



McGuireWoods

Private Equity Physician Deals: What Investors, Physicians, and Hospitals Need to Know in 2022

A “PYA Perspectives” Webinar in Partnership with McGuireWoods LLP

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PRESENTERS



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AGENDA

- ① Recent Deal Trends
- ② Potential Partnership Paths
- ③ Emerging Trends in Healthcare Acquisitions
- ④ How to Structure an Effective MSO
- ⑤ Legal Considerations in Private Equity MSO Models
- ⑥ Affiliation Models between MSO and Health Systems
- ⑦ Key Deal Pitfalls to Avoid

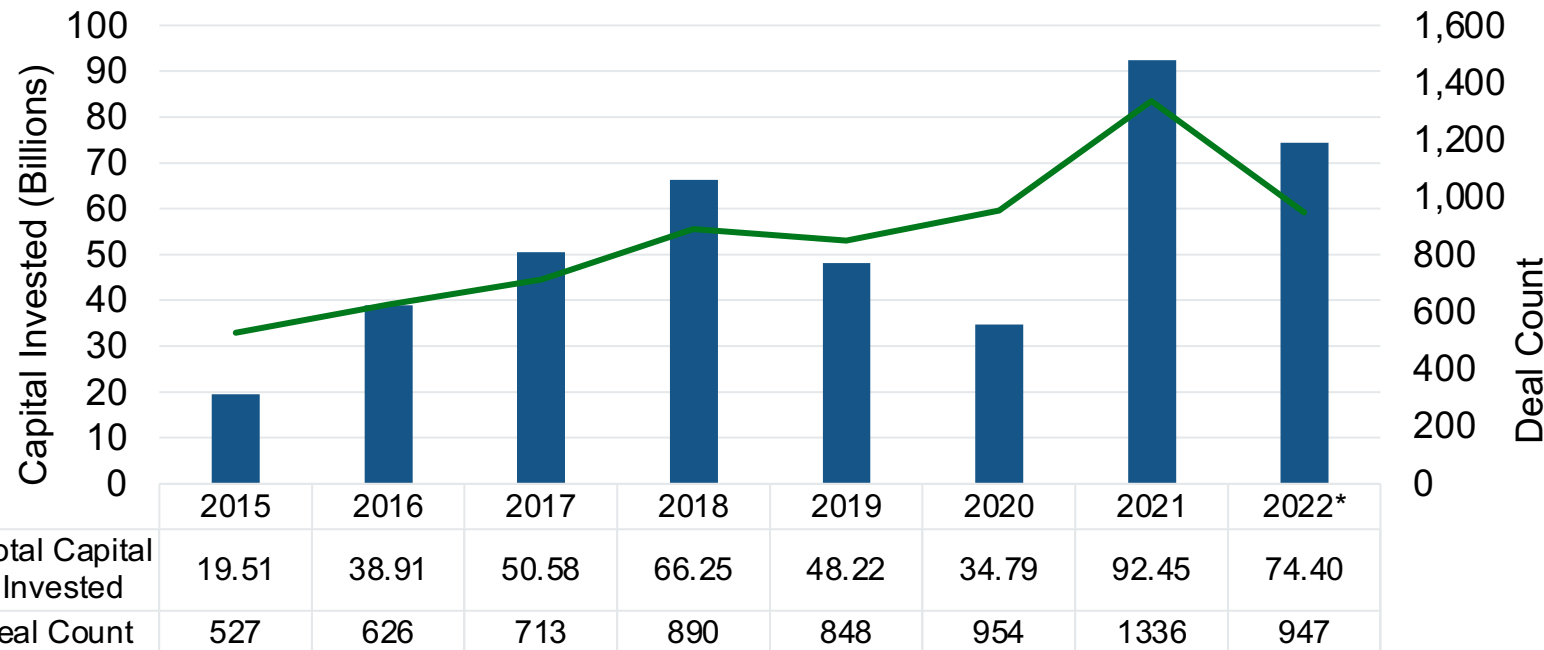


RECENT TRENDS IN DEAL FLOW

Deal volumes in total healthcare private equity on pace to decline from record 2021

Current Assessments:

Capital Invested & Deal Count



Reduced supply of attractive assets at reasonable multiples



Cost of capital increases fueled by rising interest rates affecting leveraged buyouts



Uncertainty in reimbursement, healthcare labor market, and inflationary pressures



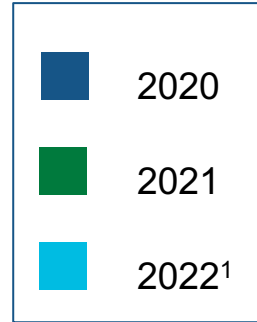
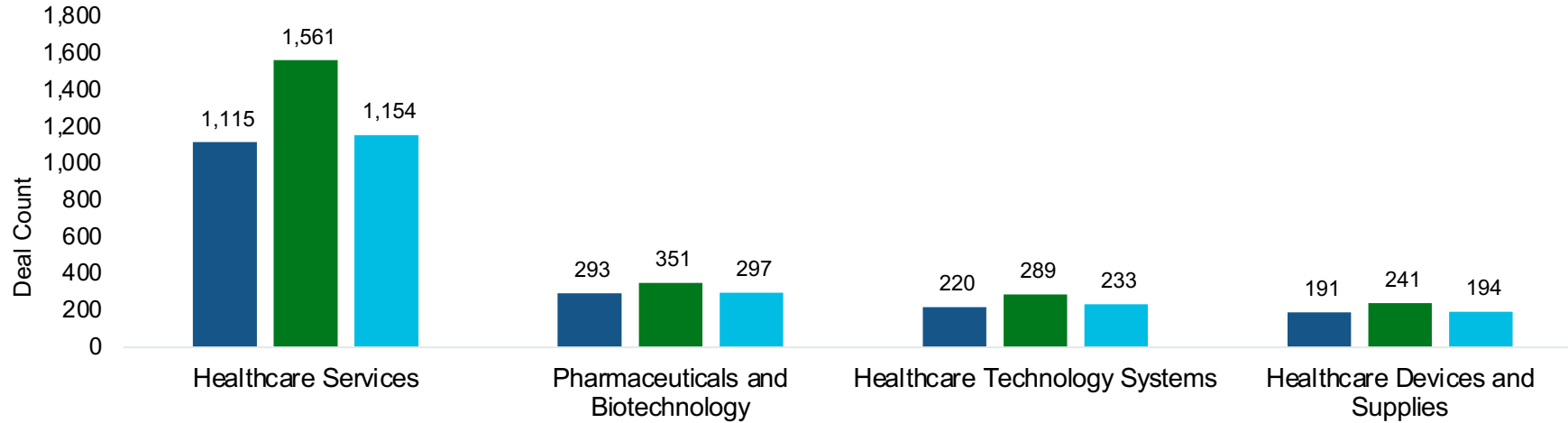
Reduced competition for assets with some buyers preserving capital

■ Total Capital Invested — Deal Count

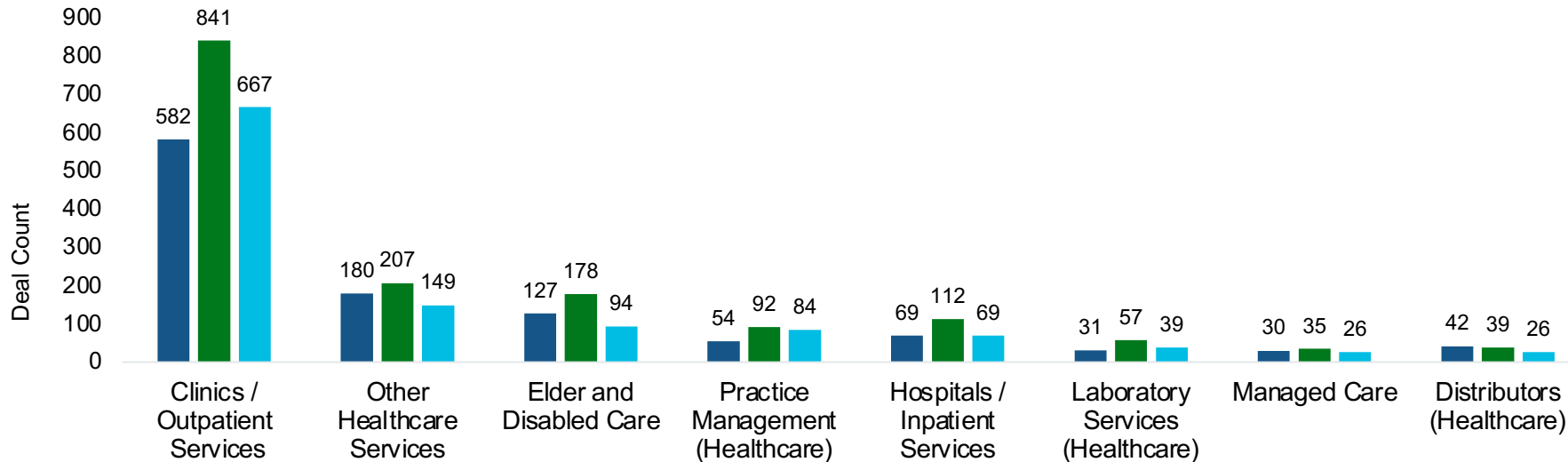
* 2022 annualized

CURRENT DEAL VOLUME BY SECTOR

All Healthcare (PE and M&A Control Transactions)



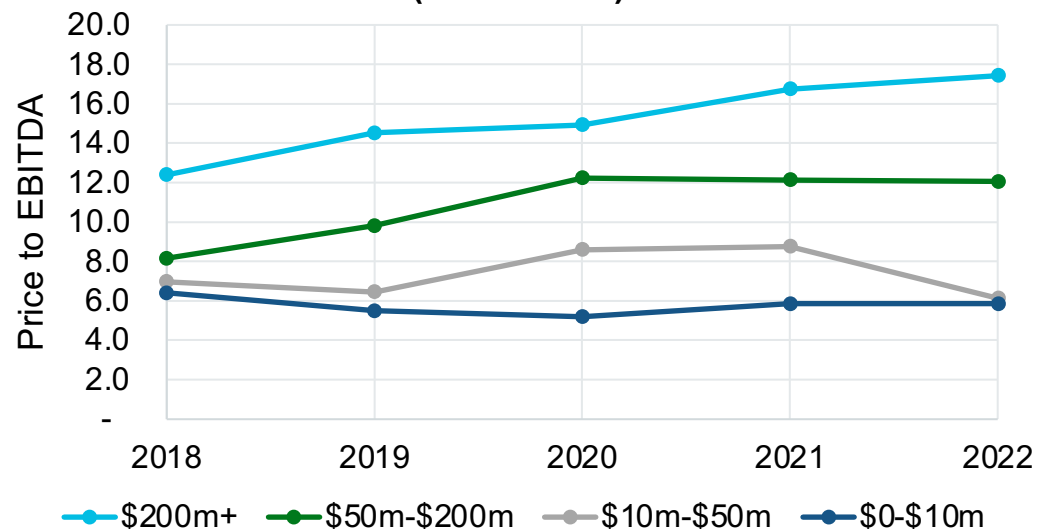
Healthcare Services Only



RECENT TRENDS IN DEAL FLOW

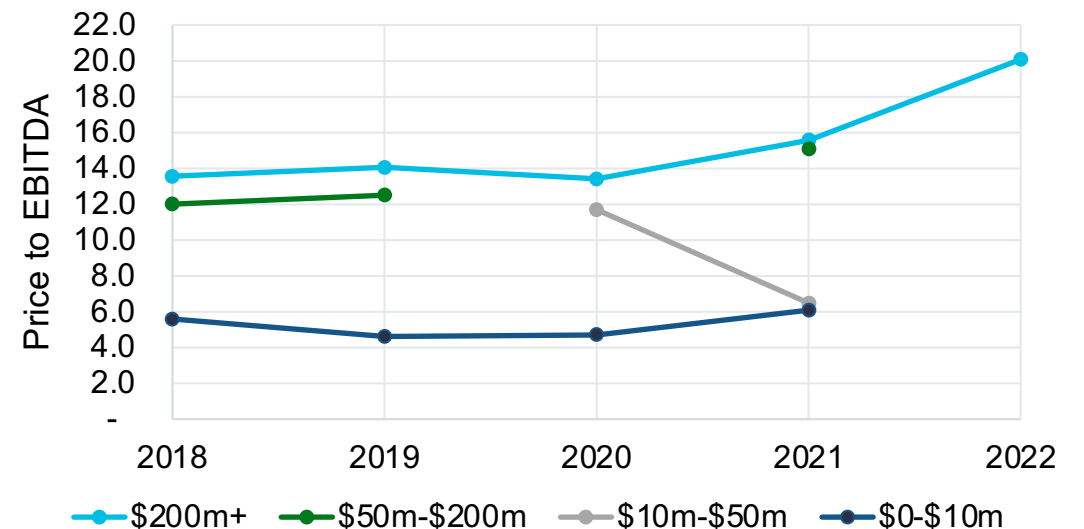
Platform companies continue to command higher valuations, with increased multiples possibly due to increased scarcity in platforms coming to market.

**Average Multiple by Deal Size
(Healthcare)**



*2022 as of 8/15/22

**Average Multiple by Deal Size
(Physician Practices & Specialty Clinics)**



*Insufficient data to trend all ranges across the five years; 2022 as of 8/15/22

FACTORS SUPPORTING CONTINUED INVESTMENT IN HEALTHCARE



Healthcare investments historically realized **attractive internal rates of return** compared to broader private equity investments



Consistent annual growth (except 2020) in health services spending, with **profits projected to grow 5% annually**¹



Healthcare still largely local, providing some **insulation to external threats**



Highly fragmented sectors present **efficiency opportunities** in rollups



Increased demand for services as populations age



Integration opportunities across care continuum



Industry's recession **resilience**

1) Source: Bain Global Healthcare Private Equity and M&A Report

POLLING QUESTION #1



PHYSICIAN PRACTICE OWNERSHIP

Physician employment remains strong coming into 2022, with only approximately 1 out of every 4 physicians in independent practice.



SELL-SIDE DRIVERS

- 1 **Shifting Financial Risk**
 - Continued reimbursement pressures
 - Managing business disruptions
 - Rising costs (i.e. labor, inflationary pressure, etc.)
- 2 **Administrative Burden**
- 3 **Consistent Regulatory Burden**
- 4 **Work / Life Balance**
- 5 **Succession Planning and Monetizing Practice Growth**



POTENTIAL PARTNERSHIP PATHS

Physician Practice / Ambulatory Service Provider

Partnership Opportunities

Health System

Private Equity / Corporate Consolidator

Payer

Objectives

<p>Targets largely fill gaps in services for care delivery and clinical integration</p> <p>Acquire and integrate (no exit plan)</p> <p>Less focused on achieving scale and efficiencies</p> <p>Heightened focus on fraud and abuse laws given referral opportunities</p>	<p>Acquire scale and efficiencies through platform and tuck in acquisitions</p> <p>Build for exit/liquidity event through focus on strong financial performance and investment return</p> <p>Structured to allow for practice management in accordance with corporate practice of medicine statutes</p>	<p>Care management to drive cost reductions</p> <p>Retain achieved savings within health plan rather than sharing with providers</p> <p>High focus on financial performance and investment return</p> <p>Possible exit in future</p>
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POTENTIAL PARTNERSHIP PATHS

Physician Practice / Ambulatory Service Provider

Partnership Opportunities

Health System

**Private Equity /
Corporate Consolidator**

Payer

**Physician
Seller
Needs to
Know**

Restrictive Covenants / Non-competes

Longer term employment agreement at fair market value compensation

Some systems avoid paying for intangible assets

Limitations on ongoing additional investments

Restrictive Covenants / Non-competes

Employment agreement at reduced compensation to create capitalized practice earnings for acquisition

Possibly some rollover equity to incentivize retention and growth

Restrictive Covenants / Non-competes

Employment agreement at somewhat reduced compensation

Various other bonus components (e.g., stock options)

SELL-SIDE SURPRISES

- 1 Due Diligence Process
- 2 Asset acquisition considerations
 - Retained liabilities / debt-like terms
 - Practice wind down
- 3 Other expenses
 - Tail Insurance
 - Transaction expenses
 - Representations and warranties insurance
- 4 Legal matters
 - Indemnification provisions / escrowed funds
 - Representations and warranties
- 5 Net working capital targets / settlements



ADDITIONAL CORPORATE DISRUPTORS



“Optum gets go-ahead from Massachusetts AG for \$236M Atrius Health purchase”

Source: Becker’s Hospital Review (April 22, 2022)

“Potential Atrius sale evokes sadness, concerns”

Source: CommonWealth Nonprofit Journal of Politics, Ideas & Civic Life (June 22, 2021)

“Vertically integrated payer-provider groups raise antitrust concerns”

Source: Modern Healthcare (March 22, 2022)

“Walgreens takes bigger \$5.2 billion stake in VillageMD as drugstore giant launches ‘Walgreens Health’”

Source: Forbes (Oct. 2021)

“Blue Cross Blue Shield of Michigan dips a toe into the provider business”

Source: Modern Healthcare (Aug. 15, 2021)

“Humana, private equity firm team up to open Medicare-centric primary care clinics”

Source: Forbes (Feb. 3, 2020)

“Walmart may soon become the largest primary care provider in the country”

Source: Forbes (Feb. 16, 2022)

EMERGING TRENDS IN HEALTHCARE TRANSACTIONS

Several themes are arising in 2022 investments

Consumerization of care

- Patients want better experiences and technology like mobile apps and smart devices are allowing them to play an active role in their health
- Investment in ambulatory access points with comprehensive services

Digital solutions that improve operational efficiency

- Digitalization of supply chain and/or leveraging data to improve revenue cycle management

Willingness to take on development risk

- Investors with scientific expertise are increasingly willing to bet on cutting-edge biopharma and life science technologies

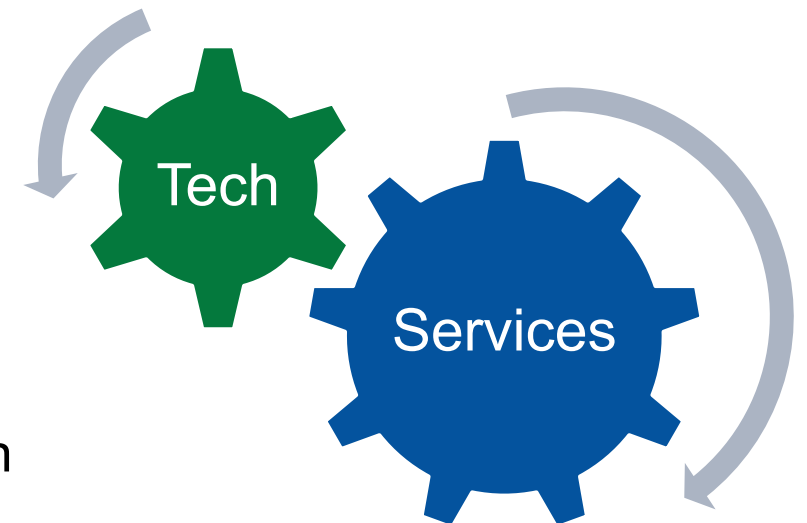
Additional value is being achieved by practices with integrated technologies or core competencies

Digital Health

- Data driven
- Evidenced clinical outcome improvements
- Tele-behavioral health expansion opportunities under Consolidated Appropriations Act, 2021

Value-based Care Competencies

- Capitated care management solutions with sophistication and systems to scale and manage patient populations
 - CMS-specific care models
 - Direct to consumer



EMERGING TRENDS IN PRACTICE ACQUISITIONS

Investor targets remain in fragmented sectors with scalability, enhanced access to consumers, and significant ancillary revenue streams



Surgical specialties (e.g., ophthalmology, gastroenterology)



Fragmented ambulatory services



Primary care with care management competencies to manage populations



Rural health



Outpatient behavioral health



Telehealth

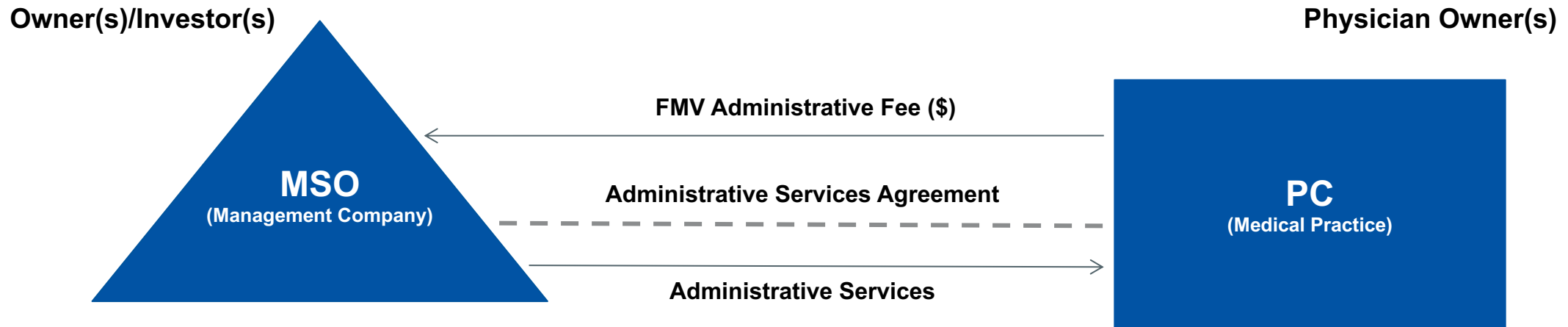
POLLING QUESTION #2



Structuring the Transaction

- Transaction Participants
 - PE Firm
 - Management Company
 - Physician Practice “Target” – selling assets / equity
 - Physician Practice Platform or Newco
- Business Points
 - Target Business Operations
 - Platform Transaction v. Add-On
 - Equity v. Asset Transaction
- Legal Considerations in Structure
 - CPOM / MSO-PC
 - Certificate of Need / CHOW
 - Antitrust
 - Tax
- Key Stages
 - LOI
 - Due Diligence / Pre-Closing
 - Transaction Documents and Closing
 - Post-Closing

HOW TO STRUCTURE AN EFFECTIVE MSO

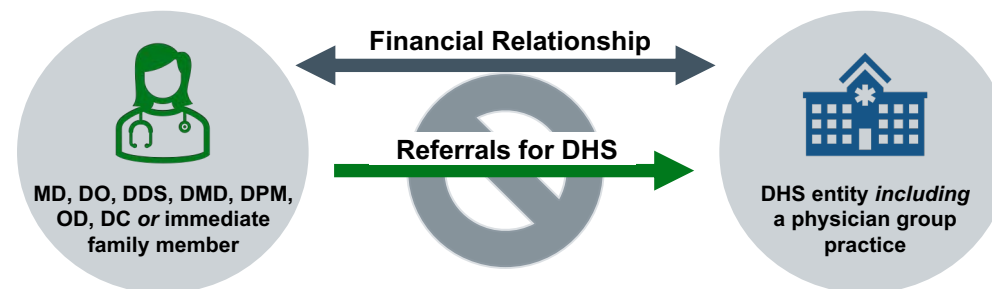


- Clinical or non-clinical owners/investors own in MSO
- PC (or PLLC) owned by one or more licensed physicians, employs the physicians and other licensed individuals who provide professional medical services, and contracts with insurance payors
- MSO owns the non-clinical assets and otherwise is only connected to PC through an Administrative Services Agreement (“ASA”)
- MSO must leave clinical decisions to the licensed physicians and mid-level providers who own, or are employed by, the PC (e.g., no pressure to perform procedures, recommend additional visits, decide to terminate patients, etc.)

LEGAL CONSIDERATIONS

Regulatory Framework

- Corporate Practice of Medicine
- Fee-Splitting
- Fraud and abuse
 - Anti-Kickback Statute
 - Stark Law
 - Civil Monetary Penalties Law
 - False Claims Act
 - Overpayment Rule
 - State Laws
- Provider Enrollment
- Billing and Reimbursement
- Licensure
- Certificate of Need
- Data Privacy and Security
- State Insurance Laws



Heightened Department of Justice and Federal Trade Commission focus on private equity in anti-trust enforcement



“We are focused on potential antitrust enforcement on private equity “roll-ups,” namely whether in particular circumstances a series of often smaller transactions can cumulatively or otherwise lead to a substantial lessening of competition or tendency to create a monopoly.

Similarly, we will analyze whether private equity companies may violate the antitrust laws with investments creating or enhancing power across a “stack” of technology or other products/services.”

- Andrew J. Forman

Deputy Assistant Attorney General

General Antitrust Division

U.S. Department of Justice



Heightened Department of Justice actions involving private equity backed healthcare consolidators

\$25 million settlement related to alleged use of unlicensed, unqualified physicians

UNITED STATES of America EX REL. Christine MARTINO-FLEMING, Relator and Commonwealth of Massachusetts ex rel. Christine Martino-Fleming, Relator v. SOUTH BAY MENTAL HEALTH CENTERS, Community Intervention Services, Inc., H.I.G. Growth Partners, LLC, H.I.G. Capital, LLC, Peter J. Scanlon, and Kevin P. Sheehan, Defendants.” *United States ex rel. Martino-Fleming v. S. Bay Mental Health Ctrs.*, 540 F. Supp. 3d 103, (D. Mass. 2021)

\$15.3 million settlement related to alleged false claims and kickbacks

United States ex rel. Mandalapu, et al. v. Alliance Family of Companies, Inc., et al., No. 4:17-cv-00740; United States ex rel. Fuller v. Respiratory Sleep Solutions, et al., No. 4:17-cv-01197; United States ex rel. Calcanis v. Alliance Family of Companies, Inc., et al., No. 4:19-cv-1497; United States, et al. ex rel. Jane Doe v. Alliance Family of Companies, LLC, et al., No. 4:19-cv-1213; United States, et al. ex rel. McKay v. Alliance Family of Companies, LLC, et al., No. 4:18-cv-1949; and United States, et al. ex rel. Krasnov v. Alliance Family of Companies, LLC, et al., No. 4:19-cv-4886.

\$8.9 million settlement related to alleged false claims

United States of America ex rel. Sheila Rose and Louis Rose v. Fortress Investment Group, LLC. et al., Case Number 3:13-cv-00314-MO.



POLLING QUESTION #3

ENGAGING PHYSICIAN SELLERS

Earnouts

Equity Considerations

- Rollover
- Profits Interests
- Z Units

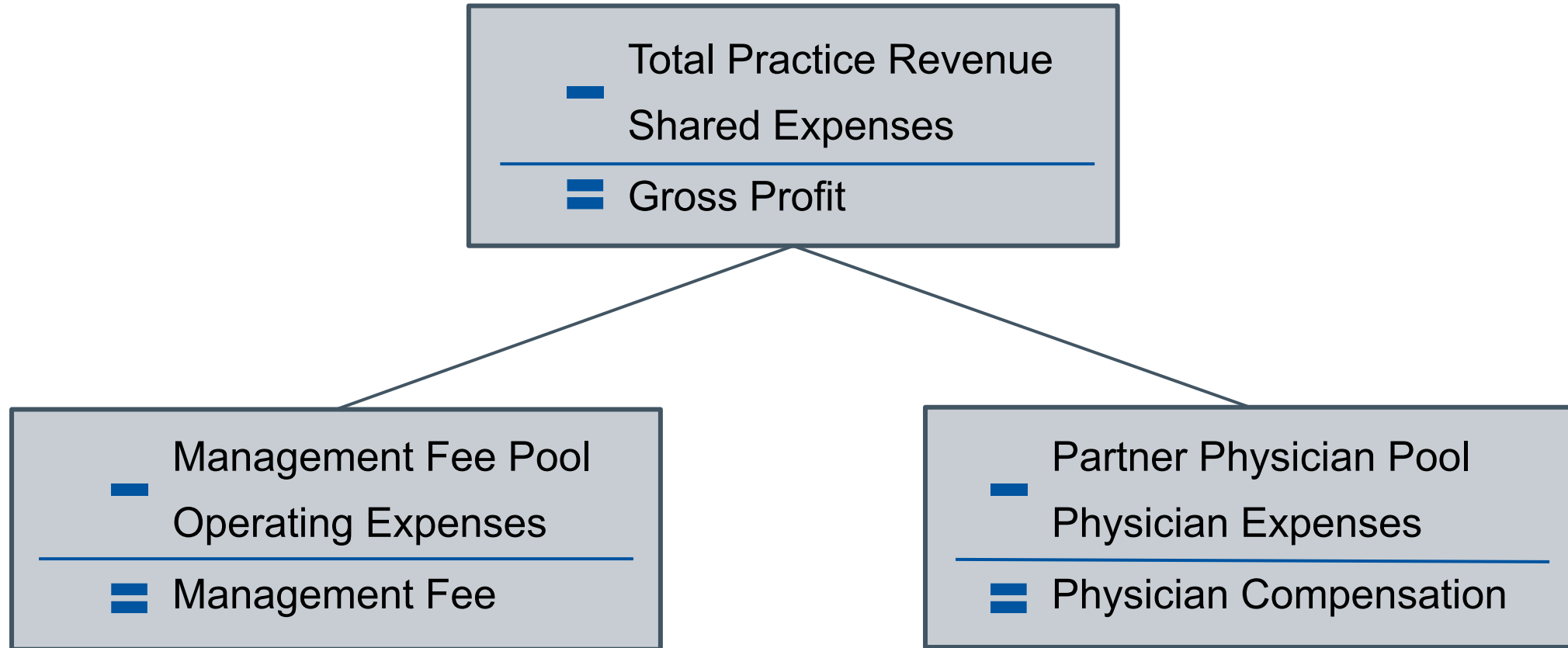
Protections in Rollover Documents

- Constructive resignation provisions in the physician employment agreements
- Inclusion of default events in LLCA related to breach of structural documents
- Requirements to enforce terms in agreements (e.g., non-competes)
- Prohibitions on amendments
- Redemption of equity in the event a breach event occurs

Effective compensation models



EBPC COMPENSATION MODEL



Growth Opportunities

- Ancillary Opportunities
 - Laboratory
 - Pharmacy
 - DME
- Lithotripsy
- Radiation Oncology
- Ambulatory Surgery

Partnership Opportunities

- JV Ambulatory Surgery Center
- Clinically Integrated Network
- Professional Services Agreement
- Clinical Co-Management

AFFILIATION MODELS BETWEEN INVESTOR-OWNED COMPANIES AND HEALTH SYSTEMS

Behavioral
Health

Inpatient
Rehabilitation

Ambulatory
Care Settings

- ⊕ Urgent Care
- ⊕ ASCs
- ⊕ Infusion Services
- ⊕ Imaging

Hospital at
Home / Home
Health

KEY DEAL PITFALLS TO AVOID

FINANCE CONSIDERATIONS

- Lack of controls around cash management/reporting
- Inappropriate application of accrual basis accounting
- Counting on non-recurring revenue sources
- Underfunding retirement benefits
- Undisclosed litigation
- Lack of Provider Relief Funding reporting
- Tax compliance issues

KEY DEAL PITFALLS TO AVOID

Compliance Matters

- Inappropriate service billings
- Incorrect application of supervision protocols
- Under arrangements
- Coding and documentation fallacies
- Prompt overpayment refunds to payers
- Financial relationships with referral sources
- IT Security / HIPAA protocols
- Effective compliance programs
- Licensure lapses

Post-Transaction Integration

- Management competencies
- Lack of physician engagement
- Cultural fit with acquirer's management



How can we HELP?

