Using Equity Funds to Achieve Health Care Delivery and Financial Goals for Physicians and Medical Practices

Lathrop GPM

Equity funds and financial institutions are searching for opportunities to move into the business of health care and the delivery of health care services.

All types of physicians and medical practices can benefit from entering into strategic relationships with business partners – selling out to a hospital or national company is NOT the only answer.

Physicians and medical practices are facing enormous levels of change in their clinical, regulatory and financial environments. Physicians and medical practices see downward pressure on reimbursements at both the federal and commercial payer level, coupled with increased emphasis on efficiency and quality.

Equity funds are helping medical practices by handling the practices' business affairs and promising compliance with complex regulatory requirements with the goal of leaving doctors to practice medicine. Equity funds also claim they can introduce work flow and cost efficiencies and leverage economies of scale in the process while paying practices and their related entities an enticing multiple of profits.

Physicians are increasingly urged to add value to the professional services they perform by leveraging information technology and offering both new and significantly improved ancillary (technical) services. As the emphasis on early detection, preventative screenings and targeted population health continues to grow, the importance and volume of effective diagnostic testing will likely continue to grow. The focus on reducing health care costs and the significant reduction to downstream costs resulting from early detection create attractive opportunities for growth in ancillary services.

The introduction of sophisticated diagnostic tools and genetic tests that are further unlocking doors to greater discoveries, enable providers to know more about diseases than ever before. While positive for both patients and physicians, the growth in biomedical knowledge is adding a layer of complexity and cost for medical professionals.

As employers desire to contract with health care providers, as employers perform their own analysis of strategies for early detection of employee health issues to reduce employee health care costs and personalized medicine, and as direct to consumer diagnostic testing opportunities continue to grow, medical practices will have new avenues (revenue opportunities) in which to provide services.

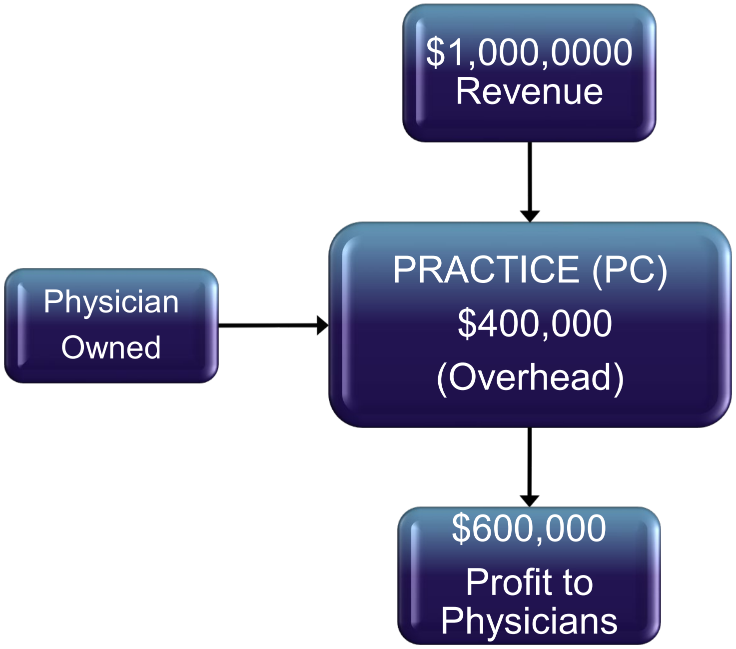
Equity funds are having success when investing in multiple types of physician sub-specialty groups. As important as maximizing profits from operations is, the benefit to the Equity fund of re-selling to even bigger equity funds. Provides access to Equity funds and different strategies for structuring arrangements with Equity funds are growing rapidly.

Why not sell to hospitals? The hospitals are not able to pay as much for medical practices as equity funds for fear of violating the federal anti kickback statutes even though not all physicians traditionally make patient referrals.

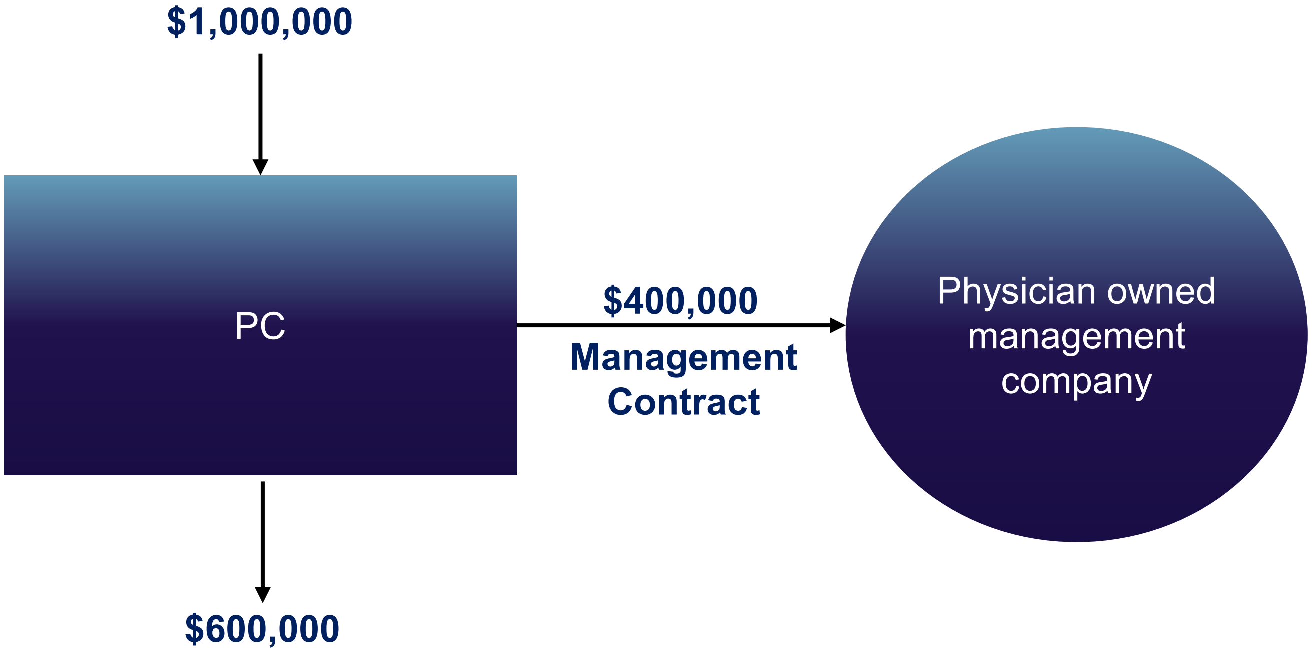
Medical practices must evaluate new opportunities. The key is to select a business partner that can give your business the potential for sustainability and upside growth.

HOW IT WORKS

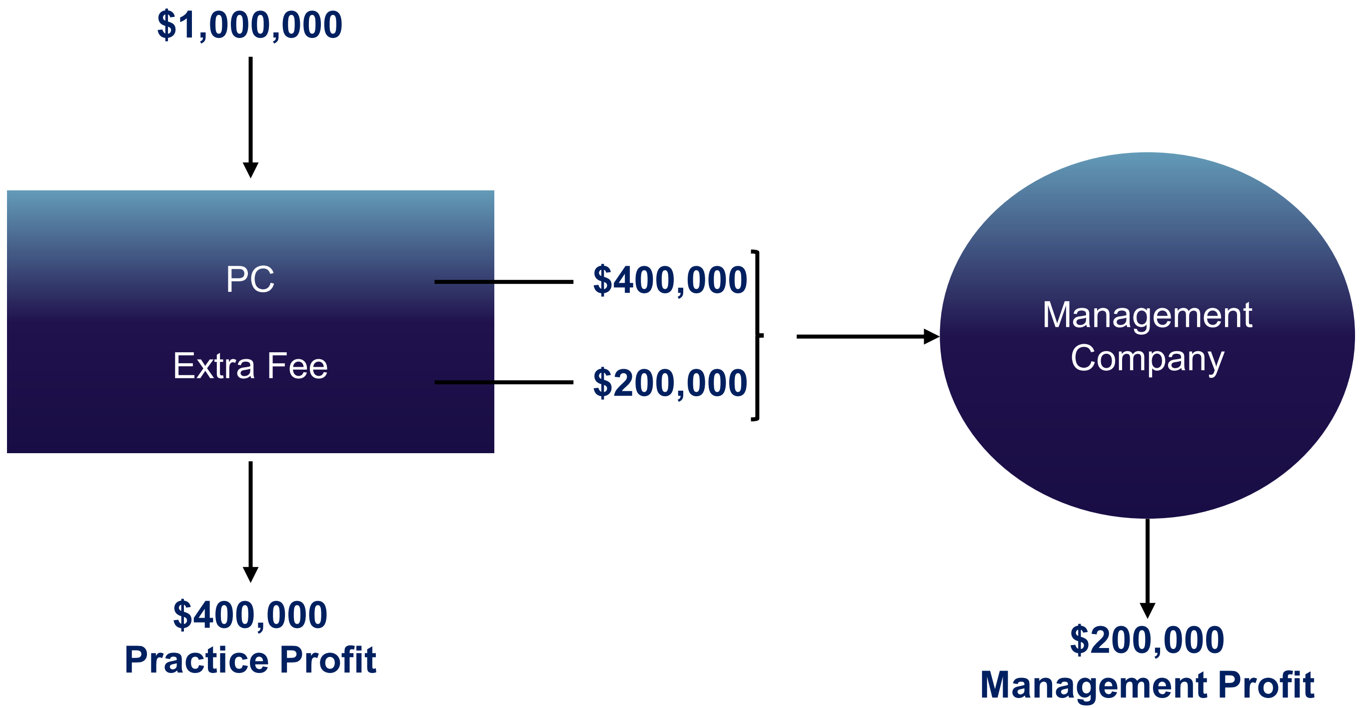
BASIC APPROACH



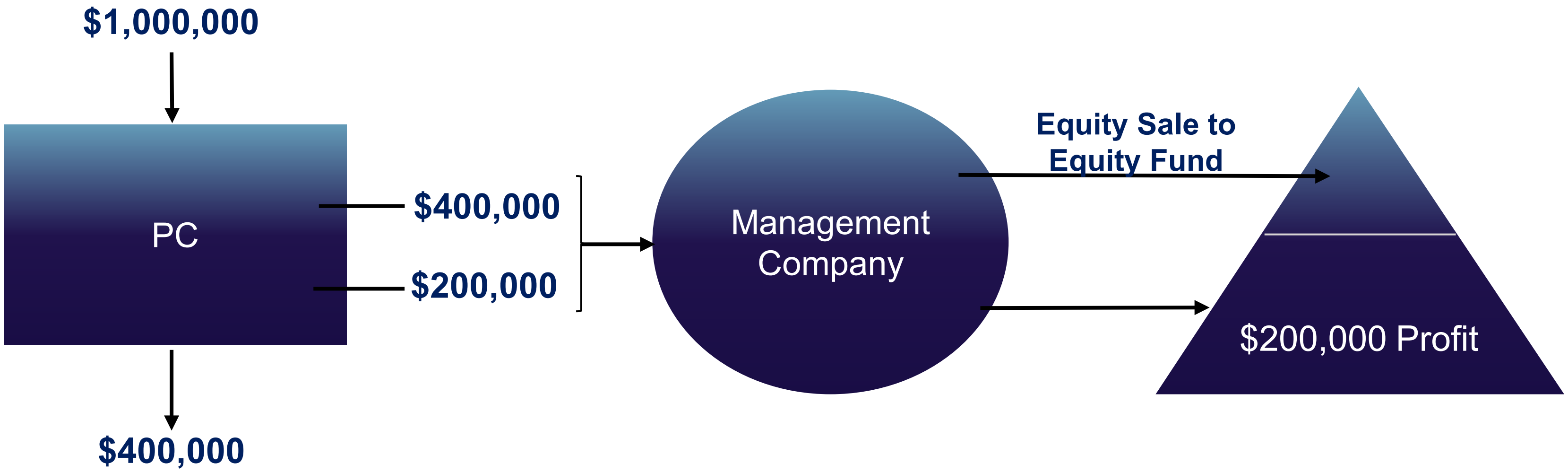
STEP 2


$1,000,000
PC
$400,000
Management Contract
Physician owned management company
$600,000

STEP 3


$1,000,000
PC
Extra Fee
$400,000
$200,000
Management Company
$400,000
Practice Profit
$200,000
Management Profit

STEP 4


$1,000,000
PC
$400,000
$200,000
Management Company
Equity Sale to Equity Fund
$200,000 Profit
$400,000

SALE PRICE

$ 200,000.00	(Profit)
x 9	(Multiple paid by Equity Fund)
$ 1,800,000.00	Cash received subject to Capital Gain Tax
x .8	
$ 1,440,000.00*	Lump sum after tax proceeds to Seller

*Taxed at 20% so post tax proceeds of 80% of sale price

ANALYSIS

$ 200,000.00	Taxed at ordinary income tax rates
x .50	(federal, state)
$ 100,000.00	
x 15	(years needed to accumulate equivalent savings)
$ 1,500,000.00	or $ 1,440,000.00 today.

ALL FUNDS INVESTED AT 6% RATE OF RETURN FOR 15 YEARS

$100,000.00 each year x .06% for 15 years =
$2,327,596.90

$1,440,000.00 lump sum x .06% for 15 years =
$3,533,894.73

THE DEAL AS PROMOTED BY EQUITY FUND

Our goal is to help grow your practice into a regional market leader by providing capital for growth initiatives and by supplementing your entity's current efforts through the addition of new management team members and board members, as appropriate.

We will help you evaluate and fund new pathways for growth through accretive acquisition opportunities, adding ancillary revenue streams, de novo office openings, and sales and marketing initiatives that expand your customer base.

We are confident that we can work with our operating partners, who have significant experience in building and growing similar healthcare service businesses, and provide capital to strategically grow the business through organic and acquisitive growth.

THE PROMISE

The Equity Fund will pay the Physicians (the "Sellers") or will pay legal entities owned by the Physicians as agreed to by the parties, in the aggregate, in cash on the closing date an amount equal to the "Closing Cash Payment"…… and;

The selling Physicians will receive equity ownership in the newly formed "Holdco" (the same holding company Equity Fund will invest in) in the form of Class A, Class C and Common Units in Holdco (the "Rollover Equity").

NON-CASH CONSIDERATION

The Class A Preferred Equity will be the first equity paid out after debt.

The Class A Preferred Equity units will carry interest bearing a six percent (6%) annual rate.

The Class C Units will carry a paid-in-kind coupon bearing a ten percent (10%) annual rate.

The Common Units will be held by every investor.

CHOICE

Sellers can opt to trade “rollover equity” value for cash at Closing Value as long as the total components of value remain unchanged.

GROWTH EARN-OUT

In addition to the Closing Cash Payment and Rollover Equity, subject to achieving the below growth thresholds, the Sellers shall also receive $2,000,000 (the “Growth Earn-Out”) in the form of cash as more fully described below.

The Sellers shall receive a Growth Earn-Out based on the Adjusted EBITDA relative to the following targets at the twenty-four full month anniversary of the closing and following the first annual audit:

Adj. EBITDA	Growth Earn-Out
$2,500,000	$0
$2,650,000	$400,000
$2,800,000	$800,000
$2,950,000	$1,200,000
$3,100,000	$1,600,000
$3,250,000	$2,000,000

For purposes of the Growth Earn Out calculation, growth related hires will be added-back (not negatively impact the Growth Earn Out calculation), including CEO, CFO, and VP of Growth and Development.

This earn out is based on the acquired locations as of the closing date and does not include any additional flow through the existing services from new physicians who utilize the facilities after Closing.

A SPECIAL DEAL

Since Dr. and Dr. will be foregoing their current management fee, Dr. and Dr. will also be eligible to receive an earn-out paid in cash at exit (the “Management Exit Earn-Out” and together with the Growth Earn-Out, the “Earn-Outs”) as more fully described below:

Additionally, Dr. and Dr. (collectively "The Acquisition Sources") shall also be eligible to receive transaction bonuses as completes add-on acquisitions.

For acquisitions with $0 to $500,000 of Adjusted EBITDA, the Acquisition Sources shall receive a minimum cash bonus of $30,000 total ($15,000 each).

For acquisitions with greater than $500,000 of Adjusted EBITDA, the Acquisition Sources shall receive a minimum cash bonus of $40,000 total ($20,000 each).

Assumptions.

Revenue and Adjusted EBITDA

Group will be free of (i) debt (including, but not limited to, all short-term, long-term, shareholder, and shareholder/related-party debt or payables, capital lease obligations, excess paid time off due to employees

Seller will leave enough cash the balance sheet to cover the next gross payroll.

All leases and contracts are in good standing and are transferable to fund.

All licenses, approvals, and consents necessary to operate the business of Seller are in good standing and transferable.

The Company is not involved in and remains unaware of any pending or threatened litigation or regulatory matters that would have an impact on the Company's operations or financial condition.

Due to state law corporate practice of medicine prohibitions, employed physicians and key employees, including each of the Sellers will enter into standard employment and equity agreements which shall include non-competition, non-solicitation, no-hire and other restrictive covenants during the period of employment and the 2-year period thereafter as par of new Management Agreement.

GOOD FAITH

We (the Equity Fund) believe that the existing management team has done an excellent job in building a platform for future growth. We also believe that the entire team is an important part of the future growth of the Company and will be relied upon going forward.

We would NEVER cut your pay or authority. BEWARE!!!

EXCLUSIVITY CLAUSE

Equity Fund and the Sellers jointly agree to pursue the Transaction exclusively with one another during the Term (as hereinafter defined).

Equity Fund and each Seller will not (and will cause its officers, directors, affiliates, Equity holders, representatives and agents (collectively, “related parties”) not to) directly or indirectly submit, solicit, initiate, encourage or discuss any proposal or offer from any person or entity.

CONCLUSION

As technology and employer involvement in patient care are expanding at a record pace, physicians, medical practices and their affiliated entities need to look for new business models and business partners to succeed in the future of health care. Physicians are enticed by the idea of an infusion of cash from Equity Funds as a way to receive an early "buy-out" and a future windfall.

Understand that every deal comes with a price and the intelligent Advisor has the ability to explain all of the issues and opportunities and strategies necessary to achieve the objectives of the Physicians and their practice.