The Future of Health Care: Physician Practices and Private Equity Investments

Private Equity in Gastroenterology: Becoming a Platform

September 20, 2017
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Provident and EBG Introduction
Service Offering
The Provident Healthcare Partners investment banking team partners with healthcare organizations to provide advisory services related to mergers and acquisitions, equity and debt capital raises, private placements, and financial restructuring. The team has a vast network of high-level, senior industry contacts, a thorough knowledge of market sectors and specialties, and unsurpassed experience and insight into the transaction process. Provident uncovers value and opportunities that others often overlook to create transaction premiums for its clients.

The firm provides financial advisory services to healthcare leaders in the following sectors:
- Behavioral Health
- Health Plans
- Healthcare IT
- Healthcare Distribution
- Life Science Services
- Outsourced Hospital Services
- Post-Acute Care
- Multi-Site Physician Providers

National Presence

Note: The above map represents Provident client headquarters locations. Provident has successfully closed transactions with clients with operations in 45 states and Puerto Rico.
### Firm Overview

#### About Our Firm: Epstein Becker Green

**Epstein Becker Green**

Epstein Becker Green was **founded in 1973** exclusively as a health law firm dedicated to the success of the health care industry which remains the firm’s focus today.

The firm is highly regarded as a **legal pioneer in the health care and life sciences industry** and have been nationally influential on health regulatory issues and business solutions for over four decades.

Epstein Becker Green attorneys have significant experience leading major health care company **mergers, acquisitions, sales and affiliations** on behalf of national health care companies (public and private), private-equity backed health care portfolio companies, and local and regional health care providers and companies.

<table>
<thead>
<tr>
<th><strong>24</strong></th>
<th>Landmark Deals Per Year</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>168</strong></td>
<td>Physician Deals Closed Since 2014</td>
</tr>
<tr>
<td><strong>14</strong></td>
<td>Offices Across the Country</td>
</tr>
<tr>
<td><strong>250</strong></td>
<td>Attorneys</td>
</tr>
<tr>
<td><strong>120</strong></td>
<td>Health Care Attorneys</td>
</tr>
<tr>
<td><strong>70</strong></td>
<td>Health Care Transactions Attorneys</td>
</tr>
</tbody>
</table>

- Supported by a deep multi-disciplinary team of healthcare regulatory, antitrust, reimbursement, tax, employment, benefits & real estate attorneys to assist in due diligence and all aspects of preparing groups for transactions and closings.

- Ranked among the top 10 firms in the 2017 *Modern Healthcare* “Largest Healthcare Law Firms” list.

- Ranked in Healthcare Nationwide and in the District of Columbia, New York, and New Jersey in 2017 by *Chambers USA*.
Goals of this Presentation

- What is Private Equity?
- Why is Private Equity Interested in Gastroenterology?
- What Are The Key Transaction Considerations in Gastroenterology?
- What Are The Key Regulatory Considerations in Gastroenterology?
What is Private Equity?
Private equity refers to the investors and funds that seek to make direct equity investments in privately-owned companies. With the capital of Limited Partners and the expertise and management of General Partners, PE firms have a record of market-exceeding returns.

### Private Equity Structure

**Limited Partners**
- Passive investors expecting a higher return on investment than attainable in public markets
- Includes: institutional investors, pension funds, endowment funds, and high net worth individuals

**PE Firm / General Partners**
- Group of managers that raise money for individual funds and manage the funds and investments.
- Compensation: Carried interest, a percentage of returns when an investment is sold, and management fees, a percentage fee applied to the total funds invested by the LPs

### Overview of a PE Fund

#### Parties Involved
- **Limited Partners** are passive investors expecting a higher return on investment than attainable in public markets
  - Includes: institutional investors, pension funds, endowment funds, and high net worth individuals
- **General Partners** are a group of managers that raise money for individual funds and manage the funds and investments.
  - Compensation: Carried interest, a percentage of returns when an investment is sold, and management fees, a percentage fee applied to the total funds invested by the LPs

#### Strategy
- Invest in high quality businesses within the fund’s industries of expertise that can be grown organically and through acquisitions
- Maintain management and provide support on high-level decisions
- Provide financial resources for acquisitions and internal investment while optimizing the business’ capital structure

#### Goals & Incentives
- Funds aim to make a return on their equity (often about 3x-4x)
- Funds plan to exit investments after a period (commonly 3-7 years)
- High returns lead to income for the GPs and in improved ability to raise investments for their next fund

With the capital and strategic resources of a private equity fund, managers can grow their business at an accelerated rate and earn substantial returns at each liquidity event.
Private Equity Investment Strategy

What is Private Equity?

Strategic Initiatives Leading to Growth

Refine Internal Infrastructure and Establish Growth Objectives

Consolidate Market Locally and Regionally

Establish Regional Hubs

Explore Exit

How Equity Value Appreciates

Synergies

Bolster Management Team

Expanding Ancillaries

Multiple Arbitrage

Risk-Based Contracting

Add On Acquisitions
## Private Equity “Roll Up” Successes

### What is Private Equity?

<table>
<thead>
<tr>
<th>Physician Practice/Private Equity Group</th>
<th>Add-on Acquisitions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dental</strong></td>
<td>Great Expressions Dental Centers &amp; Audax Group</td>
</tr>
<tr>
<td></td>
<td>Family Smiles Dentistry</td>
</tr>
<tr>
<td></td>
<td>ConsoliDent</td>
</tr>
<tr>
<td></td>
<td>Exceldent</td>
</tr>
<tr>
<td><strong>Ophthalmology</strong></td>
<td>Katzen Eye Group &amp; Varsity Healthcare Partners</td>
</tr>
<tr>
<td><strong>Pain Management</strong></td>
<td>The Spine Center &amp; Sentinel Capital Partners</td>
</tr>
<tr>
<td><strong>Women’s Health</strong></td>
<td>Women’s Healthcare Group of PA &amp; Audax Group</td>
</tr>
</tbody>
</table>

(1) Provident served as the exclusive sell-side advisor on all case study platform transactions.
Why is Private Equity Interested in Gastroenterology?
Demand from Aging Population
Why is Private Equity Interested in Gastroenterology?

**Aging Population**

- The number of U.S. citizens aged 65 and over is projected to more than double its 2000 level by 2030 (an increase from 35.0 million to 71.5 million).

- A study by the American College of Gastroenterology found that between 2004 and 2008, the incidence rate of colorectal cancer diagnoses for those aged 65 and older was 247.6/100,000, compared to 18.2/100,000 in those younger than age 65.

**Prevalence of Chronic Conditions**

- In March of 2017, the CDC released new data showing the rate of colorectal cancer screening in both men and women doubled from 2000 to 2015.

- On average, 25% of adults who are 60 years old have one or more polyps, and after age 50 the risk of developing polyps doubles every 10 years.

Sources: Administration on Aging, AAMC, ACL, World Bank, Transactions of the American Clinical and Climatological Association, CDC
**Shift to Outpatient Care Settings**

**Why is Private Equity Interested in Gastroenterology?**

<table>
<thead>
<tr>
<th>Year</th>
<th>Outpatient Spending</th>
<th>Inpatient Spending</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>$4,922</td>
<td>$7,965</td>
</tr>
<tr>
<td>2015</td>
<td>$4,655</td>
<td>$7,642</td>
</tr>
<tr>
<td>2014</td>
<td>$4,360</td>
<td>$7,249</td>
</tr>
<tr>
<td>2013</td>
<td>$4,037</td>
<td>$6,855</td>
</tr>
<tr>
<td>2012</td>
<td>$3,699</td>
<td>$6,531</td>
</tr>
</tbody>
</table>

**Spike in Outpatient Services Investment Activity**

- Due to the growth outlook and fragmentation of outpatient services, private equity firms and strategic acquirers have been bolstering their portfolios with aggressive investment in outpatient medical groups to drive regional consolidation.
- Private equity (PE) investment within outpatient medical services experienced a strong year in 2015 with 125 deals. The industry continued its robust activity with 157 PE investments within outpatient services during the course of 2016.

**Spending in Outpatient Services**

- From 2012 to 2016, outpatient services spend grew over 33% and is expected to increase at a rate of approximately 4% until 2019.
- Although outpatient spend is increasing at a faster rate year over year than inpatient spending, the cost of these services remains significantly less, which is prompting patients to defer to outpatient facilities for access to higher quality, lower cost care.

Sources: BDO, NCBI, MMI, Pitchbook
Emphasis on Quality of Services
Why is Private Equity Interested in Gastroenterology?

Cost-Effective Care

- Healthcare providers are tasked with the difficulty of maintaining cost-effectiveness while also upholding quality of care.
- Physician groups are utilizing M&A as a catalyst to adopt new medical technology and population health initiatives which is resulting in enhanced outcomes without being exposed to excessive financial risk.
- The projected physician shortage will put further pressure on hospitals to utilize outpatient facilities in order to maximize efficiency and dedicate the resources that are necessary for inpatient services.

Outpatient Surgery Demand

- Since developing in the 1970s, the ASC industry has grown to over 5,500 freestanding facilities across the U.S., with an average of 341 new Medicare-certified facilities entering the market annually.
- Approximately 25% of all ASC procedures performed are gastrointestinal cases.

Sources: CMS, IBIS World, Becker’s ASCReview
Gastroenterology Market Fragmentation

Why is Private Equity Interested in Gastroenterology?

Independent Gastroenterology Practices with 20+ Doctors

- 0
- 1
- 2
- 3
- 4
- 5

Market Fragmentation in Gastroenterology

Gastro Health: 2017 Acquisitions

- August 2017: Hialeah Ambulatory Surgical Center
- July 2017: Digestive Health Physicians
- June 2017: Pediatric Gastroenterology Associates
- April 2017: Gastroenterology Consultants
- March 2017: Orlando Torres
- March 2017: South Palm GI
- February 2017: Douglas M. Weissman

Taking Advantage of Market Fragmentation

- The national market for gastroenterology is highly fragmented with 24 states lacking an independent gastroenterology practice greater than 20 doctors.
- This fragmentation provides an opportunity for platform caliber organizations to leverage their scale and infrastructure to bring additional practices onto their platform and become a market leader in states where a clear dominant player does not exist.
- Gastro Health, a portfolio company of Audax Group, has leveraged the resources of Audax to complete seven add-on acquisitions to date in 2017, and has greatly expanded its presence within the highly-competitive Florida market.

Note: The map is according to publicly available information.
Replicating Success in Other Specialties
Why is Private Equity Interested in Gastroenterology?

Beginning with significant investment into the dental space in the late 90's, private equity groups have experienced years of success in scaling multisite, provider-based business. Private equity groups are looking to replicate the successes they’ve experienced in other physician specialties within the gastroenterology industry.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Investment Date</th>
<th>Platform Practice</th>
<th>Private Equity Group</th>
<th>Current Private Equity Portfolio Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dental</td>
<td>1996</td>
<td>American Dental Partners</td>
<td>Summit Partners</td>
<td>35</td>
</tr>
<tr>
<td>Pain Management</td>
<td>2008</td>
<td>Advanced Pain Management</td>
<td>Excellere Partners</td>
<td>6</td>
</tr>
<tr>
<td>Dermatology</td>
<td>2011</td>
<td>Advanced Dermatology &amp; Cosmetic Surgery</td>
<td>Axia Group</td>
<td>21</td>
</tr>
<tr>
<td>Ophthalmology</td>
<td>2014</td>
<td>Claris Vision</td>
<td>Candescent Partners</td>
<td>11</td>
</tr>
<tr>
<td>Gastroenterology</td>
<td>2016</td>
<td>Gastro Health</td>
<td>Axia Group</td>
<td>1</td>
</tr>
<tr>
<td>Urology</td>
<td>2016</td>
<td>Chesapeake Urology</td>
<td>Axia Group</td>
<td>1</td>
</tr>
<tr>
<td>OB/GYN</td>
<td>2017</td>
<td>Axia*</td>
<td>Axia Group</td>
<td>1</td>
</tr>
<tr>
<td>Orthopedics</td>
<td>2017</td>
<td>Southeastern Spine Institute*</td>
<td>Candescent Partners</td>
<td>1</td>
</tr>
</tbody>
</table>

* Provident represented the selling shareholders in these transactions
What Are The Key Transaction Considerations in Gastroenterology?
### How Private Equity Deals Are Structured

#### What Are The Key Transaction Considerations in Gastroenterology?

<table>
<thead>
<tr>
<th><strong>Most Common Private Equity Structure</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A Multiple of “EBITDA”</strong></td>
</tr>
<tr>
<td>• Transactions with private equity groups will be based on the ADJUSTED EBITDA of the group*</td>
</tr>
<tr>
<td>• The valuation for a group will be determined based on the multiples of ‘EBITDA’ a buyer is willing to pay</td>
</tr>
<tr>
<td>• Example: $5 million EBITDA at a 8x multiple is a $40 million valuation</td>
</tr>
<tr>
<td>• The exact multiple a private equity group is willing to pay is dependent on a number of factors including (but not limited to):</td>
</tr>
<tr>
<td>• Size</td>
</tr>
<tr>
<td>• Ancillaries</td>
</tr>
<tr>
<td>• Geography</td>
</tr>
<tr>
<td>• Growth</td>
</tr>
<tr>
<td>*Adj. EBITDA explained on following slide</td>
</tr>
<tr>
<td><strong>Minority Vs. Majority</strong></td>
</tr>
<tr>
<td>• There are two types of private equity deals: Minority or Majority</td>
</tr>
<tr>
<td>• A minority deal is equal to less than 50% sale.</td>
</tr>
<tr>
<td>• The vast majority of deals will be a majority sale</td>
</tr>
<tr>
<td>• Most commonly, a deal will be anywhere between 60 – 80 % sold equity</td>
</tr>
<tr>
<td>• By pursuing a minority partner, a practice limits the number of PE groups that would be interested as most funds look to make a majority investment</td>
</tr>
<tr>
<td>• There is a valuation premium for a majority transaction</td>
</tr>
<tr>
<td><strong>“Roll Over Equity”</strong></td>
</tr>
<tr>
<td>• Any physician practice transaction with a private equity group will involve roll over equity</td>
</tr>
<tr>
<td>• Private equity groups want physician shareholders to maintain a significant ownership in the business moving forward</td>
</tr>
<tr>
<td>• Most commonly anywhere from 20 – 40 %</td>
</tr>
<tr>
<td>• Allows private equity group to ensure physicians are tied to the business</td>
</tr>
<tr>
<td>• Allows physicians to participate in upside of business growth in future</td>
</tr>
<tr>
<td><strong>Flexibility</strong></td>
</tr>
<tr>
<td>• There are no two transactions exactly alike</td>
</tr>
<tr>
<td>• Private equity groups are willing to get flexible to meet the needs and goals of the right group</td>
</tr>
<tr>
<td>• The exact equity split can reflect the goals of the group</td>
</tr>
<tr>
<td>• “Earn Outs” structured in to reward a group’s prior investment in growth</td>
</tr>
<tr>
<td>• Most deals feature significant cash at close, no claw backs, no contingency clauses, no benchmarks, etc.</td>
</tr>
<tr>
<td>• Physicians maintain control of daily clinical decisions</td>
</tr>
</tbody>
</table>
**EBITDA Explained**

**What Are The Key Transaction Considerations in Gastroenterology?**

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## Accounting EBITDA Overview

*EBITDA is the earnings of a business before interest expense, taxes, depreciation and amortization*

- Interest is added back due to the assumption that the company will pay off any debt in a transaction
- Taxes are added back due to the change in tax structure as a result of the transaction
- Depreciation and amortization are added back due to the non-cash nature of those expenses

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## Deal Process EBITDA Overview

*EBITDA is a proxy for cash flow*

- A private equity firm’s offer for total purchase price will typically be a **multiple of Adjusted EBITDA**
- **Adjusted EBITDA** provides a buyer with a normalized representation of the business’ cash flow by adding back:
  - One-time nonrecurring expenses or revenue
  - Expenses varying from the market rate (salaries, rent, etc.)
  - Discretionary, non-business expenses of the shareholders
- Increasing Adjusted EBITDA using Add Backs
  - Some add backs may result in a decrease in shareholder salary or discretionary expenses
  - However, any decrease in expense that increases EBITDA is subject to the purchase multiple, resulting in an increased immediate payment

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## Visualization of EBITDA in a Deal Process

### EBITDA Calculation:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest</td>
<td>25</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>15</td>
</tr>
<tr>
<td>Tax</td>
<td>10</td>
</tr>
<tr>
<td><strong>EBITDA</strong></td>
<td><strong>150</strong></td>
</tr>
</tbody>
</table>

### Add Backs to EBITDA:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Normalized compensation</td>
<td>125</td>
</tr>
<tr>
<td>One-time expenses</td>
<td>50</td>
</tr>
<tr>
<td>Discretionary expenses</td>
<td>30</td>
</tr>
<tr>
<td>Other Income</td>
<td>(5)</td>
</tr>
<tr>
<td><strong>Adjusted EBITDA</strong></td>
<td><strong>350</strong></td>
</tr>
</tbody>
</table>

### Purchase Multiple

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purchase Multiple</strong></td>
<td><strong>10x</strong></td>
</tr>
</tbody>
</table>

### Purchase Price

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purchase Price</strong></td>
<td><strong>3,500</strong></td>
</tr>
</tbody>
</table>

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**Purchase price is calculated from Adjusted EBITDA and the purchase multiple, so an increase in Adjusted EBITDA will therefore increase the purchase price. Provident works with the accounting and management teams to determine EBITDA-maximizing add backs that represent the full value of the business and drive purchase price for shareholders.**
Motivations to Pursue a Transaction
What Are The Key Transaction Considerations in Gastroenterology?

Pursuing a partnership (whether that be a private equity firm, strategic consolidator, payor, or health system) can provide a gastroenterology practice with opportunities to drive growth by utilizing access to capital, key industry relationships, and expertise in creating efficient operations. A partnership also leads to opportunities for a shareholder including risk mitigation and significant liquidity events.

Business Considerations
- **Access to Capital**
  - Acquisitions to expand geographic reach & potentially diversify service lines
  - Investments in infrastructure needed to grow:
    - Information technology/billing
    - Hiring supplemental management
    - Working capital for de novo growth
- **Resources of a Partnership**
  - Strengthen leverage for contract negotiations with payors
  - Expertise needed to augment acquisitive growth strategy
  - By increasing size and scale, the organization can improve access to care by offering greater subspecialty expertise

Shareholder Considerations
- **Risk Mitigation**
  - Capital investments and debt will no longer be personally guaranteed by shareholders
  - Monetization of equity during a strong market reduces impact of potentially significant future valuation changes
  - Operational and financial business risks due to uncontrollable outside influences will be diversified away from shareholders
- **Liquidity Events**
  - Large upfront cash payment to shareholders
  - In a PE transaction, shareholders can retain a percentage of equity going forward, thus participating in the accelerated growth of the company
  - The potential exists for a second, third, and even fourth liquidity event for those shareholders with longer career horizons

Pursuing a transaction can lead to accelerated growth, operational improvements, and overall value creation for a practice. Shareholders can benefit from this growth while reducing risk and maintaining ownership in their company.
Ideal Candidate for Private Equity
What Are The Key Transaction Considerations in Gastroenterology?

Private equity firms look to make initial investments into a specific industry through a “platform” investment. There are a limited number of groups in gastroenterology that would qualify as a platform, providing limited opportunities for investors interested in the specialty. We have identified the following factors that can set groups apart from their peers and positively influence valuation from a qualitative perspective.

- Strong Internal Infrastructure (Billing, Finance, IT, HR, etc.)
- Ancillary Services (ASC, Anesthesia, Pathology, etc.)
- “In-Network” with Major Payors
- Strong Reputation in Respective Community
- Patient-Centric Focus & Positive Outcomes Data
- Investments in Growth
- Diverse Payor Mix
- Strong Management Team
Choosing the Right Partner
What Are The Key Transaction Considerations in Gastroenterology?

<table>
<thead>
<tr>
<th>Factors to Consider</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investment Approach &amp; Strategy</strong></td>
</tr>
<tr>
<td>Private equity firms have varied approaches; some are very hands-on, while others are more passive</td>
</tr>
<tr>
<td><strong>Cultural Fit &amp; Personality</strong></td>
</tr>
<tr>
<td>When groups are considering a transaction, philosophic alignment is imperative and should be one of the main decision factors</td>
</tr>
<tr>
<td><strong>Related Portfolio Company Experience</strong></td>
</tr>
<tr>
<td>Groups that have experience with clinic-based healthcare sectors can bring more value to the investment</td>
</tr>
<tr>
<td><strong>Average Return on Investment</strong></td>
</tr>
<tr>
<td>Past investment returns in healthcare vary depending on the fund and are key to maximizing rollover equity</td>
</tr>
<tr>
<td><strong>Relationships to Leverage</strong></td>
</tr>
<tr>
<td>What value can they bring in terms of operating partners or potential executives?</td>
</tr>
<tr>
<td><strong>Add-on Acquisition Pipeline</strong></td>
</tr>
<tr>
<td>Have they had conversations with other potential add-on acquisitions within the gastroenterology sector?</td>
</tr>
<tr>
<td><strong>Conversation with References</strong></td>
</tr>
<tr>
<td>Other portfolio company executives can speak to their experiences with the investor</td>
</tr>
<tr>
<td><strong>Cross-Selling Opportunities</strong></td>
</tr>
<tr>
<td>Do they have relationships with payors or hospitals that can be leveraged?</td>
</tr>
</tbody>
</table>
Structuring the Deal for All Shareholders

What Are The Key Transaction Considerations in Gastroenterology?

Provident understands the motivations of shareholders at various stages in their careers and has experience structuring transactions with to meet their needs.

<table>
<thead>
<tr>
<th>Rollover Equity</th>
<th>Cash at Closing</th>
<th>Post-Closing Compensation</th>
<th>Lifestyle Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Early &amp; Mid-Career Partners</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Retain higher equity percentage</td>
<td>• Retire any medical school debt</td>
<td>• Productivity-based</td>
<td>• Focus on practicing medicine</td>
</tr>
<tr>
<td>• Participate in multiple transactions</td>
<td>• Address other investments on hold</td>
<td>• Bonuses tied to ASC and ancillary income</td>
<td>• Less stress and risk as an owner</td>
</tr>
<tr>
<td><strong>Late-Career Partners</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Retain less equity</td>
<td>• Diversify wealth before retirement</td>
<td>• Structured based on desired role post-closing</td>
<td>• Opportunity for a transition to part-time or retirement</td>
</tr>
<tr>
<td>• Second liquidity event</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>All Partners</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Continue as an owner</td>
<td>• Take “chips” off the table</td>
<td>• Market-rate</td>
<td>• Focus on patient care, not governance</td>
</tr>
<tr>
<td>• Secondary liquidity events</td>
<td>• Multiple years of ordinary income at closing</td>
<td>• Less risk given cash proceeds</td>
<td>• Use an investor’s capital instead of personal guarantees</td>
</tr>
</tbody>
</table>

The physicians of the practice are the key assets in a transaction, and it is imperative that a deal is structured to properly align physician incentives with the investor both in the short and long-term.
What Are The Key Regulatory Considerations in Gastroenterology?
Overview

1. Due Diligence Process.


4. Questions.
Overview of Diligence Process.

- What is “due diligence” and why is it important to buyers?

- Diligence requests ask for certain information and documents, such as:
  - Financial records (e.g., P/L statements, billing and claims A/R, etc.).
  - Organizational documents (e.g., certificates of incorporation, by-laws, shareholder or LLC member agreements).
  - Litigation, investigations and audits.
  - Material contracts (e.g., insurance or managed care contracts, employment agreements, etc.).

- How do buyers analyze the produced due diligence materials?
  - Successor liability.
  - Emphasis on compliance issues in health care billing and referral “arrangements.”
  - Impact on “sustainability” of revenues and practice reputation.
Common Regulatory Issues in Gastroenterology Transactions.

- Coding and Billing
- Stark Law and Self-Referral Prohibitions
- Compensation, Investment and other Financial Arrangements
- Arrangements with Hospitals
- Compliance Program – Existence & Implementation
Common Regulatory Issues in Gastroenterology Transactions.

Coding and Billing.

**Common Billing and Coding Problems**

- **Documentation and Medical Necessity.**
  - E.g., Performance and documentation of medical history, physical assessment and/or pre-surgical assessment prior to gastroenterology procedures (e.g., colonoscopy and endoscopy).

- **Utilization Review and Comparison to Industry Norms.**
  - Are procedures over-used as compared to industry norms?

- **“Unbundling.”**
  - E.g., Is moderate sedation or other anesthesia included in a comprehensive billing gastroenterology procedure code?
Common Regulatory Issues in Gastroenterology Transactions.

Coding and Billing.

**Common Billing and Coding Problems**

- **Infusion Services:**
  - E&M visits and date of service
  - Remicade and appropriate codes for biosimilars

- **Pathology** – medical necessity

- **Anesthesia** - use of correct billing units

- **ASCs** – use of placement devices and dates of placement v. dates of service

- **Diagnostic tests** (e.g., capsule endoscopies, ultrasounds) – Anti-Mark-Up Rule
Common Regulatory Issues in Gastroenterology Transactions. Coding and Billing.

**Future Billing Problem Areas**

- Weight Loss Procedures
  - Covered by Medicare, Medicaid or Commercial Insurance?
  - Which Procedures Are Covered?
  - Accurate Coding/Billing Codes.

- Medication Administration
  - Self-Administered Medication.
  - Proper Billing and Use of Modifiers for Discarded Medication.

- Drug Dispensing

- FDA Approval for Fatty Liver (Non-Alcoholic) Drugs
Common Regulatory Issues in Gastroenterology Transactions.

Stark Law and Self-Referral Prohibitions.

  - *Physicians* may not make referrals for *DHS* to entities with which the physician (or an immediate family member) has a *financial interest*.
  - Bills may not be submitted by an *entity* if a referral violates the Stark Law.
  - *UNLESS* an exception applies.

- Certain exceptions are particularly available to a “Group Practice.”
  - e.g., In-office ancillary services (“IOAS”) and physician services exceptions.
  - Productivity bonuses should be based on personally performed services.

- “Group Practice” Definition – must meet multiple requirements.
- Payments from hospitals (and other referral recipients) require an exception.
Common Regulatory Issues in Gastroenterology Transactions.

Stark Law and Self-Referral Prohibitions.

- Common Stark Law Diligence Concerns
  - Does the gastroenterology practice rely on being a “group practice?”
    - E.g., for IOAS Exception
  - Does the practice meet the qualifications to be a “group practice?”
  - Does it meet the requirements for the exception?
  - If not, does another exception protect the arrangement(s)?
  - Potential liabilities?
    - Criminal, civil or monetary?
    - Sanctions or suspensions?
Common Regulatory Issues in Gastroenterology Transactions.

Compensation, Investment and other Financial Arrangements.

- How are shareholders, employees and mid-level providers paid?

- Examining relationships with vendors, independent contractors, management or billing companies, hospitals and other referral recipients and sources.
  - In writing, signed, fair market value & commercially reasonable.

- Due Diligence Concerns
  - “Tainted Business”?
  - Liabilities?
  - Sustainability of revenues, profits and growth projections.
Common Regulatory Issues in Gastroenterology Transactions. 

Arrangements with Hospitals and ASCs.

- Examples of hospital arrangements that warrant regulatory scrutiny:
  - Medical directorship (and other professional service arrangements).
  - Rental of space and equipment (both ways).
  - The provision of services for free or below “fair market value” (both ways).

- Ambulatory Surgery Centers.
  - Compliance with Anti-Kickback Safe-Harbors.
  - Redemption of Non-Compliant Physicians (e.g., physicians who do not satisfy 1/3 tests under Safe-Harbor).

- Other diligence concerns with gastroenterology group relationships.
  - Restrictive covenants in contracts?
  - Change of control/assignment prohibitions?
Compliance Program – Existence and Implementation

- Has the gastroenterology group adopted and fully implemented a corporate compliance program?
  - Review of policies, procedures and compliance/risk management programs.
  - Is the compliance program functional?
- Past areas of concern and actions taken to remedy previous deficiencies.
- HIPAA privacy and security compliance?

- Avoid issues during negotiations with investors by conducting pre-transaction assessments and “clean-up.”

- Detect and correct potential compliance and regulatory risks.
  - Monitoring and auditing with regulatory risk areas in mind.
  - Implement systems to ensure corrective action is working.

- Do not conceal potential compliance risks and violations in diligence!
  - NDA/Confidentiality Agreement/Common Interest Agreement.
  - Depending on the risk, the parties may address these problems with indemnification language and escrows and holdbacks.
Questions?

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