WHITE PAPER

Does Due Diligence Matter?

Mergers and acquisitions can be an exciting part of physician practice transformations, especially if you're a physician owner who's received an attractive offer from a prospective buyer. Similarly, you may be the buyer of a physician practice who is eager to get the transaction behind you. However, while the future is without a doubt filled with promise, it's important not to get too ahead of yourself, as the next step in the process can be a lengthy one-due diligence.

We have assisted many entities (including physicians themselves, private equity firms, and management services organizations) with due diligence of physician practices, and can attest to the highly structured process of due diligence. There are myriad of items to review and question, which go beyond having a mere rough idea of what equipment is in the practice and whether there are any malpractice claims.

What is Due Diligence?

Due diligence is an important part of the acquisition process and represents the orderly investigation of any matter pertaining to business dealings. Essentially, it’s about understanding how a business really works. Since no two medical practices are the same, it's important that a diligent effort is made in order to obtain any information that would be relevant in the sale or purchase of a physician practice and its assets. A key aspect of due diligence is to examine the strategic positioning of the “target” medical practice. In mergers and acquisitions, due diligence helps clients recognize any financial, legal, or operational risks that may not be noticeable from outside perspectives.

Why Should Due Diligence Matter to You?

While due diligence may seem like it only benefits one party, the fact is that due diligence helps both the buyer and the seller in the acquisition of a physician practice. It is the seller's responsibility to provide buyers, investors, and potential business partners with the information needed to make an informed decision. Yes, it means turning over extremely sensitive corporate documents such as profit and loss statements, business plans, payroll records, payer contracts, lease agreements, and so on.

From a buyer's perspective, due diligence gives them peace of mind that they're making the right deal and have all the information they need to make a good purchasing decision. This information can include learning more about the practice's existing patient base and referral relationships and either validates positive assumptions or alerts them about potential irregularities.

From a seller's perspective, due diligence helps physician owners take a deeper dive into the financial integrity of their business and can also help them uncover the fair market value of their practice. As valuations and acquisition prices are intertwined, it's essential that physician owners, private equity firms, and management services organizations invest in quality due diligence reporting and services.

What is Included in Due Diligence Reporting?

First of all, it is important to note that non-disclosure agreements (NDAs) are standard. If you are a potential seller and you are not offered an NDA by the potential buyer (this includes with a broker if you have chosen to hire one), then a red flag should be alerted right from the start.

Every detail matters, from patient volumes and catchment areas, to existing relationships with referring physicians, to the workforce itself and what the competitive environment for that medical practice looks like. Good due diligence may validate your assumptions, but maybe more importantly, it can help alert you to any irregularities or possible issues in a business (or any aspect that may bring the value of a “target” medical practice down). Ideally, any issues would be surfaced before the due diligence stage, but sometimes things slip through the cracks, or may not be fully considered in the right context.

Here are a few key categories of due diligence reporting:

Financial Information – Most buyers spend the majority of their due diligence looking at and confirming financial reporting. All documentation and accounting information should be up to date and accurately portray numbers that were disclosed during the deal-making stage.

Legal – Understanding if the business being acquired has any potential liabilities is another important consideration in due diligence. This includes looking into current partnerships and contracts in place to ensure there are no irregularities before moving forward.

Business Sustainability – Cash flow management and long-term business sustainability are important aspects to due diligence. Careful analysis and previous years of data (e.g. patient volumes, procedures, billings and collections, etc.) will help potential buyers diagnose trends and decide if their investment is worthwhile.

Assets – Buyers will want to ensure what assets are in place and if they are in good working order, because if not, they will have to make investments after closing. Service agreements will be reviewed as well as any lease arrangements. Additionally, real estate (owned or leased) will need to be evaluated and discussed strategically with the seller.

Human Resources – Contracts on physicians and any other employees may need to be redone and thus the buyer will often have sensitive discussions with the seller during due diligence as it relates to those. All other employee-related items (e.g. benefits plans, 401(k), COBRA continuations, etc.) should be readily accessible as these can take time to review and make determinations on post-transaction changes.

Having said all that, it is important to note that not all due diligence investigations are the same, and surprises are to be expected. This can greatly impact the length of the due diligence process as well as the time invested by all parties. And, if due diligence drags on for too long, one or both parties can lose interest in the potential transaction at stake.

The due diligence process is a must, but it's inherently filled with conflict. This conflict usually arises with a first-time seller who is hesitant to turn over sensitive information and who may be untrusting of the buyer, especially if the buyer is a competitor or if the transaction was unsolicited by the potential seller. These are keen reasons why it may be of interest for the seller to engage the services of an independent consultant.

Due diligence will always be an important part of mergers and acquisitions, especially as deal stages come to a close. By knowing what to expect when preparing for a successful business transition, you'll be able to provide accurate and timely reporting that increases the value of your medical practice while helping you address irregularities if and when they arise.

ABOUT ABISA

ABISA offers advisory services to help clients formulate strategic direction and advance healthcare business initiatives. As a trusted source for strategic healthcare initiatives, ABISA enables physicians to concentrate more of their time on patient care. For more information about our services, visit www.abisallc.com.

P.O. Box 1465

Valrico, FL 33595

www.abisallc.com

info@abisallc.com