Private Equity and Ophthalmology

Explore Your Options, Beware the Hazards

From choppy regulatory waters to rapidly increasing costs, there are many reasons to ponder your economic future. Should you stay the course? Consolidate your practice with others? Or seek a deal with private equity? There is much to consider.

By Lori Baker-Schena, MBA, EdD

PROPONENTS OF PRIVATE EQUITY say that it can provide capital, economies of scale, enhanced management expertise, and extra leverage when negotiating with payers. Critics worry what its emphasis on profitability might mean for patient care as well as for physician and staff job satisfaction. And many ophthalmologists remember the physician practice management companies (PPMCs) of the 1990s, whose business model turned out poorly for investors and physicians alike (see "PPMCs in the 1990s," page 43). Will today's private equity firms prove to be more sustainable?

Private Equity Today

Why private equity is looking to make deals. "Ophthalmology is attractive to private equity: It has all aspects of care, from general to subspecialty, with an elective cash pay component," said Mark D. Abruzzo, JD, with Wade, Goldstein, Landau & Abruzzo in Berwyn, Pennsylvania. In addition, the specialty is technologically advanced and offers ambulatory surgery center opportunities.

An early participant in the current wave of acquisitions. Gary I. Markowitz, MD, founder, and now director emeritus, of the Delaware Eye Care Center in Dover, Delaware, was involved with the first wave of the most recent private equity movement. He sold his practice to EyeCare Service Partners (ESP) in 2014. "Everything was centralized to cut overhead, from billing and human resources to the optical lab, and this consolidation produced cost savings," explained Dr. Markowitz, who now represents ophthalmologists in sales to private equity firms.

Private equity's surging interest. After ESP's early success, other private equity firms came into the market. "Today, they number 30 to 35. In the meantime, the valuations increased," noted Dr. Markowitz.

This uptick in private equity interest was confirmed in a recent study. "We found that acquisitions of ophthalmology practices by private equity firms have increased dramatically over the past two years, with the majority of the activity concentrated in the eastern United States and Midwest," said Gary J. Lelli Jr., MD, at Weill Cornell Medical College in New York City. A dearth of peer-reviewed research prompted Dr. Lelli to join his colleagues in studying private equity acquisitions in ophthalmology. They presented their findings in a poster at this year's annual meeting

Pat Kinsella

of the Association of Research in Vision and Ophthalmology (ARVO).[1]

Profit is paramount. "Private equity companies are looking for return on investment, and their ultimate goal is to flip the practice within five years," said Arvind Saini, MD, MBA, with Integrity Eye, a practice in Escondido, California. "There is a ticking clock, and they have to show profitability to their institutional investors. They are not necessarily making business decisions with the same motivations as physicians." Dr. Saini has a unique perspective on the private equity trend, as he previously earned a Wharton MBA with classmates who aimed to work in private equity. He also worked with a management company that purchased and managed nonophthalmology physician practices.

EBITDA is used to determine acquisition price. Private equity determines its acquisition price for a practice based on a multiple of the practice's adjusted EBITDA, which is an acronym for earnings before interest, taxes, depreciation, and amortization (see "EBITDA Primer"). In 2014, platform practices—defined as practices with more than $2 million of adjusted EBITDA—were bought at about 6 times EBITDA, and the smaller practices—with substantially less than $2 million of adjusted EBITDA—were acquired at 2 to 4 times EBITDA, said Dr. Markowitz. Today, the large platform practices are paid multiples of the adjusted EBITDA ranging from 8 to double digits; smaller practices are paid multiples of 5 to 8. One strategy is to merge smaller practices with a bigger "platform" practice, then find a buyer who would apply the larger multiple to the pooled EBITDA of the merged practices. "It is all part of the plan to grow, repackage, and sell," said Mr. Abruzzo.

After the sale. "Ophthalmologists should prepare themselves for change once their practices are sold," said Dr. Saini. "Ultimately, meeting financial targets will be very important to a private equity company, which means that all aspects of a practice—from physician and staff salaries and benefits to capital expenditures and daily patient volume—will be scrutinized. This can have positive or negative outcomes on work culture, depending on what the practice was like prior to the sale."

Ensuring physicians keep some skin in the game. "It is very important to the private equity firms to have the doctors incentivized and pulling in the same direction," Mr. Abruzzo noted. For example, the selling owners may be required to roll back some of their sales proceeds into the entity that will now be running their practice. Nonowner associates are offered opportunities to purchase equity in these management companies as well, said Dr. Abruzzo. This will give them a share of the proceeds when private equity sells the practice. "It's all about the second sale, and they make no bones about it," he said. "The idea is to buy and then resell in five years or so at, hopefully, a higher EBITDA and higher multiple."

What's in It for Ophthalmologists?

"Whether private equity is right for you depends on a variety of factors, from your age to the way you want to practice medicine," said Dr. Lelli. "Without a doubt [a sale to] private equity changes the emotional dynamics of a practice for doctors, especially if they are not majority owners."

What the research says. According to the research that Dr. Lelli and his colleagues presented at ARVO,[1] physicians are motivated to sell their practice to survive increasing local competition,

EBITDA Primer

Mr. Abruzzo explained that acquisition prices are based on a multiple of a practice's *adjusted* EBITDA (earnings before interest, taxes, depreciation, and amortization). For example, a smaller practice might be valued at five times its adjusted EBITDA, and a larger platform practice might be valued at up to 12 times its adjusted EBITDA.

Why adjust the EBITDA? The adjustments to the EBITDA are often referred to as "normalization adjustments." They take into account expenses and revenues that were factored into the EBITDA calculation, but they won't appear on the practice's books after the sale. Examples include one-off expenses, such as legal settlements.

Some adjustments reduce EBITDA. Suppose, for example, the practice has been getting a sweetheart deal on rent because the physician owners—via a separate legal entity—also own the building. If the rent is going to increase to market rate after the practice is sold, the buyer would want the EBITDA to be adjusted downward.

Some adjustments boost EBITDA. Typically, the selling owners' wage will be significantly lower after the sale. As this reduction in wages will increase the practice's cash flow, the EBITDA will be adjusted upward. (Most private equity companies will compensate the selling physicians at 30% of their individual collections, though collections from drugs, if applicable, and ancillary testing are excluded.)

obtain access to capital and infrastructure, and counter growing administrative burdens. They also found that physicians who were able to remain majority owners, or who had a greater say in running the practice, had the more successful mergers and seemed happier. The big unknown, Dr. Lelli added, is how private equity will change the delivery of health care, "which is why research in this area is so important."

What added expertise does private equity bring to a well-run practice? "Ophthalmologists are smart. They know their markets; they know their patients; and they know what makes their practices successful," said Dr. Saini. "While private equity does bring the potential for economies of scale, as well as contracting and billing expertise, ophthalmologists are selling themselves short if they think they need private equity to run their practices in the future."

Does practice management bring more stress than satisfaction? While running one's own practice may be stressful at times, ophthalmologists realize much of their job satisfaction comes from their ability to control their work environment and create a culture of community for patients and staff members, said Dr. Saini.

A Grueling Process

The best thing you can do when considering private equity is to conduct your research and proceed with caution, Dr. Markowitz said. Here are some key stages of the private equity transaction:

- It starts with extensive internal discussions in the practice, followed by vetting and hiring of advisors.
- The physicians must then think about "marketing" their practice to potential buyers.
- Nondisclosure agreements are signed.
- The private equity firm reviews the practice's financial information to derive a value and offer a price.
- Eventually a letter of intent is signed, followed by extensive due diligence (see page 49) by both parties.
- A Quality of Earnings review takes place, as part of the above due diligence, to be sure that the financial information that the private equity firm used to calculate the adjusted EBITDA was accurate.
- Formal transaction documents are negotiated, and a formal purchase agreement is signed.
- Between signing of the purchase agreement and closing, other ancillary agreements—such as employment agreements and lease assignments—are negotiated.
- The deal is closed (ancillary agreements signed, price paid), and the transition starts.

PRIVATE EQUITY AT THE MID-YEAR FORUM (MYF). *Private equity has been a recurring topic at the Academy's MYF and was discussed at this year's forum by (top row, left to right) Dr. Wiggins, Kimberly A. Drenser, MD, PhD, and Dr. Saini, along with (bottom row) Dr. Markowitz, Dustin C. Carter, and Dr. Epley. Don't miss MYF 2020 (aao.org/myf) April 22-25, 2020, in Washington, D.C.*

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Case Study: A Small Pediatric Practice

Pediatric ophthalmologist K. David Epley, MD, was not looking to be purchased by a private equity firm. Since 2008, he had been building his Kirkland, Washington, practice, Children's Eye Care, from the ground up—incorporating play areas and movie rooms to decrease the anxiety for his young patients.

Yet over the years, several different entities approached him, including private equity firms, a physician services group, and a hospital. "Ours is a small practice, with 10 employees. We were happy and everything was working smoothly," Dr. Epley recalled. "Yet we were thinking about our future, the growth of our practice, and, eventually, a retirement strategy."

In need of capital. Dr. Epley noted that his practice was "bursting at the seams" and he wanted a way to raise capital without taking out a million-dollar loan. He also did not want to be acquired by a private equity firm that would turn around and sell the practice again in five years.

Due diligence. After a yearlong due diligence process, which included intense negotiations involving salary, purchase price, and other contract details, Dr. Epley sold the practice in March 2018 to a private equity firm that was merging different specialties to help staff neonatal intensive care units. "We felt it solidified a niche, and we were its third metro area—Dallas, Las Vegas, and now Seattle—and thus we would be a part of their long-term expansion."

After the sale, a bumpy transition. As of August 2019, the practice continues to experience transition challenges. "While the sales team for the com-

pany was organized, the implementation team was not. Consequently, there were a lot of hiccups in the first year," Dr. Epley noted. He attributed some of the issues to the company's lack of knowledge about running ophthalmology practices, from vision plans and optical retail operations to software and electronic health records.

Biggest speedbump: new software. "The most stressful aspect of this has been transitioning from our software to the company's software so that the organization can make data decisions about how we are doing," Dr. Epley said.

Financial security. While there have been some frustrating moments, Dr. Epley noted several upsides to the arrangement, including the purchase of assets that gave the physicians money to invest in their retirement, along with stock options.

Increased support and improved benefits. "The company is big, with 35,000 employees, so it gives our staff plenty of room to grow and a path to leadership," said Dr. Epley. "We have great tech support whenever we need it and educational opportunities that we didn't have before. Our benefits package is much better than what we were providing, including an improved health care plan, 401K, and employee stock options."

Optimistic about the future. Ultimately, said Dr. Epley, the private equity acquisition has taken his practice to higher levels without personal or financial risk. "We are still in the middle of this transition and hope that it will be completed by 2020. And I see the waters calming, with a positive long-term result."

Case Study: A Large, Growing Practice

Minnesota Eye Consultants (MEC) in Bloomington—a practice with more than 350 employees, five offices, and four ambulatory surgery centers—had considered being acquired by a private equity firm for several years. Reductions in reimbursement and the increasing cost of technology had made such a deal seem increasingly appealing, said Elizabeth A. Davis, MD, who is a partner at the practice.

Due diligence. After an exhaustive 18-month due diligence process, in 2017 the partners chose the private equity firm that most closely aligned with MEC's vision and values.

After the sale, no interference in clinical care. "Two years later, we haven't experienced any direct impact on patient care, and our clinical decisions are the same. Thus far, we have not been told to change our treatment approaches, and we certainly hope that won't change going forward," said Dr. Davis. "This is why choosing the right private equity group is so important. These firms need to stay in their own lanes—otherwise they will

__LEAVING A PRIVATE EQUITY PRACTICE.__ At MYF 2019, Dr. Saini urged young ophthalmologists to consider the repercussions of joining a private equity practice: If you have equity, is there a difference in your class of stock? If you leave the practice, how do you cash in on that equity? And how would the noncompete agreement impact you, given that the entity might extend across state lines?

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derail their own success. And success is not only increased revenues but also having happy doctors, happy staffs, and happy patients."

Fewer practice management responsibilities. The partners at the practice no longer call all the shots when financial or management decisions must be made, said Dr. Davis. "Now we still have monthly meetings of a governance committee, but the day-to-day operations are less in our hands."

More number crunching. The private equity firm provides daily reports on every single aspect of the practice, including the number of patients seen, number of surgeries, and how these data compare to the budget and year-over-years. "It is a financial analysis to a level that we never came close to doing, helping us to increase productivity and reduce overhead," Dr. Davis said.

The changes have involved pros and cons. On the one hand, it has been a huge adjustment to transition from controlling every management decision of the practice to not being involved in the daily operations, said Dr. Davis. On the other hand, the private equity firm has "removed the headache—and risk—involved with practice management," allowing the physicians to focus on patient care. The equity firm also gives MEC an edge when negotiating with insurance companies and provides more capital for growth.

Case Study: Give Private Equity a Second Chance?

Despite Dr. Wiggins' ill-fated experience 20+ years ago (see "PPMCs in the 1990s," next page), he and his partners recently took a year to explore private equity opportunities. "We found that these companies seem to be better capitalized now, offering much more cash in these deals, whereas the 1990s deals were stock heavy," he said.

Private equity's allure. "They were also making

the same arguments—increasing efficiency and bringing down costs through economies of scale," said Dr. Wiggins. "And that is the appeal because of current reimbursement pressures and increasing regulations as our costs continue to increase."

Considering the cons. Dr. Wiggins and his partners were concerned about the downsides to private equity arrangements. Of these, the biggest would be the loss of autonomy. Another would be decreased influence on the culture of the practice. In addition, because of the broad range of physician ages in the practice, it was clear that the senior partners would come out better financially while assuming less risk. This is because their time horizon was shorter than that of their younger colleagues.

"We were also concerned about the uncertainty when the practice is sold again by the private equity firm," Dr. Wiggins explained. "Ultimately, we felt that we are a successful practice, really didn't need new capital, and wanted to remain independent, and we decided against it."

The Generational Divide

A private equity acquisition affects older and younger ophthalmologists differently, said Dr. Davis. While those close to retirement are generally pleased with the arrangement, there is concern among the youngest partners about impact on future income. "Since you own less of the practice, going forward your income is reduced," he said.

Dr. Saini pointed out that while private equity may work out for some, "there are younger ophthalmologists who may find themselves working for practices that are less interested in long-term strategic decisions and instead are more focused on the short-term sale of the practice." Dr. Saini serves on the Academy's Young Ophthalmologist (YO) Committee, where he has spoken to many YOs about their experience working for private equity–purchased practices. "Without motivated younger associates," said Dr. Saini, "many practices will struggle. Senior ophthalmologists whose practices have been acquired by a private equity firm must figure out how to engage their younger

PPMCs in the 1990s

To many ophthalmologists, the current private equity activity in ophthalmology feels like déjà vu. In the mid-1990s, physician practice management companies (PPMCs) raised billions of dollars to invest in physician practices. However, the bubble burst within a few years, and the model collapsed due to a dwindling secondary market for the purchased practices and poor investment returns to equity shareholders and physicians. By 2002, eight of the 10 largest publicly traded PPMCs had declared bankruptcy.

Dr. Wiggins lived through the era.

"At the time, people were turning to PPMCs for different reasons," he recalled. "My partners and I were young and weren't looking to get a payout and retire. Instead, we sought out PPMCs to keep our practice strong for our entire careers. Managed care was growing, and there was a concern we wouldn't have access to contracts if we continued as a single practice."

Dr. Wiggins' practice was bought by a PPMC and received a substantial component of the purchase as stock in the new company, as well as cash and debt. The PPMC's ultimate goal was to grow the company as big as possible, take the company public, and then make money in the stock sale.

But within a few years, the physician owners realized they were not receiving the

LESSONS LEARNED FROM THE 1990S. *Speaking at MYF 2019, Dr. Wiggins said that for private equity's current business model to be successful, firms must: 1) provide value to physicians in terms of income prospects and reduced administrative burden; 2) develop a model with effective governance that aligns incentives and engages physicians; and 3) ensure that the new entity thrives in the local market.*

value they expected either in terms of management expertise or additional contracts.

"Eventually, we purchased back our practice, which cost us money," Dr. Wiggins said. "We got to keep the stock we had in the company, but by the time we sold, the price of the stock had decreased tremendously. I eventually ended up with a worthless stock certificate. This experience for me was a motivation to go back to school and enroll in an MHA program."

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physicians to go the extra mile—even though they are an employee versus building their own practice with sweat equity."

What's Down the Line?

Narrowing margins. When we look at sustainability, it is important to note the high prices that private equity is paying for practices, said Dr. Markowitz. "So when they do sell them, their profit margins will be smaller. Also, the larger number of acquiring firms means more competition."

Much uncertainty. The private equity trend is so new—and the health care marketplace is so uncertain—that there is no way to make concrete predictions on results or ramifications five or 10 years down the road, said Mr. Abruzzo. "I wish I had a crystal ball," he said. "Who will be the purchasers this second time around? I question whether there will be a market then—or, at least, a sufficient market. And if there isn't, will these private equity firms have the stomach to hold on to these [practices]? Probably not. And if not, where do things go from there?"

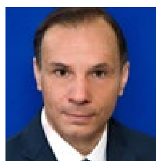
Practice consolidation. "One trend is certain," Mr. Abruzzo said. "Consolidation of ophthalmology practices is here to stay. It really was starting to happen anyway, but this wave of private equity acquisitions has accelerated consolidation 10-fold. And interestingly, when practices merge, they become bigger targets for private equity acquisitions."

THE GENERATIONAL DIVIDE. *Senior physicians near retirement may be keener than their younger colleagues on a private equity deal.*

1 O'Donnell EM et al. Private equity acquisitions in ophthalmology in the United States. Poster presented at: ARVO Annual Meeting; May 1, 2019; Vancouver, British Columbia, Canada.

Further reading. Want to grow your practice without private equity? For a brief overview of your options, see this article at aao.org/eyenet. For a more detailed look, see the December *EyeNet*.

Meet the Experts



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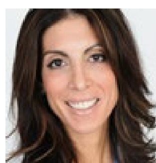
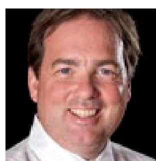


Elizabeth A. Davis, MD, is a cornea, cataract, and refractive surgeon and partner of Minnesota Eye Consultants in Bloomington, Minn. *Relevant financial disclosures: None.*



K. David Epley, MD, is a pediatric ophthalmologist with Children's Eye Care in Kirkland, Wash.

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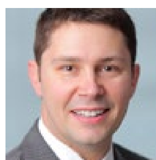

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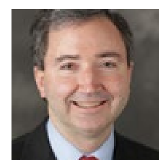
Arvind Saini, MD, MBA, an owner of Integrity Eye (formerly Hidden Valley Eye Associates) in Escondido, Calif. *Relevant financial disclosures: None.*



Robert E. Wiggins, MD, MHA, specializes in pediatric ophthalmology and neuro-ophthalmology and serves as the physician administrator for Asheville Eye Associates in Asheville, N.C. *Relevant financial disclosures: None.*

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

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