Anesthesia Group Mergers, Acquisitions and (Importantly) Alternatives

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It's come to the point that a good part of my work with anesthesia groups involves *surgery*: removing an earworm—a catchy tune that continually runs through the group's mind.

In fact, it's always the same tune, part of The Clash's *Should I Stay or Should I Go Now*:

Should I stay or should I go now?
Should I stay or should I go now?
If I go, there will be trouble,
and if I stay it will be double.
So come on and let me know.
This indecision's bugging me.

Stay, as in should our group remain independent?

Go, as in should we sell out to someone, maybe anyone, who'll buy us?

But as is generally the case in life, the decision is not purely either/or, black or white, yes or no. There are many alternatives. And that's what we "operate on" as part of what I call the Future Finder™ process.

Some Background

As you're certainly more than familiar, there's a storm of uncertainty resulting from the rapidity of market change in healthcare in general and in anesthesiology in particular.

Hospitals seek to employ or otherwise "align" physicians. They seek to control specialty referrals through employment models, accountable care

organizations and other hospital-centric networks.

For independent anesthesia groups there's mounting competitive pressure from large regional and national groups. And for all anesthesia providers, from the individual to the immense group, there's the looming impact of technology.

Many believe that they will find shelter from this 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.

What 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 valued 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 a lesser \$70x, then a purchaser would, conceivably, value the group based on a multiple of the difference, that is, on a multiple of \$30x.

As a part of the sale, the group's physician owners would receive an employment contract for, in our simplified example, \$70x per year, often for a guaranteed number of years.

The astute 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 five, or six, or

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more times that $30x up front because they have no intention of working for more than one or two additional years.

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

While 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 actually 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.

Alternatives

Just because the acquisition market is hot doesn't mean that you should be interested in a sale or, even if you are, that it's the right option for you or that any buyer would actually purchase your group.

And, for the many who seek to control their own future, no sale can deliver that ability. By definition, you will have sold off your ability to control your professional future, at least within the confines of the acquired group and maybe, depending on the scope and enforceability of covenants not to compete, within a significant geographic area. Maybe that trade-off is worth it to you. Maybe it's not.

And, for those who believe that larger is smarter or that larger is safer, consider the example of General Motors' bankruptcy.

There are multiple alternatives to a sale, some mutually exclusive and others additive. Let's explore some of them.

1. Become a Much Better Competitor

Reminiscent of Garrison Keillor's imaginary Lake Wobegon, "where all the women are strong, all the men are good-looking, and all the children are above average," I've yet to meet an anesthesia group that doesn't claim that it provides wonderful care and fantastic service and that it has a great relationship with the hospital's administration.

But, as Richard Feynman quipped, "The first principle is that you must not fool yourself—and you are the easiest person to fool." So, begin with telling the truth.

Immediately start to take steps to cement your relationship with the facilities at which your group currently provides services. Correct service deficiencies. Correct personnel deficiencies. Create an Experience Monopoly™ in regard to the level of service that your group provides to its "customers": hospitals, referring physicians and patients. If you receive a coverage stipend, seek ways to reduce it, knowing that that is how competitors often gain a foothold.

Explore opportunities to expand your practice to encompass additional facilities. This must include additional hospitals and, very importantly, outpatient facilities. Expansion outside of acute care hospitals is essential in order to hedge against a future that will likely not be hospital-oriented.

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 bank capital to enable the group to expand on multiple fronts.

2. Do Your Own M&A

Instead of simply thinking of mergers and acquisitions (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's no reason why you need to restrain your thinking to paying cash.

Your group can combine with other groups through merger to form your own larger entity. Although size itself doesn't secure success, it can enable your group to establish a wider geographic presence, achieve some economies of scale and potentially create stronger payer contracting power. It 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.

3. Alignment Models

Within bounds permitted between competitors (although the truly entrepreneurial reader will realize that there's no need to deal only with competitors), there's little limit on the types of non-traditional or hybrid ventures that can be constructed.

For example, it's possible to construct co-op type ventures in which groups across geographic bounds align for purposes of reducing costs (e.g., malpractice insurance) and of amassing data that can be analyzed and used to improve their practices (e.g., through the design of protocols) as well as to

demonstrate value to hospitals and health systems.

Or, as another example, it's possible to construct management services organization (MSO) structures in which multiple groups link to centralize various management functions. There's a mention of MSOs below, from a slightly different angle.

Note that these ventures do not have to be limited to arrangements with other anesthesia groups. Depending on the specifics, they can be cross-specialty (e.g., anesthesiology and radiology) and cross-profession (e.g., MD and CRNA).

4. Profit From Existing Capabilities and Intellectual Capital

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 MSO type services to other groups as well as to your own.

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

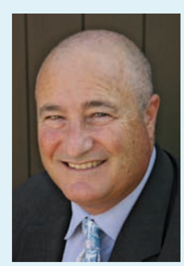
Importantly, your MSO structure can be a vehicle to create initial relationships that might later be expanded to make the client a merger or acquisition target.

CONCLUSION

There are always more options than you've considered to date. There are always alternative structures to a sale and alternative strategies for the success of your practice.

Even if you're committed to seeking a buyer, you can't stop or even slow your efforts to develop your business while you're searching. There might not be a buyer. If there is, you may not like the price. You might realize that you don't want to sell. You might actually want to buy.

In closing, remember that 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 continue to search for the right structure, the right deal, for *you*.



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