

Presenting a live 90-minute webinar with interactive Q&A

Hospital Joint Venture Trends and Post-Transaction Arrangements

Meeting Regulatory and Valuation Requirements; Navigating
Employee Leasing, Physician Compensation and Other Arrangements

WEDNESDAY, SEPTEMBER 20, 2017

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Colin McDermott, CFA, CPA/ABV, Managing Director, **VMG Health**, Dallas

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Hospital Joint Ventures (JVs): Trends and Post-Transaction Contractual Considerations

Colin McDermott, CFA, CPA /ABV, Managing Director

Alex Higgins, Director



September 20, 2017

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AGENDA

- I. Joint Venture Trends
- II. Regulatory Considerations for JVs
- III. Valuation Process, Trends and Structure
- IV. Post-Transaction Contractual Arrangements
- V. Valuation Considerations for Post-Transaction Contractual Arrangements
- VI. Compliance Considerations for Post-Transaction Contractual Arrangements
- VII. Case Study

Joint Venture Trends

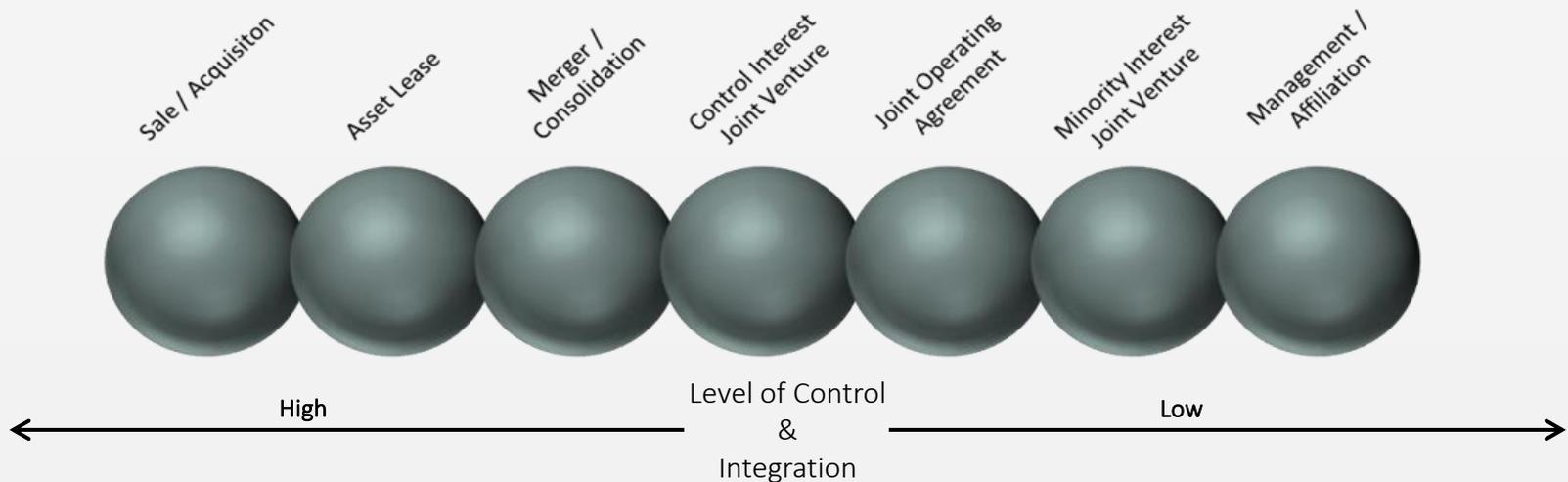
JOINT VENTURE TRENDS

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Joint Venture Background

What is a Joint Venture?

- The cooperation of two or more businesses in which each agrees to share profit, loss, and control in a specific enterprise
- Typically formed to undertake a particular business transaction or project



JOINT VENTURE TRENDS



Joint Venture Participants

For-Profit Health Systems

Not-For-Profit Health Systems

Ancillary Service Providers

Physicians

Many health systems are participating in joint ventures including for-profit systems such as LifePoint Health and Universal Health Services, as well as not-for-profit systems such as CHRISTUS Health and Banner Health.

Ancillary service providers and physicians are often key partners to a joint venture structure.

JOINT VENTURE TRENDS



Pros vs. Cons

PROS

Market Share

Network Integration

Management Expertise

Capacity / Access

Geographic Penetration

Branding

Reimbursement

CONS

Lower Ownership

Regulatory Issues

Slow Development Process

Multi-Party Decision-Making

Loss of Control

Greater Complexity

Complex Accounting

JOINT VENTURE TRENDS



Acute Care



ASC's



Behavioral



Diagnostic Imaging



Dialysis



Lab Services



Managed Care



Physical Therapy



Physician Services



JOINT VENTURE TRENDS



Acute Care Hospitals



LIFEPOINT
HEALTH®

“Our recent joint venture with LHC Group brings our company to another level of focus on **home health and hospice** and enhances our opportunity to grow this portion of our business. We believe we have opportunities for growth in each of our existing markets by adding profitable service lines and recruiting physicians.”

-William F. Carpenter, Chairman & CEO, 2017 Q1 Earnings Call

Recent Notable Activity



- **Joint venture** finalized in January 2017.
- Allows both companies to expand **home health and hospice** service offerings.
- LHC manages day-to-day management and assets of JV, which includes LifePoint’s 20 home health and 10 hospice locations.
- All locations will continue to operate under existing names.

JOINT VENTURE TRENDS



Ambulatory Surgery Centers



“Our pipeline is double the size it was a year ago. I think **we're very attractive to that large group of independent ASCs** that are out there looking for a partner.”

-Christopher A. Holden, CEO, President & Director, 2017 Q2 Earnings Call



- **Merger** announced in June 2016.
- Combined company named “Envision Healthcare Corporation.”
- Combines one of the largest provider organizations that manages physician services, **ambulatory surgery**, post-acute care and medical transportation.



- Amsurg **acquired** 55% stake in Campus Surgery Center.
- Campus Surgery Center is a multi-specialty ASC that provides outpatient surgery for more than 5,000 patients a year.

JOINT VENTURE TRENDS



Ambulatory Surgery Centers



“While the strategy of **adding platform physician practices** remains sound and holds significant long-term growth potential, the near-term results can often be challenging during the initial phase of integration. As a result, we have **introduced a joint venture model**, and these practices have been performing as expected during the first quarter.”

-Michael Thomas Doyle, CEO & Director, 2017 Q1 Earnings Call

“Again, a continued look at **3-way joint ventures with health systems** is not as a core growth strategy but as an opportunity on a market-by-market basis to make an impact and do the right thing for the physician partners and the communities that they operate in.”

-Michael Thomas Doyle, CEO & Director, 2017 Q1 Earnings Call



JOINT VENTURE TRENDS



Behavioral Health

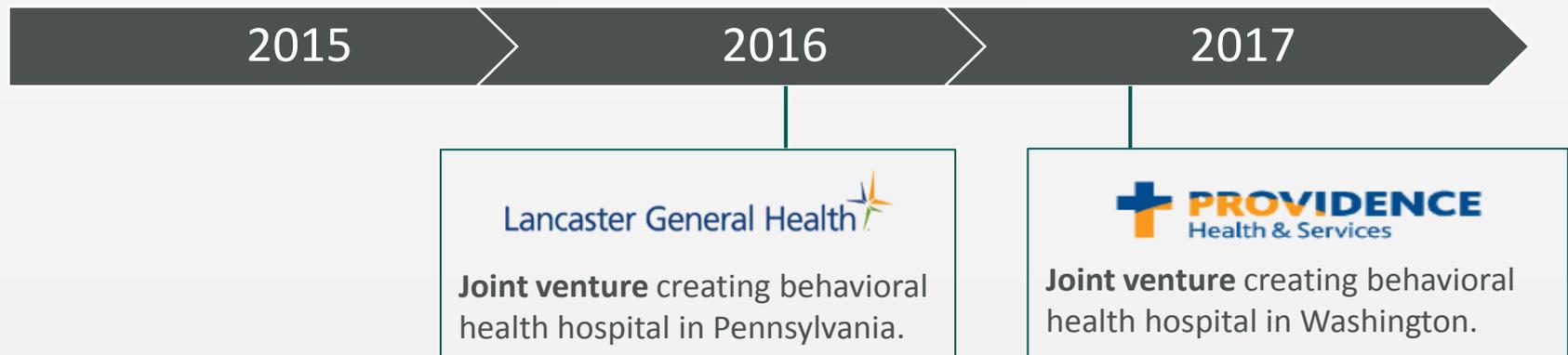


“As far as the joint venture strategy on the **behavioral** side, those conversations continue to be quite active. I think we've already announced a number of those ventures, including some new hospitals that are being built in partnership with **big acute care partners.**”

-Steve G. Filton, CEO, Executive Vice President & Secretary, 2017 Q2 Earnings Call

“...we continue to have a large number of conversations with a variety of **not-for-profit hospitals**, largely not-for-profit, actually, some for-profit hospitals around the country about being able to joint venture with them in some way to help them run their **behavioral** operations. Some of those conversations have already been executed and acted upon.”

-Steve G. Filton, CEO, Executive Vice President & Secretary, 2017 Q1 Earnings Call



JOINT VENTURE TRENDS



Diagnostic Imaging



“At the beginning of the second quarter, we commenced the operations of two Los Angeles joint ventures with Cedars-Sinai Medical System in Santa Monica and in San Fernando Valley. These joint ventures mark our continued interest and activity around the **joint venture model**, a business strategy we've employed on the East Coast for some time.”

-Howard G. Berger, CEO, President & Treasurer, 2017 Q2 Earnings Call

“So we have found that **all of our joint ventures** ultimately, we believe, will **enhance the company's overall performance** either by growth inside those joint ventures or enhancing our opportunity for reimbursement or new reimbursement models... I think at the present time, **our primary focus is doing more joint ventures with the large health systems.**”

- Howard G. Berger, CEO, President & Treasurer, 2017 Q2 Earnings Call



JOINT VENTURE TRENDS

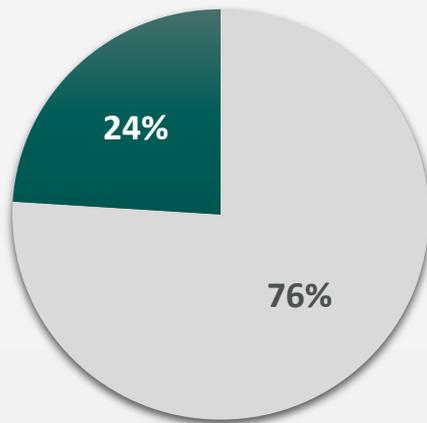
Dialysis



“As it relates to going after JVs, we remain consistent in our philosophy there, which is **we really like the clinical value that a joint venture partner offers**. So that has not changed and we don't expect that to change.”

-Javier J. Rodriguez, CEO of Kidney Care, 2016 Q4 Earnings Call

2016 Revenue Split



■ Wholly-Owned ■ Equity JV

Recent Joint Ventures



JOINT VENTURE TRENDS



Lab Services



“But as importantly, what I said in my introductory remarks is we're actually going to use this joint venture to provide some of the basic health care services to help with what we could do with **population health** and **bending the cost curve.**”

-Stephen H. Rusckowski, Chairman, CEO & President, 2017 Q2 Earnings Call



JOINT VENTURE TRENDS



Managed Care



“We furthered our provider engagement strategy by signing a joint venture with Sutter Health, **marking the fourth JV in the past 15 months**, and our bswift platform signed its largest plan sponsor to date, serving as a proof point of the strong capabilities of our platform and the ability to move upstream and serve the needs of larger plans.”

-Mark T. Bertolini, Chairman & CEO, 2017 Q2 Earnings Call

“We have a healthy pipeline of opportunities. **They will not all be joint ventures. I think there are other models emerging.**”

-Mark T. Bertolini, Chairman & CEO, 2016 Q4 Earnings Call



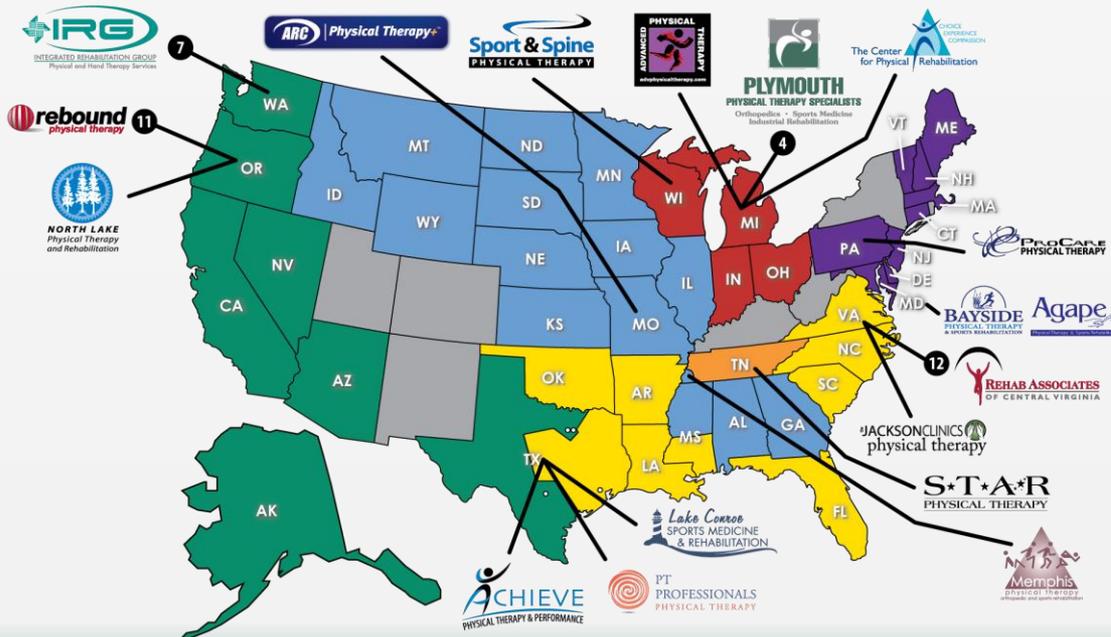
JOINT VENTURE TRENDS

Physical Therapy



“And we always said when we do acquisitions, we want to structure micro de novo deals, where the founders keep a significant equity stake, so that they stay motivated to grow the business. And we want operating partners, meaning clinicians that are practicing, treating patients, talk to doctors, et cetera. Typically, we have a deal with them that for 3 to 5 years, they can't sell their equity interests.”

-Lawrance W. McAfee, Executive VP, CFO & Director, 2016 Q4 Earnings Call



28 acquisitions since 2005 ranging from 3 to 52 clinics.

JOINT VENTURE TRENDS



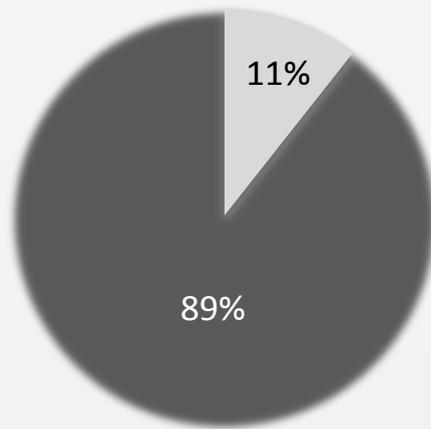
Post-Acute Care



“...our joint venture efforts continue to gain steam, as reflected in a **robust pipeline for IRF JVs**, in addition to broad-based **post-acute JVs with large health system partners.**”

-Benjamin A. Breier, CEO, President & Director, 2017 Q1 Earnings Call

Inpatient Rehabilitation Facility Split



■ Wholly-Owned ■ Equity JV

Recent Joint Ventures



JOINT VENTURE TRENDS



Post-Acute Care



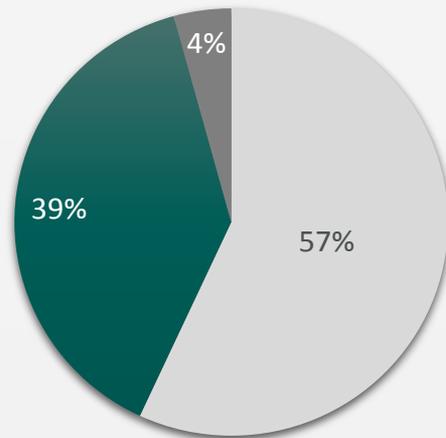
“Our pipeline of potential joint venture opportunities is unprecedented, and we continue to focus strategically on **high-quality, stand-alone, freestanding acquisitions, primarily in Certificate of Need States.**”

-Keith G. Myers, Co-Founder, Chairman & CEO, 2017 Q1 Earnings Call

“Whenever we go into a hospital joint venture, we may be looking at the home health. **We normally are looking at home health** primarily. But what comes with that is of **the opportunity to add hospice and personal care services over the long term.**”

-Keith G. Myers, Co-Founder, Chairman & CEO, 2017 Q1 Earnings Call

Facility Split



■ Wholly-Owned ■ Equity JV ■ Other

Recent Joint Ventures



JOINT VENTURE TRENDS



Post-Acute Care



IMPROVING QUALITY OF LIFE

“...**the joint ventures on the rehab is really our focus.** I mean -- and as you've seen from our announcements, **our focus is on the large systems.** But we have done some LTAC joint ventures, but I expect them to be probably more modest and smaller.”

-Robert A. Ortenzio, Co-Founder & Executive Chairman, 2017 Q2 Earnings Call



VALUATION PROCESS, TRENDS AND STRUCTURE



Joint Venture Transaction Drivers

Historical Drivers

Reimbursement and Payor
Networks

Access to Capital

Management Expertise

Cost Efficiencies

Declining inpatient stays and shift
to outpatient care

Branding & Market Position

VALUATION PROCESS, TRENDS AND STRUCTURE



Commentary on Transaction Drivers

Market Position

“As we've shared with you in the past, we are committed to building leadership positions in the markets in which we compete. **Our objective is to be either #1 or #2**, and we currently hold these positions in 21 of our 31 markets... Increasingly, we see partnerships with an attractive vehicle to **improve our position** where we already have a presence or expand our footprint to new geographies.”

-Trevor Fetter, CEO of Tenet, 2014 Q4 Earnings Call

Access to Capital

“Partnerships can have all the strategic benefits of an acquisition but with a **much lower capital commitment**.”

-Trevor Fetter, CEO of Tenet, 2014 Q4 Earnings Call

Branding

“...we're acquiring small home health agencies that we **rebrand** and establish a hospital-based agency essentially. It's more efficient to do that, in many cases, than it is to open up an agency even in a non-CON state.”

-Keith G. Myers, Co-Founder, Chairman & CEO of LHC Group, 2017 Q1 Earnings Call

Reimbursement

“So we have found that all of our joint ventures ultimately, we believe, will enhance the company's overall performance either by growth inside those joint ventures or enhancing our opportunity for **reimbursement or new reimbursement models**...”

- Howard G. Berger, CEO, President & Treasurer Of RadNet, 2017 Q2 Earnings Call

Regulatory Considerations for JVs

REGULATORY CONSIDERATIONS FOR JVs

FMV Definitions

The standard of value being addressed within this report is FMV. According to the *International Glossary of Business Valuation Terms*, FMV is defined as follows:

The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms-length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.

According to the IRS's Revenue Ruling 59-60, FMV is defined as:

FMV, in effect, is the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts.

Within a healthcare setting, FMV is also defined as (42 CFR §411.351):

The value in arms-length transactions, consistent with the general market value. "General market value" means the price that an asset would bring, as the result of bona fide bargaining between well-informed buyers and sellers who are not otherwise in a position to generate business for the other party; or the compensation that would be included in a service arrangement, as the result of bona fide bargaining between well-informed parties to the arrangement who are not otherwise in a position to generate business for the other party, on the date of acquisition of the asset or at the time of the service Arrangement.

REGULATORY CONSIDERATIONS FOR JVs

FMV Definitions (Continued)

Notable definitions related to FMV as stated in Stark include:

GMV is compensation that would be included in a service agreement as the result of bona fide bargaining between well-informed parties. (STARK II, PHASE I, FR Vol. 66, No. 3)

The compensation must be set in advance, consistent with fair market value, and not determined in a manner that takes into account the volume or value of referrals or other business generated by the referring physician. (STARK II, PHASE II, FR Vol. 69, No. 59)

REGULATORY CONSIDERATIONS FOR JVs

Commercial Reasonableness

Commercially reasonable is another pertinent term defined by Stark II:

An arrangement will be considered “commercially reasonable” in the absence of referrals if the arrangement would make commercial sense if entered into by a reasonable entity of similar type and size and a reasonable physician (or family member or group practice) of similar scope and specialty, even if there were no potential DHS (designated health services) referrals. (STARK II, PHASE II, FR Vol. 69, No. 59)

REGULATORY CONSIDERATIONS FOR JVs



Stark Law and Anti-Kickback Statute

Stark Law

Overview

- Financial relationship with physician results in prohibition on referral and billing of designated health services to Medicare and Medicaid patients under Stark Law unless financial relationship meets an exception

Requirements for exceptions

- Written agreement specifying terms
- Fair market value consideration set in advance that does not vary based on referrals
- Commercially reasonable

Anti-Kickback Statute

Overview

- Prohibits knowing and willful offer, payment, solicitation or receipt of remuneration to induce or reward referrals of services reimbursable by a federal health care program

Important considerations

- Commercial reasonableness
- Documentation of fair market value
- No special treatment related to volume or value of referrals

REGULATORY CONSIDERATIONS FOR JVs



Tax Exempt Issues

Requirement to maintain tax exempt status

- Non-Profit must be and remain organized and operated exclusively for charitable purposes

Contribution of charitable assets

- Must be fair market value
- May require Attorney General approval under state law

Remuneration paid by non-profit partner

- Purchase price, management fee, etc.
- Must be fair market value

Activities of JV attributed to non-profit partner

- Income treated as taxable unrelated business income unless activities are substantially related to charitable purposes
- If JV is substantial part of non-profit partner's activities, it could also impact overall tax exempt status

REGULATORY CONSIDERATIONS FOR JVs



Tax Exempt Issues

Are JV activities substantially related to charitable purposes of non-profit partner?

- Nature of activities – are they consistent with charitable activities contemplated by IRS (e.g. direct patient care)?
- Governance control – can non-profit partner ensure that activities will be solely in furtherance of charitable purposes?

Key governance considerations and Revenue Rulings 98-15 and 2004-51

- Board control
- Reserved powers
- Term of management agreement
- Charity care policies

REGULATORY CONSIDERATIONS FOR JVs



Antitrust Issues

Analysis of JV formation

- Are JV partners currently competitors?
- How is competitively sensitive information treated during transaction – limitations on sharing of information, third-party analysis of sensitive information?
- Does JV result in concentration of market power that may be subject to challenge?
- Does JV transaction require Hart-Scott-Rodino filing?
Will FTC / DOJ require any divestiture of facilities?

REGULATORY CONSIDERATIONS FOR JVs



Unique Issues in JV Transactions

Fair Market Value

No buyer synergies

Expenses to account for all expenses to operate as a freestanding business

Revenue/reimbursement changes to reflect “market” and not particular buyer

Strategic Value

Incorporates synergies to specific buyer

Unique hospital based reimbursement

Paying greater than the market could be deemed “paying for referral”

REGULATORY CONSIDERATIONS FOR JVs



Benefits of Receiving a FMV

Compliance

- Stark
- Anti-Kickback

Knowledge

- What the target is worth?

Credibility

- Thousands of valuations
- Both sides of the table

Independence

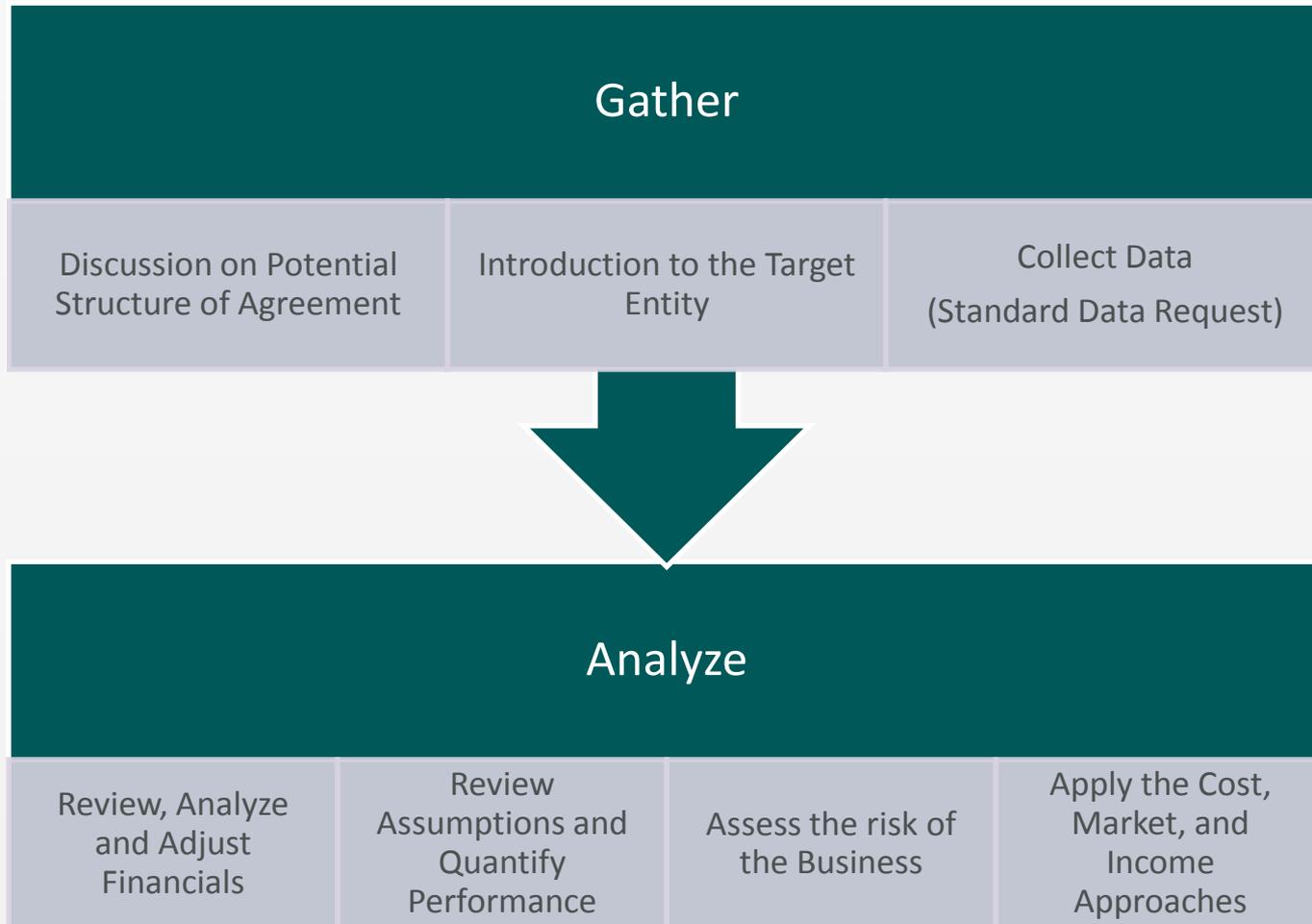
- No emotional involvement
- Just the facts

Valuation Process, Trends and Structure

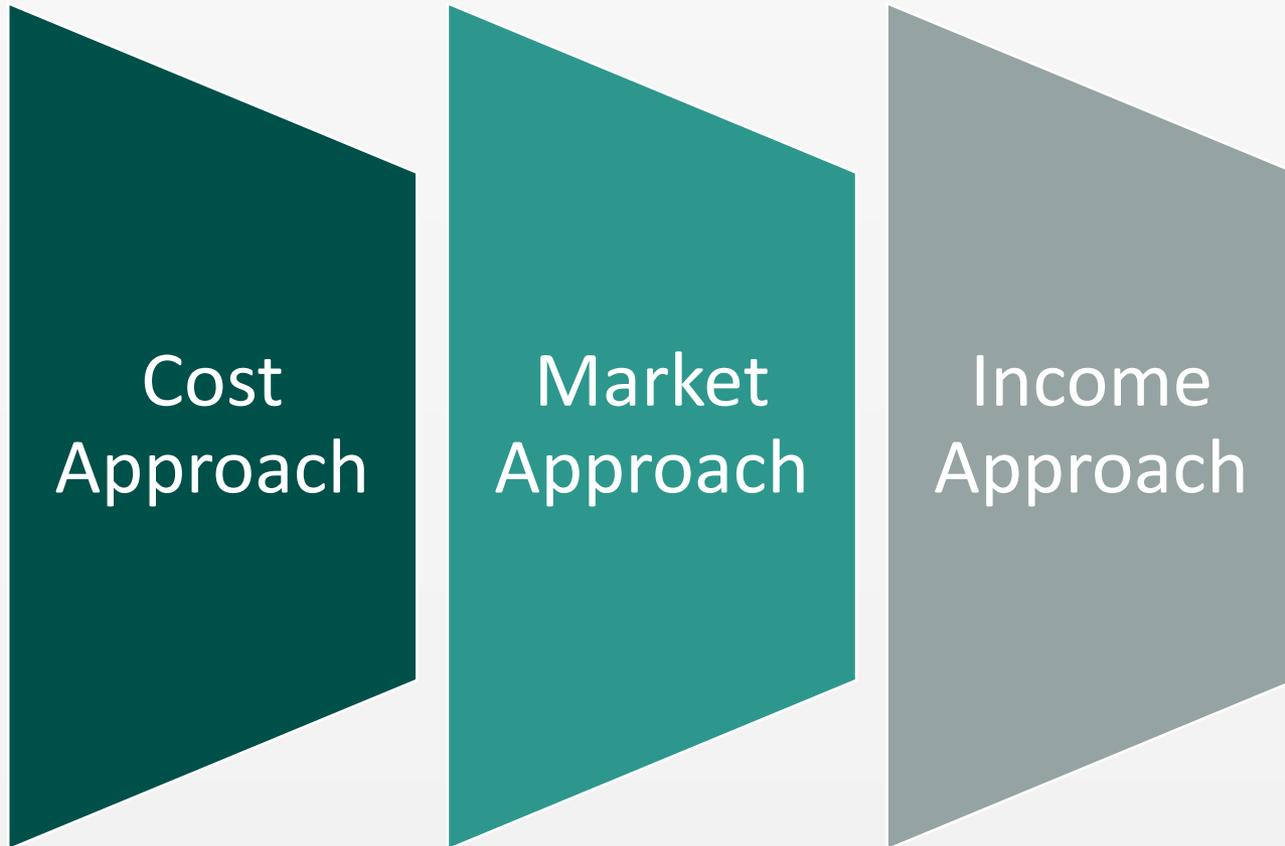
VALUATION PROCESS, TRENDS AND STRUCTURE



The Valuation Process



VALUATION PROCESS, TRENDS AND STRUCTURE



VALUATION PROCESS, TRENDS AND STRUCTURE



Cost Approach

Cost Approach



Cost of replicating a comparable asset, security or service with the same level of utility

Tangible Assets

- Working capital
- Fixed assets
- Real estate (if applicable)



Intangible Assets

- Legal title, protectable, separately marketable
 - *Trade name*
 - *Phone number*
 - *Medical chart*
- *Covenants not to compete*
- *Trained Workforce*

VALUATION PROCESS, TRENDS AND STRUCTURE



Market Approach

Market Approach



What is the Market's Perception of Value?

- Guideline Public Company Method
 - Data gathered from healthcare M&A research
- Similar Transaction Method
 - Information is also gathered from experience
- EBITDA and Revenue Multiples differ depending on Center Specific Characteristics including:
 - Sector (ASC, Imaging, Phy. Practice)
 - CON
 - Earnings & Margins
 - Specialties/Modalities
 - Number of Owners
 - Number of Centers
 - Size
 - Location

VALUATION PROCESS, TRENDS AND STRUCTURE



Income Approach

Income Approach



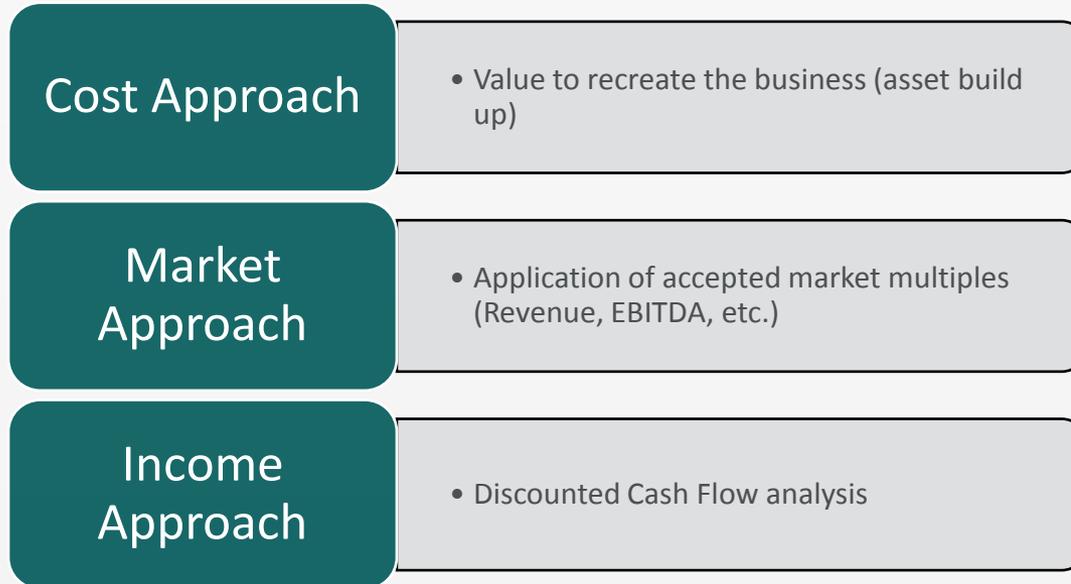
A Discounted Cash Flow (“DCF”) Analysis



VALUATION PROCESS, TRENDS AND STRUCTURE



The Valuation Process Summarized



Reconcile appropriate Approach(es) to arrive at

Total Invested Capital

Deduct outstanding interest bearing debt



Total Equity Value

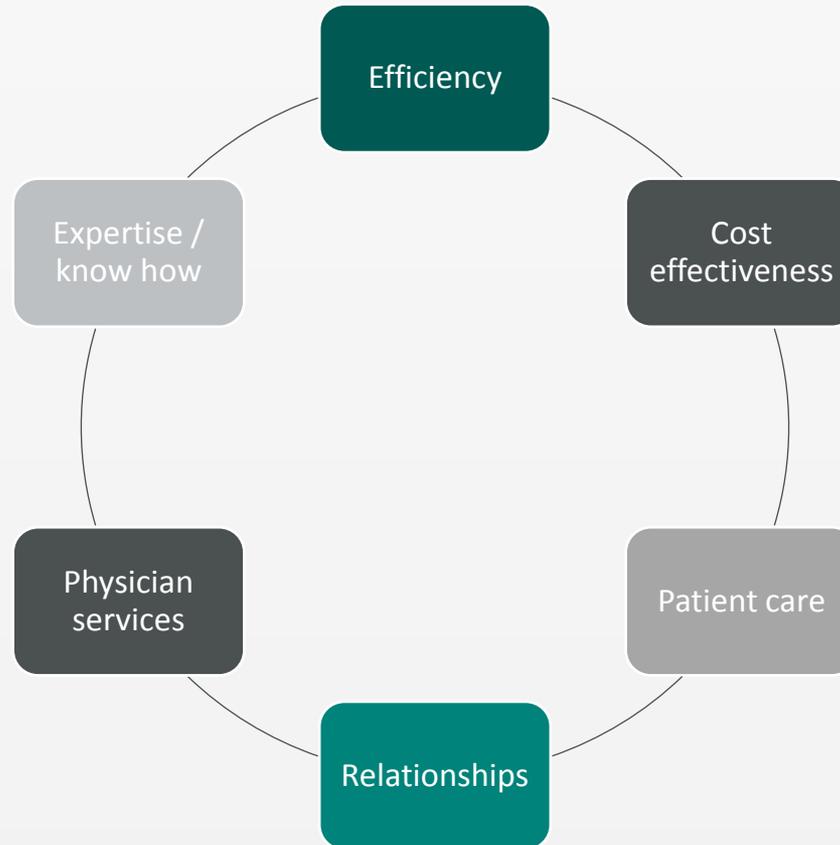
Include Industry data, finalize report, present to management

Post-Transaction Contractual Arrangements

POST-TRANSACTION CONTRACTUAL ARRANGEMENTS



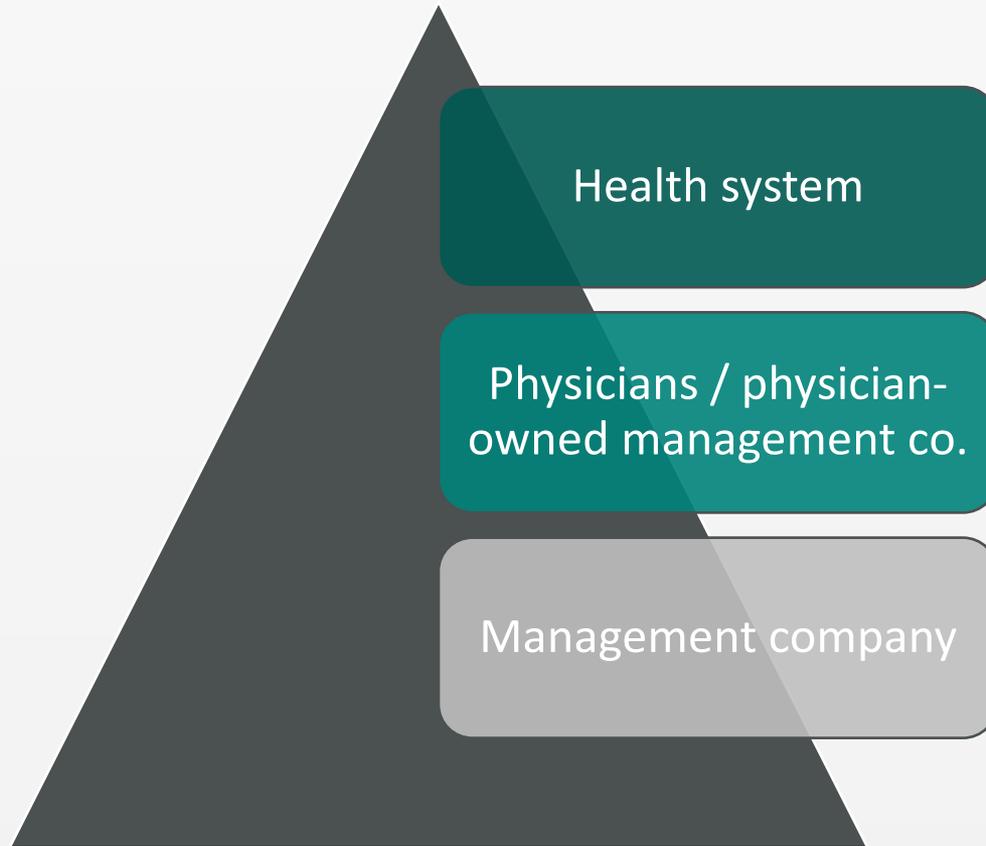
Why should contractual arrangements be considered?



POST-TRANSACTION CONTRACTUAL ARRANGEMENTS



Services Providers



POST-TRANSACTION CONTRACTUAL ARRANGEMENTS



Common Post-Transaction Contractual Arrangements



POST-TRANSACTION CONTRACTUAL ARRANGEMENTS



Services by Provider

Health system

- Management (typical, non-clinical)
- Billing and collection
- Managed care contracting (only)
- Leased staff
- Tradename / brand

Physician group

- Management (typical, non-clinical)
- Billing and collection
- Leased staff
- Physician services
- Clinical management

National management company

- Management (typical, non-clinical)
- Billing and collection
- Leased staff

POST-TRANSACTION CONTRACTUAL ARRANGEMENTS

Tradename / Brand License

Who provides the tradename / brand?

- Typically health system or hospital

What does the license include?

- Tradename
- Trademarks
- Collectively referred to as the “brand”

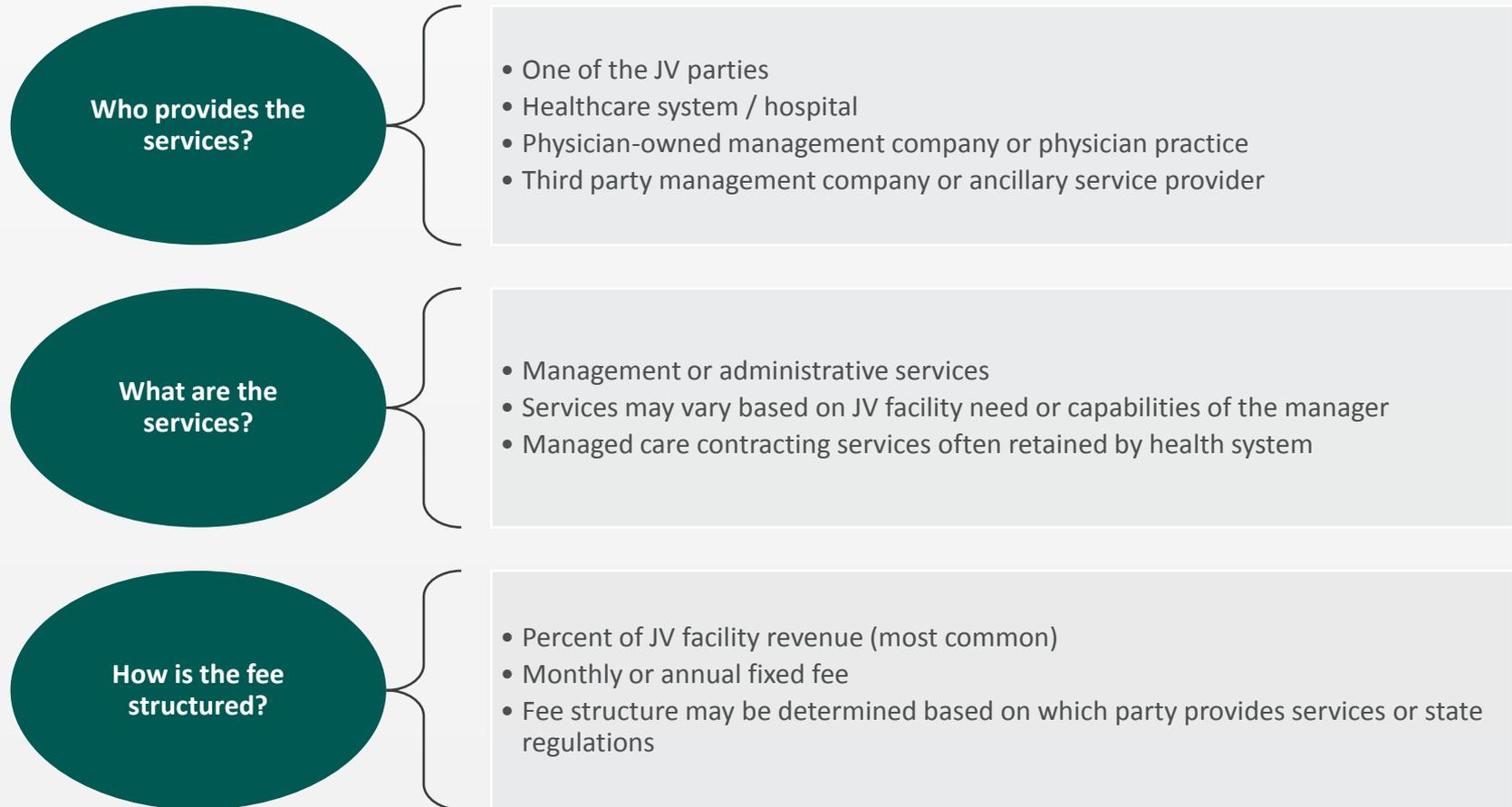
How is the fee structured?

- Royalty or license fee as a percent of JV revenue (most common)
- Monthly or annual fixed fee

POST-TRANSACTION CONTRACTUAL ARRANGEMENTS



Management / Administrative Services



POST-TRANSACTION CONTRACTUAL ARRANGEMENTS



Billing and Collection Services

Who provides the services?

- One of the JV parties
- Healthcare system / hospital
- Physician-owned billing and collection company or physician practice
- Third party management/billing company or ancillary service provider

What are the services?

- Billing and collection services
- Little variation in services provided in the market

How is the fee structured?

- Percent of JV facility revenue (most common)
- Monthly or annual fixed fee
- Fixed fee per bill
- Fee structure may be determined based on which party provides services

POST-TRANSACTION CONTRACTUAL ARRANGEMENTS



Employee Lease



POST-TRANSACTION CONTRACTUAL ARRANGEMENTS



Physician Compensation

What are the services?

- Professional / clinical services (i.e. professional reads)
- Medical directorship
- Other physician-required administrative services
- Pay-for-performance

How is the compensation structured?

- Depends on the services provided
- Caution against fees stated as a percent of revenue

Valuation Considerations for Post-Transaction Contractual Arrangements

VALUATION CONSIDERATIONS FOR POST-TRANSACTION CONTRACTUAL ARRANGEMENTS

Three chevron-shaped boxes pointing to the right, arranged horizontally. The first is dark teal, the second is a lighter teal, and the third is grey. Each contains text representing a valuation approach.

Cost
Approach

Market
Approach

Income
Approach

VALUATION CONSIDERATIONS FOR POST-TRANSACTION CONTRACTUAL ARRANGEMENTS

Trade Name / Brand License

Income Approach / with and without analysis

Market Approach / market data for similar transactions

Cost Approach / cost to recreate intangible asset

VALUATION CONSIDERATIONS FOR POST-TRANSACTION CONTRACTUAL ARRANGEMENTS

Management / Administrative / Billing & Collection Services

Cost to provide services

Reasonable rate of return on services

Market range for similar services

Check for comparability of services to market

Consider other value drivers in the market

Who provides the managed care contracting?

VALUATION CONSIDERATIONS FOR POST-TRANSACTION CONTRACTUAL ARRANGEMENTS

Employee Staff Lease

Cost of salary and benefits

Reasonableness of salaries

Reasonable rate of return on services - consider key risk factors that drive value of the mark-up to leased staff costs

VALUATION CONSIDERATIONS FOR POST-TRANSACTION CONTRACTUAL ARRANGEMENTS

Physician Compensation

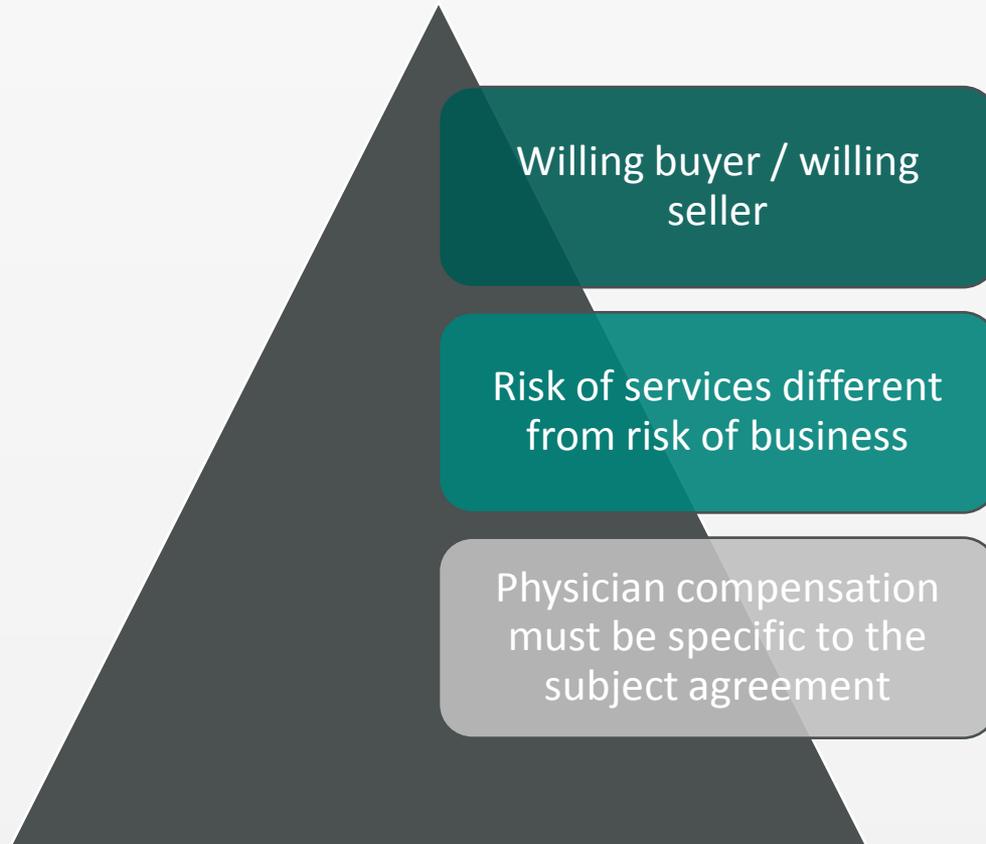
Value drivers will vary depending on services provided

Consider specialty, services provided, and relevant market data

Do the services require a physician?

VALUATION CONSIDERATIONS FOR POST-TRANSACTION CONTRACTUAL ARRANGEMENTS

Valuation Cautions



Compliance Considerations for Post-Transaction Contractual Arrangements

COMPLIANCE CONSIDERATIONS FOR POST-TRANSACTION CONTRACTUAL ARRANGEMENTS



Understand Risk

Services
Provider

Health system

Physicians / physician-
owned management co.

National management
company

COMPLIANCE CONSIDERATIONS FOR POST-TRANSACTION CONTRACTUAL ARRANGEMENTS

Non-Physician Services Arrangements

Are the services required for the operation of the facility and/or to benefit the facility's patients?

Check for overlap of services

Services are actually provided and consistent with agreement terms

Fees are set in advance at FMV

COMPLIANCE CONSIDERATIONS FOR POST-TRANSACTION CONTRACTUAL ARRANGEMENTS

Physician Services Arrangements

Are the services required for the operation of the facility and/or to benefit the facility's patients?

Log hours if hourly-based services

Physicians cannot bill and collect for patient/procedural work while performing administrative services

Physician required to perform the services

Check for overlap of services

Services are actually provided and consistent with agreement terms

Physician compensation must be set in advance at FMV

Case Study: Home Health & Hospice JV

Case Study: Inpatient Rehabilitation Hospital JV

Case Study: Urgent Care JV

● ● ● BIOGRAPHIES



Colin McDermott, CFA, CPA/ABV is a managing director with VMG Health. He specializes in providing financial, valuation, and transaction advisory services to clients in the health care industry. His clients have included hospitals, hospital systems, health plans, ambulatory surgery centers, imaging centers, laboratories, physician groups, and other healthcare entities.

Mr. McDermott received a Bachelor of Business Administration in Accounting and a Master of Science in Finance from Texas A&M University. Mr. McDermott is a licensed Certified Public Accountant (CPA) in the state of Texas and holds the Chartered Financial Analyst (CFA) designation.

● ● ● BIOGRAPHIES



Alexandra Higgins is a director in the Professional Services Agreement Division of VMG Health. She specializes in the valuation of a wide variety of agreements and agreement structures, including: management fees, billing and collection fees, physician and non-physician executive compensation, co-management compensation, and shared savings arrangements.

Ms. Higgins graduated Magna Cum Laude from Texas Christian University with a Bachelor of Science in International Economics. She has recently been published in *HFM Magazine*, *Health Care Compliance Today*, *Becker's Hospital Review*, and *ImagingBiz* and has recently presented at national healthcare conferences including AICPA Healthcare Industry Conference, HFMA National Payment Innovation Summit, and Becker's ASC Annual Meeting.

Thank You

