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ANESTHESIA GROUP ACQUISITIONS AND ALTERNATIVES

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In a period of rapid change, physician practices react differently to the resulting uncertainty.

Hospitals seek to employ or otherwise "align" primary care physicians. They seek to control specialty referrals through employment models, accountable care organizations and other hospital-centric networks. And particularly for anesthesiologists, competitive pressure is mounting from large regional and national groups.

Many anesthesia groups are interested in seeking shelter from uncertainty through a sale to a large regional or national group or to a private equity-backed venture. Yet others are forging new routes, alone or in alliance with other practitioners and creating their own futures. Which route is best for you?

Acquisitions

It's important to understand the basic economic structure of an anesthesia group acquisition. As opposed to the sale of, for example, a manufacturing business that includes inventory, machinery, raw materials and real estate, all of which can be valuated and sold, the only thing that most anesthesia groups have to sell is their future cash flow. Accordingly, the usual anesthesia practice acquisition is essentially a valuation, at a multiple of the group's reconstructed earnings—reconstructed because most groups don't have significant, or any, earnings in the technical sense due to the fact that they annually distribute all of their available cash to their physician owners.

To illustrate, if the group is normally distributing $100x to the physicians when the amount of compensation required to recruit and retain is $70x, a purchaser likely would value the group based on a multiple of the difference—that is, a multiple of $30x. As part of the sale, the group's physician-owners would receive an employment contract for $70x per year, often for a guaranteed number of years.

The savvy reader might realize that, all things being equal, the group has financed the purchase price by forgoing the collection of the additional $30x: That's correct. However, those physicians nearing the end of their active careers may be more than happy to obtain four, five, six or more times that $30x up front because they have no intention of working for more than one or two additional years.

Even physicians who foresee many years of continued practice sometimes favor an acquisition because it results in a shifting of risks, for example, the risk that the hospital contract might be terminated, or that collections will plummet, one year into the term of a multiple-year employment guaranty.

Although certain risks can be shifted, sellers do assume other risks, such as the fact that continued practice without a sale might be more remunerative or that the lump-sum purchase price received might not deliver a higher return than would a continued investment in their own careers.

How long the hot acquisition market will last is anyone's guess. Certainly, large groups in key markets—"key" being different for each potential acquirer—tend to drive higher valuations. But that's not to say that a smaller group, in a particular buyer's viewpoint, wouldn't make a prime candidate to fill in perceived gaps in their footprint.

One more point: Many anesthesiologists want to know the magic multiple that will apply in connection with their imagined acquisition. In other words, they want to know now, up front, what their practice is worth.

The real answer is that it's worth what an *actual* buyer will pay you to acquire your practice. If Buyer A will pay $30 million and Buyer B will pay $40 million, then your practice is worth the latter. That's true even if Buyer B is a fool. On the other hand, if no buyer is interested in your practice, then for you, for now, there's absolutely no value to be had through an acquisition.

Although you can look to the greater market for trends, such as the fact that anesthesia practices are selling like hotcakes, to gauge the likelihood that there is a potential buyer in the wings, the only way of actually knowing is to engage in the process of looking for one, or preferably many.

Alternatives

Just because the acquisition market is hot doesn't mean that you should be interested in a sale. Again, unlike the calculus that the owner of a manufacturing business uses, no one is likely to pull enough cash out of a sale to head off and buy a villa on Lake Como or even a nice second home in Aspen. And for the many who seek to control their own futures, no sale can deliver that ability.

But there are multiple alternatives to a sale:

1. *Elevate Your Game*. Immediately begin taking steps to cement your relationship with the facilities at which your group currently provides services, and intensify your efforts to secure additional services contracts. At the same time, tighten up your group's internal operations. Get your governance structure in order to enable your group to make quick decisions. Review your compensation plan to make certain that it creates the proper incentives and motivators. And begin to amass capital to enable the group to expand on multiple fronts.

2. *Create a Profit Stream From Your Internal Business Function.* If your group has an internal business operation with a dedicated practice manager, consider expanding that function into a separate spun-off business entity that provides management services to other groups as well as to your own.

For example, you can sell your manager's and your group leaders' business expertise; you can repackage billing services; and you can operate a locum service with your own group's physicians or with third parties.

Importantly, your management services organization, or MSO, structure can be a vehicle to create initial relationships that later might be expanded to make the client a target for merger or acquisition.

3. *Do Your Own Mergers and Acquisitions*. Instead of simply thinking of M&A from the perspective of a target, consider that your group can become an acquirer. Although you might actually consider buying another local group, that is, engaging in a true acquisition, there is no reason to restrain your thinking to paying cash.

Your group can combine with other groups through merger to form your own larger entity. Although size by itself doesn't ensure success, it can enable your group to establish a wider geographic presence, achieve economies of scale and potentially create stronger payment rate contracting power. Size also serves to create leverage in connection with facility contract negotiations.

There is a plethora of ways to structure mergers, from those in which your group essentially makes itself larger by subsuming other groups into its fold, to structures in which your group and another create a new entity.

4. *Nontraditional Models.* Within bounds permitted between competitors (although the truly entrepreneurial reader will realize that there is no need to deal only with competitors), nothing

limits the types of nontraditional or hybrid ventures that can be constructed. Consider, for example, the use of cooperative ventures, limited-scope joint ventures and alliance models.

Conclusion

More options exist for your practice than you may have considered. There are always alternative structures to a sale and alternative strategies for the success of your practice. Even if you are committed to seeking a buyer, you can't stop or even slow your efforts to develop your business while you are searching for the right one. There might not be a buyer. If there is one, you might not like the price. You might realize that you don't want to sell. You might decide you want to buy.

The best strategy formulation is not a straight-line process. It's not an on-off, sell or don't sell, merge or don't merge situation. Rather, it's a fluid, circular process, keeping options open even as you explore a primary one, continuing to build as you, for example, continue to search for the right deal—that is, the right deal for *you.*

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