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Insights

Private Equity Investment in Medical Practices Series: STEP 2 - Should I Use a Broker?

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Private equity (PE) health care transactions continue to capture the attention of many in the industry. Whether viewed as an opportunity to grow, stabilize, or exit a business, owners feel compelled—even obligated—to explore PE alternatives before the market cools or they are otherwise left behind.

Unfortunately, health care providers sometimes consider PE transactions at the wrong time or for the wrong reasons, including when their business is experiencing stress (e.g., recruitment or reimbursement challenges) or when they have been approached by a prospective buyer.

While both scenarios can be managed, the better time to consider a PE transaction is when the business is stable (or strong) and you have formulated a strategic plan and longer-term goals. Being proactive is critical and engaging your team of outside advisors is a great first step in the planning process.

Given the complexity of their operations, most health care businesses already have a solid team of advisors. This team should include an accountant and an attorney. When considering these team members for your PE discussions, be sure each professional or someone else in their firm has specific experience with PE. Ask for details of other transactions. Ask for client references.

It is also important to consider adding a business broker / investment banker to your team, who can serve an important role in "packaging" the business for consideration by multiple PE firms.

As noted above, businesses often first consider selling when they get a cold call or an inquiry from a colleague who has been through a recent PE transaction. Although these individuals may have your best interests at heart, they may be incentivized to find more acquisition opportunities. Even in the best case, they are limited in their perspective. Engaging in these discussions without an investment banker can mean limiting your buyer options, sharing information about your business before it is ready, and wasting time with unqualified buyers.

Even if you are in a narrowly focused specialty or niche, and think you know the most likely buyers for your business, a good investment banker can introduce you to other options. At a minimum, as they take you through their process, any previously identified prospective buyer will now know that you are serious and you are considering other opportunities. This process typically results in an increase in the final purchase price, often by 10% or more.

Investment bankers also prepare your business for a possible PE investment. In conjunction with your accountants and attorney, investment bankers will review your business operations and identify areas that may be of interest or concern. They will help you anticipate issues that may be raised by a buyer. For example, how do you define your market? Are your rates competitive? Do you have family members working in the business at above market salaries? Do you rent space in a building you own and have you been charging yourself enough rent? Do you have an old lingering lawsuit? Items like these should be addressed in advance to best present your business to potential buyers.

Buyers do not like surprises. Surprises will slow down the negotiating process and can be used by buyers to drive down the price, even after you have turned other opportunities away. Your advisor team will help put the business in the best possible light for buyers. They will help you tell your past, present, and future story, and will work with you to articulate your goals.

Anticipating and collecting this information before a buyer requests it also takes some pressure off you and your staff. Although there will still be a large volume of requested information (a process often called "due diligence"), having your own advisors help collect and organize this information will be more efficient than asking your staff to do so. It can also help maintain more confidentiality about the process in the early stages of the discussions when uncertainty around a potential transaction could lead to concerns among your staff.

Investment bankers will ask you to sign an engagement letter or contract. That engagement letter should be reviewed by counsel to ensure that the terms are reasonable. Once it is signed, they will send you a list of requested due diligence items and you should ask that they sign a Non-Disclosure Agreement to protect the confidentiality of the information that is provided.

Once the engagement letter is signed, investment bankers normally charge a flat monthly fee as they help gather data, assimilate and "scrub" it, and explore potential buyers. If you are concerned about the process dragging out and becoming too expensive, a one-time flat fee can also be considered. If a transaction is not completed, you still owe this monthly amount for the work that has been done, but not the larger transaction fee discussed below.

If a PE transaction is achieved, the investment banker is also paid a percentage of the total consideration paid, including purchase price, debt assumed, etc. The amount varies depending on the type of business being sold, the competitiveness of the current market, and the size of the transaction. Commission rates of between 1% and 5% of the total value of the transaction are common, and expect to pay a higher percentage if there is a lower or no monthly fee. Sometimes the rate is tied to different segments of the purchase price, with a higher commission being used for amounts an investment banker achieves above what is a typical market price, which might be considered an additional "success fee." Depending on where your business is in the transaction process, you may be able to negotiate exclusions from the percentage fee or lower percentage fees for certain buyers with whom you have an existing relationship.

If you are considering a PE transaction or would just like to understand the process in more detail, please contact **Thomas N. Hutchinson**, **Brian M. Heaton**, or your regular Krieg DeVault attorney.

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