



COLLEGE of AMERICAN
PATHOLOGISTS

What to Expect During and After the Merger or Acquisition of a Pathology Group

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Robert H. Tessier, MPH

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Other upcoming PMC presentations

July 18th - “Get What You Want From Administrators and Clients With Compelling Annual Reports”

August 17th – “Patient Blood Management Best Practices for Quality and Costs”

August 19th and 20th – PMC Workshop on Fundamental Practice Management Skills – “What medical schools *don’t* teach you and business schools *can’t* teach you”

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A presentation by

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Council on Membership and Professional Development

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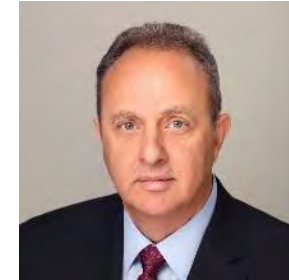
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Today's Speakers

Karim E. Sirgi, MD, MBA, FCAP

President of the CAP Foundation

Ex-Officio Member of CAP Board of Governors



- **Owner, CEO, Sirgi Consulting LLC**
- **Intimately involved with the merger of three Denver based pathology groups, resulting in the largest privately owned, multispecialty pathology group in the Rocky Mountains region, which he presided for many years.**
- **While president of the group, Dr. Sirgi led the sale of its privately-owned technical laboratory (while protecting the PC complete independence) to a national entity, resulting in a full-service technical laboratory covering the Denver metro area, and multiple states.**

Today's Speakers

Robert H. Tessier, MPH

Senior Reimbursement Consultant

HBP Services, Inc.

- Senior Reimbursement Consultant , HBP Services Inc.
- For 35 years he has provided consulting services and actively manages successful pathology groups. Consulting focus is hospital support for Part A services.
- Bob has negotiated more than 200 third party contracts. His firm is retained by hospitals to study the *fair market value* of technical services and routinely performs billing audits for pathologists.
- Most recently, a number of pathology clients have merged with other groups. He is also familiar with acquisitions by companies such as Quest, Sonic and Aurora.

Key Objectives

- 1. Know the difference between a merger and an acquisition**
- 2. Selecting the best team of advisors**
- 3. Understanding financial competitive strategies**
- 4. Establishing cost centers vs a single approach**
- 5. Learn the best Intra/Inter practice communication strategies**
- 6. Post M&A professional and managerial governance and dynamics**
- 7. Understand the use of different classes of stock**

The Difference Between a Merger and an Acquisition

Merger

- Union between two (or more) corporate entities
- Impact on corporate culture: Blending vs assimilation

Acquisition

- One organization acquires the properties and assets of another one
- Governance usually relinquished to buyer

Why Merge or Sell?

1. **Ever-increasing complexity of medical specialties and the need for ready access to subspecialists**
2. **Improving negotiation and contractual positions with payers and large healthcare providers**
3. **Economy of scale with technical and professional talents**
4. **Improving purchasing power with suppliers**
5. **Broadening geographic reach and coverage**
6. **Increasing ability to organize care along specialized service lines, with implications on overall quality of care delivery**

Why Merge or Sell?

(cont'd)

- 7. Bettering chances of attracting the brightest and the best talents at all levels of the organization (professional and technical staff)**
- 8. Enhancing deployment of best operational and professional practices to a broader enterprise**
- 9. Accessing more capital for better space and equipment**
- 10. Initiating and participating in R&D projects**
- 11. Engaging in a defensive move in order to neutralize one or more competitors**

Merge or Sell?

- 1. We see more Pathologists and less clinical productivity from the groups receiving a guaranteed hospital salary – at 80% or less**
- 2. If the group has neither the talent nor the willingness to do the things we have mentioned, then consider merging with a larger group which could provide:**
 - **Administrative resources (Medical, CEO/CFO)**
 - **Sales and Marketing**
 - **Better Third Party reimbursements**
 - **More efficient and less expensive billing**
- 3. Don't consider selling unless you first strengthen the Practice to achieve the best possible price!**

The M & A Journey

**Resulting organization is (should be)
more than the sum of its initial parts**

The Initial Contact

- **Interest in your organization may come from all sorts of sources, expected and unexpected ones**
- **Be prepared to recognize the subtle (and not so subtle) signs of courting**

The **FIRST** Meeting

- **Casual**
- **Formal**
- **In-house**
- **Neutral terrain**
- **Importance of signing an NDA**



Who Should Attend the First Meeting?

- **Good communicator(s) from both parties**
- **Communication needs to be external, but also internal**
- **Explore synergies between both organizations from a high altitude**

Mergers

Phase 1

Interest and Initial Meetings

- 1. Enter into a Non-Disclosure Agreement. Consider the term of the agreement and pros and cons of an exclusivity provision.**
- 2. Begin to discuss a common vision**
- 3. Physicians need to assess whether they can work with the physicians in the other group**
- 4. Select a consolidation committee consisting of key representatives of the 2 practices**
- 5. Establish a meeting schedule for all participants and the consolidation committee**

Interest and Initial Meetings (cont'd)

6. Parties meet to review pros and cons, considering:

- **Ownership**
 - Percentage ownership interest that a physician has in the entity does not necessarily have to correspond to physician's voting power in governance issues
- **Governance**
 - Understand voting rights and issues that need to be approved by officers, directors and/or shareholders
- **Compensation**
 - Each physician involved in the practice merger will want to know what the practice merger will mean in terms of income
- **Tax**
 - Attempt to structure the transaction so there is little, if any, tax impact on the parties
- **Benefits Issues**
 - There will not be separate practices anymore; there will be one unified group
 - Analyze the different benefit plans that each practice provides before the affiliation
- **Office/Personnel**
 - Consider need of combined practice for existing locations and personnel

Expanding the Initial Contact Team into a Steering Committee – Needed Expertise

- **Professional leadership expertise**
- **Practice management expertise**
- **Technical expertise**
- **Billing and accounting expertise**
- **Legal expertise**

A. Professional Leadership Expertise

- **Staffing and work distribution philosophies**
- **Partnership track record and roadmap**
- **Subspecialty work allocation**
- **Work/lifestyle balance**
- **Governance style and philosophies**
- **Organizational culture**

B. Practice Management and Technical Expertise

- **Organizational structure**
- **Administrative talents present and needed**
- **Technical services needed and offered**
- **Human resource matters
(pre and post merger/acquisition)**

C. Financial and Legal Expertise

- **Financial health of either organization**
- **Valuation of either organization and EBITDA**
- **Current and post merger/acquisition legal corporate structure**
- **Taxation structural considerations**
- **Governance documents**
- **Many checklists are available to get the dialogue started (off the shelf, without expense)**

Mergers

Phase 2

Evaluation – Due Diligence

Some of the most vital data elements include:

- 1. Financial statements for each practice for the 3 most recent fiscal years**
- 2. Federal income tax returns for each practice for the 3 most recent fiscal years**
- 3. List of significant or key operating assets with the practice**
- 4. Copy of the current malpractice insurance policy for each practice and past claim history for each physician**
- 5. Copies of office rental leases for each practice location**
- 6. Copies of leases for any medical equipment**
- 7. Bank loans, letters of credit and other debt obligations**
- 8. List of major insurance payers that the practice participates with**

Evaluation – Due Diligence (cont'd)

Other vital data elements:

8. List of practice management software and EMR systems currently in use
9. List of all physicians and physician assistants who work in the practice, and base salary and compensation formula for each provider
10. List of all office staff employees with current rate of pay, benefits, and date of last salary increase
11. Current summary of aged accounts receivable in total and by major insurance payer
12. Disclosure of any pending litigation and third-party payer audits
13. Copy of current fee schedule. Includes charges and adjustments per provider. This and payer/reimbursement data can be “Consultant’s Eyes Only.”

About Attorneys

- Indispensable
- To include corporate and tax attorneys
- Listen to their invaluable counsel but do not abdicate all decisions to them, especially matters directly affecting the practice of medicine/pathology
- Be wary of “boiler-plate” or “pre-templated” “one-size-fits-all” documents

The Single Most Important Ingredient of M & A Success.....

Cultural Harmony

Cultural Harmony

- **Work load/Income/lifestyle balance**
- **Governance style and philosophy**
- **Work distribution preferences**
- **Respect for subspecialty specificities and variances**
- **Appetite for business entrepreneurship**

- **Demographic diversity (age, gender, ethnicity, religion)**
- **Comfort with practice settings, for example hospital versus outpatient based practices**
- **Desire for geographic integration of practices**
- **Experience with managing technical personnel**

- **Allowances for extracurricular activities and moonlighting**
- **Rainmaking skills and marketing**
- **Allowance for part-time employment and impact on partnership status (“partner” at 80%)**
- **Tolerance and guidelines for differential compensation**
- **Recognition, support and reward for leadership activities**
- **Minimum continuous medical education requirements**
- **Adaptability to practice pattern changes**

Words of Wisdom



Take the time to know each other better

- 1. Exchange of pathologists across group lines**
- 2. Deployment of pathologists in geographies and practice settings representative of their future settings**
- 3. Meaningful social events bringing the groups together in various settings (with and without spouses, with and without critical non-physician staff, at work facilities and off work settings)**

Take the time to know each other better

4. **Exchanges of leadership talents (physician and non-physician staffs) to various critical areas of the operation or, at a minimum, leadership dyads to observe and compare leadership styles and philosophies**
5. **More extensive open conversations between all members of the groups, not just the leadership or designated steering committees**
6. **Identify nay-sayers on both sides and invite them to serve across company lines; re-evaluate their position vis-à-vis the M&A effort**

Leave the Door Open for Nay Sayers

Build a grace period into the post-merger non-compete clause

Allow/encourage “nay sayers” to seek other employment opportunities

Safeguards

- **If possible, include a pre-nuptial agreement**
- **Establish upfront a list of success criteria**
- **With evaluation exercises at regular time intervals**
- **Build a list of objective and subjective points that would trigger corrective measures ... or corporate separation**

Mergers

Phase 3

Implementation

1. **Begin to draft definitive documents (e.g., merger agreements, bylaws and articles of incorporation) and employment contracts**
2. **Identify board of directors**
3. **Select officers and committee members**
4. **Select new practice name**
5. **Review administrator positions and functions**
6. **Prepare to consolidate functions such as billing and collections, on-call schedule, policies, employee benefit structure, employee pay scale, and human resources and personnel decisions**

Implementation

(cont'd)

- 7. Select practice management systems**
- 8. Decide on new compensation formula**
- 9. Obtain federal tax identification number and state employer identification number**
- 10. Seek quotes from malpractice carrier and begin process of consolidating all physicians' coverage to one carrier**
- 11. Prepare to consolidate fee schedule**
- 12. Begin credentialing process and prepare to notify Medicare, Medicaid, and third-party payers of change and new practice information such as new tax ID number**
- 13. Vote to approve transaction and enter into agreements**

Acquisition Considerations

Accounts Receivable

- 1. A/R is often included in the purchase.**
- 2. Depending on size of group, you may want to negotiate to retain your AR if your Billing Company can segregate for services prior to and after closing**
- 3. If your pathologists have a stake in AR, project an estimate so they understand how those payouts will come in and go out**

Post Closing Management

- 1. Post closing management of the practice requires bookkeeping services**
- 2. Set up partnership accounts at the bank to receive AR funds and pay out pre-closing liabilities**

Other Insurance

Insurance requiring tail includes:

- **D&O/EPLI**
- **Data Security**

Vacation and Bonus

- 1. Liabilities have to be paid out**
- 2. Conduct an analysis of your liabilities**
 - **Your final payroll can be substantial**
 - **You will need sufficient cash to cover**

Retirement Plans

- 1. Retirement plans require termination**
- 2. If you have contributions (Profit Sharing, Safe Harbor, etc.), timing of those payments is critical to when you freeze the account**
- 3. They will also “compliance test” your plan, so if employees front load their 401K, it may trigger contributions to lower salaried staff to meet compliance requirements**

Fringe Benefits

- 1. Make sure you have overlap with insurance benefits**
- 2. One acquiring company started benefits in May, the old practice closed in March and paid for health, dental, and vision through May. The new entity agreed to pay for that portion of the premium.**

Medical Malpractice Insurance

- 1. Should evaluate for tail liabilities**
- 2. One group had a modified claim made and no tail liabilities**
 - **If there had been a regular claims made policy, tail liabilities would have been substantial**
 - **You might also negotiate tail coverage for the remaining MDs if they stay for at least 3 years**
 - **If they leave before that, the new company would charge them for the tail**

Merger

Competitive Financial Strategies



Prepare for a Merger or Acquisition

1. **Many groups produce a limited financial report that needs to be improved in order to have a dialogue with other groups or when discussing mergers**
2. **Add Cost Centers**
 - **What is the technical profit on billing globally for referred services?**
3. **Compare to prior year and budget**
4. **Adjust for any major accrued items -at least on an annual basis**
5. **Add or Expand Footnotes**
 - **ID any changes in the “run rate” of income and expenses**
6. **Prepare a SWOT analysis and address each item found to be lacking**

Re-Invest

Often nothing is spent other than essential operating costs

Each Practice should function like larger groups - many cite this as the main reason to merge

1. Market the Practice

- Collateral
- Website
- PR

2. Retain Sales and Client Support

- Hire and pay sales staff like programs at commercial labs: 8/4/2

3. Professional Management (at least on a part-time basis)

4. Support IT initiatives and prioritize your important projects

Strengthen

- 1. Give the Chief (or those with administrative skills) plenty of time to develop relationships with Administration as well as organizations like ACOs**
 - Too often, in small groups, the Chief is expected to handle a full clinical workload
 - Large groups understand the value of having a CEO or Managing Partner(s) with limited clinical functions to focus on Part A and Part C
- 2. Consider a regional approach to sharing resources such as a Dermatopathologist**
- 3. Hire senior talent rather than bringing in recent trainees**
 - Is it possible to add a well-respected academic Pathologist to the mast head?
 - Someone you consult for specific problem cases, e.g., Neuro, GI

4. **Does your Practice have a WRITTEN succession plan?**
5. **Make sure that rainmaking skills are rewarded!**
 - **These are highly valued at legal, accounting and consulting groups**
 - **Why not Pathology as well?**

Establishing Cost Centers vs. Single Approach

- 1. Our experience indicates the importance of developing and maintaining detailed cost centers within a merged practice**
- 2. The philosophy would be “eat what you kill”**

Establishing Cost Centers vs. Single Approach (cont'd)

3. Each of these individual practices may also have different approaches they want to maintain

- **Productivity**

- One group is comfortable with 8,000 work units
- The other group finds 11,000 to be their norm

- **Vacation and CME Policy**

- 6-8 weeks vacation plus 2 weeks CME (use or lose)
- 4 weeks vacation plus unspecified CME

- **Health Insurance Benefits**

- One group has a high deductible family plan with a large health savings account (HSA) contribution
- The other pays for a regular plan for employees only

Establishing Cost Centers vs. Single Approach (cont'd)

- **Pathology Assistants**

- One of the practices employs 2 PAs
- The other group has 1 PA employed by the hospital

- **Compensation for the Chief/President**

- A differential of 10% above senior compensation is paid to the Chief
- A second group recognizes a fixed payment of \$25,000/\$50,000, or all senior partners are paid equally

Establishing Cost Centers vs. Single Approach (cont'd)

4. **Senior pathologists in the merged group earn:**
 - **Group 1 (Cost Center): \$500,000**
 - **Group 2 (Cost Center): \$675,000**
5. **We find that a great deal of flexibility can be maintained as long as the retirement plans have comparability testing, and malpractice insurance is uniform. This is all subject to the creativity of your legal team.**

Communication During the M & A Process

Internal

- Pathologists at various stages of the partnership track journey and/or of their career
- Management of Technical staff employed by the group
- Technical staff employed by the group

External

- Hospital management of institutions covered by the group
- Laboratory staff of hospitals covered by the group
- Clients of services offered by the group
- Community leaders affected by the M&A activity



Have a Communication Plan and Strategy in Place

- **Identification of the various audiences that will be recipients of communication**
- **The various levels of confidential information that will be communicated to each party**
- **The timeliness of the various communications**
- **The parties responsible for disseminating the information**

Post M & A Professional and Managerial Governance and Dynamics

Acquisition

- The purchaser owns and manages the acquired entity
- Possibility of seats on the governing board
- Aim at forming a Joint strategy (or advisory board) with pathologists participation

Merger

- New governance structure negotiated between the parties involved
- Strong leadership with clearly delineated lines of authority needed
- Time allocation for the physician leader to lead

Use of Different Classes of Stock

- 1. When a smaller group (2 - 3) joins a larger practice (5 or more), using a democratic decision-making vote (1 partner, 1 vote), it is possible to protect the smaller group.**
- 2. This is accomplished by setting up 2 classes of stock:**
 - Class A**
 - Class B**

Use of Different Classes of Stock (cont'd)

- 1. The holders of Class A stock (smaller group) “can never be out-voted or be in a minority on matters affecting their cost center / hospital affiliation / practice location”**
- 2. However, the merged group can still make majority decisions on matters such as practice advisors, billing system and third party negotiations**
- 3. In other words, a delineation of the unique cost center vs. group can be structured**

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