Using Equity Funds to Achieve Health Care Delivery and Financial Goals for Physicians and Medical Practices

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Presented by | Randy Schultz, Partner, Lathrop GPM LLP

INTRODUCTION

Now more than ever physician groups and other health care providers are looking for ways to work with equity funds as an opportunity for future success and to avoid what they perceive as the unwelcome consequences of selling out to a hospital or another large medical provider.

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The purpose of this presentation is to introduce attorneys who are unfamiliar with these emerging strategies to the basics of engaging private equity to enhance or to acquire a medical practice. This power point presentation and the following comments are intended to introduce you to the concept of working with equity funds and using equity markets to help clients achieve success in the business and practice of medicine.

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Hospitals, their "foundation models", and national entities are acquiring physician practices at an extraordinary rate. Unfortunately, physicians who sell to these organizations are often left with a career that means working ten or more hour days for a fixed wage. Jeff Moody, MD, my co presenter, will address the physician thought processes about the future of a medical practice and how equity funding is impacting that process.

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The question is how do physicians want to practice in the future? Many physicians believe they can either push the clock as an employee of a hospital or other large entity or take a risk on the opportunity to practice medicine through a new delivery model. Fortunately, physicians are learning that private equity can help them control their destiny and make money through the "enterprise value" of their practice in addition to earning technical and professional fees.

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Equity funds are helping medical practices by handling the practices' business affairs and promising compliance with complex regulatory requirements with the goal of leaving doctors to practice medicine. Equity funds also claim they can introduce work flow and cost efficiencies and leverage economies of scale in the process while paying practices and their related entities an enticing multiple of profits.

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Physicians are increasingly urged to add value to the professional services they perform by leveraging information technology and offering both new and significantly improved ancillary (technical) services. As the emphasis on early detection, preventative screenings and targeted population health continues to grow, the importance and volume of effective diagnostic testing will likely continue to grow. The focus on reducing health care costs and the significant reduction to downstream costs resulting from early detection create attractive opportunities for growth in ancillary services.

The introduction of sophisticated diagnostic tools and genetic tests that are further unlocking doors to greater discoveries, enable providers to know more about diseases than ever before. While positive for both patients and physicians, the growth in biomedical knowledge is adding a layer of complexity and cost for medical professionals.

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As employers desire to contract with health care providers, as employers perform their own analysis of strategies for early detection of employee health issues to reduce employee health care costs and personalized medicine, and as direct to consumer diagnostic testing opportunities continue to grow, medical practices will have new avenues (revenue opportunities) in which to provide services.

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Equity funds are having success when investing in multiple types of physician sub specialty groups. As important as maximizing profits from operations, is the benefit to the Equity fund of re-selling to even bigger equity funds. Provider access to Equity funds and different strategies for structuring arrangements with Equity funds are growing rapidly.

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Why not sell to hospitals? The hospitals are not able to pay as much for medical practices as equity funds for fear of violating the Stark and federal anti kickback statutes. Payments deemed in excess of fair market value could be deemed inducements for referrals resulting in exclusion from the Medicare program.

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Medical practices must evaluate new opportunities. The key is to select a business partner that can give your business the potential for sustainability and upside growth.

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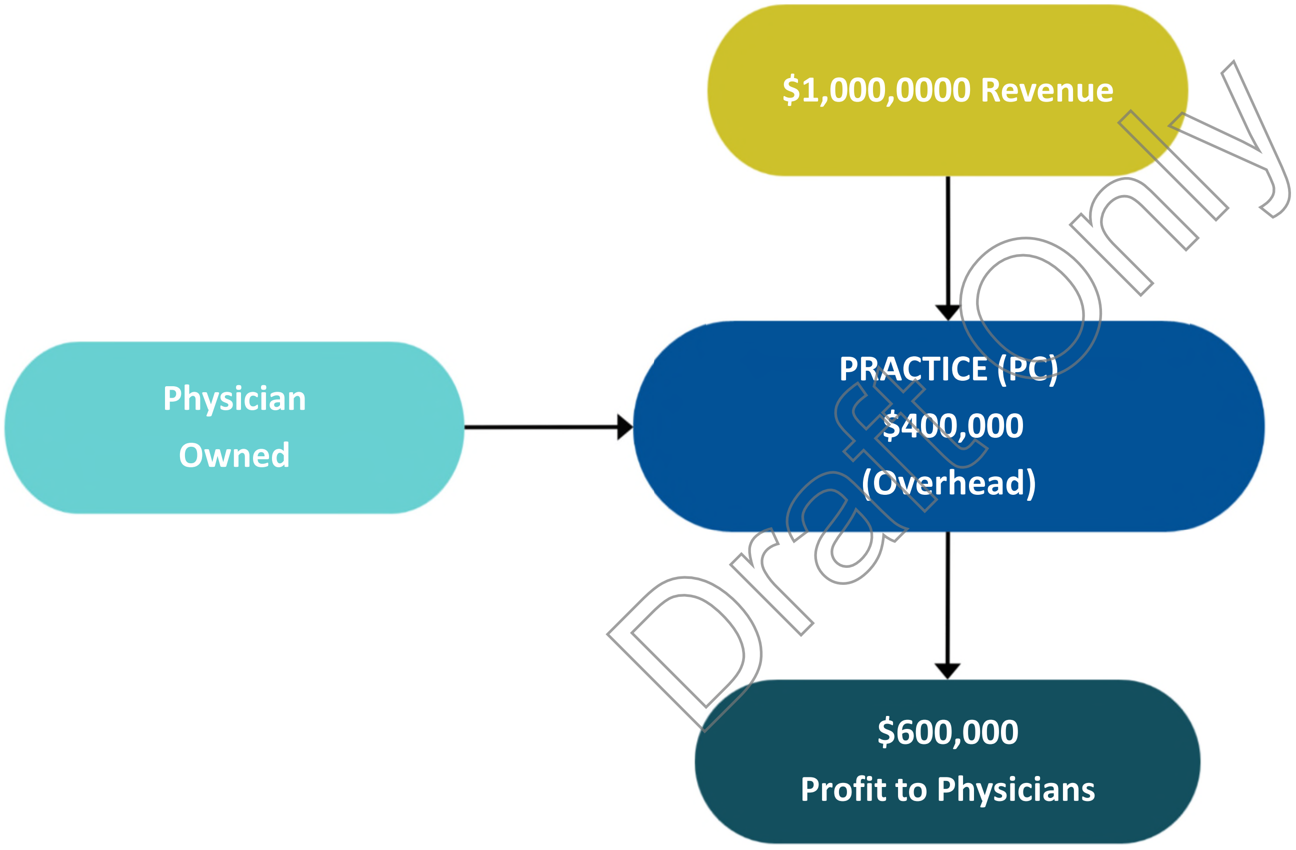
HOW IT WORKS

Basic Approach



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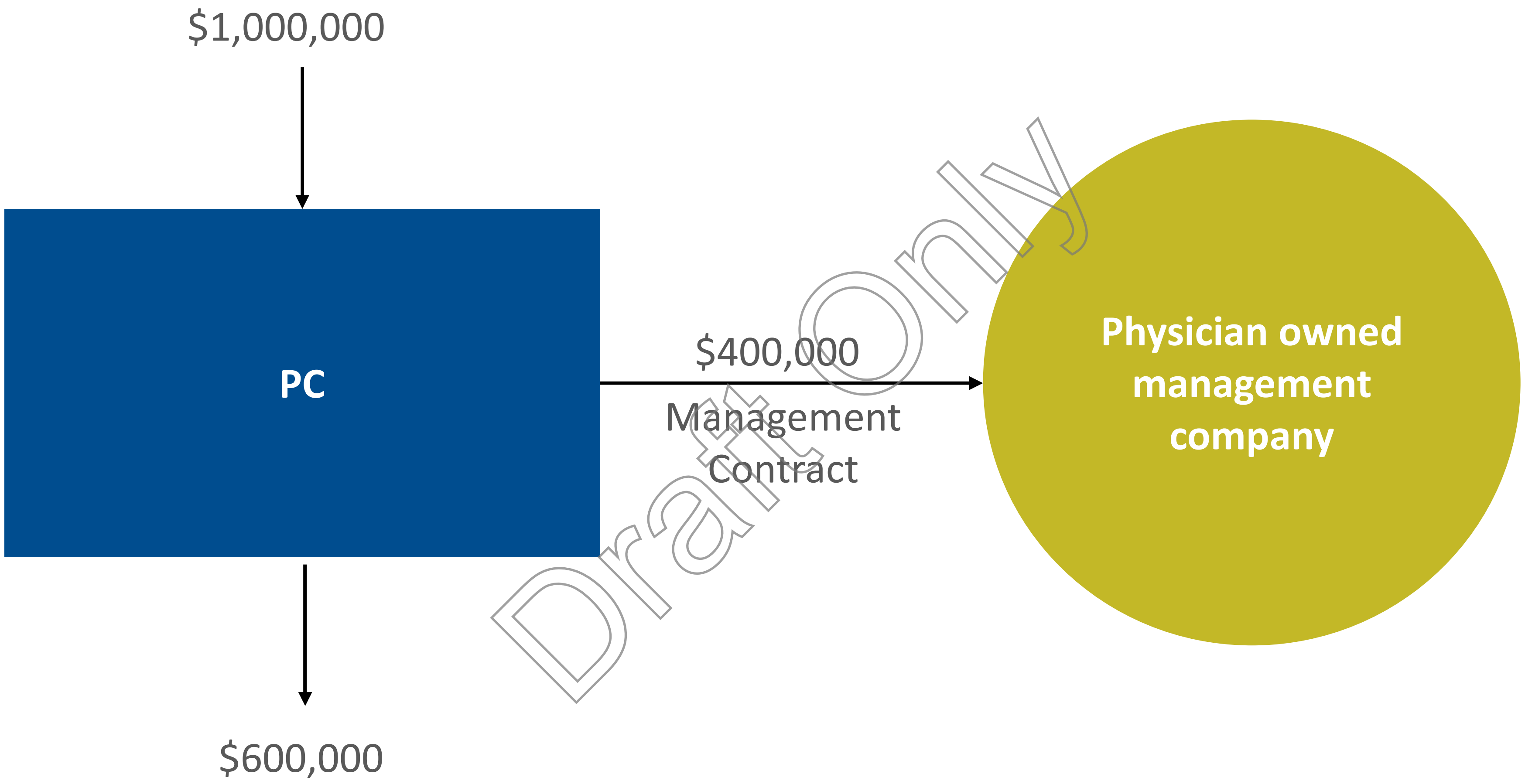
STEP 2



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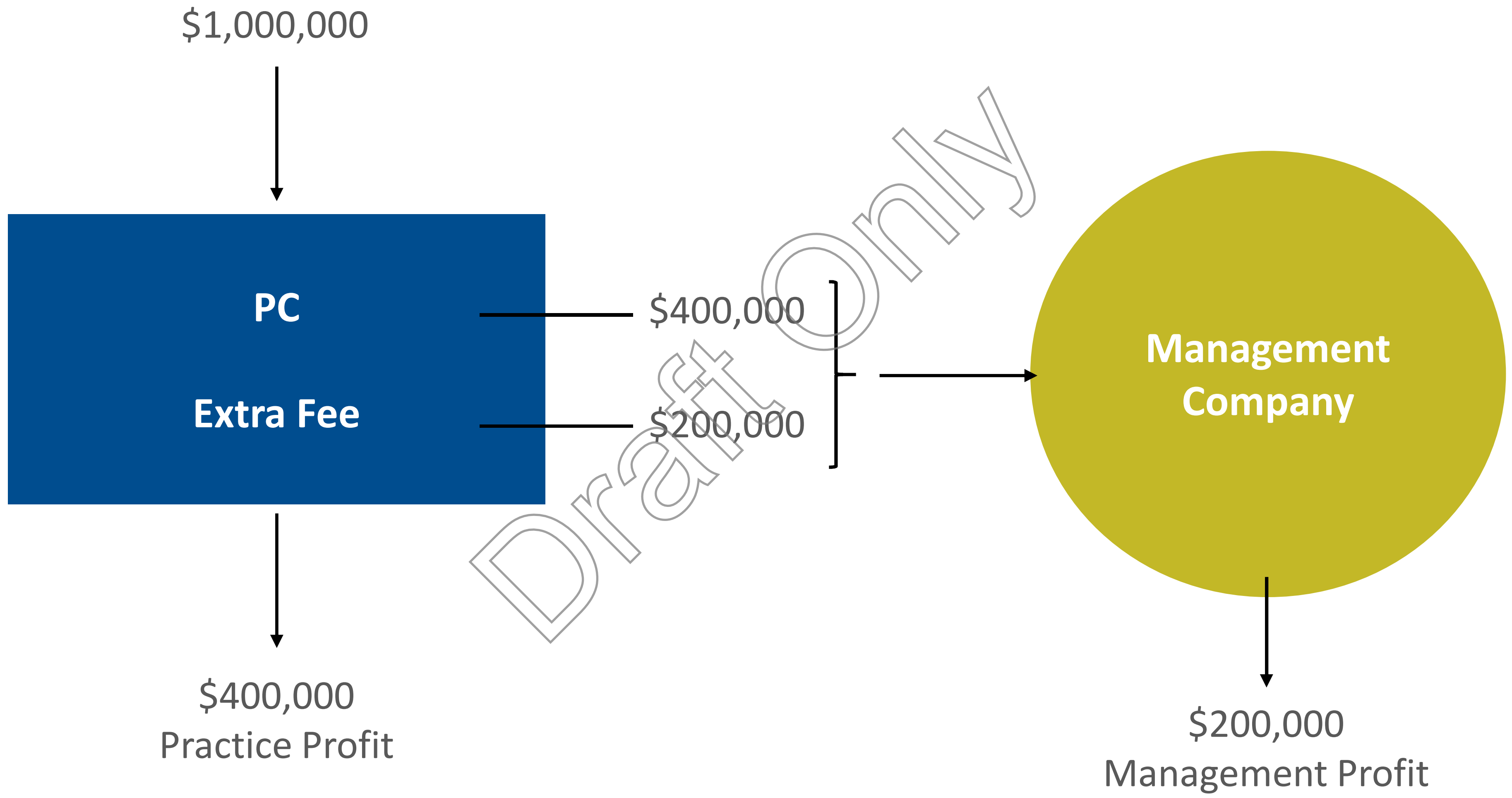
STEP 3



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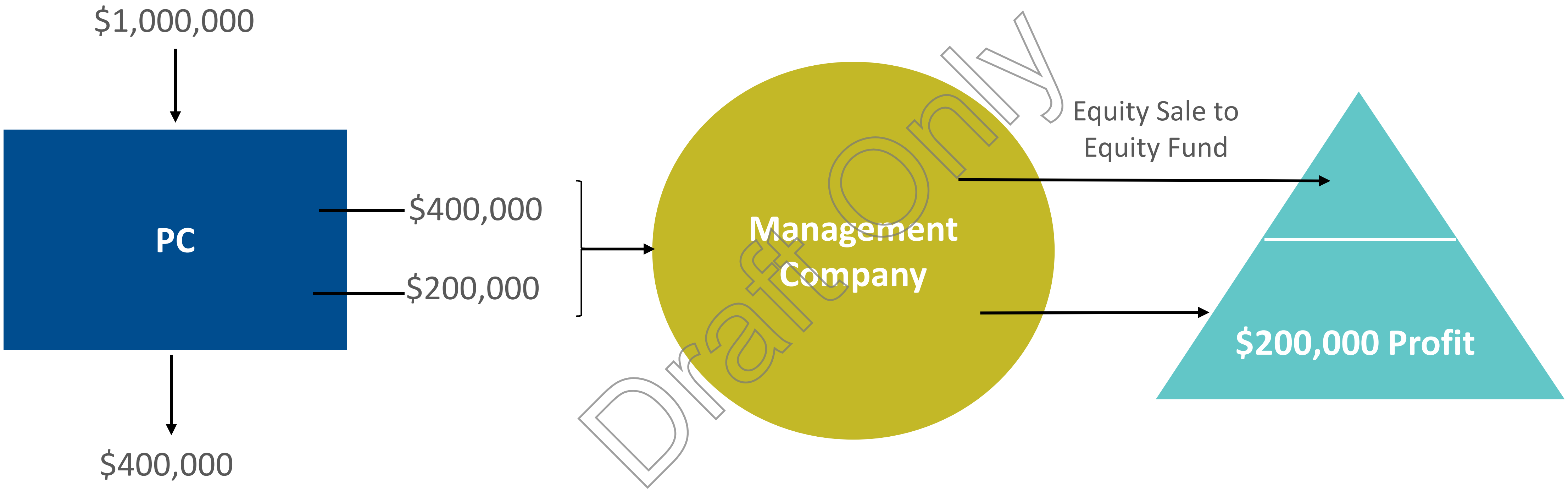
STEP 4



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SALE PRICE

$ 200,000.00	(Profit)
x 9	(Multiple paid by Equity Fund)
$ 1,800,000.00	Cash received subject to Capital Gain Tax
x .8	
$ 1,440,000.00*	Lump sum after tax proceeds to Seller

*Taxed at 20% so post tax proceeds of 80% of sale price

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ANALYSIS

$ 200,000.00	Taxed at ordinary income tax rates
x .50	(federal, state)
$ 100,000.00	
x 15	(years needed to accumulate equivalent savings)
$ 1,500,000.00	or $ 1,440,000.00 today.

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ALL FUNDS INVESTED AT 6% RATE OF RETURN FOR 15 YEARS

$100,000.00 each year x .06% for 15 years =
$2,327,596.90

$1,440,000.00 lump sum x .06% for 15 years =
$3,533,894.73

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THE DEAL AS PROMOTED BY EQUITY FUND

Our goal is to help grow your practice into a regional market leader by providing capital for growth initiatives and by supplementing your entity's current efforts through the addition of new management team members and board members, as appropriate.

We will help you evaluate and fund new pathways for growth through accretive acquisition opportunities, adding ancillary revenue streams, de novo office openings, and sales and marketing initiatives that expand your customer base.

We are confident that we can work with our operating partners, who have significant experience in building and growing similar healthcare services businesses, and provide capital to strategically grow the business through organic and acquisitive growth.

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THE PROMISE

Equity will pay Practice Equityholders (the "Sellers") or will pay legal entities owned by the Equityholders as agreed to by the parties, in the aggregate, in cash on the closing date an amount equal to (the "Closing Cash Payment").

Equityholders shall receive equity ownership in the newly formed "Holdco" (the same holding company Equity fund shall invest in) in the form of Class A, Class C and Common Units in the Purchase.

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NON-CASH CONSIDERATION

The Class A Preferred Equity will be the first equity paid out after debt.

The Class A Preferred Equity units will carry interest bearing a six percent (6%) annual rate.

The Class C Units will carry a paid-in-kind coupon bearing a ten percent (10%) annual rate.

The Common Units will be held by every investor.

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CHOICE

Sellers can opt to trade rollover equity value for cash at Closing Value as long as the total components of value remain unchanged.

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GROWTH EARN-OUT

In addition to the Closing Cash Payment and Rollover Equity, subject to achieving the below growth thresholds, the Sellers shall also receive $2,000,000 (the “Growth Earn-Out”) in the form of cash as more fully described below.

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The Sellers shall receive a Growth Earn-Out based on the Adjusted EBITDA relative to the following targets at the twenty-four full month anniversary of the closing and following the first annual audit:

Adj. EBITDA	Growth Earn-Out
$2,500,000	$0
$2,650,000	$400,000
$2,800,000	$800,000
$2,950,000	$1,200,000
$3,100,000	$1,600,000
$3,250,000	$2,000,000

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For purposes of the Growth Earn Out calculation, growth related hires will be added-back (not negatively impact the Growth Earn Out calculation), including CEO, CFO, and VP of Growth and Development.

This earn out is based on the acquired locations as of the closing date and does not include any additional flow through the existing services from new physicians who utilize the facilities after Closing.

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A SPECIAL DEAL

Since Dr. and Dr. will be foregoing their current management fee, Dr. and Dr. will also be eligible to receive an earn-out paid in cash at exit (the “Management Exit Earn-Out” and together with the Growth Earn-Out, the “Earn-Outs”) as more fully described below:

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Additionally Dr. and Dr. (collectively “The Acquisition Sources”) shall also be eligible to receive transaction bonuses as completes add-on acquisitions.

For acquisitions with $0 to $500,000 of Adjusted EBITDA, the Acquisition Sources shall receive a minimum cash bonus of $30,000 total ($15,000 each).

For acquisitions with greater than $500,000 of Adjusted EBITDA, the Acquisition Sources shall receive a minimum cash bonus of $40,000 total ($20,000 each).

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ASSUMPTIONS

Revenue and Adjusted EBITDA

Group will be free of (i) debt (including, but not limited to, all short-term, long-term, shareholder, and shareholder/related-party debt or payables, capital lease obligations, excess paid time off due to employees

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Seller will leave enough cash the balance sheet to cover the next gross payroll.

All leases and contracts are in good standing and are transferable to fund.

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All licenses, approvals, and consents necessary to operate the business of Seller are in good standing and transferable.

The Company is not involved in and remains unaware of any pending or threatened litigation or regulatory matters that would have an impact on the Company's operations or financial condition.

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Due to state law corporate practice of medicine prohibitions, employed physicians and key employees, including each of the Sellers will enter into standard employment and equity agreements which shall include non-competition, non-solicitation, no-hire and other restrictive covenants during the period of employment and the 2-year period thereafter as par of new Management Agreement.

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GOOD FAITH

We (the Fund) believe that the existing management team has done an excellent job in building a platform for future growth. We also believe that the entire team is an important part of the future growth of the Company and will be relied upon going forward.

We would NEVER cut your pay or authority.

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EXCLUSIVITY CLAUSE

Fund and the Sellers jointly agree to pursue the Transaction exclusively with one another during the Term (as hereinafter defined).

Fund and each Seller will not (and will cause its officers, directors, affiliates, Equityholders, representatives and agents (collectively, “related parties”) not to), directly or indirectly, (i) submit, solicit, initiate, encourage or discuss any proposal or offer from any person or entity.

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CONCLUSION

The legal aspects of negotiating and structuring an equity fund/physician practice transaction requires the attorney to understand state corporate law, health care regulations, tax strategies for properly allocating the purchase price proceeds to assets sold, future compensation opportunities, ERISA, anti-trust rules, securities rules and a host of other technical/legal considerations. These transactions will require significant legal due diligence to assure the physician's regulatory house is in order to avoid substantial claw backs of the purchase price paid by the equity fund. Inaccurate representations and warranties regarding regulatory matters and incomplete schedules are the most common causes of litigation associated with these deals. Industry knowledge of typical values paid for various types of practices, understanding unique ancillary revenue opportunities for the subspecialty and utilizing other strategies that drive value (and thus price) is essential.

Most importantly, the good lawyer will know his/her client, their expectations, their knowledge base and risk tolerance, and future practice/financial objectives.

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LEGAL PRACTICE TOOL

The AHLA has published numerous presentations on this topic and has created a “Closing Checklist/Agenda” that is an excellent reference for determining the types of transaction documents and other considerations utilized in these types of practice sale/joint venture arrangements.

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If your ‘Why’ is strong enough,
you will figure out ‘How’.

Bill Walsh, San Francisco 49ers,
3-time Super Bowl Winner

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Equity Markets Offer New Opportunities for Physicians

Doing Nothing Becomes a Choice

- Can’t we just practice medicine?
  - Docs have traditionally no financial background
  - Let us be docs
- We have been Sold
  - Bill of goods, told one thing, lied to, commoditized, taken advantage of
  - History of takeovers: HMOs, PPO, Mergers, ACOs
  - Employed?

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Equity Markets Offer New Opportunities for Physicians

The NEW ENGLAND JOURNAL of MEDICINE

Perspective

MARCH 18, 2021

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Private Equity and Physician Medical Practices — Navigating a Changing Ecosystem

Jane M. Zhu, M.D., M.P.P., M.S.H.P., and Daniel Polsky, Ph.D., M.P.P.

Equity Markets Offer New Opportunities for Physicians

Headaches

- Reimbursement goes down every year
- Regulatory/compliance environment skyrocketing
- Information overload/Specialization
    - Medically
    - Management services
- Burnout
    - Is there any burnout in AHLA?

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Equity Markets Offer New Opportunities for Physicians

Can’t we participate in the value creation/generation going on around us?

- Opportunities
  - New technology/Personalized medicine/Prevention/Value-based care/Cost-effectiveness
  - Business process improvement/New ideas
  - Monetize value vs. nothing/3 months of A/R
  - How to capitalize/participate/pay for it?

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Equity Markets Offer New Opportunities for Physicians

Private Equity

- Opportunity
    - Chance of immediate liquidity and equity with ongoing ownership
    - 15 transactions in Urology in last 5 years
    - 5 largest urology groups represent only 4% of all urologists
- Evolution
    - From Solo practice all the way to National integration
    - $1T of PE estimated waiting to be invested in healthcare

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Equity Markets Offer New Opportunities for Physicians

Considerations for Doctors for PE

- Why
  - Liquidity, buyouts, growth, security
  - Timing
  - Group demographics
  - Math – EBITDA, “scrape”, multiple, back end/ L.A.D.
  - Do you have a Partner or a boss?
  - Continuity of Practice
  - Control? Working for or with the Man?

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Considerations for Doctors for PE

- Why
    - Life after Deal
    - Roll Up/Second Bite
    - Penalties in deal language for lack of performance
    - Exits

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Equity Markets Offer New Opportunities for Physicians

ALL PE is Not Created Equal

- Preference/Flavor
- Strategy: Growth vs Exit
- Speed/Timing of PE firm plan
- Flip vs. Long term investment
- Experience/Dedication/Team for Medicine

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Equity Markets Offer New Opportunities for Physicians

Advantages of PE for Doctors

- Upfront liquidity
- Achieve scale immediately
- Upfront capital
- Roll over Equity – ownership vs. income/Wealth vs. Cash
- Expertise
- Protection
- Data aggregation/monetization
- Recruiting vs. Health system – can be (+) if structured correctly

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Equity Markets Offer New Opportunities for Physicians

Disadvantages of PE for Doctors

- Loss of control
- Early loss of cashflow
- A bad deal can be worse than no deal
- Are you still an owner?
- Does PE account for changes in marketplace/reimbursement?

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Equity Markets Offer New Opportunities for Physicians

Key Points

- Assess utility of PE for your clients
- Don’t stick head in sand/ignore possibilities
- Pick an aligned partner
- Challenge the thinking about equity vs. income and deriving ongoing value from your efforts
- Private Equity can be a vehicle for profitability and maintaining independence.

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Equity Markets Offer New Opportunities for Physicians

Where does AHLA come in?

- Don’t sell me
- Convince me we are on same side of table
- Deal Analysis is table stakes
- Describe the Utility of PE for your clients
- Assess the possibilities
- Help your client choose an aligned PE partner

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Equity Markets Offer New Opportunities for Physicians

Key Points

- Be and be seen as a Trusted Advisor
- You, my lawyer, are my Guide.
- Make your Docs the Heroes
- Help your docs realize the facts or FAD of the deal
- How do you bring value to practice, deal, life after deal, future opportunities and keep me out of trouble?
    - Play Offense and Defense
- Give me the information to make a good decision
    - Docs are decision-making machines

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Questions

Randal Schultz, JD
Lathrop GPM LLP

randal.schultz@lathropgpm.com

10851 Mastin Boulevard
Building 82, Suite 82
Overland Park, KS 66210

(P) 913-451-5192

Jeff Moody, MD
Colorado Springs Urological Assoc.

jmoody@ppuro.com

6071 East Woodmen Road
Suite 300
Colorado Springs CO 80923

(P) 719 531-7007

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