

# Private Equity Investment in Physician Groups

---

JOY HORD, ESQ.

*PARKER POE*

TODD ZIGRANG, MBA, MHA, FACHE, CVA, ASA

*HEALTH CAPITAL CONSULTANTS*

# Presenter Bio

---

**Joy M. Hord, J.D.**, is a partners in the Charlotte office of the law firm of Parker, Poe, Adams & Bernstein, LLP where she provides legal representation to hospitals, physician practices, and other healthcare providers and facilities. Ms. Hord has over 20 years of experience representing physicians and physician groups in affiliation transactions, including acquisitions, joint ventures, professional services arrangements and management relationships. Ms. Hord is a graduate of Davidson College and Vanderbilt School of Law. She is recognized as an expert in healthcare law by Woodward/White's The Best Lawyers in America in Health Care Law and Chambers USA's list of America's Leading Lawyers in Health Care Law. She is a frequent speaker on healthcare law issues.



Direct Dial: (704) 335-9848

Email: [joyhord@parkerpoe.com](mailto:joyhord@parkerpoe.com)

# Presenter Bio

**Todd A. Zigrang, MBA, MHA, FACHE, CVA, ASA** is the President of **HEALTH CAPITAL CONSULTANTS (HCC)**, where he focuses on the areas of valuation and financial analysis for hospitals, physician practices, and other healthcare enterprises. Mr. Zigrang has over 23 years of experience providing valuation, financial, transaction and strategic advisory services nationwide in over 2,000 transactions and joint ventures involving acute care hospitals and health systems; physician practices; ambulatory surgery centers; diagnostic imaging centers; accountable care organizations, managed care organizations, and other third-party payors; dialysis centers; home health agencies; long-term care facilities; and, numerous other ancillary healthcare service businesses. Mr. Zigrang is also considered an expert in the field of healthcare compensation for physicians, executives and other professionals.



Mr. Zigrang is the co-author of the “*Adviser’s Guide to Healthcare – 2<sup>nd</sup> Edition*” (AICPA, 2015), numerous chapters in legal treatises and anthologies, and peer-reviewed and industry articles such as: *The Guide to Valuing Physician Compensation and Healthcare Service Arrangements* (BVR/AHLA); *Valuing Professional Practices and Licenses* (Aspen Publishers); *Business Appraisal Practice*; and, *The Value Examiner*. Additionally, Mr. Zigrang has served as faculty before professional and trade associations such as the American Bar Association (ABA); American Health Lawyers Association (AHLA) National Association of Certified Valuators and Analysts (NACVA); Physician Hospitals of America (PHA); Healthcare Financial Management Association (HFMA); and, CPA Leadership Institute.

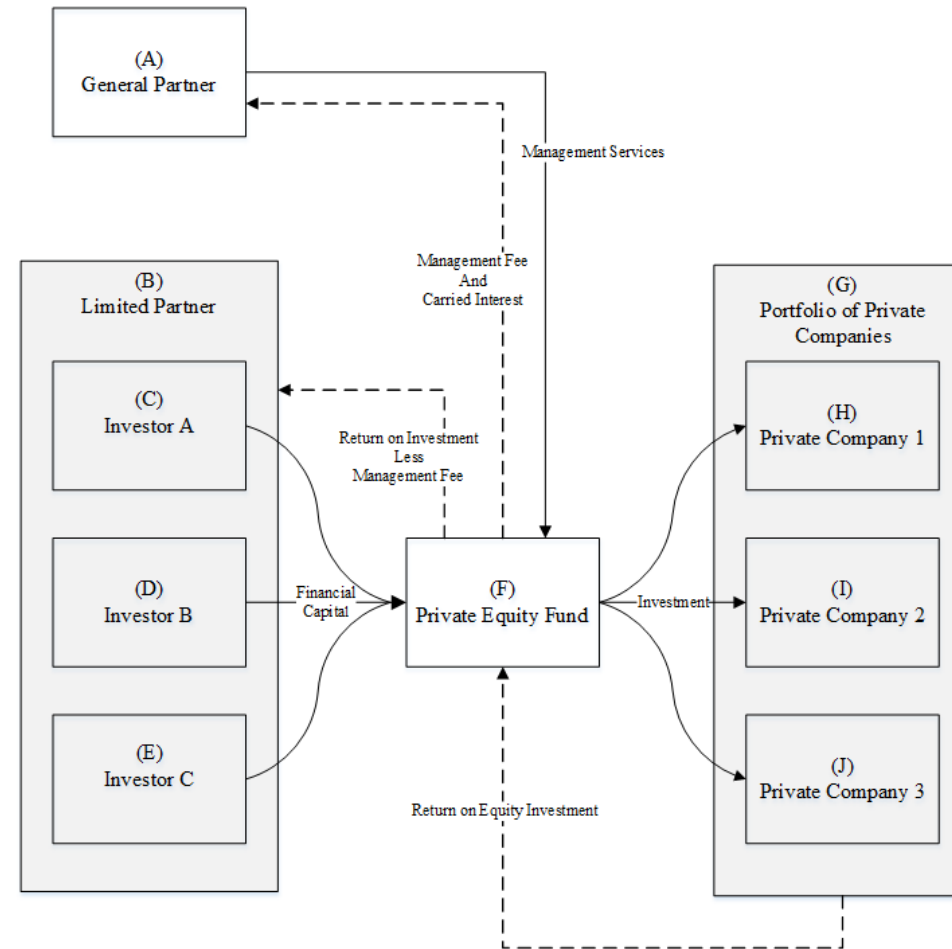
# Session Agenda

---

- What is “Private Equity”?
- What are the national/regional/local trends regarding medical practices?
- What types of practices are private equity investors most interested to partner with?
- How is private equity investment structured?
- What are the NC specific rules and limitations on investment in medical practices?
- What happens next? Is private equity worth it?

# What is “Private Equity”?

- Sample of a simplified private equity fund:



# What is “Private Equity”?

---

➤ 4 typical areas of private equity investment:

1. Venture Capital

- The traditional concept (what most think of when they hear “private equity”)
- Seek out investments in early to mid-stage startup companies (often pre-revenue)
- Commits capital to a portfolio of potential firms with the knowledge that often these companies will never achieve profitability, but a potentially small number of the investments may generate returns sufficient to offset the losses from the non-performing investments

# What is “Private Equity”?

---

➤ 4 typical areas of private equity investment:

## 2. Distressed Companies

- For those looking to manage a turnaround
- Involves investment in firms that have a solid core concept, but perhaps also have issues with capital access or with low quality of management
- These investments often require a considerable amount of management control to be exercised by the private equity firm
- Private equity funds investing in distressed companies will often have a short term (i.e., 3 to 5 year) investment horizon, after which they will divest of the (hopefully healthier) firm at a premium over their acquisition price

# What is “Private Equity”?

---

➤ 4 typical areas of private equity investment:

3. Mezzanine Financing

- In the gray area between debt and equity financing
- Involves investment through debt which may be convertible to equity or include purchase warrants/options for equity at a specified price in the future
- Often secured by late stage startup firms that have a reasonable track record of profitability and provide greater flexibility than traditional senior debt, e.g., the ability to capitalize interest into the loan in the event that the company fails to generate sufficient income to make an interest payment



# What is “Private Equity”?

---

➤ 4 typical areas of private equity investment:

## 4. Buyouts

- *Similar* to distressed company investments in that:
  - Their strategy involves the acquisition of companies with the goal of restructuring the firm to enhance profitability for sale under a relatively short time horizon
  - They provide an enhanced depth of management and access to capital that allow the acquired company to reach its full potential
- *Differ* in that they are not necessarily seeking out financially distressed firms to invest in – instead, they are seeking firms with unrealized cash flow potential that, under the right type of management, could be fully achieved

# National Trends

---

- Acquisition Prices Paid by Private Equity
  - Typically based on earnings before interest, taxes, depreciation, and amortization (EBITDA)
    - Platform Practices: 8-12x EBITDA
    - Smaller Practices: 2-4x EBITDA
- Variables that may increase/decrease price or practice:
  - Existence of ancillary services
  - Whether specialty/practice is anticipated to be in high demand going forward (i.e., a service that will be utilized by aging *Baby Boomer* population)
  - Whether the specialty/practice is scalable (identification of “add-on” practices) and the opportunity to manage risk through improved practice performance
  - Physician owner compensation increase/decrease after transaction

# Regional and Local Trends

---

- Physician Practice Specialties with the Most Private Equity Activity
  - Primary Care
  - Dermatology
  - Dental
  - Ophthalmology
  - Pain Management
  - Orthopedic Surgery
  - Urology
  - Behavioral Health
  - Hospital-Based Practices (e.g., Emergency Medicine, Anesthesia, Radiology)
- Physician practices with significant revenue streams beyond physician services
  - Diagnostics and other medical peripherals
  - Services provided by allied professionals
- Physician practices with the potential to add significant revenue streams
  - Screening mammography, laboratory services
- Physician practices with exclusive and/or long term professional services agreements
- Physician practices with significant purchasing needs (e.g., oncology drugs)

# Structure of Private Equity Investment

---

## ➤ Direct/Majority Ownership (Typical)

- Will typically create a wholly-owned subsidiary company for the acquisition, which holds ownership interest in the acquired company; may also include equity swap (target company owners receive remuneration in the form of a partnership interest in the limited partnership of the PE or VC fund)
- Recent example – July 2018 sale of Kindred Healthcare

## ➤ Physician Practice in NC

- Investment is through a joint venture or separate management company
- Physician retains an equity position in the new entity (20-30%)

# Structure of Private Equity Investment

---

## ➤ Joint Venture

- Private equity firm can provide financial capital and management expertise
- Healthcare industry partner can provide the specialized knowledge, skills, and abilities necessary to assess the value of healthcare enterprises and to provide expertise in operations post-acquisition
- Affords both members independence in their operations, while sharing in the profit stream generated by the joint venture
- Example – 2011 joint venture between Ascension Healthcare and Oak Hill Partners

# Structure of Private Equity Investment

---

- Management Services Organizations (MSOs)
  - Provide management services, such as, billing, administrative, financial and accounting, human resource and staffing services, to physician practices, typically for a management fee (can be either fixed fee or percentage of practice revenue)
  - Allows private equity firms to participate in the healthcare industry without running afoul of regulatory restrictions such as state Corporate Practice of Medicine prohibition; must still be mindful of Fee Splitting prohibition in NC
  - Example – August 2018 partnership between JW Childs (JWC), a private equity group, and New Jersey Urology (NJU), a large urology practice

# Structure of Private Equity Investment

---

## ➤ Real Estate Investment Trusts (REITs)

- Similar to MSOs in that this structure allows private equity firms to participate in the healthcare industry without running afoul of regulatory restrictions
- Similar to private equity firms in that both collect funds from multiple investors with the goal of acquiring a portfolio of assets that will generate a stream of income in the future
- Particularly popular in the long-term care subsector
- Example – July 2018 transaction between Apollo Global Management and HCP, Inc.
- Currently significant interests in NC in investing in properties leased to stable physician practices (often buying out the physician owners of RE)

# NC Specific Rules/Limitations on Medical Practice Investment

---

## ➤ Corporate Practice of Medicine

- NC Medical Board Position #1 – Businesses practicing medicine in NC must be owned in their entirety by persons holding active NC licenses
- NC Medical Board Position #2 – Physicians must not divide professional fees with non-professionals
- Lawsuits in NC bringing corporate practice of medicine to forefront
- Rise in enforcement by NC Medical Board (censure letters)



# Other Considerations on PE Investment/Relationship

---

- Employment terms, including covenant not to compete, grounds for termination
- Community/hospital relationships (and barriers to entry for competition)
- In NC, a CON must be obtained for certain types of facilities, peripheral/diagnostic services and other expansions
- Prohibitions on payment for referrals (federal and state)
- General healthcare landscape

# What Happens Next?

---

- Contract representations and warranties, personal indemnity
- PE firms do not typically want day-to-day management of the company
  - Balance between PE Control and the Physicians' Clinical Control through the Board and Committees
- Private Equity's relatively short holding period – typically 3-7 years
  - Motivates a near-sighted perspective affecting patient care
    - Longer-term projects with the potential to improve patient outcomes may be foregone in favor of strategies that maximize the profitability in the near term to facilitate a more profitable exit

# Is Private Equity Worth It?

---

- PE Gut Check – Questions physicians should ask themselves:
  - Do I want to be part of a platform practice or a rollover?
  - Can I relinquish control of management decisions to the private equity firm? How much?
  - What if the private equity firm sells out subsequent to our transaction (or there's even a second subsequent transaction)?
  - What is my time horizon (*i.e.*, to retirement)?
  - What are my personal exit options (non-compete considerations)?