PRIVATE EQUITY AND OPHTHALMOLOGY IN THE ERA OF COVID-19

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2021 AAOPS Annual Meeting

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FINANCIAL DISCLOSURES

Advisory Board – Nevakar, LLC

Employee - Mednax

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Private Equity Deal: Basics of the Deal

- Private Equity Firm offers practice a load of cash: 2-4x EBITDA for smaller practices, 8-10+ for "platform practice" ($2-3 million or more EBITDA).
- PE Firm won't assume any liabilities—any debt the practice has will need to be paid off.
- PE Firm then pays physicians a base salary with bonus structure, usually less than the physician was earning previously.
- PE Firm offers contract for guaranteed employment by physician for x number of years (5-10 years is typical).
  - Note: if you decide to leave early, you will likely owe the company money: caveat emptor
- You will likely need to sign a restrictive covenant.

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Negotiating the Deal

- PE Firms are willing to negotiate on the initial purchase price, reimbursement per wRVU (or however they are going to pay you), possibly a bonus or equity structure, but not likely on all fronts.
- Due diligence process is important for both sides.
- Get financial advice from your practice administrator or accountant.
- Hire a good attorney who has negotiated these deals before.
  - You still need to read the contracts carefully, but you also need an attorney with experience to translate the legalese and compare to standard practices.

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Negotiating the Deal

- If you own an optical, be sure that you have a plan for that business with regard to the sale.
- If you own real estate, you will need a plan for how to deal with this: maintain ownership and lease to PE Firm, or sale/leaseback to a REIT.
- It's a good idea to research the PE Firm so that you know what their long-term objective is:
  - Some firms aim to grow but stay an independent firm
  - Some firms are adding lines of business to diversify and make themselves stronger;
    - With the aim of being "unassailable" in the marketplace, i.e. too big to fail
    - With the aim of being acquired by a larger company
  - Most are growing to sell down the road
    - The timeline here and your contract with them become very important in this situation

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Negotiating the deal

- Sign the nondisclosure agreement.
- Be thorough in your due diligence: both parties need to know as much about the other as possible.

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Take Time to List the Pros and Cons

PROS

- Purchase Price allows investment now for retirement
- Insurance contracting
- Stock options/equity
- Improved benefits for employees
- Ability to add docs, open new offices or purchase equipment
- Insulate against unknown changes to healthcare industry
- Higher salary?

CONS

- Loss of control
- Less freedom for time off or extracurricular engagement
- Limits to using pre-tax dollars to pay for things like meetings, dues, etc.
- Unanticipated expenses
- Conflict between partners (age)
- Layer of bureaucracy
- Loss of control over hiring/firing
- Lower salary?

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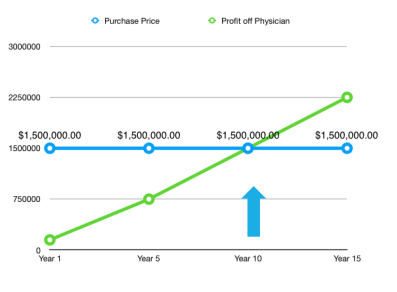
Private Equity Deal: How Does This Work?

- PE Firm lays out cash to purchase the practice
- PE Firm pays physicians less than they are taking in
- PE firm is hoping to sell down the road at increased EBITDA



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It's Not Such a Simple Issue

- Need to consider a number of factors that influence the crossover in your timeline:
  - Capital gains taxes vs. your personal taxes
  - Opportunity of investing the bolus of money
  - The compounding effect of interest
  - Your timeline to retirement
  - Any equity you have in the new company, stock options, etc. and the potential for growth or loss
  - Company's plan to sell or be acquired: can be a pro or a con
- Remember, to PE Firm is in business to make money and they have the leverage in these financial deals.

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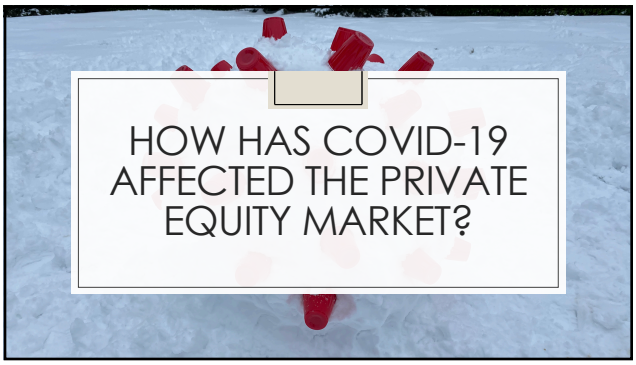

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The Pause

- More than 20 PE transactions in ophthalmology in the first quarter, 2020
- In March, April and May, these transactions ground to a halt.
  - Deals that were nearly complete were paused, but most closed a few months later
  - Deals in the nascent stage were put on hold while PE firms and their lenders assessed the risks and weighed them against the uncertainty of resumption of business for ophthalmology practices.
  - Complicating factors such as the patchwork nationwide response to the pandemic and geographic variances of the pandemic's impact to ophthalmology practices made the assessment more difficult.
- In the third quarter, more than a dozen transactions were reported, suggesting renewed vigor in acquiring ophthalmology practices.

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Valuations

- It's not clear what the impact here will be: if you are considering selling, the fine print will be important.
- Some valuations have gone down because the valuations are based on EBITDA and most physician practices had a reduction in EBITDA due to the pandemic.
- Some PE firms are basing valuations on 2019 EBITDA while requiring proof that the practice has returned to pre-COVID or near to pre-COVID levels.
- Some PE firms have changed the deal structure in the way the purchase price is paid out.
  - Part of the purchase price may be held back as a "milestone" payment, with the practice required to demonstrate return to pre-COVID financial performance to receive the balance of the payment.

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The Flip

- To continue to attract investors, PE firms must deliver a high rate of return.
- The goal of some firms is to sell to a larger firm in a short 3-5 year timeline. Others seek to sell practices at a healthy profit in a similar time frame.
- Experts think that the COVID-19 pandemic will delay these practice "flips" by 1-3 years, depending on many factors:
  - Return to full financial performance
  - Changes in payor mix
  - Changes in local insurance demographics
  - Increased expenses to practices for PPE, cleaning, breakdown of equipment and furnishings due to the enhanced cleaning schedules
  - Fluctuation in staffing due to COVID-related personnel changes

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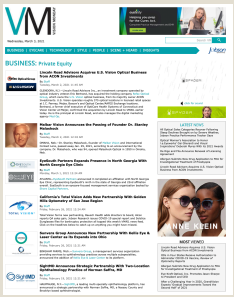
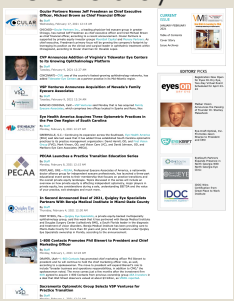
It's Clear PE is Here to Stay





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Post-Acquisition Challenges

- General
- Staff
- Clinic Operations
- Technical Staff
- Physicians
- The Unexpected

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Post-Acquisition Issues: General

- New layer of management may not affect you much, but it will be a HUGE adjustment for your practice manager.
- Employee stress over adapting to change:
  - new software, new procedures for purchasing equipment, supplies, new reporting structure and procedures, change in operations for optical, ASC, etc.
- Tech and physician stress over adapting to a new PM software, EHR, office procedures and policies, complaints from patients, etc.

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Post-Acquisition Issues: General

- Contracting issues.
  - PE Firm probably won't start contracting until the deal is inked.
  - If they don't know ophthalmology, they may not realize the need to contract optometrists, to contract with vision as well as medical insurances, etc.
  - Different price structure
  - Servers, computers, compatibility with ophthalmology devices, technology and software
  - This can significantly affect your pay in the first year; don't drop your guard and assume they will do this correctly!

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Post-Acquisition Issues: General

- Reporting to Upper management
  - Additional layer of responsibility for the office manager and the medical director
- Are they paying you according to contact?
  - Are they interpreting reports and data correctly?
- Limits on purchasing office supplies, snacks for staff, office equipment, etc.
- Changes to office expenses
  - Cell phones used as pagers no longer covered
  - Annual allotment for CME and travel

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Post-Acquisition Issues: General

- Management of ASC
- Management of Optical
- Will they allow a staff member to pursue AR from the old practice?
- What is the process to purchase new equipment

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Post-Acquisition Issues: Staff

- May need to have regular staff meetings to walk your employees through transition issues
  - Explaining 401k changes
  - Explaining other benefits
  - Changes to how vacation/personal leave time are accrued
  - Employees adapting to having to pay something for their healthcare insurance
  - Navigating benefits portals, expense portals, CE options, etc.
  - Discussing changes to reporting, ordering, workflow, etc.

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Post-Acquisition Issues: Clinic Operations

- Front desk operations may need to change.
  - New phone system; new PM software; new sign pads, scanners, etc.
- Scheduling templates may need to be reworked based upon patient flow with new software.
- Billing and other staff roles may change.
- Purchasing rules and requirements may change.

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Post-Acquisition Issues: Technical Staff

- Patient flow may need to be adjusted if new software is involved.
- Workflows may need to change
  - How many patients per hour
  - What types of exams
  - Which order special tests or exam elements are performed
- Optical processes
  - Inventory management
  - Reporting structure to upper management
  - Changes to suppliers or vendors

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Post-Acquisition Issues: Physicians

- Senior vs. Junior Partners and how the deal was structured.
- Adapting to change
- Loss of control and decision-making power
- Staying a role model for all the staff

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Post-Acquisition Issues: the Unexpected

- VSP refused to contract with the new company
  - They only contract with physician-owned practices
- Byzantine process by which they pass along pay from an external contract
- New company's fee schedule is excessively high compared to our old schedule
  - Lots of complaints and angry tirades on social media: big hit to our Yelp rating
  - New company didn't understand the retail business of optical and local price competition for eye exams; wanted to price all contact lens fittings at $225 regardless of complexity.
  - Any new line of business for the PE Firm will require your firm guidance in this transition

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Post-Acquisition Issues: the Unexpected

- Optical
  - Mednax has rules and security restrictions on who can do what
- Changing EHRs
  - Ouch
- Real Estate
  - How this is handled is critical.
  - Contracts for assumptions of lease for to your real estate interest

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Summary

- Private Equity deals can be a win for the physician practice
  - Short timeline to retirement, it's a no-brainer
  - Long timeline to retirement needs careful consideration
- Beware the allure of money
- Be sure to do your due diligence
  - Know the company
  - Frank discussions with partners, associates, and with staff
  - Get it in writing!
- If you move forward with the deal, recognize that the first three years will be tumultuous
  - Even with good planning, the transition can be rocky and the unexpected is never welcome.

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