

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

Dermatology Practice Mergers, Acquisitions, Divestitures and Affiliations

Conducting Due Diligence, Meeting Regulatory Compliance
Requirements, Overcoming Integration Challenges

WEDNESDAY, JUNE 29, 2016

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

Today's faculty features:

Richard S. Cooper, Member, **McDonald Hopkins**, Cleveland

Bradley V. Martorana, Counsel, **Snell & Wilmer**, Phoenix

William C. Bundy, Managing Director, **Bundy Group**, Roanoke, Va.

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Dermatology Market Observations

- ▶ There are over 4,000 dermatology practices in the U.S.
- ▶ Most of these practices are individually owned or owned by 2 or more partners
- ▶ Many practice owners are seeking ways to increase profits and improve efficiency as a result of reimbursement rate cuts
- ▶ Consolidation of practices and practice acquisitions are rapidly occurring

Dermatology Market Observations

- ▶ There is a material increase in the number of “roll-up” / consolidation companies entering the marketplace and private equity funds are targeting dermatology.

How Buyers Value Dermatology Practices

- ▶ The value of a practice is based on the number of acquirers wishing to purchase the practice and the offers received
- ▶ Most buyers want the existing dermatology practice owner(s) to continue practicing after the transaction is closed
- ▶ Post closing, the previous owner will normally be paid a fixed salary with a performance-based bonus or a percentage of his collections like the other practitioners

How Buyers Value Dermatology Practices

- ▶ Most buyers will pay the practice owner a multiple of the “profit” of the business
- ▶ “Profit” can also be defined as EBITDA (earnings before income taxes, before interest expense, and before depreciation and amortization expense)
- ▶ Most sellers want to know what the multiple is
- ▶ The multiple is a function of the number of bidders and the amount of the EBITDA
- ▶ Estimated range – 4 to 9 times EBITDA

Transaction Structures

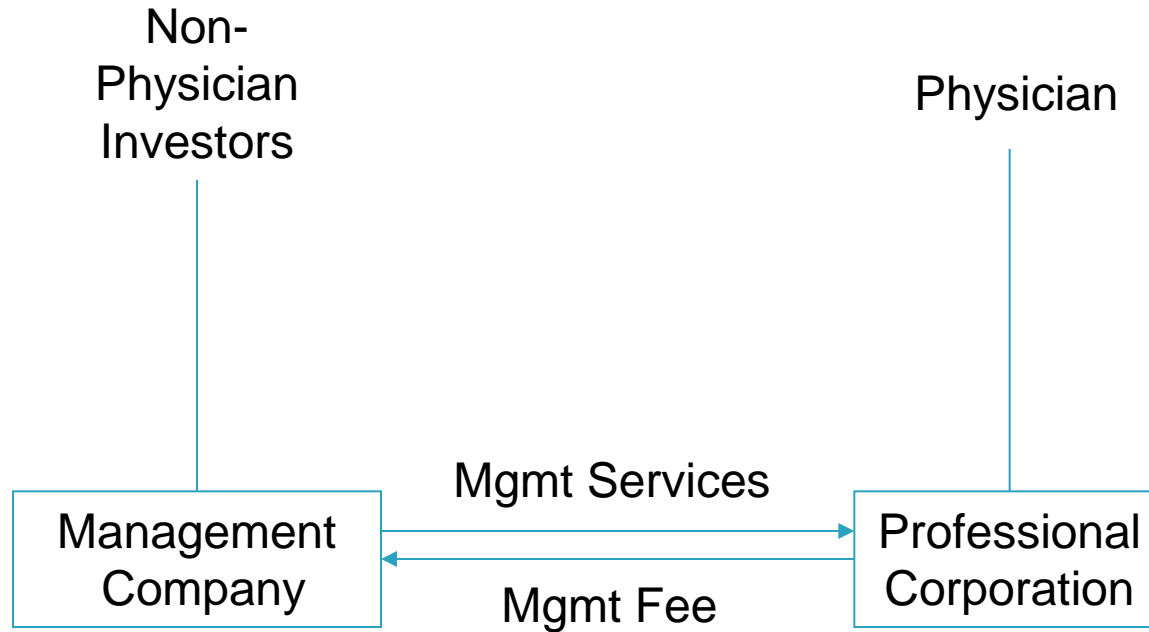
- ▶ Depends on the type of legal entity of the practice (C corp, S corp, LLC)
- ▶ Stock sale verses asset sale
- ▶ All cash deals plus escrow
- ▶ Purchase of a majority of the stock by the acquirer with existing owners maintaining minority equity interests
- ▶ Merger of two or more practices with all or some of the partners maintaining ownership in the consolidated entity

Practice Acquisition Transaction Structures

Corporate Practice of Medicine

- Corporate practice of medicine doctrines vary under State law. For example, in California:
- "Any person who practices or attempts to practice, or who holds himself or herself out as practicing... [medicine] without having at the time of so doing a valid, unrevoked, or unsuspended certificate...is guilty of a public offense." Cal. Bus. Prof. Code 2052.
- "Corporations and other artificial entities shall have no professional rights, privileges, or powers." Cal. Bus. Prof. Code 2400.

Practice Acquisition Structures



Practice Acquisition Structures

- ▶ Fee Splitting Prohibitions
- ▶ Anti-Kickback Prohibitions
- ▶ Self-Referral Prohibitions
 - May affect post-closing compensation structures, and purchase price adjustments
- ▶ Antitrust concerns
 - Market concentration
 - Collaboration among competitors

Due Diligence

- ▶ Extent of due diligence will depend on a variety of factors, principally the type (structure and complexity) of transaction, the degree of integration, and dollar “value” of the transaction.
- ▶ As a general rule, the more integrated a transaction, the greater the due diligence.
- ▶ Examples:
 - Compliance, regulatory, and licensure matters.
 - Clinical competency issues.
 - Hospital and payor relationship.
 - Financial matters—including legacy commitments.
 - Litigation—history and pending.
 - Organizational documents.
 - Other contracts.
 - Ownership, policies regarding admission of new owners.

Due Diligence

Non-competes

- ▶ Buyers want to see comprehensive, enforceable non-competes in place for the physicians and key management, administrative, and sales/marketing personnel.
- ▶ Buyers will enter into new non-competes as part of the transaction with designated individuals generally including all dermatologists

Due Diligence

Non-competes

- From the dermatologist's standpoint must be reasonable in terms of duration, geographic scope and practice type
- Harder to “sell” to non-owner dermatologists who did not get a monetization event on sale
- ▶ Pre-transaction, dermatology groups should determine whether they have non-competes in place for all key physicians and employees and if there are flaws in the non-competes that should be corrected before “going to market.”

Due Diligence

Non-competes

- ▶ Laws can vary by state regarding consideration necessary to support the addition/modification of a non-compete clause after employment commences.

Due Diligence

▶ Non-Competes- California Example

◦ General Rule

- Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void. Cal. Bus. Prof. Code 16600.

◦ Exception for Sale of Business

- Any person that sells a business and the goodwill of the business (whether structures as an asset sale or stock sale) may agree with the buyer to refrain from carrying on a similar business within a specified geographic area in which the business so sold... has been carried on, so long as the buyer, or any person deriving title to the goodwill or ownership interest from the buyer, carries on a like business therein. Cal. Bus. Prof. Code 16601.

Due Diligence

Coding/Billing Compliance

- ▶ Key area of concern for buyers due to the level of scrutiny by payers and the potential extent of federal, state and private payer claims for inaccurate or fraudulent coding or billing.
 - Huge dollar exposures are possible.
 - An action by one payer can cascade into actions by multiple payers.

Due Diligence

Coding/Billing Compliance

- ▶ Will be a key focus in due diligence and addressed in reps and warranties
 - Coding
 - Billing
 - Overpayments
- ▶ Buyers may hire an independent auditor of claims.
- ▶ More of an issue in stock deal or where the buyer assumes payer contracts
- ▶ Generally, sellers should conduct an audit before going to market.

Due Diligence

In-house laboratory

- ▶ Some dermatology groups have formed their own dermatopathology laboratories to diversify revenue source and increase revenues.
- ▶ To establish a laboratory, the laboratory must meet certain criteria to fit within exceptions/safe harbor to the Stark and anti-kickback prohibitions. (State laws and payer contracts should also be reviewed).

Due Diligence

In-house laboratory

- ▶ These arrangements can be technical only (the laboratory) or also include professional pathology services. Under the latter, the group hires a pathologist and bills for that pathologist's services.
- ▶ To be compliant:
 - Arrangement must fall within the in-office ancillary exception
 - The laboratory must be located within practice or a wholly-owned subsidiary

Due Diligence

In-house laboratory

- Group practice is
 - Single legal entity
 - 75% of services of all dermatologists must be provided through the entity
- Ancillary revenues cannot be allocated among the dermatologists on the basis of each individual's referral volume

Due Diligence

In-house laboratory

- ▶ With respect to the pathologist services:
 - Must be provided in the same building as the dermatology practice or a centralized building used exclusively for pathology services for the group. (Note: The Medicare anti-markup regulations contain more stringent requirements regarding place of service.)

Due Diligence

In-house laboratory

- Group must be viewed as the provider of pathology services so the pathologists must enroll under the group's payer contracts, the interpretations must be on the group's letterhead, and the group must provide the infrastructure required to provide the services. The pathologist and group must enter into a contract that meets either the personal service on bona fide employment exceptions under Stark or their equivalent under the anti-kickback Law.

Regulatory and Compliance Challenges

Patient Confidentiality

- ▶ Federal Law / HIPAA – “Health care operations” is defined to include:
 - The sale, transfer, merger, or consolidation of all or part of the covered entity with another covered entity, or an entity that following such activity will become a covered entity and due diligence related to such activity.... 42 C.F.R. 164.501
- ▶ State Law (AZ) – A.R.S. § 12-2294(C) permits disclosures under State law without the written authorization of the patient as otherwise authorized by state or federal law.

Regulatory and Compliance Challenges

Transfer of Medical Records

- ▶ **Patient Confidentiality Statutes.**
 - “When a health care provider retires or sells the provider's practice the provider shall take reasonable measures to ensure that the provider's records are retained pursuant to this section.” A.R.S. 12-2297(B)

- ▶ **Physician Licensure Statutes. E.g., A.R.S. 32-3211.**
 - A health professional must prepare a written protocol for the secure storage, transfer and access of the medical records of the health professional's patients [that includes]:
 - If the health professional terminates or sells the health professional's practice and the patient's medical records will not remain in the same physical location, the procedure by which the health professional shall notify each patient in a timely manner before the health professional terminates or sells the health professional's practice in order to inform the patient regarding the future location of the patient's medical records and how the patient can access those records.
 - Violation is unprofessional conduct.

- ▶ **American Medical Association Code of Medical Ethics (Op. 7.03, 7.04, 7.05).**

Regulatory and Compliance Challenges

Patient Records – Negotiating Points

- ▶ EMR/Hard Copy – Process and Cost for Conversion
- ▶ Records to be Retained by Target
- ▶ Records to be Retained by Acquirer
- ▶ Notice to Patients
- ▶ Business Associate Agreement

Integration Challenges

General

- ▶ Should be identified and addressed well in advance of closing and early in the process of identifying the lead buyer and negotiating the deal.
- ▶ The buyer paying the highest price isn't always the one that a group should sell to. The quality of practice and compatibility with the buyer are critical.

Integration Challenges

General

- ▶ Keys to a successful integration include:
 - Compatible cultures – there will never be a perfect match but material differences can create long-lived dissatisfaction.
 - Common strategic vision
 - Support of an agreed upon clinical approach and quality standards
 - Clear understanding of dermatologist role in buyer and lines of authority
 - Dermatologist advanced input where appropriate
 - Aligned economic incentives

Integration Challenges

Physician Employment Agreements

- ▶ Expectations for full-time or part-time status
- ▶ Moonlighting
- ▶ Compensation Methodology
- ▶ Services

Enhancing The Value of Your Practice

- ▶ Focus on maximizing EBITDA. An EBITDA goal should be at least 20% of gross money collected.
- ▶ Remember EBITDA includes compensation taken out by the dermatology practice owner that exceeds the amount paid to the employee dermatologists.
- ▶ Hire one or more physician assistants to expand services.

Enhancing The Value of Your Practice

- ▶ Offer ancillary services and products that are higher profit and not subject to reimbursement rate reductions.
- ▶ Mohs surgery – add a new location for a broader geographic scope.
- ▶ Have an outside CPA prepare reviewed or audited financial statements, including calculating of EBITDA. Focus on increasing the gross margins of the practice.

Best Practices Process

- ▶ An effective transaction process:
 - Accounts for all deal components and identifies their order and interconnection
 - Assigns a timeframe and responsible party(ies) to each deal component
 - Has an effective intra and inter group system for communication
 - Establishes and adheres to all overall project timeframe or promptly address divergences

Best Practices Process

- ▶ Supports a commitment of the time and resources necessary to complete the transaction – management time must be freed up which may mean that other duties will need to be delegated as appropriate.
- ▶ Involves a willingness to be open and honest about issues and concerns and to address them in a timely fashion – do not delay addressing key issues of “touchy subjects” – address early in process.

Best Practices Process

- ▶ Involves a willingness to compromise – no party to a combination will get everything it wants.
- ▶ Recognizes that the transaction's success is materially determined by what happens after closing – a combination takes time to work – all parties must devote ongoing energy to its long-term viability.

Speakers

William C. Bundy

The Bundy Group, LLC

Bill is the Managing Member and Founder of Bundy Group, LLC, an investment banking firm. Bundy Group represents clients in mergers, acquisitions, and capital raises. He is actively involved in the sale and acquisition of dermatology practices, and his most recent representation included the sale of a multi-physician dermatology practice to an investment group. He is actively involved in the sales process of another dermatology practice currently. Bundy Group, LLC has been established for over 26 years, and has represented over 200 clients in the successful sale of their practices or businesses.

Richard S. Cooper

McDonald Hopkins LLC

Rick Cooper is a member with a law firm of McDonald Hopkins and is the chair of the national healthcare practice group and co-chair of the healthcare restructuring practice group. He works extensively with dermatology practices on M&A transactions. He has authored a number of articles on the subject of dermatology practice sales and is a frequent speaker for webinars and dermatology association meetings on the subjects of dermatology practice sales, consolidations and similar transactions. He is the co-author of a toolkit prepared for the American Academy of Dermatology on the subject of emerging dermatology practice models. He has been listed in The Best Lawyers in America for health law for 23 consecutive years, and has been selected for inclusion in Ohio Super Lawyers (2005–2016).

Brad Martorana

Snell & Wilmer

Brad Martorana focuses his practice on corporate and M&A transactions in Arizona and California, where he often represents healthcare practices and healthcare companies in acquisition and sale transactions, private equity/venture capital transactions, and other lending and financing transactions.

Q&A

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Thanks.

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