

Evaluating and Executing Physician Practice Acquisitions in Today's Market



25th Annual Compliance Institute

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1

Agenda



Introductions



Industry Review



Financial & Operational Considerations



Legal Considerations



Looking Ahead



Questions?

2

Presentation Team



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3

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Lara Flatau's practice focuses on mergers and acquisitions as well as regulation, compliance and operational issues for healthcare companies. She provides counsel to a variety of clients in the healthcare industry, including hospitals, skilled nursing, behavioral health, acute care and long-term care facilities, home healthcare agencies, physician practice management companies and healthcare information technology companies, among others.

Her practice includes:

- Mergers & Acquisitions** – Providing counsel in a variety of business transactions, including mergers, acquisitions, combinations and dispositions of hospitals, outpatient service providers and other healthcare companies; conducting due diligence and analysis of joint ventures, mergers and acquisitions from a business and healthcare regulatory perspective; analyzing regulatory requirements and operational impacts related to the purchase and sale of healthcare facilities.

- Contracting, Regulatory & Operational** – Advising clients on regulatory matters, including licensure and issues related to the corporate practice of medicine; assisting clients with various operational agreements, including physician employment and recruitment agreements.

Lara is active in various healthcare organizations including the Nashville Health Care Council and Leadership Health Care.

Prior to joining Bass, Berry & Sims, Lara practiced at Harwell Howard Hyne Gabbert & Manner, P.C.

4

4

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Brandt Jewell is a senior vice president at Coker Group where he leads the physician services team, which focuses on delivering value across all areas of ambulatory operations. He has extensive consulting experience related to executive leadership development, practice acquisitions, physician alignment strategies, operational efficiency, financial stability, organizational structures, revenue cycle management, and competitive landscapes for health systems and provider groups across the country.

Brandt partners with health systems, investors, and medical groups to implement operational solutions and strategies that improve provider entities' financial health. He also develops value-based care strategies for integrated networks of employed and independent providers.

5

5

INDUSTRY REVIEW

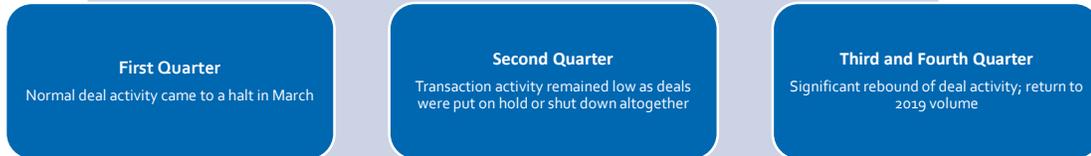
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6

6

General Overview – 2020 Physician Deal Activity

Peaks and Valleys



2020 opened with the promise of robust transaction activity involving physician practices, which is coming to fruition much differently than anticipated.

7

2020 Physician Deal Activity

Hot Physician Acquisition Sectors

Primary Care	•Several for-profit companies that are asset-light and poised for growth as payment models increasingly reward value-based care models that improve care delivery and outcomes
Women's Health - OB/GYN and Fertility	•Combination of demographics to older females starting families coupled with additional preventative care and even value-based payments •Historically younger and Medicaid patients to older Medicare services
Orthopedics	•Fragmented sector growing quickly with significant ancillary investment opportunities including ASC
Urology	•Fragmented sector growing quickly with ancillary investment opportunities including ASC
Ophthalmology	•Fragmented sector with demographics and supply demand concerns
Gastroenterology	•Fragmented sector with ancillary investment opportunities
Podiatry	•Fragmented sector growing quickly with significant ancillary investment opportunities including ASC
Other	•Vet (healthcare light), hospitalists, radiology, oncology, pathology, pain, dermatology, behavioral health

8

2020 Physician Deal Activity

Selected Transactions

- Radiology Partners acquisition of MEDNAX Radiology Solutions, a division of MEDNAX, Inc. (NYSE: MD)
- Advanced Dermatology and Cosmetic Surgery, Inc. Acquisition of Colorado Dermatology Specialists (Denver, CO) and Nielson Dermatology (Boynton Beach, FL)
- New platform U.S. Orthopedic Partners (launched by PE Chicago-based Thurston Group and San Francisco-based FFL Partners) acquisition of Mississippi Sports Medicine and Orthopaedic Center
- Paladina Health, a Denver, Colorado-based provider of primary care services, has acquired Healthstat, a privately held worksite health clinic provider in Charlotte NC, to help employers reduce healthcare costs and improve employee health through on and near-site health clinics and 24/7 access to virtual care.
- Oak Street Health, (NYSE: OSH) a Chicago-based network of value-based, primary care centers for adults on Medicare, announced in early Aug the pricing of its initial public offering of 15,625,000 shares of its common stock at \$21 per share. Today the stock trades near \$52
- Walgreens Boots Alliance, Inc. [NASDAQ:WBA], the retail and wholesale pharmacy company, based in Deerfield, IL, announced early July that it has agreed to invest USD 1bn in VillageMD, a Chicago-based provider of primary healthcare services.

9

FINANCIAL & OPERATIONAL CONSIDERATIONS

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10

COVID-19 Impact

- Significant differences in how investors and health systems are managing acquisitions
- Provider groups that would not previously have had interest in selling are now seeking buyers, both health systems and private investors
- Hospitals and employed medical groups are struggling to rationalize clinic locations and employed provider strategy, driving more interest towards other investors
- Acquiring parties, both investor and health system, are forced to be more selective with acquisitions
- Investors continue to target single specialty groups with scalable infrastructures, which requires unique management services and operational consistency
- Volume and pro forma analyses are less reliable, particularly if using 2020 data
- Telemedicine, remote patient monitoring, and virtual care are shifting the fundamentals of care delivery and practice economics / strategy
- Strategic plans have been set aside to focus on recovery and getting back to 100% of patient volume and revenue

11

11

Financial Due Diligence

In advance of the transaction, review financial data and information to identify opportunities and/or concerns related to the entity's financial performance, provider productivity, provider compensation and payer contracts. The financial due diligence scope will typically include but is not limited to:

- Benchmarking of historical compensation, productivity and related ratios against market data
- Payer contracting black box analysis
- Review of each entity's revenue recognition and overall revenue cycle financial ramifications for all entities (professional and technical fees)
- Revenue integrity assessment and validation
- Analysis of growth projections and financial pro forma

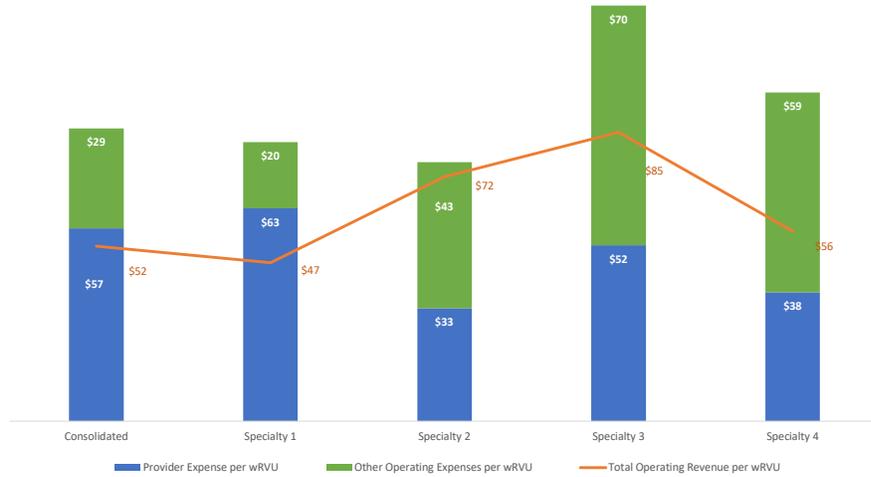
A coding audit is highly recommended during the due diligence process.

12

12

Financial Due Diligence Example

Revenue and Expense Profile per wRVU



13

13

Financial Due Diligence Example

Revenue Key Performance Indicators

Category	CY Actual	Physician FTEs	Market %tile
Total wRVUs	50,175	6.63	63
Total Encounters	21,988	6.63	71
wRVU to Encounter Ratio	2.28	6.63	31
Gross Charges - Practice Total	\$15,587,298		
Gross Charges - MD Total	\$13,937,317		
Gross Charges - MD Professional	\$11,515,986	6.63	77
Gross Charges - MD Ancillary	\$2,421,331		
Adjustments to FFS charges	(\$9,008,190)		68
Collections - Practice Total	\$6,550,696		
Collections - MD Total	\$5,717,419		
Collections - MD Professional	\$4,595,159	6.63	54
Collections - MD Ancillary	\$1,122,259		
Gross Collection % (Practice)	42%		34
Gross Collection % (MD)	41%		31
Net Collection % (Practice)	99.6%		83
MD Collections per wRVU (Professional)	\$91.58	6.63	58

14

14

Operational Due Diligence

In advance of the transaction, review both quantitative and qualitative components of the entity, including operational structure and workflows. Analyze data relative to best practice benchmarks and conduct on-site observations and interviews with key stakeholders, including providers, administrators and staff. The operational diligence process typically includes, but is not limited to:

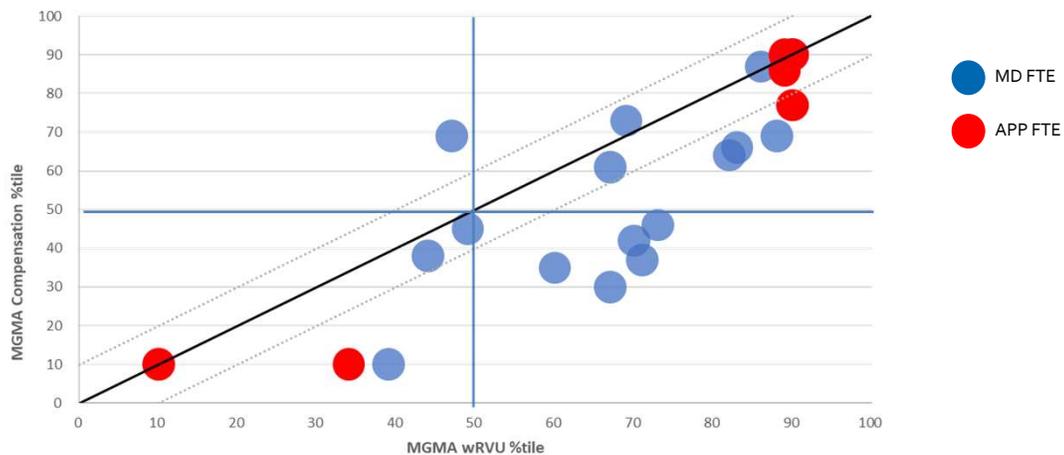
- Interview key stakeholders: providers, staff and management
- Review revenue cycle structure and processes, focusing upon accounts receivable, collections, denials, and claims processing
- Review organizational structure and span of control
- Review operational workflows and processes
- Assess non-provider staffing levels, benchmarking to industry standards and evaluating deficiencies and opportunities
- Review system (technology) utilization
- Evaluate overall operational structure, management proficiency and general viability for acquisition
- Prioritize findings and high-level recommendations

15

15

Operational Due Diligence Example

Provider Productivity and Compensation Benchmarking

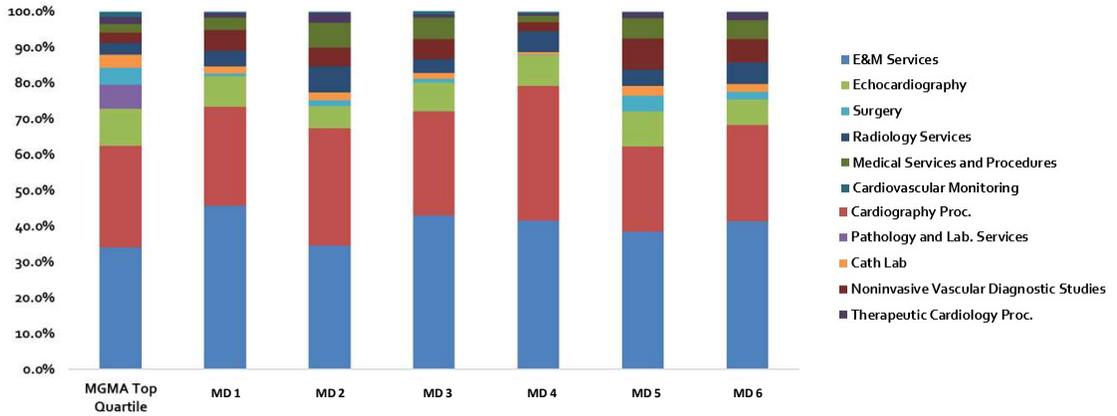


16

16

Operational Due Diligence Example

Procedure Profile by Physician – Cardiology Example

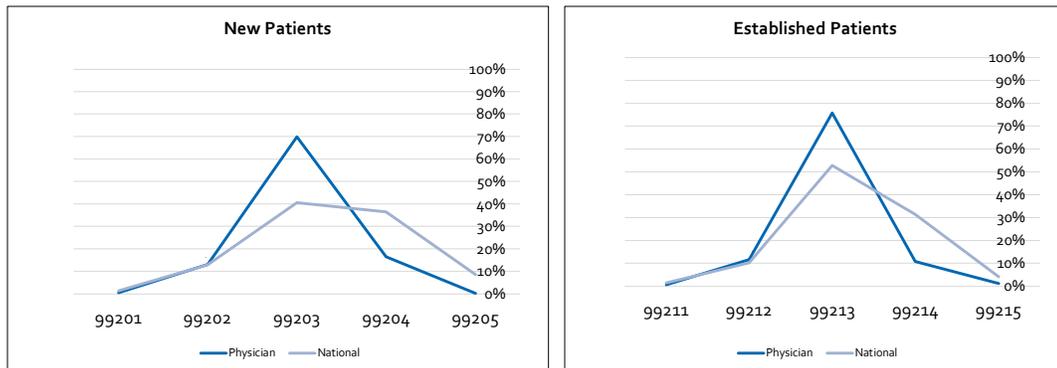


17

17

Operational Due Diligence Example

Coding Bell Curve Analysis



18

18

Financial Due Diligence Example

Non-Provider Staffing Analysis

CURRENT STAFF FTEs			FTE Need (Reduction)
Sector	wRVUs	Total FTEs	Total
Location 1	9,172	9	(4.68)
Location 2	13,182	10	(3.79)
Location 3	7,297	10	(6.56)
Location 4	13,646	10	(3.57)
Location 5	11,492	10	(4.59)
Location 6	11,166	12	(6.74)
Location 7	13,870	13	(6.47)
Location 8	11,962	9.0	(3.4)
Totals (before Float)	91,788	83.0	(39.8)
Float Pool		12	
Grand Total (with Float)	91,788	95.0	(51.8)

Staff Role	Current FTEs	wRVUs	MGMA Median	Recommended FTEs	FTE Need (Reduction)
Medical assistants, nurse aides	5.44	31,450	2.40	7.55	2.11
Medical receptionists	2.59	31,450	1.64	5.16	2.57
Clinical laboratory	2.83	31,450	0.44	1.38	(1.44)
TOTAL	10.86	31,450	--	14.09	3.23

19

19

Post-Transaction Optimization

After closing the transaction, all parties should prioritize and implement recommendations resulting from the operational and financial due diligence. Priorities will vary significantly for each transaction and should be addressed strategically from compliance, operational, and financial perspectives.

- Revenue cycle management
- Operational policies and procedures, workflows, resources
- Leadership and staffing integration to include training and education
- Information system integration and transition
- Accounts receivable management
- Patient and provider communication plans
- Marketing strategy

20

20



LEGAL CONSIDERATIONS

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21

21



Key Legal Considerations for 2021

- While transaction structures largely remained unchanged, COVID-19 created additional areas of focus in diligence and negotiation of definitive transaction documents
 - Participation in COVID-19 Relief Programs
 - Due Diligence
 - Specific Representations and Warranties (including RWI exclusions)
 - Increased frequency of Earnouts/Contingent Payments
 - COVID-19 Specific Covenants
 - Closing Conditions relating to COVID-19 Matters
 - Indemnification Terms

22

22

COVID-19 Relief Programs

- Paycheck Protection Program
 - Many physician practices were eligible for and received relief by obtaining PPP loans
 - Depending on size of loan, practice will be subject to automatic audit by the SBA
 - Consent from PPP lender and SBA required in connection with change of ownership
 - Some buyers required PPP funds to be returned before Safe Harbor Date
- HHS Provider Relief Funds:
 - Physician practices are required to make certain certifications regarding satisfaction of terms and conditions
 - Physician practices are required to comply with documentation and reporting requirements
 - Anticipate retrospective review of funds received and use of funds by HHS/OIC
- Other Relief:
 - Employee Retention Tax Credit
 - Participation in Multiple Programs; Effect on PE portfolio companies

23

23

Due Diligence

- Financial Diligence: Assess target's financial condition, accounts receivable, etc.
- Impact of pandemic on target's business:
 - Customer and vendor relationships
 - Changes in hours/policies and procedures relating to operation of physician practice
 - Workforce Changes (layoffs, furloughs, reductions)
- Compliance with Laws
 - Labor/Employment
 - Local/State Laws and Regulations
 - Relief Programs (eligibility and compliance with program "rules")
 - HIPAA

24

24

Representations and Warranties

- Consider whether to include COVID Specific Reps and Warranties or rely on standard reps that may already cover any COVID-related matters
- COVID Specific Reps:
 - Compliance with COVID Related Laws (including changed workplace regulations)
 - No Material Adverse Effect; Seller is Operating its Business in the Ordinary Course
 - Disclosure of COVID-19 Measures in Place
 - Vendors/Customer performance under contracts
 - Specific Reps relating to PPP Loan and/or Provider Relief Funds
- Representations and Warranties Insurance
 - Current Landscape
 - COVID Related Exclusions

25

25

Earnouts / Contingent Payments

- Bridging the Valuation Gap
- Post-Closing Disputes
- Beware of anti-kickback risks when structuring contingent payments involving potential referral sources

26

26

Covenants and Closing Conditions

- Covenants:
 - Operation of the practice in the “ordinary course”. How do the parties define ordinary course?
 - Third-party consents
- Closing Conditions:
 - No Material Adverse Effect (How is this defined?)
 - No COVID-Measures in Place (shelter-in-place; social distancing; executive orders)
 - Third Party Consents (including SBA/bank consent for PPP Loan recipients)
 - Debt Financing
 - No defaults under material contracts
 - Bring-down of reps and warranties

27

27

Indemnification

- Similar Considerations as Pre-COVID Transactions
 - Asset vs. Equity Deal
 - Classes of Representations (e.g. Ordinary, Special and Fundamental)
 - Specific Indemnity?
- Representations and Warranties Insurance:
 - General Exclusions
 - COVID Exclusions (broad vs tailored)

28

28

LOOKING AHEAD

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29

29

Post-Pandemic Physician Affiliation

Hospital – Physician Affiliation



- Physicians will have an enhanced level of interest in affiliation and alignment.
- The interest from hospitals will be more selective, and potentially the compensation they offer to physicians may be less lucrative (in economic terms).
- In the alternative, contract structures may change putting a greater portion of compensation to the provider at risk such as being based on production and clinical outcomes.
- Hospitals will be able to select from those physician groups they believe are most strategically, tactically, and clinically proficient. This factor will depend on the overall supply within their service area.
- While the interest in alignment transactions will increase, transactions may not happen quickly, given the priorities of hospitals and health systems, as well as private practicing physicians to return to their normal progression and volume of services.
- Telehealth will be an increasing factor of transactions going forward. This will include its ability to impact quality of care and value-based reimbursement.

30

30

Post-Pandemic Physician Affiliation

Physician – Physician Affiliation



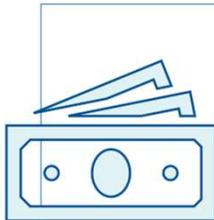
- Multispecialty group mergers, while always a difficult challenge, will not predominate in the marketplace in the immediate term.
- Single-specialty mergers may create interest as an alternative, especially if hospital integration is not probable.
- The reasons for merging will continue to exist post-pandemic, but because of financial and other more pressing needs, mergers among groups—single specialty or otherwise—will be limited.
- Mergers, though the interest may be limited, may be “legal only” structures with limited and-or deferred operational combinations.
- Many physician groups will seek a private equity investor instead of or in addition to group mergers.

31

31

Post-Pandemic Physician Affiliation

Investor – Physician Affiliation



- Private equity deals may be deferred for a short period as PE firms address the issues of existing investments.
- Private equity firms will be in the healthcare market in a substantial way—perhaps more than any other industry.
- Because they will have abundant options from which to choose, PE firms will be more selective and only align with top performing groups and consortiums.
- Physician groups and related healthcare entity sellers to private equity may have to retain greater equity (albeit a larger minority interest) and be willing to accept lower multiples on EBITDAC.
- In general, private equity organizations will be aggressive, selective, and still subscribe to significant ROI, placing more stress on the physicians to perform.
- Physician groups will be challenged to convince their partners to pursue a PE transaction. Compensation reductions that result from PE deals will not be well-received, given the significant loss of income in 2020.

32

32

Additional Resources

Information Links

- [Bass Berry Sims – Private Equity Dealmakers Guidebook to Healthcare M&A During the COVID-19 Pandemic](#)
- [Bass Berry Sims – Healthcare Transactions Year in Review](#)
- [Bass Berry Sims – Healthcare Mergers, Acquisitions & Dispositions](#)
- [Coker Group - Compliance Risk Mitigation in Healthcare Mergers and Acquisitions](#)
- [Coker Group - Post-Merger Integration Strategy Starts Early](#)
- [Coker Group - Post-Pandemic Crisis Affiliation: Which Way is Up?](#)
- [Coker Group - An In-Depth Look at Private Equity Transactions in the Healthcare Services Sector](#)

33

33

THANK YOU

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34