WHITE PAPER

Thinking about Joining an MSO?

While there are a couple of variations to Management Services Organizations (MSOs), this article will focus on the more common type which is a private equity-backed management company. Essentially, this type of MSO is a limited liability corporation (LLC) operated by a team of management professionals and the corporation is owned by a private equity firm. The private equity firm owns this MSO as one of several companies in their investment portfolio; some of the companies are healthcare-related while others may be in a multitude of different industries (e.g. energy, transportation, etc.). Within healthcare, one of the primary reasons a private equity firm utilizes an MSO is that it creates a corporate "vehicle" which allows them to operate throughout the United States regardless of the various corporate practice of medicine laws. These private equity-backed MSOs are specialty specific, meaning the MSO would only focus on one medical specialty, although a private equity firm may have a couple of different MSOs targeting different medical specialties.

The Process

Many times I hear physicians state that they "sold to private equity." Well, in a sense, that is correct but in other ways it is not. Private equity individuals do not personally knock on the doors of medical practices to solicit a sale and I have never witnessed private equity investors involved in negotiations with physicians. These are the roles of management personnel that are employed by the MSO. The MSO team members, often with a title of "business development", are the people that exhibit at physician specialty conferences and call upon physician owners of medical practices. Once the MSO team can establish a dialogue with physician owners and explain the benefits of their particular structure, they will issue a non-disclosure agreement (NDA) for the physician practice to sign. Most of you reading this article have most likely signed NDAs before for some sort of discussion or potential transaction.

Letter of Intent

Upon executing the NDA, the management team will request some preliminary documentation. It is here where the MSOs can vary greatly as to the type and amount of documentation requested. At a minimum, you can expect to release financials for three full years plus the current year-to-date. This gives them a good high-level picture of your practice and they will no

doubt have a ton of questions for you as it pertains to the practice history, current operations, challenges, trends, future plans, and more. At the conclusion of this, they will issue a Letter of Intent (LOI). Again, each MSO is different and they may request a lot more information prior to producing an LOI. For example, they may ask for productivity reports from your EHR as well as charges by CPT code, physician compensation, etc. The LOI is a non-legally binding document which essentially outlines the key terms of the deal. It would include items such as the estimated value of the practice (and a related purchase price multiple), purchase price terms of the practice (and related procedures such as escrow), the relationship of the MSO and medical practice post-transaction, an estimated effective date for the transaction, a recasting of physician compensation (i.e. what physician compensation looks like now as compared to being a part of the MSO), percentage equity the company will buy vs percentage equity physicians will retain, and potentially several more items. The other important item (in case you are trying to consider several different purchasers) is what's known as a no-shop clause. While you can be engaged in countless NDAs, there can be only one LOI that you execute at a time. This no-shop clause basically states that you agree to not entertain any offers from any other purchaser for a period of time (usually a minimum of 90 days) so that this first management company can complete its due diligence and deliver a firm offer.

Due Diligence

This is the first painful and time-consuming process. Depending on a great many factors, this could be six weeks or six months. Here are a few factors that can determine the length of the process:

- Number of locations the practice has.
- Number of providers the practice has.
- How slow the practice is at responding to requests for documents (this can often include the time of year as your accountant could still be working on tax return filings)
- What sort of issues they find that need further clarification (e.g. big decrease/increase in revenue, large capital purchase, recent changes in providers, lawsuits, etc.)

There are a whole host of items to be reviewed under the due diligence process but some of the key elements are:

- **Financial information**. Income statements, balance sheets, tax returns, CPT charges, productivity reports, provider compensation, fee schedules, etc.
- **Legal**. Vendor contracts, payor contracts, physician governance documents, litigation or complaints (these could be medical malpractice, labor law violations, other liability issues, etc.)
- **Business sustainability**. This is of course very important as of late with the pandemic. Expect a deep dive into patient volumes, procedures, billings, and collections, etc.
- **Assets**. All clinical equipment, IT equipment, and office equipment will be reviewed. Expect someone to physically come on site for this process.
- **Human resources**. Employee performance evaluations, bonus structures, and all of your

benefits (paid time off, health insurance, dental insurance, 401(k), COBRA continuations, etc.).

There is nothing pleasant about the due diligence process and there are absolutely no shortcuts, so be prepared for an arduous task here. Remember though, that there is no way private equity will spend their investors' money on your practice without performing a thorough due diligence. Thus, if you want to see this through, then you will have to go through the due diligence process.

Purchase Agreement

Once you have made it through the due diligence process, the management company will most likely provide you with an updated term sheet as some items (e.g. price) may need to be altered as a result of their findings in due diligence. From there, they will produce a purchase agreement which is similar to buying a house. It states the terms of the sale, equity, payment(s), escrow, and a number of other legal provisions. If everything has been above board and communications have been free flowing thus far, there should not be any surprises and few major hurdles for negotiation at this point.

Management Services Agreement

With MSOs, there will also be a Management Services Agreement (MSA). The MSA is essentially a 30-60 page document that is akin to an operating agreement for how the relationship works post-transaction. Ideally, you would have seen this during the due diligence phase. This outlines in detail everything related to practice operations and how the MSO will deal with them (i.e. billing/collections, human resources, finances, accounting, taxes, information technology, purchasing, marketing, etc.).

Final Thoughts

MSOs are not for every physician, but they are certainly here to stay for a long time to come. Some specialties have been working with MSOs for a long time (e.g. ophthalmology, dermatology, oncology) and some specialties are just starting to see/hear of MSOs. Private equity has great interest in medical practices and the MSOs allow them to operate legally and with mutual benefit to physicians. However, consideration of a MSO is certainly nothing that should be taken lightly. When you begin contemplating this initiative, it is highly advisable to contact a transactional consultant who has a lot of experience working with MSOs as that individual will be able to answer your questions as to the pros and cons and help you weigh whether or not this endeavor is a good fit for your practice.

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