

DETERMINING THE MARKET RENT OF A MEDICAL FACILITY ON A SPECIFIC EXAMPLE

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Abstract: The aim of this paper is to determine the value of market rent and to assess the differences in valuation of the healthcare business just mentioned. For the purposes of this paper, a gynecological clinic is used as a medical facility, using the complete documentation of the facility. The property method is used for valuation purposes. However, given that the method chosen does not take sufficient account of the benefits of the reputation of the gynecological clinic, goodwill, the intangible asset component, is valued at the interest rate level of the average profit corrected for past periods. Corrected earnings are expressed for all available periods. Thus, the monthly rent is fixed, the value of the goodwill is determined separately. A generally applicable methodology for the valuation of intangible assets for any medical facility is presented.

Keywords: company valuation, goodwill, market rent, medical facility

1 Introduction

Healthcare facilities can be considered a so-called specific economy. It is an enterprise that differs, for example, from an industrial, construction or transport enterprise. In addition to the legal form of a trading company, it can also be operated by a natural person doing business on a non-trade license basis. Medicine is often not regarded as a profession but rather as a mission. This is logically related to the specific behavior of the healthcare provider and the customers, patients. Equally specific is the determination of the value of such an enterprise. Its tangible assets are not large (Shalowitz, 2017). However, the business is built on patient confidence. The key asset will be intangible assets in the form of goodwill, medical facilities, physicians (Hourd and Williams, 2008).

A general prerequisite for determining the value of an evaluated ambulance is the assessment of the assumption of continued continuity of practice. Krejčíř and Bradáč (2004) states that it is in essence that, in the current setting of the business model, the practice is in the long term able to meet its obligations. In the long run, the practice must be able not only to maintain solvency but also to cover its opportunity costs for its operator, which is the cost of missed opportunities that the operator sacrifices by undertaking ambulance operations instead of other actions.

If the asset is actively and regularly traded, there are no more serious problems determining its value. Current transactions provide a clear indication of its value (Machová and Rowland, 2018). However, if there is no stabilized market where the asset is traded on a regular basis, the following methodological procedures or a combination thereof are used to determine the value estimate (Machová and Vrbka, 2018). It is always necessary to assess the applicability of the relevant method depending on the purpose of the valuation and the nature of the subject being assessed (Vochozka et al., 2016).

Due to the underdeveloped market in leases of medical facilities with a similar property structure, it is not possible to use the market comparison method.

In order to assess the amount of rent for the gynecological clinic and its equipment it is possible to use essentially two basic methods: economic rent based on yield methods and economic rent on the basis of an estimate of the value of individual property components of the subject of the lease relationship.

1.1 Economic rent based on revenue methods

Using this method, future cash flows from the operation of a gynecological clinic are estimated. Subsequently, these cash flows are translated to their present value and the reasonable

rates of earnings of the lessor are set in the form of interest rates. The rate is derived using the Capital Asset Pricing Model (CAPM), i.e. the risk free value (i.e. interest on 10-year government bonds) and the proportional rate of systematic risk and risk premium (Křulický and Horák, 2019). Alternatively, an analogy method can be used in the knowledge of a similar situation. This method estimates the potential of the whole subject of the lease relationship (Klieštk et al., 2014).

The value of the gynecological clinic does not depend on the number of cards in the card index but on the so-called free cash flow that results from the activity of the ambulance to its owner or operator. This variable has to be calculated on the basis of a professional financial plan, its volatility, riskiness and, last but not least, the timewill of goodwill (Rowland and Vrbka, 2016) must be analysed.

1.2 Economic rent on the basis of an estimate of the value of the individual property components of the subject of the rental relationship

This method estimates the approximate value of individual asset components of the leased property, its useful life and its ability to perform its function in the future (Kislingerová, 1999). Even when applying this property method, it is necessary to set a reasonable rate of earnings of the lessor in the form of an interest rate. The rate is derived using the Capital Asset Pricing Model (CAPM), i.e. the risk free value (i.e. interest on 10-year government bonds) and the proportional rate of systematic risk and risk premium. Alternatively, an analogy method can be used in the knowledge of a similar situation (Mařík, 2011).

The aim of this paper is to determine the value of market rent and to assess the differences in the valuation of a healthcare company.

2 Data and methods

2.1 Data

Within this paper a health facility will be evaluated, specifically a gynecological clinic. It is an enterprise of a natural person doing business on a non-business license in Sokolov in the Czech Republic. The decisive date for the award is December 31, 2015.

The gynecological clinic equipment will be evaluated according to Table 1.

Tab. 1. Gymnastic outpatient equipment

1.	Ultrasound Philips HD7 L CORE, VASCULAR SW APPLICATION, GENERAL IMAGING APPLICATION, OB/GYN APPLICATION, C5-2 TRANSDUCER, L12-3 TRANSDUCER, C8-4V TRANSDUCER, CARTRIDGE CONNECTOR, BLANKING PANEL, CZECH MANUAL, B/W PRINTER
2.	Colposcope BTL-KAPS model KP 3000
3.	Adjustable examination bed BTL incl. accessories
4.	Examination gynecological chair GRACIE + tool table
5.	PC setup + printer
6.	Furniture in the surgery

Source: Authors.

The vehicle fleet will also be listed in Table 2.

Tab. 2. Vehicle fleet

Car	Subaru LEGACY OUTBACK 2.5 I	Subaru OUTBACK 3.6 R
Registration number	XXXX	XXXX

Date of first registration	2008-08-01	2012-07-19
Technical license number	XXXX	XXXX
Vehicle ID number	XXXX	XXXX
Engine volume	2,457 cm ³	3,630 cm ³
Mileage	150,800	90,700
Purchase price incl. VAT	799,900 CZK	1,098,011 CZK

Source: Authors.

Part of the value of the healthcare facility will be the value of its goodwill.

The following documents will be used for the valuation:

1. Background material from tax records:

- Accounting by type of pre-contract 2015 (1st-11th month).
- Income and Expense Report for 2015 as of December 4, 2015.
- Accounting by type of pre-contract 2014.
- Accounting by type of pre-contract 2013.
- Accounting by type of pre-contract 2012.
- Accounting by type of pre-contract 2011.

2. A copy of the tax return from the income tax of a natural person:

- For the taxable period of 2014,
- For the taxable period of 2013,
- For the taxable period of 2012.

3. A list of movable items that are subject to valuation.

4. Copy of the vehicle registration certificate Part II:

- No. UC 567987 of vehicle Subaru LEGACY OUTBACK,
- No. UE 807791 of vehicle SUBARU OUTBACK.

5. Tax documents - invoices:

- Tax document – Colposcope acquisition - BTL-KAPS model KP 3000.
- Tax document – purchase of a tool table.
- Tax document – acquisition of the examination gynecological chair GRACIE.
- Tax document – acquisition of a PC setup.
- Tax document – acquisition of a printer.
- Tax document – acquisition of an examination chair - BTL incl. accessories.

6. Price offer for GRACIE examination gynecological chair from 24/11/2015.

7. Purchase contract - purchase of "HD7 L CORE Ultrasound Philips" incl. accessories.

8. Contract for the sale of gynecological ambulance equipment from "2011-02-30".

9. Photographic documentation of gynecological ambulances and passenger cars.

10. Documents of an expert body from an on-site investigation.

2.2 Methodology

Due to the fact that the hospital facility itself can not generate income and therefore profits without a qualified physician, it is more appropriate to choose property for valuation of the rental method. In this case, the procedure for tangible assets is as follows (Krabec, 2015):

1. List of individual property items of the subject of the lease including the determination of the acquisition cost of the property - the value of the curtailment from the submitted accounting documents.
2. Assessment of the period of use of individual components of tangible assets.
3. Assessment of the lifetime, or estimation of the time of possible further use of individual components of tangible assets.
4. Calculation of actual value of tangible assets – ambulance equipment, which is given by:

$$SHpv = \frac{Pc * (Dz - Sm)}{Dz} \quad (1)$$

where:

- SH_{pv} actual current value of equipment in CZK,
P_c purchase cost of the asset in CZK,
D_z lifetime of property in years,
S_m the age of the property on the valuation date in years.

5. Calculation of the actual present value of the tangible assets – passenger cars, that is, the vehicle's time value, is given by:

$$SHv = Pcv * \left(1 - \frac{ZAD+ZAP}{2}\right) \quad (2)$$

where:

- SH_v actual current value of the vehicle in CZK,
P_{cv} purchase price in CZK,
ZAD amortization for the period of operation according to expert standard I / 2005 in %,
ZAP amortization for the number of kilometers according to expert standard I / 2005 in %.

6. Calculation of average wear and tear of tangible assets per year according to the relation:

$$OHM = \frac{SHpv (SHv)}{t} \quad (3)$$

where:

- OHM wear of tangible assets in CZK,
SH_{pv} (SH_v) the current value of the equipment (alternatively the present value of the vehicle in CZK),
t remaining lifetime of the property in years.

7. Calculation of a reasonable profit in the value of rent in the form of an interest rate according to the formula:

$$\bar{R}_i = r_f + \beta * r_{pod} \quad (4)$$

where:

- (R_i)⁻ represents the alternative cost of equity or the proportion of reasonable profit in the rental price in %,
r_f the value of interest on 10-year government bonds (taken from the pages of the Czech National Bank as the value of the German government bond) in % (Czech National Bank, 2019),
β systematic risk (taken from prof. Damodaran: <http://pages.stern.nyu.edu/~adamodar/>),
r_{pod} risk premium for business risk (taken from the Ministry of Industry and Trade of the Czech Republic, 2015) in %.

8. The calculation of the annual rent for each item of tangible assets is the product of the average wear and tear of tangible assets per year and the alternative cost of equity increased by one according to the relationship:

$$RN = OHN * (1 + R_i) \quad (5)$$

where:

- RN annual rent in CZK,
OHM wear of tangible assets in CZK,

$(R_i)^{-}$ represents the alternative cost of equity or the proportion of reasonable profit in the rental price in %.

9. Calculation of monthly rent for tangible property according to the relation:

$$MN = \frac{RN}{12} \quad (6)$$

where:

MN monthly rent in CZK,
RN annual rent in CZK.

Given that the method chosen does not take sufficient account of the benefits deriving from the reputation of the gynecological clinic in place, goodwill, the intangible asset component, will be valued at the interest rate level on the average of the corrected profit for the past periods. For the purposes of determining the annual and then the monthly rental rates, it is assumed that the lessor waives the economic income resulting from the practice and expects the asset to be redeemed. In this case, the rate of interest derived from the CAPM method will be used.

Corrected profit is generally the basic measure of the success of the business strategy of the gynecological clinic and is calculated according to the following formula:

$$KZ = OP - OV - IIN - ON \quad (7)$$

where:

KZ corrected profit,
OP operating income,
OV operating expenses,
IIN implicit investment intensity,
ON opportunity expenses.

All income derived directly from the performance of a gynecological clinic that is valued should be included in operating income, and it is highly likely that it will be achievable for any successor (Brabec, 2015). For the purposes of this appraisal, the following items are included in operating income (abbreviated as "Accounting by Type of Pre-Contingency"):

- 602000P,
- 602001P,
- 602020,
- 602030P.

Operating expenses include only expenses that are directly related to the operation of the ambulance and in some cases it is necessary to correct them at the usual time and place. For the purposes of this appraisal, the following items are included in operating expenditure (abbreviated as "Posting by Type of Pre-Contingency"):

- 504010V,
- 501000 / 501099V,
- 501001V,
- 501010V,
- 501030V,
- 502000,
- 511000 / 511011,
- 518010V,
- 342000V (increased by OSSZ, VZP payments),
- 521000V (increased by OSSZ, VZP payments),
- 518030V,
- 538000,
- 548000,
- 548010,
- 568000V.

Operating expenses are partly linked to tax depreciation, which, unfortunately, does not reflect the actual wear and tear of the property concerned and therefore their amount is not considered in operating expenditure. Instead, imputed implicit investment

intensity will be expressed, which estimates the implicit amount that will be required to periodically spend periodically on maintenance of the office equipment.

Opportunity expenses will be considered at a rate corresponding to the usual wage of a doctor, taking into account the shortened ordination period of the gynecological clinic within 24 hours / week, which show the average monthly wages of employees of private health care facilities; data for 2014 and 2015 are not available and will therefore be considered as a salary in 2013 (IHIS 2011; IHIS, 2012, IHIS, 2013).

The office in question began operations in 2011. Corrected profits will be expressed for all available periods.

3 Results

3.1 Determination of the value of market rentals for tangible assets

The property components forming the subject of the rental relationship, including the cost of the property and the estimated time of use of the components, are given in Table 3. This table also shows the actual present value of the ambulance equipment and the actual current value of the passenger cars.

In determining the actual present value of tangible fixed assets – passenger cars, amortization for vehicle operating time (ZAD) and amortization for the number of kilometers travelled (ZAP) was determined using the I / 2005 Expert Standard as follows:

- Subaru LEGACY OUTBACK 2.5 I,
ZAD – 70.00%,
ZAP – 59.96%.
- Subaru OUTBACK 3.6 R,
ZAD – 50.00%.
ZAP – 40.13%.

For the purpose of calculating a reasonable profit in the value of rent, the r_f of 0.5% was considered, coefficient β was 1.26 and r_{pod} was 8.54%.

Tab. 3. Calculation of monthly rent for tangible property

Item	Date of acquisition	Purchase price incl. VAT (Pc)	Age of property in years (Sm)	End of life of assets in years (l)	Actual asset usage time in total	Actual Present Value of Assets (SH _{pr} / SH _l)	Value of wear and tear for one year of use (OHM)	Annual rent (RN)	Monthly rent (MN)
Philips ultrasound	2010-11-01	215,446 CZK	5.17	2.83	8	76,214 CZK	26,931 CZK	29,963 CZK	2,497 CZK
Colposcope BTL-KAPS model KP 3000	2011-06-28	122,799 CZK	4.51	15.49	20	95,107 CZK	6,140 CZK	6,831 CZK	569 CZK
BTL Adjustable Examination Bed with Accessories	2010-11-04	24,719 CZK	5.16	14.84	20	18,341 CZK	1,236 CZK	1,375 CZK	115 CZK
Examination gynecological chair GRACIE + tool table	2015-12-15	73,810 CZK	0.04	19.96	20	73,662 CZK	3,691 CZK	4,106 CZK	342 CZK
PC setup + printer	2011-03-31	21,709 CZK	4.76	5.24	20	11,376 CZK	2,171 CZK	2,415 CZK	201 CZK
Passenger vehicle Subaru LEGACY OUTBACK 2.5 I; SPZ 2K5 3777	2008-08-01	799,900 CZK	7.42	2.58	10	280,109 CZK	108,569 CZK	120,792 CZK	10,066 CZK
Passenger vehicle Subaru OUTBACK 3.6 R; SPZ 3K2 6111	2008-08-01	1,098,011 CZK	3.45	6.55	10	603,187 CZK	92,090 CZK	102,457 CZK	8,538 CZK
Furniture in surgery	2010-03-01	50,000 CZK	5.84	14.16	20	35,400 CZK	2,500 CZK	2,781 CZK	232 CZK
TOTAL FOR MOVABLE PROPERTY								270,720 CZK	22,560 CZK

Source: Authors

3.2 Determining the value of market rentals for intangible assets

As already stated, the market value of the rental for intangible assets was determined taking into account the adjusted profit achieved in each period. Due to the fact that the gynecological clinic has a relatively short history of its operation, one value of the adjusted profit was set as the arithmetic mean of the adjusted profits achieved in 2013, 2014 and 2015. The results of the 2011 and 2012 financial years were negatively affected by the beginning practice and were therefore not calculated.

Corrected earnings were determined for operating income and expenses. An important element for determining the adjusted earnings is implied implicit investment intensity. For the purpose of determining this quantity, a market survey was carried out in order to determine the usual purchase price of the office equipment and passenger cars, taking into account the usual life of the individual components.

Tab. 4. Imputed investment intensity

Asset item	Amount of investment	Life expectancy in years	Investment demand / month
Ultrasound Philips HD7 L CORE	790,000 CZK	15	4,389 CZK
Colposcope BTL –KAPS model KP 3000	125,000 CZK	20	521 CZK
Examination bed	25,000 CZK	20	104 CZK
Examination gynecological chair GRACIE	255,000 CZK	20	1,063 CZK
Surgery furniture	50,000 CZK	20	208 CZK
Passenger vehicle Subaru LEGACY	800,000 CZK	15	4,444 CZK
Passenger vehicle Subaru OUTBACK	1,100,000 CZK	15	6,111 CZK
TOTAL	3,095,000 CZK		16,840 CZK
Imputed investment cost of the ambulance per calendar year			202,083 CZK

Source: Authors

The figures in Table 4 do not imply the necessary investments in the gynecological clinic, but it is a calculation of the real expected cash flow.

Another, no less important item of the adjusted earnings calculation is the opportunity costs that will be considered at the rate corresponding to the usual wage of the doctor. With regard to the office hours of the existing ambulance, the wages of the doctor will be reduced by the ratio of 24/40. For the calculation of the adjusted profit, the average monthly salary of a doctor in private health care facilities of 58,153 CZK (IHIS, 2013) which was increased by the employer's statutory payments for employees (health insurance and social security contributions). Total annual cost of opportunity is 561,060 CZK (calculation procedure: $(58,153 * 12 * 1.34) * 24/40$).

Corrected earnings for individual years were calculated, with operational revenues and expenditures from the relevant calendar year (overview included in the appendix), imputed investment cost and opportunity costs being considered for the same period for all periods.

For the next calculation, the average adjusted earnings for 2013-2015, i.e. 587,317 CZK, were used.

The annual rent from intangible assets (RN_{nehm}) corresponds to the alternative cost of equity, respectively. the rate of reasonable profit from the average corrected profit:

$$RN_{nehm} = (0.5\% + 1.26 + 8.53761665690777\%) * 587,317 \text{ CZK} \quad (8)$$

$$RN_{nehm} \cong 66,120 \text{ CZK}$$

Monthly rental from intangible assets (MN_{nehm}) then corresponds to one twelfth of RN_{nehm} .

$$MN_{nehm} = \frac{66,120 \text{ CZK}}{12} \quad (9)$$

$$MN_{nehm} = 5,510 \text{ CZK}$$

3.3 Overall recapitulation

The total recapitulation of the valuation and, subsequently, the rental rates are given in Table 5.

Tab. 5. Table 5 Recapitulation of results

Item	Amount
Annual rent for tangible assets	270,720 CZK incl. VAT
Annual rent for intangible assets	66,120 CZK incl. VAT
Annual rental total after rounding up	336,840 CZK incl. VAT
Monthly rent for tangible assets	22,560 CZK incl. VAT
Monthly rent for intangible assets	5,510 CZK incl. VAT
Monthly rental total after rounding up	28,070 CZK incl. VAT

Source: Authors

The value of the market rent of a private gynecological clinic is determined with respect to the current material and technical background, to 28,070 CZK including value added tax. The value was determined with the assumption that the lessee will bear the costs of securing the normal operation of individual items of tangible property.

4 Conclusion

The aim of the paper was to determine the value of market rent and to assess differences in the valuation of a healthcare company.

The goal of the paper was met.

The monthly rent was determined on the basis of the valuation of the tangible and intangible assets of a person doing business under a non-trade license in the amount of 28,070 CZK. The value of goodwill is 5,510 CZK per month.

The greatest benefit of the paper can without doubt be considered the methodology of leading the valuation of intangible assets, namely goodwill. The methodology is applicable as standard for any medical device. The advantage is the possibility to standardize the process and not only to appreciate this asset component, but also the possibility to compare individual healthcare facilities (and probably regardless of their specialization). On the other hand, we need to realize that the value of goodwill was set at 31 December 2015. It is thus a question of whether the value of goodwill will remain the same for an indefinite period of time or will change over time. The question is whether it will grow or the value will fall. At the same time, it is necessary to say whether the future value of goodwill will always be based on its present value. However, this is the topic for any further follow-up.

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Annex

Tab. 6: Overview of Operating Income and Expenses

	Abbrev.	Name	yr. 2013	yr. 2014	yr. 2015
Operating income	602000	Sale of products and services	2,453,138	2,468,503	2,157,701
	602001P	Medical services		36,000	7,527
	602020	Regulatory fees	27,960		
	602030P	sale of services-others		18,000	21,818
Operating expenses	504010V	Goods	39,000		
	501001V	Medical supplies		155,088	167,411
	501030V	Minor assets		75,094	70,450
	342000V	Advances for employees incl. levies	36,019	41,728	41,728
	521000V	Employee wages incl. levies	436,840	321,600	321,600
	501000	Other overhead costs	340,199	22,843	15,801
	501010	Office supplies	10,041	9,869	5,877
	502000	Power consumption	6,595	6,476	7,440
	511011	repairs, small TZ DM		65,799	47,007
	511000	Repairs	97,124		
	518010	Phone fees	31,536	53,249	56,997
	518030	Rent	140,096	148,239	134,265
	538000	Taxes and fees	937	9,400	10,255
	538000	Insurance	69,406	85,999	47,050
	548010	Legal employee insurance	957	948	1,034
	568000V	Bank fees	2,349	2,351	2,569
Total operating income in CZK			2,481,098	2,522,503	2,187,046
Total operating expenses in CZK			1,211,100	998,682	929,484
Opportunity expenses in CZK			561,060	561,060	561,060
Imputed implicit investment intensity in CZK			202,083	202,083	202,083
Corrected profit in individual years in CZK			506,855	760,678	494,419

Source: Authors