CASE MODEL

DR. JOSEPH SPINE — OSTEOPATHIC PHYSICIAN

Dr. Joseph Spine, an osteopathic physician, wants to install a new large piece of equipment in place of several smaller ones in his clinic. He will need to hire a therapist to administer the larger equipment and estimates that incremental annual revenues and expenses associated with the equipment would be as follows:

Revenues	$10,000
Less Variable Expenses	3,000
Contribution Margin	7,000
Less Fixed Expenses	
Insurance	900
Salaries	2,600
Depreciation	1,500
	5,000
Net Income	**$2,000**

Parts for the equipment would cost $15,000 and have a 10-year life. The old machines could now be sold for a $1,000 salvage value. Dr. Spine requires a payback of 5 years or less on all investments.

SOLUTION:

Net Income (above)	$2,000
Add: Non-cash deduction Depreciation	1,500
New Annual Cash Flow	3,500
Investment in the New Equipment	15,000
Deduct: Salvage value old machines	1,000
Investment Required	14,000

Payback Period = $140,000 / $35,000 = 4.0 Years

KEY ISSUES:

1) Was Dr. Spine correct or not with regard to:
   - Revenues?
   - Fixed and variable expenses?
   - Contribution margins?
   - Insurance?
   - Salaries?
   - Depreciation?

Using the framework reflected in this chapter, also consider what changes the osteopathic clinic might implement to ensure that it regularly makes good decisions on such issues as medical equipment payback analysis.