard to the procedure intended
- Keeping abreast with the latest development across the globe and get best practices
- Location(s) and locational advantage
- Follow ART Guidelines (see box)
- Follow tax and other regulatory compliances

For valuing an IVF practice, there are several popular methods being used to express a fair value of the IVF practice. These include: income approach, market approach and cost or asset based approach.

Income approach

This approach assumes value



based on the projected income expected to be generated by the IVF practice. There are two most common method of determining value using the income approach.

Discounted cash flow approach (DCF):

The DCF method presumes past earnings of the practice are not sufficiently relevant for the valuation, and instead, requires a projection of future revenues of the practice for a number of years. These future earnings are then utilised to determine the value of the practice. This method is used where the practice has not matured and is in growth stage and there is variance in the revenue significantly year on year.

Capitalisation of excess earnings method (CoEE):

The CoEE method makes a presumption that the IVF clinics past earnings are representative of its future earnings. Once the earnings

ART Bill & Business Valuation



Salient points of ART Bill impacting valuation:

- All ART Clinics shall register themselves with the Registration Authority
- Certificate of accreditation from Authority is must for practicing ART
- All ART clinics shall obtain temporary registration within 6 months and regular registration within 18 months from date of notification
- Registration Authority may suspend registration if conditions are not being followed by ART clinics
- Registration Authority shall have power to inspect ART Clinics
- No ART procedures shall be performed on a women below 21 years of age
- Written consent from patient
- ART clinics should maintain complete records regarding patients
- No ART clinic shall offer to provide a couple with a child of pre-determined sex

Impact of transparency guidelines:

- Small clinics with flexible pricing, claiming false inflated results, will be affected
- All clinics will be open to inspection and accreditation
- Advantageous to chain based on quality and transparency



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and personal
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stream is determined, and appropriate adjustment is made for earnings on the value of assets, the remainder is subjected to a capitalisation rate. The resulting number represents the value of the “intangible asset” of the practice. The fair market value of the practice’s assets is added to this amount.

The total of these two amounts represents the value of the practice. This method is used to value mature IVF practices that have reached mature cash flows and growth and therefore capitalisation assumes a single proxy for each and every future year’s return on the IVF practice.

Market approach

The market approach measures value based on what investors paid for similar medical practices. This approach relies on either similar publicly-traded medical practices or actual sales transactions of similar medical practices as an indication of value. There are

four steps involved in applying either market approach to an IVF practice. These steps are as follows:

- Determination of representative earnings and cash flow levels for the subject practice
- Selection of comparable publicly traded practices or practices recently sold (comparable practices)
- Selection of appropriate capitalisation rates based on a relative risk analysis between the subject practice and the comparable practices
- Determination of fair market value of the subject practice’s debt and equity

In India, there are hardly any publically-listed IVF practices or deals in the IVF space. Hence, this approach becomes a reference check to what approach other valuations took. Therefore, a proxy of recent deals in the healthcare sector is used. These could be grossly out of reference for IVF practice valuations (see table).

There is preference to use the market approach because it illustrates what real investors have been willing to pay and accept in real transactions. This approach is also used because it is not as much subject to the valuation companies’ ‘opinion’. Thus, issues such as adjustments for compensation or the discreet valuation of goodwill that are required in the income approach and the cost approach are unnecessary.

Cost or asset-based approach

The cost approach focuses on the balance sheet and relies on the estimated value of the assets, both tangible and intangible, which comprises the IVF practice. Due to its controversial nature encompassing a variety of meanings, goodwill is the most complicated component of practice value to measure. In the case of IVF, specialised equipment is required to run the practice, an exact replacement of equipment might be necessary.

However, in the case of most companies, the business operator is primarily concerned with replacing assets with similar assets and having the assets (equipment) installed. Further, we are concerned with embedding the aging of the asset in the analysis, but the aging reflected by depreciation methods may not actually reflect economic depreciation. Therefore, proper aging of the assets must be considered.

The issue of Goodwill in IVF practice

The IVF business and personal goodwill are difficult

enough to define (see the determinants); they are even harder to measure. The contribution of Goodwill toward total IVF practice value is often the most difficult component to agree upon and determine. Every successful IVF practice has an inherent component of goodwill. This quality may arise from any one or any number of subjective determinants outlined above for the IVF practice. The value of goodwill to be carried into the valuation of an IVF practice is subjective. Most personal goodwill of an IVF specialist can be transferred to a new owner because most of the patients have trust and confidence in the selling IVF specialist. Thus, the selling IVF specialist's recommendation is likely to carry substantial weight in the patient's decision to stay with the new IVF practice owners. However, once the goodwill of an IVF practice has been defined and its transferability confirmed,



an analysis of the accounting records can begin.

Adjusting of the valuation to fair market value

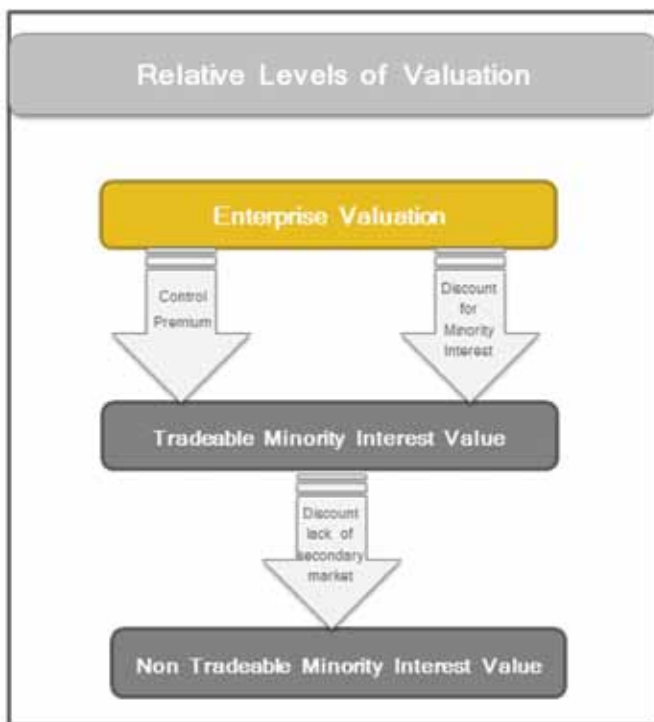
It is necessary to examine whether a discount or a premium is required to adjust a value obtained using a specific valuation method to the value required for valuing the IVF practice. Before beginning a discussion of discounts, it is necessary to understand

the base or level to which the premium or discount is applied. The diagram (Relative Levels of Valuation) illustrates various levels of ownership of an IVF practice. The level of interest is important because a controlling interest is usually worth more than a minority interest, and a tradeable minority interest is usually worth more than a closely held minority interest.

Thus, whenever a particular method is used it will likely result in a value for a specific level of value. The value may require an adjustment, the addition of a premium or subtraction of a discount, to obtain a value after the method that is suitable for that particular IVF Practice.

Conclusion

While there are several ways to value a practice, the ones listed in the article are the most common ones used to assist in IVF practice buy or sell side negotiations. Each has its benefits and drawbacks, and should be given careful attention to understand the context and the key determinants for which the valuation is carried out.



About the Author:

Kapil Khandelwal has earned recognition as an angel investor, venture capitalist and expert in health sciences, education, agri, clean tech and information communications and technology (ICT). His expertise positions him as one of the thought leaders in India, Asia Pacific and emerging markets. In his 25 years of his career, he has carried out over 30 transactions including cross-border and buyouts. He has chaired various committees at various industry bodies. Kapil runs an early stage investment fund and his own investment banking and advisory services company EquNev Capital Private Limited. He can be contacted at: kapil@kapilkhandelwal.com