Considering a Private Equity Deal? Due Diligence Is Crucial

For an ophthalmology practice, the importance of due diligence when considering a private equity acquisition cannot be overstated. "I've spoken to a lot of upset people, who were looking to grow, thought they found a good business model with a lot of capital, but eventually had a bad experience, some of which can be attributed to not doing their due diligence on the front end," said Dustin C. Carter, at M&M Eye Institutes in Prescott, Arizona.

Be on your guard. "A lot of physicians believe they are business-savvy people," noted Kimberly A. Drenser, MD, PhD, a retina specialist in Royal Oak, Michigan. "Yet when dealing with a private equity sale, it becomes very apparent that even the most business-savvy physician pales in comparison to the expertise and background of the different financial entities involved in the process. That puts doctors at risk, which is why due diligence is vital," said Dr. Drenser, who, as *EyeNet* goes to press, is deep in that process with multiple private equity firms.

Know what you want. A great deal of self-reflection is also necessary to determine why the practice wants to sell, what monetary compensation it expects, and what the culture will look like after the sale. The answers to these questions will help the practice find a firm with values that align with its own.

Be Ready for a Marathon

Dr. Drenser warns ophthalmologists to be emotionally and mentally prepared for a marathon. "It's like having a second full-time job, and it is a lot of work just to get to the point of deciding whether you want to go forward with a deal . . . and with whom," she said. "You are giving up a good 18 months of your life and a lot of time and money."

Mr. Carter agreed that it is an exhausting process. He was tasked with researching whether the practice should sell to a private equity entity or maintain the status quo. After many months of speaking to multiple groups and participating in the due diligence process with experts in the field, the practice narrowed down the finalists from seven to three. After selecting one of those three, coming to an agreement with it took yet another year.

Shop Around

"One of the biggest mistakes a practice can make is dealing directly with only one private equity firm. While this is an appealing approach because of its simplicity, it is potentially dangerous because you are only seeing one deal—and receiving all your financial advice from the very buyer who gains the most," Dr. Drenser said.

Instead shop around for the ideal partner. "You want to check out all 30 or 35 firms out there, and you basically want to create a bidding war," said Gary I. Markowitz, MD, a medical practice private equity consultant in Dover, Delaware. "Ultimately, three, four, or five firms will have an interest in your practice."

Three Tips

Based on his experience, Mr. Carter suggests that you do the following:

Know your value. It is vital to understand your EBITDA (see page 40), and this can be done by partnering with investment bankers or, if you are a smaller practice, your accountant and lawyer.

Get all prospective purchasers on the same schedule. Try to get all the private equity companies to reach deadlines in unison. For example, they should provide letters of intent as close in time as possible. This ensures good faith practices in the negotiating stage

Watch your money! Mr. Carter has heard horror stories of physicians who received payouts from private equity groups in the form of stock. "However, they were not aware that there can be different classes of stock—so when the time came to cash out the stocks, they did not get what was expected. In some cases, they got far less than other stockholders," he said. "So be sure to research every single detail of the deal."

BY LORI BAKER-SCHENA, MBA, EDD, INTERVIEWING **MARK D. ABRUZZO, JD, DUSTIN C. CARTER, KIMBERLY A. DRENSER, MD, PHD,** AND **GARY I. MARKOWITZ, MD.**

Get Experts on Your Side

Dr. Drenser recommended hiring experts to help you navigate a rigorous due diligence process right from the beginning. "While it may be more expensive on the front end," these experts "can save you from making poor decisions while helping you get the best deal," she said.

These experts include the following:

Third-party brokers. Much like real estate agents, these brokers earn their money on the back end of a deal. They do the background search on the private equity companies. Once the practice value is determined and the full package is created, they will shop your practice around to those firms.

Investment bankers. They serve as financial advisors and can help practices explore pretransaction, process, and operational and transitional issues. They help the physician owners maximize the value of the transaction.

Attorneys. Legal advisors protect the interests of the selling physician. Dr. Drenser suggested looking for attorneys who specialize in health care mergers and acquisitions.

Accountants and tax professionals. They focus on helping practices with asset protection and tax structuring. Because purchase prices are generally based on a practice's EBITDA (earnings before interest, taxes, depreciation, and amortization; see page 40), accountants play an important role in determining whether the purchase price was calculated accurately and whether any extraordinary expenses should be adjusted out of the calculation (generally, one-time expenses that would not ordinarily be incurred by the practice).

Do Your Homework

Mark D. Abruzzo, JD, an attorney in Berwyn, Pennsylvania, said one of the most common mistakes practices make is not doing their homework from the very beginning. You can start by asking the following questions.

Does the firm understand how to run an ophthalmology practice? Find out what sort of experience the CEO and other key executives have, said Mr. Abruzzo. "Many of these executives have experience in health care, but many folks in health care don't understand the private practice industry and the breadth of health care regulation on a state and federal level."

Mr. Carter also urges practices to look for firms that have a track record with ophthalmology. "Risk management, regulatory requirements, contract negotiations, insurance, technology, the specific personnel—so many aspects of the business of ophthalmology are unique," he said.

What's the firm's "personality"? "Through research, you want to evaluate each firm, obtain an explanation of their process from the principals, and learn the dynamics and how the firm is run," said Dr. Markowitz. Is the firm so focused on volume, numbers, and spreadsheets that patient care may suffer indirectly? It can be disconcerting to be dealing with an entity whose primary goal is making money, when the physician owners are focused on delivering excellent patient care. "Every firm is different," Dr. Markowitz said. "While one firm might be controlling, ultimately changing the culture of your practice and causing employee termination, another entity may continue to run your practice much as you did—as it helps the practice grow."

What are the private equity company's plans for your practice? Practices need to obtain an understanding of the company's motives and its approach. "You can and should determine how their current acquisitions are doing," said Mr. Carter. "Do they have a road map outlined? Do they have the management structure in place to support growth? Is the private equity firm investing in the practice, or simply purchasing and holding until they can resell? We are seeing diversity in the long-term plans of private equity groups."

How has the firm treated your peers? "At a minimum, practices should be speaking with other physicians who have sold their practices to the private equity firm" and get their honest feedback on what it is like to work with the firm, said Mr. Abruzzo. How does the firm treat physicians and staff members, from the top to the bottom, from the providers to the line staff? "Discussion of sale terms will be off limits because formal purchase agreements generally contain confidentiality clauses. But selling physicians should be able to discuss their postsale experiences with the firm."

Mr. Abruzzo warned that this strategy, while important, can be difficult to accomplish. Private equity is keen to make sure physicians' interests are aligned with its own; consequently, your peers may be incentivized to only say good things about their experience.

Will the firm provide leadership? "The private equity firm must be able not only to manage but also to provide positive leadership to practices, especially through the changes that will occur during the merger phase after acquisition," said Mr. Carter. Has the firm exhibited such leadership with its past acquisitions?

What Next?

If you make a deal with a private equity firm, expect change. There will be changes, challenges, and difficulties during the transition, said Mr. Carter. But "be assured that with the right leadership at the helm and a cooperative spirit, you can have a successful and rewarding experience."

What if you don't pursue a deal? "Even if your deal doesn't go anywhere, you can feel good knowing that you made the best decision because you did rigorous due diligence," said Dr. Drenser.

Mr. Abruzzo is an attorney with Wade, Goldstein, Landau & Abruzzo in Berwyn, Penn. *Relevant financial disclosures: Wade, Goldstein, Landau & Abruzzo: E.*

Mr. Carter is the director of clinics at M&M Eye Institute in Prescott, Ariz. *Relevant financial disclosures: Consent Solutions: E.*

Dr. Drenser is a retina specialist with Associated Retinal Consultants in Royal Oak, Mich., and director of the Pediatric Retinal Disease Molecular Genetics Laboratory on the Royal Oak campus. *Relevant financial disclosures: None.*

Dr. Markowitz is director emeritus at Delaware Eye Center and Blue Hen Ambulatory Surgical Center in Dover, Del. and president and CEO of SuperVision Advisors. *Relevant financial disclosures: SuperVision Advisors: C,O.*

See disclosure key, page 8. **For full disclosures,** find this article at aao.org/eyenet.