Approaching Independent Physician Practices

How to Prioritize, Acquire and Employ in the COVID-19 Era

Presenters

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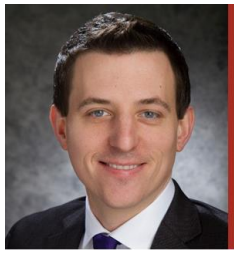
20+ Years in Physician Practice Management and Consulting

Expertise in:
- Fair Market Value and Compliance
- Provider Compensation Models
- Physician Strategy Development
- Practice Performance Improvement



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Expertise in:
- Employed Physician Network Growth
- Physician Network Strategy
- Market Development Strategy
- Operational and Financial Performance
- Management Infrastructure

Company **Overview**

HSG builds high-performing physician networks so health systems can address complex changes with confidence.

Headquarters: Louisville, KY

Formed: 1999

Focus: Health Systems and Physician Network Strategy and Execution

Physician Strategy

Driving a common strategic focus with engaged physicians.

Physician Leadership

Identifying and engaging strong physician leaders is integral to the network's development and success.

Performance Improvement

Improving the performance of employed physician networks.

Network Integrity

Leveraging Physician Network Integrity Analytics™ to create and monitor strategies for patient acquisition and retention.

Physician Compensation

Aligning physician compensation with health system and employed network goals.

HSG Webinar Series

Comprehensive registration information for all upcoming webinars can be found here: https://hsgadvisors.com/webinars/hsg-upcoming-webinars-may-2020/

Title	Description	Date
Approaching Independent Practices – How to Prioritize, Acquire and Employ in the COVID-19 Era	**We will discuss what criteria health systems should utilize to prioritize independent practices, and then provide an overview of the process HSG considers best practices for due diligence, acquisition and contracting with these providers.**	**Thursday May 21st**
After the Surge: Employed Network Leadership Considerations for the Second Half of 2020	We will discuss critical considerations for employed physician network leaders in a Post-Surge environment, including – physician leadership structures, employed group management infrastructure and governance, physician/administration culture, and physician compensation models.	Thursday May 28th
Virtual Health: Long-term Strategies for Employed Physician Networks	Many of the historic barriers to virtual care have been obliterated. Strategically developing a new long term plan is required – one that recognizes the reduced patient and provider barriers, one that accounts for the predicted roll back of the CMS and commercial insurer latitude afforded during the pandemic, and one that provides a seamless transition from pandemic "crisis" into the "new normal.	Thursday June 4th
Advanced Practice Providers: Employment, Compensation, and Utilization Models	Employment, compensation, and utilization strategies and tactics are just as important for APPs as they are for physicians – but many health systems do not approach them in the same way. This webinar will explore effective APP employment vehicles, address comprehensive APP compensation models, and promote effective APP utilization.	Thursday June 11th

Approaching Independent Practices

How to Prioritize, Acquire and Employ in the COVID-19 Era

Agenda Items for Today's Discussion	
1	HSG Observations on Independent Practice Dynamics During COVID-19
2	Evaluating and Prioritizing Acquisition Opportunities
3	Executing Successful Transactions
4	Management Priorities for 2021 In a Post-Growth Environment

HSG Observations on Independent Practice Dynamics During COVID-19

Background

The financial and operational challenges from COVID-19 have been devastating for many independent physician practices. These independent groups have begun approaching health systems in volumes similar to the late 2000s, seeking the financial shelter of employment. While the financial challenges of adding incremental employed providers can be daunting, this dynamic represents an opportunity for forward-thinking health systems to alter the competitive landscape in the near-future.

> *"So I think that's absolutely going to be part of what we're going to see is, is more consolidation in the industry in general, and especially in the physician area for a lot of physician groups that are independent that going through something like this. They just don't have the reserves to make it through this type of event.[1]"*
>
> - Warner Thomas, CEO Ochsner Health

1: https://www.firesidechatpodcast.com/25-covid-19-youve-got-to-adapt-with-warner-thomas-president-and-ceo-ochsnerhealth/

Physician Movement Observations

- Significant increase in provider movement overall in April/May 2020
  - Migration of providers across markets
    - Anecdotal evidence of providers fleeing markets where COVID will be of greater impact to future volumes (heavy urban, etc.)
  - Independent practice attitudes towards employment shifting:
    - Increasing receptivity to employment
    - Increasing proactively engaging of health systems for employment
    - Splintering of independent groups as economic risk is valued differently by partners within a group
- Health Systems largely overwhelmed by surge and financial impact and not engaging quickly on providers seeking employment

The Imperative for Proactivity

- COVID-19 is creating a unique strategic bubble for health systems capable of responding amid the crisis
- Economic factors will inevitably drive a consolidation of the independent physician market
- The dynamics causing this situation not going away any time soon, but the window for health systems to respond effectively will be limited
- Health systems must be able to prioritize and effectively acquire practices that drive strategic value
- Failure to do so will invite intervention from outside sources
  - Competitor health systems
  - Private equity
  - Other up-market competition

Evaluating and Prioritizing Acquisition Opportunities

Developing Criteria for Prioritizing Providers

- Importance to health system strategy
- Patient utilization patterns
- Community need
- Reputation
- Cultural fit
- Clinical performance

Importance to Health System Strategy

Two critical Areas of Focus:

1. **Medical Staff Development Plan**
   - How does tighter alignment with existing group impact our strategic provider needs?
   - What gap does losing a group to a competitor create?
   - Does acquisition give us a base for building a specialty through recruitment that we've historically been unable to grow?

2. **Service Line Strategy**
   - How critical is the practice to accomplishing service line goals?
   - Does the practice control a critical amount of directable patient volume?
   - For specialty practices, do we have the referral network to direct patient volume to alternate, aligned practices?

Utilization Patterns (Patient)
Independent Family Medicine Practice

Evaluate criticality of practice to employed network

Provider Drill Down Example

Visits to Key Specialties occurring within 90 days of a patient interaction with a client employed primary care provider.

Grouped by primary care provider

Shown as percent of total, grouped by employment and medical staff status of specialist.

Source Provider Name	Obstetrics & Gynecology	Orthopaedic Surgery	Surgery	Cardiology	Hematology & Oncology
PCP #1	**83%** 17%	**91%** 9%	**93%** 7%	48% 52%	93% 7%
PCP #2	**97%** 3%	**76%** 23% 1%	**60%** 17% 23%	75% 25%	73% 27%
PCP #3	**88%** 12%	**83%** 9% 8%	**81%** 8% 11%	77% 23%	25% 75%
PCP #4	**98%** 2%	**61%** 39%	**90%** 10%	43% 57%	83% 17%
PCP #5	**100%**	**63%** 37%	**83%** 12% 4%	50% 50%	87% 13%
PCP #6	**97%** 3%	**81%** 19%	**67%** 27% 6%	89% 11%	100%
PCP #7	**85%** 15%	**79%** 21%	**98%** 2%	84% 16%	76% 24%
PCP #8	**60%** 40%	**94%** 6%	**94%** 6%	91% 9%	36% 64%
PCP #8	**98%** 2%	**93%** 7%	**45%** 45% 9%	78% 22%	82% 18%
PCP #10	**61%** 39%	**73%** 27%	**89%** 11%	78% 22%	100%
PCP #11	100%	**87%** 13%	100%	100%	

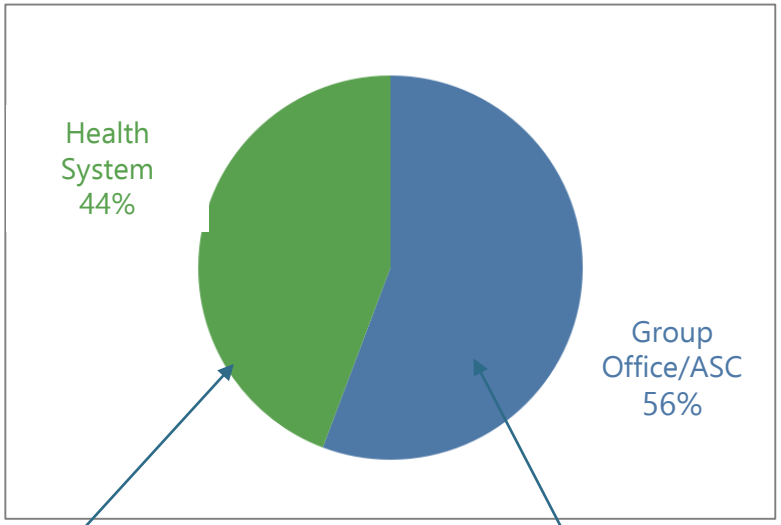
Category
- Employed
- Active/Associate Staff
- Other

SOURCE: HSG Network Integrity Analytics, Patient Share of Care

Utilization Patterns (Facility Utilization)

Independent Orthopedic Group Drill Down Examples

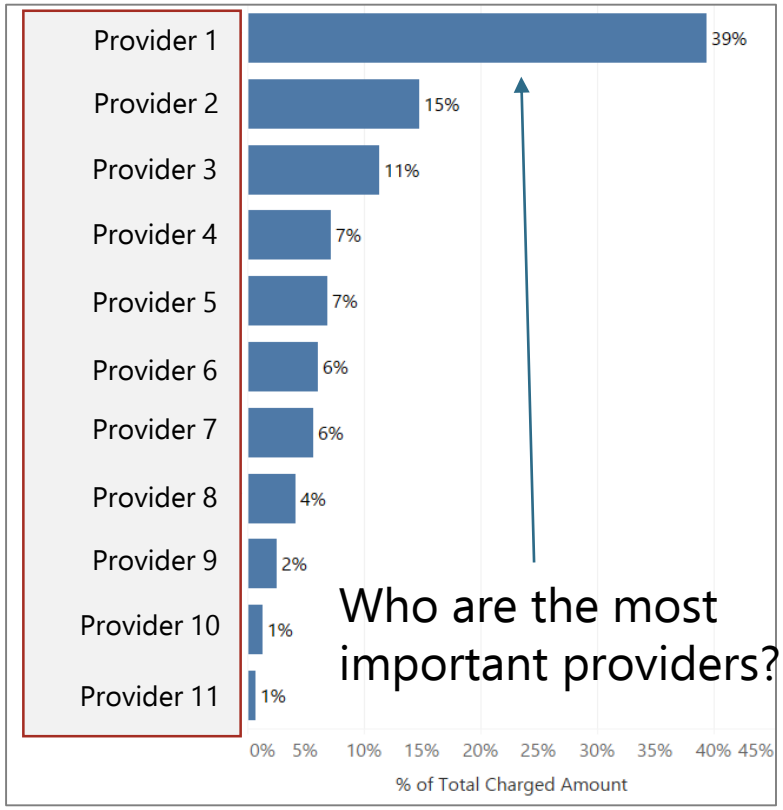
Total Charges by Service Location



How volume-reliant are we on the group?

How much volume doesn't come to us?

Total Charges by Rendering Provider



Who are the most important providers?

SOURCE: HSG Network Integrity Analytics, Provider Service Location

Executing Successful Transactions

Practice Acquisition and Employment Process
Best Practices – Knowing What You're Getting Into

- Non-disclosure or confidentiality agreement
- Data request
- **Operational assessment (preliminary due diligence)**
- Practice valuation
- Financial Proforma
- Compensation model and package
- Term sheet
- Negotiation
- **Letter of Intent (LOI)**
- Draft Contract
- A little more negotiation
- **Due diligence**
- Signing and closing
- Transition process

Practice Acquisition and Employment Process
Best Practices – Setting Transactions Expectations

- Key areas to set expectations:
  - Compensation and fair market value parameters and organizational standards
    - Be prepared for how COVID-19 has impacted physician views and desires related to compensation
  - Formal approval process and timeline for completion
  - Valuation approach (asset vs. business valuation)
    - Hospitals and health systems typically do not "buy" practices or stock, normally they acquire assets for ongoing practice operations
    - "We don't buy practices or trained and assembled workforce or medical records. We just buy assets—and just assets we plan to use."
  - Staff impact and considerations

Practice Acquisition and Employment Process
Data Collection

Assessment Data *(pre Agreement/LOI)*	• Federal income tax returns (**last 3 years**) and/or • Annual financial statements (**last 3 years**) • List of practice assets • Accounts receivable • CPT code (wRVU) productivity (**last 3 years**) • Malpractice cost and claim history • Pending litigations • Employee list with salary and benefit info • Outstanding liabilities or loans
Due Diligence Information *(post Agreement/LOI & pre Employment/Signing)*	• Payer contracts • Insurance details • Software licenses • Other licenses • Hazardous materials • Human resource details • Real estate details • Service agreements • Medical records

Practice Acquisition and Employment Process
Valuation

- Practice assessment will reveal if approach other than asset approach (i.e., income approach is warranted)
- Typically, only asset approach is warranted (or standard)
- Third-party appraiser is recommended in either case
- For asset valuations…
  - If available, use depreciable asset list as a guide
  - Physically inventory all assets owned by the practice
  - Assign a fair market value to each asset
    - The price that is typically paid for used office and medical equipment
  - Exclude leased items; hospital to assume lease payments or terminate/not renew lease
  - Exclude items not to utilized
  - Allow physician to review list for accuracy of items included on list
    - Physician should retain personal belongings: pictures, artwork, diplomas, etc.

Practice Acquisition and Employment Process
Practice Assessment

Productivity & Volume *Considerations*	• What is each provider's historical level of production? • What has been the level of compensation given the level of production? • What are coding patterns? • What is the practice's payer mix and revenue cycle challenges? • Types of procedures performed in-office? Procedures not performed? • What, if any, ancillary services are provided?
Overhead & Financials *Considerations*	• What does the practice's overhead look like? What challenges or opportunities exist? • What is current staffing and staff salaries and benefits? How does staff fit into the health system's existing salary and benefits structure, any challenges? • Any malpractice concerns? What is cost?
Future State *Considerations*	• What are technology needs and challenges? What is the plan going forward? • How well do the practice's providers fit into existing compensation structures?

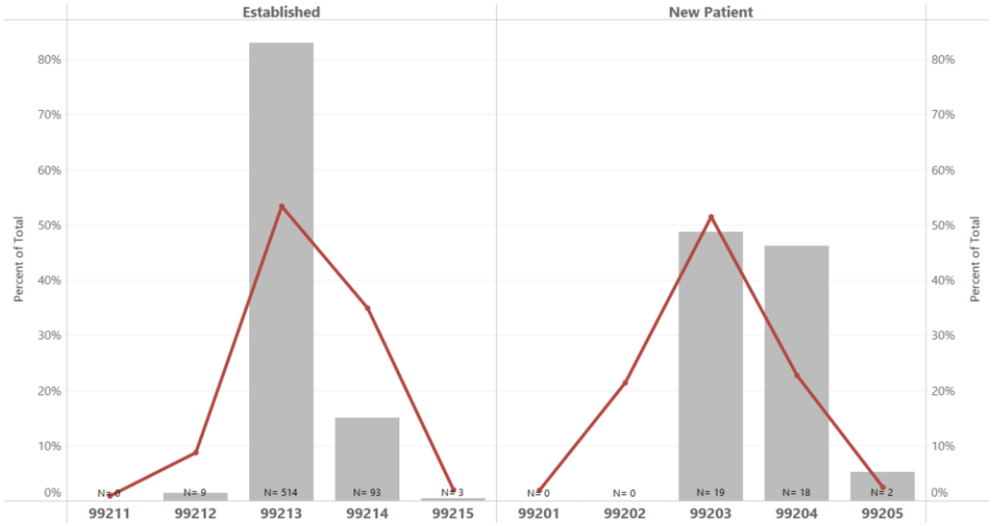
All must be considered in the context of the impact of COVID-19

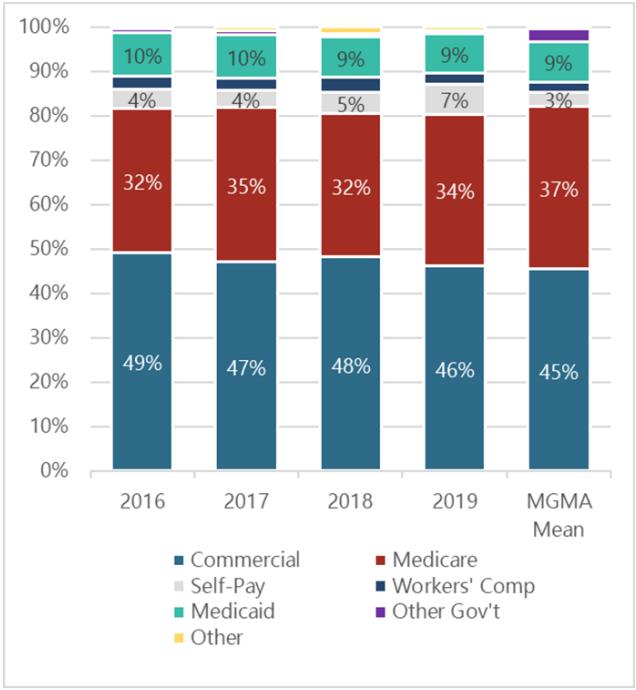
Practice Assessment

- Compare with internal data (existing specialties and practices)
- Compare with benchmark survey data, such as:
  - American Medical Group Association Medical Group Compensation and Productivity Survey.
  - American Medical Group Association Medical Group Operations and Finance Survey.
  - Integrated Healthcare Strategies Physician Compensation and Production Survey.
  - Medical Group Management Association Provider Compensation and Production Survey.
  - Medical Group Management Association Cost and Revenue Survey.
  - Sullivan, Cotter and Associates Physician Compensation and Productivity Survey Report.

Practice Assessment

Specialty	FY17 wRVUs	FY17 wRVU %tile	FY18 wRVUs	FY18 wRVU %tile	FY19 wRVUs	FY19 wRVU %tile	FY20 wRVUs	FY20 wRVU %tile
Orthopedic Surgery: Foot and Ankle					5,060	14	1,974	13
Orthopedic Surgery: General	9,914	65	9,145	58	7,629	41	2,673	44
	7,984	44	7,815	43	7,574	40	2,709	45
	8,295	47	6,577	28	6,853	32	2,672	44
	5,712	24	5,392	16	6,569	27	2,704	45
Orthopedic Surgery: Hand					3,720	90	2,570	29
Orthopedic Surgery: Spine	5,363	14	5,109	14	5,412	14	1,943	18
Orthopedic Surgery: Sports Medicine	15,089	89	13,809	85	12,870	81	3,786	71
	7,177	31	7,918	38	8,608	46	2,569	35
PA: Orthopedic (Surgical)	3,246	66	2,808	57	2,585	53	980	59
	2,522	52	2,084	45	2,204	46	898	54
			1,138	25	2,510	52	1,107	67
			755	35	1,796	39	806	50
	78	0	11	0	26	0	17	0
Physiatry (Physical Medicine and Rehabilitation)	3,152	17	3,373	20	2,769	13	944	13





	FY19 Actual	FY 19 MGMA %tile Rank	FY20 Actual	FY20 MGMA %tile Rank	MGMA Median
Gross Collection Rate	37%	45th	36%	44th	38%
Net Collection Rate	86%	23rd	83%	20th	94%

	FY19 Actual	FY 19 MGMA %tile Rank	FY20 Actual[1]	FY20 MGMA %tile Rank	MGMA Median
Collections per Provider	$347,493	26th	$390,341	33rd	$501,914
Collections per wRVU	$62.49	13th	$62.23	12th	$78.81

wRVU Compensation Rate (Comp per wRVU)

- Considerations:
  - Historical and demonstrated compensation per wRVU
  - Current range of rates for employed provider in same specialty

Rate Calculation – Neurology

Detailed Rate Range Calculation – Using 2018 MGMA: National

Percentile	Total Compensation	wRVUs	Implied Lag	Rate
25	$252,460	3,514	-25	**$86.18**
30	$263,220	3,792	-20	**$79.86**
35	$272,785	4,064	-15	**$74.51**
40	$280,714	4,309	-10	**$70.28**
50	$302,827	4,779	0	**$63.37**
60	$327,365	5,343	10	**$56.68**
65	$345,599	5,644	15	**$53.65**
70	$362,277	6,004	20	**$50.44**
75	$380,603	6,379	25	**$47.47**

FMV compliance risk

Financial sustainability risk

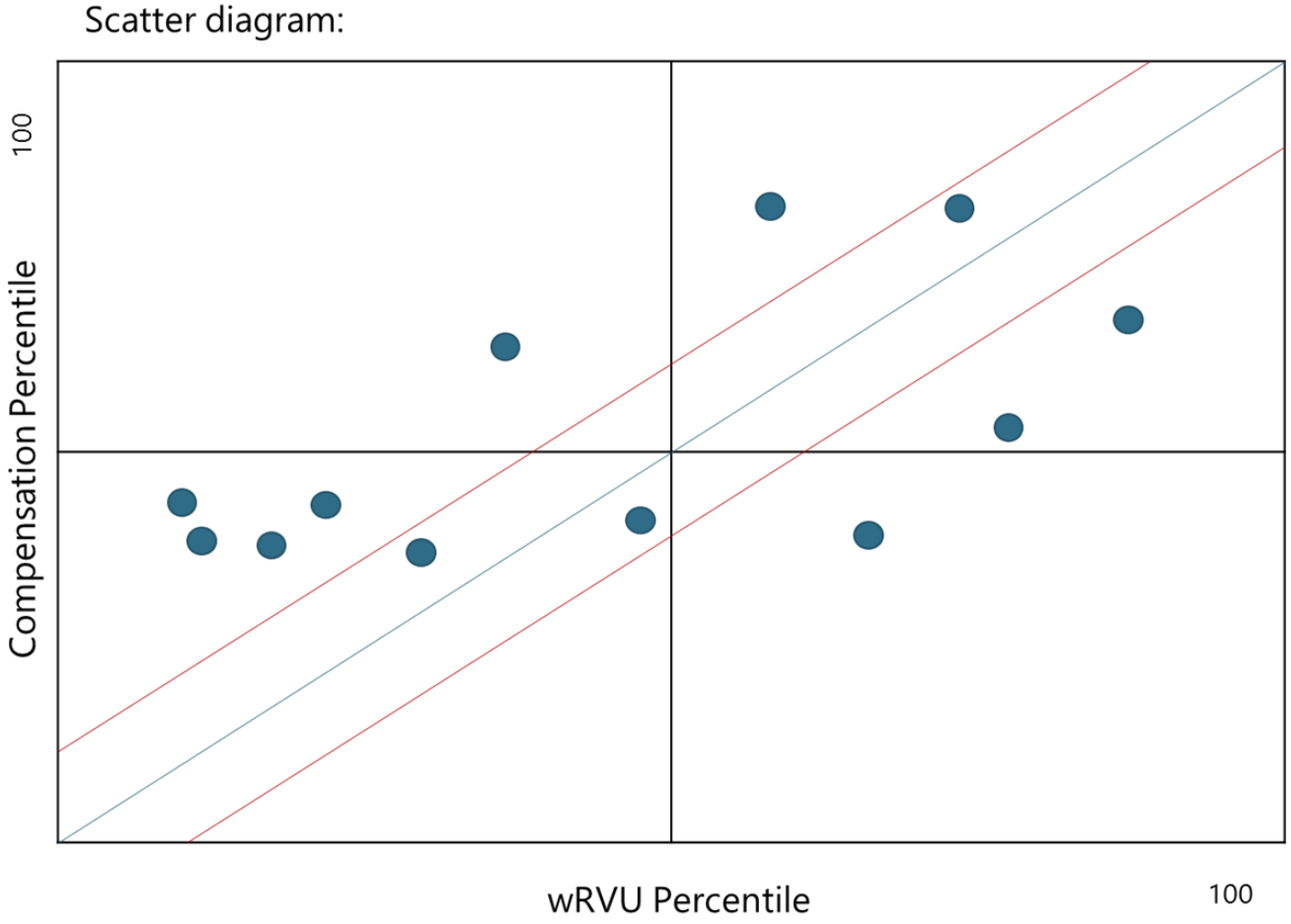
Financially sustainable target zone

Potential recruitment / retention challenges

- Caution: Do not automatically use MGMA, Sullivan Cotter, and other published compensation per wRVU rates

wRVU Compensation Rate (Comp per wRVU)

Provider Production vs. Compensation



Practice Assessment
Examples of Practice Assessment Outcome

Category	High-Level Takeaway Example
Productivity	More than 60% of providers are below the median for their specialty, indicating capacity. • Need to understand referral patterns to group. • Must develop robust marketing plan. • Evaluate whether there are too many providers. • Compensation must reflect the level of production.
Payer Mix	Payer mix reflects mean for specialty, as well as hospital's payer mix.
Revenue Cycle	Accounts receivable issues have depressed collection rates and revenue generation, suggesting improved performance with acquisition.
Compensation	Historical compensation per wRVU lags the median for specialty and levels for like specialists within the network currently.
Overhead	• Square footage and space costs are high. • Staffing levels are high in administrative areas, but low in clinical areas.
Coding and Documentation	Extensive, almost exclusive, utilization of level 3 code for established patient visits. • Coding and documentation review and education indicated.
Summary	Improvements in coding and AR, reduction of unnecessary space and locations are expected to offset increased compensation per wRVU.

Transaction Development

- Based on discussions, criteria, and practice assessment…yes, we want to do a deal. Then…
  - Prepare term sheet
  - Negotiate, but know parameters and "deal breakers"
  - Prepare agreements
    - Employment
    - Asset purchase (if necessary)
    - Lease (if necessary)
  - Physician transaction committee and approval process documents
  - Fair market value opinions
  - Plan and timeline for credentialing
    - Allow enough time (at least 90 days), don't force a delayed start or worse provide services for free

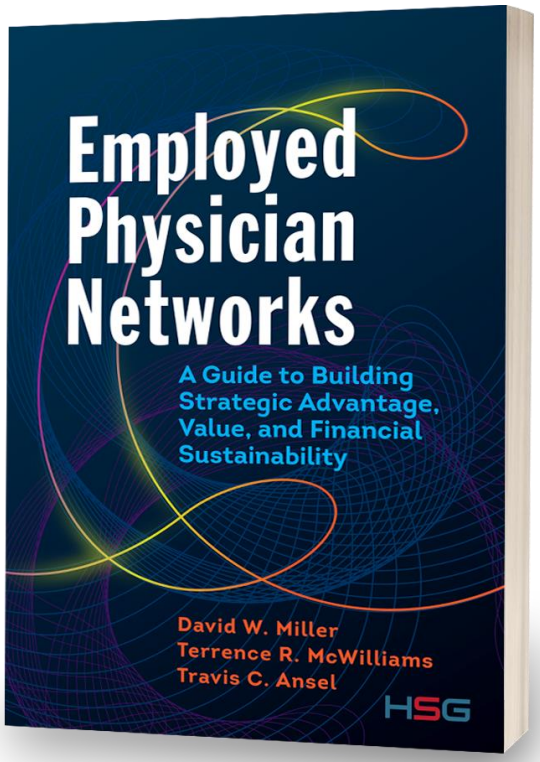
Due Diligence
Examples of Due Diligence Outcome

Category	High-Level Takeaway Example
Assets	• Hospital IT team reviewed and completed walk through. • Hospital will not purchase existing practice IT equipment. • New computers and phone system required. • Will not renew copier lease. 30 days notice required.
Facilities/Real Estate	• Hospital facilities team completed walk through. • Will lease space from physician-owned holding company. • Appraisal and fair market value lease rate required. • Will not renew hazardous waster removal service. 30 days notice required.
Payers	• Practice non-par with Humana. Needs to be added to contract. • Allow a minimum of 90 days for payer credentialing.

- Other areas should be addressed as well in similar fashion.
- We use a comprehensive due diligence checklist.

Management Priorities for 2021 In a Post-Growth Environment

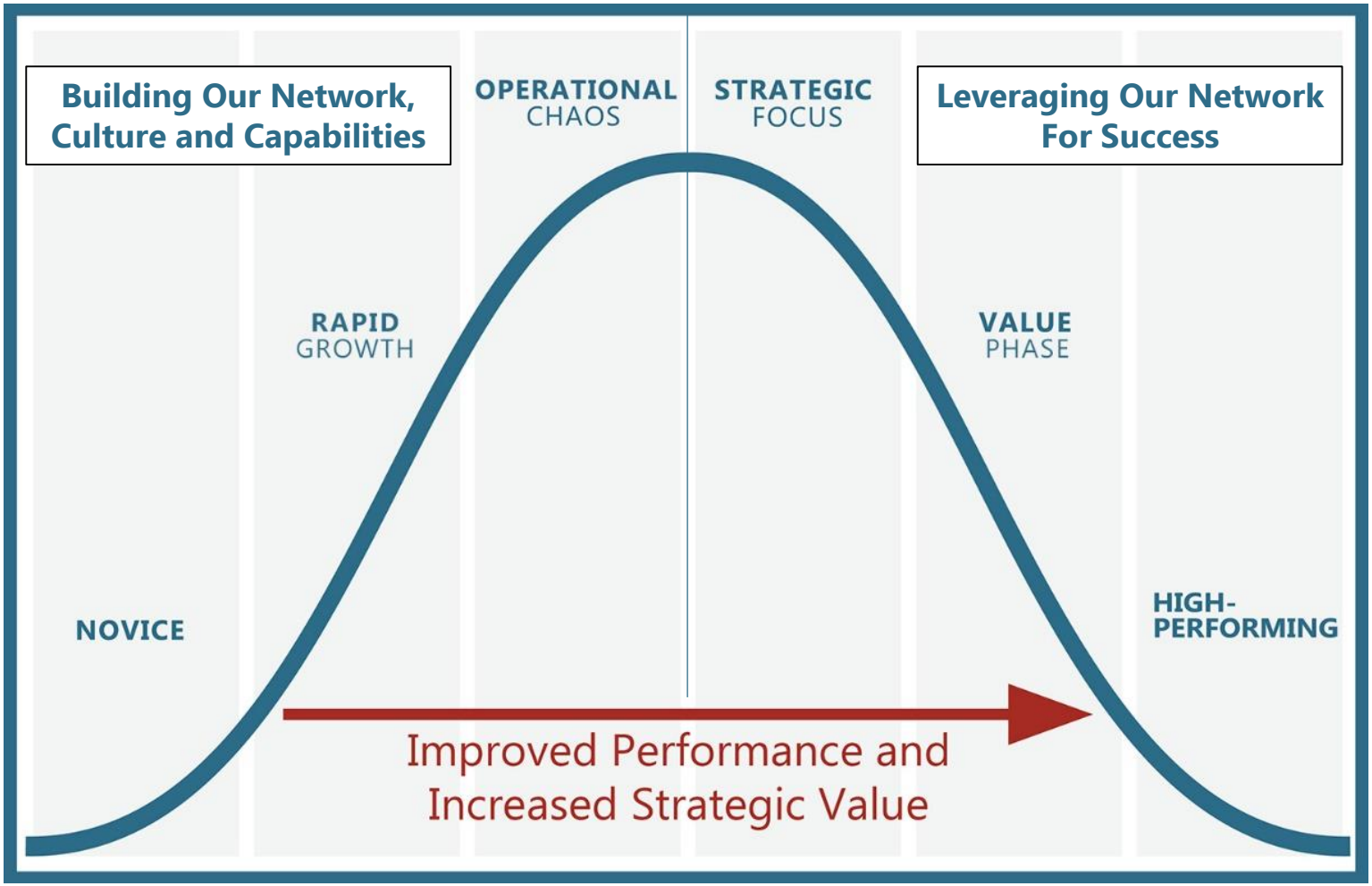
Systematic Employed Physician Network Improvement



HSG Physician Network Growth Phases™

Our Philosophy on Employed Network Growth: As an Employed Physician Network evolves towards maturity in terms of its growth and size, **the network must have a systematic plan** that is focused on evolving its management team's capabilities, infrastructure, governance, provider engagement and leadership to address the network's current and future needs as well as execute on the health system's strategic goals.

Will Networks Re-enter Another Rapid Growth Phase?



Post-Rapid Growth Considerations
2021?

Significant growth in an employed network requires re-evaluation of the fundamental managerial and cultural dynamics of the organization

- Evaluate sustainable Performance Improvement opportunities
- Re-evaluate Shared Vision of Employed Network
- Re-evaluate Management Infrastructure given growth in size of network
- Re-evaluate Governance given growth in size of network

Closing Items

HSG Upcoming Webinars

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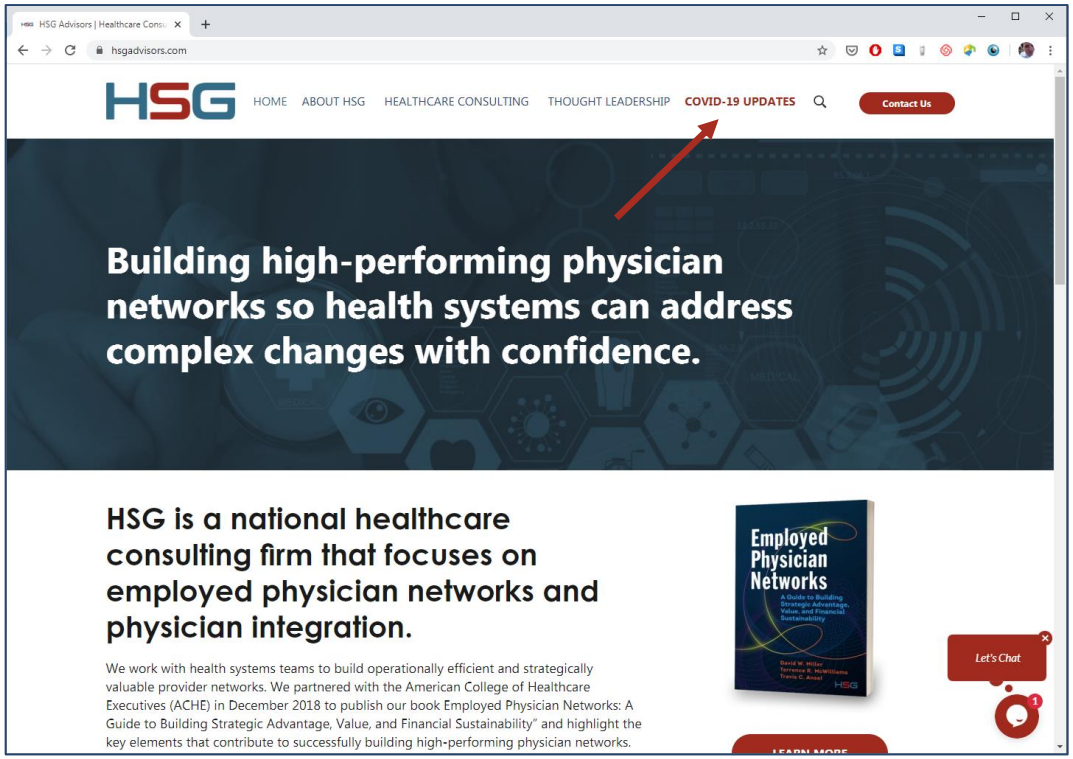
Supplementary Resources



- HSG COVID-19 Resource Library
- Available on our homepage - www.hsgadvisors.com

Questions?

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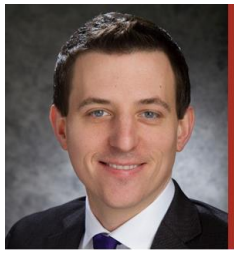

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