Dental Practice Mergers, Acquisitions, Divestitures and Affiliations

Conducting Due Diligence, Meeting Regulatory Compliance Requirements, Overcoming Integration Challenges

THURSDAY, MARCH 26, 2015

1pm Eastern  |  12pm Central  |  11am Mountain  |  10am Pacific

Today’s faculty features:

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Dental Practice Transactions:
Buying and Selling, Mergers and Affiliations
March 26, 2015

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Agenda

- Market Conditions and Process
  - Market Composition
  - Potential Acquirers
  - Transaction Process
- Corporate Practice of Dentistry and Fee Splitting
  - Transaction Structures
- Due Diligence Issues
  - Non-Compete Enforceability
  - Licenses
- Regulatory Compliance Challenges
  - Stark Law and Anti-Kickback Statute
  - HIPAA
  - State Legislation
Market Conditions

- Market Composition Divisions
  - Large Consolidators
  - Medium/Regional Operators (3-15 locations)
  - Small Practices (1-3 locations)

- Payor Impact on Value

- Potential Acquirers:
  - Strategic Operators
    - 1-2 Locations, Multi-Site Practices
  - Financial Acquirers
    - 4+ Locations, $3mm+ EBITDA, $10mm+ Revenues
Transaction Process

• Pre-Transaction Strategy
• Transaction Process (3-6 months):
  – Self-Diligence/Housekeeping
  – Restructuring (if needed)
  – Go to Market – Confidential Information Memorandum
  – Letter of Intent
  – Due Diligence
  – Negotiate Documents
  – Closing
## DPM vs JV Structures

<table>
<thead>
<tr>
<th></th>
<th>DPM</th>
<th>Joint Venture</th>
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<tbody>
<tr>
<td>Business Revenue:</td>
<td>Professional Services Fees</td>
<td>Facility and Other (Non-professional) Fees</td>
</tr>
<tr>
<td>Revenue Implies:</td>
<td>Employed/1099 Dentists</td>
<td>No Employed/1099 Dentists</td>
</tr>
<tr>
<td>Invokes Corporate Practice of Dentistry?</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>CPOD Affects Structure</td>
<td>Requires MSO/PC Structure in many states</td>
<td>Permits Direct Joint Venture Structure</td>
</tr>
<tr>
<td>Examples in Other Sectors</td>
<td>Dental Clinics Physician Clinics Urgent Care</td>
<td>ASCs Labs Imaging Dialysis Lithotripsy</td>
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## Regulatory Environment – Compared to PPM

<table>
<thead>
<tr>
<th>DPM</th>
<th>PPM</th>
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<tr>
<td>Newer</td>
<td>More Established</td>
</tr>
<tr>
<td>Disruptive to existing business models</td>
<td>Already built into the fabric</td>
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<tr>
<td>Largely Private Payors (other than Medicaid model businesses)</td>
<td>CMS and Private Payors</td>
</tr>
<tr>
<td>Fragmented Industry</td>
<td>“P.E.A.R.” practices largely penetrated</td>
</tr>
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Corporate Practice of Dentistry

• Structure of Entity Driven by State Corporate Practice of Dentistry and Fee Splitting Restrictions
  – Professional Going Forward
  – Licensure of Professionals
  – Necessity of the Nominee in All States
  – Restrictive Covenant Agreement With Lead Professional

• State Laws
  – North Carolina
  – Illinois
  – Texas
  – Florida
  – Georgia
Basic DPM/DSO Structure

- Investor owns all or most of a Management Services Organization (MSO)
- Professional Corporation (PC) owned by one or more licensed Dentists employs the Dentists
- Investor connection to the business is limited to a Management Services Agreement (MSA) which pulls all or most of the income from the PC
Balancing Control vs Enforceability

• Tension Between Control and Enforceability
• Long List of Available Tools
• Lack of Clarity in Many States
Balancing Control vs Enforceability- Challenges

- Dental Boards Challenge Enforceability of the MSO Relationship
- Nominee Owner Walks Away with Business.
  - Distressed Situations
- Local Dentists Walk Away
  - Claim Unenforceable Non-Competition Covenants
- Nominee Owner Regulatory Violations
  - Threaten Ability to Operate Business
- Lack of Corporate Control Over Business Collateral or Contracts
- Lack of Control Over the PC (i.e., an inability to replace the PC owner)
Balancing Control vs Enforceability- Tools

- Share Transfer Restriction Agreements
- Termination Fees
- MSA Fee Structures
- Lien on Assets of PC
- “Friendly” Owners
- Diverse Jurisdictions of Operation
- Other Contractual Tools
Diligence Issues for Acquirers

• Location of Assets and Collateral
• MSA Terms and Controls
• Non-Competes
• Billing and Coding Compliance
• Relationships with Referral Sources
• Stark Law/Anti-Kickback Statute Compliance
• Compliance with Commercial Insurance Contracts and Medicare/Medicaid Provider Agreements
Diligence Issues for Acquirers

• Assets and Collateral Locations
  – Hard assets should be owned by MSO and non-professionals should be employed by MSO
  – Only licenses and billing agreements should be held by the PC
  – Collections run through the PC

• Restrictions on Professionals
  – Non-Competes and Non-Solicitation Restrictions
  – If “friendly” PC model, is the primary professional also an owner in the MSO?
Diligence Issues for Acquirers

• MSA Terms Dictate Controls
  – What is the term of the MSA?
  – How is the management fee structured?
  – Does MSO have control over all non-medical decisions?
  – Power of attorney for billing/collections
  – MSO should have right to pledge A/R of the PC (if permitted by law)
  – What types of non-competes and solicitation restrictions are in place through the MSA?

• Specific Tax Issues
  – MSA as “Hot Asset”
Primary Regulatory Challenges

• Federal Stark Law
  – Designated Health Services
  – Exceptions
• Federal Anti-Kickback Statute
  – Intent-Based Statute
  – Safe Harbors
• HIPAA
  – Privacy Rule
  – Security Rule
• State Fraud and Abuse Laws
  – Medicaid Fraud Laws
Regulatory Environment – Characteristics

• Dental Practice Management
  – Disruptive to Existing Business Models
  – Largely Private Payors or Medicaid Model
  – Fragmented Industry

• Regulatory Environment
  – Continued Expansion
  – North Carolina Cases
  – Texas Dental Bill
  – Federal Inquiry
Best Practices for Compliance

• Establish Effective Compliance Policies and Procedures
  – Quality Care
  – Billing and Coding
  – HIPAA

• Designate an Independent Compliance Officer and Committee

• Train and Educate Staff
  – General Policies
  – HIPAA

• Review Compliance Program

• Reporting Channels
Questions or Comments?

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