Ethical Issues of Private Equity Dermatology

COI: None
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Case

• 65 yo dermatologist cannot sell his lucrative private practice
• Private equity (PE) firm is willing to buy his practice for FIVE times his EBITDA (Earnings Before Interest, Taxes, Depreciation & Amortization)
• Even though he has to work as an employee for a few yrs while they hire another derm, APRNs & PAs, the pay out is better than he hoped for
• What should he do?

Definitions: Mini MBA

• Private Equity (PE) (firm or fund) = Pool of $ to invest in or buy co’s. Firm only operates to buy & sell co’s. Financing provided in return for equity stake in potentially hi-growth co’s.

• Venture Capital (VC) = money that is provided to seed growth companies. VC funds invest in co’s in exchange for equity in the co’s.

2018 Dilemmas of Clinical Practice

• Private Practice = small business
• Escalating overhead, uninsured pts, “healthcare reform”, HIPPA, PQRS (quality reporting), contracts with insurers, MACRA (medicare access & CHIP Reauthorization), MIPS (merit incentive payment), MU (meaningful use), advertising, EMRs, …
• Student debt, MOC, Recertification, Sunshine Act, …

Why Could VC be the Future of Derm?

Dermatology Times 6/2/17 Zoe Draelos, MD
“Cold Iron Truth” Dermatology News: December 2017. Brett M. Coldiron, MD

• PE/VC promises of economies of scale, freedom from bureaucracy, better contracts…
• Indiv derm get $ value for practice otherwise impossible to sell
• Combine practices w/ central billing, managerial staff, EMR, advertising
• Viewed as good option by retiring derm

2/1/2018
Dermatology Landscape

- ~35% Solo practices +
- ~50% gps of >3 derms + fragmented care + rising costs + complexity of practice + profit margins high
- # of MDs practicing independently declining by >2 to 5% per yr
- Young derms favor employment in large gp w/ guaranteed salary & no capital outlay
  - ~5% derm residents plan on solo practice

Harris Williams LLC Investment Banking Services // Ehrlich, et al. Trends in dermatology practices & the implications for the workforce. JAAD 2017;77:746-52

Marketplace Reality: Why Derm?

- Dermatology = Growth market & skin hth awareness
- Aging pop + skin ca + disposable income + cosmetics + demand for preventative care + insurance coverage + labs (DP) + surgery + nonMD providers
- Financial outlook + unmet demand = growth + PE consolidation
  - Skin disease Rx: $7.5 billion 2015→$8.6 billion 2020
  - “Derm industry generated $12.7 billion in 2015… projected 16.3 billion in 2020” Skin in the Game. Dermatology World 7/16
- 2017 estimates predict: market revenue for derm = $13 billion
  - Annual market revenue growth for next 5 yrs = 5.2%

Dermatology in Demand in 2017

- “In 2016, derm was one of the most sought-after subsectors of htlcare services from both strategic & PE sponsors”. Ajeva Shekar, Sr Assoc at Provident Htlcare Partners, htlcare focused investment bank
- “With fresh capital resources & new PE partners eager to sell their investments, we expect strategic acquirers to become increasingly competitive w/ PE firms for platform acquisitions win the derm sector. …2017 is likely to be a favorable seller’s market, both from a valuation & structuring perspective.”

VC Owned Derm → Business Entity

- Low interest rates = looking for better returns on $ = buy derm gps
- Commoditizing derm & taking control of future of derm
- VC Goal = Make $ on short time line (~5yrs)
- Purchase & sale based on economic forces
- Shifts control of derm from MDs to business entities: health care morphs into making $ for investors

Derm Practice Consolidation Fueled by Private Equity

- Purchase large gps as anchor investments = add smaller & regional derm offices to consolidate regional marketplace
- Ultimate goal: realize profitability secondary to sale in 3-7 yrs to another PE or publically traded entity

Who Owns Dermatology?

2016 AAD Gp Practice Survey

- Derms moving to gp practice
- Larger the practice = less likely to be independently owned
  - >50% of multispecialty gps owned by corporate entities

Dermatology World 1/2018
Acquisition Trends: Consolidation

• 30 of 200 PE acquisitions of medical practices in 2014-2016 were derm

• Since 2014: ~20% of PE acquisitions of hlcpractices = derm (derm <1% of specialty MDs)
https://www.m-scribe.com/blog/dermatology-specialty-consolidation
https://the-dermatologist.com/content/acquisition-trends-consolidation-dermatology

• 16 derm practices w/ 700 derms owned by PE
Brett Coldiron, MD Dermatology News  Oct 2017

PE Firms Invested in Derm then Flip Them
Exit for Market Returns (M&A)

• 2014 Forefront derm’s 37 clinics bought by Varsity Hlthcare Partners → then acquired by OMERS
• 2016 Advanced Derm & Cosmetic Surgery’s >90 clinics recapitalized by Harvest Partners’ (in 2011 backed by Audax Gp) for > $600 million
• 2016 Riverchase Derm’s 25 clinics acq’d by GTCR (previously backed by Prairie Capital)
• 2016 Dermatology Associates’ 42 clinics acq’d by ABRY Partners(previously bought by Candescent Partners)
• 2017 Forefront Dermatology’s >100 clinics acq’d by Ontario Municipal Employment Retirement System for > $450 million

Main PE Players

Historical Perspective


• 2011-2012: Audax Gp, PE firm, acq’d majority stake in Advanced Derm & Cosmetic Surgery (ADCS) (Maitland, FL based derm provider w/ 53 clinics)
• 2016: ADCS expanded into 14 states w/ 140 clinics
• Other PE followed: now 20+ platform investments w/derm (4 already sold to other PE investors)
• 2017: 14 acquisitions w/ PE backed players (as US Derm Partners, Platinum Derm, Epiphany Derm)

BIGGEST Deals

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Cold Iron Truth:
Should you sell your dermatology practice?

Brett Coldiron, MD Dermatology News Oct & Dec 2017

• Good deal for older MDs ~5 yrs from retirement
  – Lump sum payment: ~60% of 5-8X’s>EBITDA (=profitability) + 40% equity stake in practice
• Bad deal for younger MDs: employees
  – Buy out money: MD owner pays it back over ~5yrs of minimum employment (contractual)
  – Salary ~40%, overhead ~40%, PE profit ~20%
Promises Made by PE to MD

- Overhead thru centralization (economies of scale)
- Market power to contract better (power in #’s)
- Relief from practice management, EMR, advertising, & govt regulation (regulatory demands & quality reporting)
- Cash pay out (lucrative exit strategy)

Pay Day? To Sell or Not to Sell

- Purchase price multiple of EBITDA (Earnings Before Interest Taxes, Depreciation & Amortization) = free cash flow
  - 3-5X for solo practice
  - 5-8X for small dermatology groups
  - Up to 13X for large integrated multisite groups
- Derm stay on w/salary + stock in “company” replaced by younger cheaper derms & non-MDs
- Salary post sale reduced (pay cut) leaving earnings on table which is basis for valuation

VC Derm = Not All Sunshine

- 20% of practice profit to PE -> resources & salary
- Secondary sale in 3-7 yrs, new boss w/ diff values
- Practice acquisitions at inflated prices -> consolidation & sale to future investors -> bankruptcies w/ loss of derm jobs & derms for pts
- Reduction in diversity of practices available for future derms & pts

VC Derm = Not All Sunshine

- PE/VC: value $ Versus
- MD: values compassion, altruism, hi quality pt care

VC Derm = Not All Sunshine

- How will derms “retain control of their humanitarian aspirations amid a profit driven business model”?
- How will “dermatologic medical science mesh w/a nontraditional practice environment”?

VC Derm = Not All Sunshine

- Profits via PAs / ARNPs (satellites; supervised/unsupervised)
- Redirect DP & Mohs (Stark Law compliance) to employees
- Younger, employed derms: lower compensation in future yrs (reductions in % of collections distributed: “normalization of physician payment”)
- Non-compete clauses make it difficult to restart careers nearby
- “I owe my soul to the company store”
VC Derm = Not All Sunshine

• Loss of MD autonomy in clinical decision-making
  – Which pts can be referred for Mohs
  – Where to send Mohs/DP
  – Provider/Staff compensation
    @ corporate level ⇒ impact retention
  – Staffing; Capital equipment purchases
  – Push volume, procedures, cosmetics
  – Model = APRNS + PAs > MDs = more profit for VC

https://www.m-scribe.com/blog/dermatology-specialty-consolidation

Ethical Impact of VC on Derm

• Autonomy: pt’s right to have a role in how Rx
• Beneficence: pt’s best interests come first
• Non-maleficence: do no harm
• Truthfulness: informed consent

MD model replaced by MD extender model
Profits > patient welfare

• Dignity: for the pt & practitioner

MD model replaced by MD extender model
MD loss of control of how to practice

Consequentialism Ethics

• The consequences of one’s conduct = the ultimate basis for any judgment about the rightness or wrongness of that conduct
• Have we learned nothing from the dermpath story?
  • The Amer Assoc of Independent DP Labs morphs into Ameripath ⇒ Dermpath Diagnostic ⇒ Quest

Utilitarianism

• Doing the greatest good for the greatest # of people ⇒ overall benefit to society
• Is the PA-APRN & PE model the best model for pts?

Rise of Corporate DP: Similar Story of Greed

• Other corporate labs acquire independent DP labs
• Lab directors sell equity, stay on w/ salary + stock options
• New hires: employees
• Grow in size ⇒ eliminate competition
  – Most vulnerable: independent, physician office lab (POL) & university labs
• New dermpath docs can’t get desirable jobs
• Diversity in types of labs reduced
Virtue-Based Theory (Character Based)

- Emphasizes an individual’s character as the key element of ethical thinking
- Rather than rules or their consequences
- A right act = action a virtuous person would do in same circumstances
- Is selling to PE the right thing to do for future generations of dermatologists & patients?

Case

- 65 yo dermatologist cannot sell his lucrative private practice
- Private equity firm is willing to buy his practice for one year’s gross!
- Even though he has to work as an employee for a yr while they hire another derm, APRNs & PAs, the pay out is better than he hoped for.
- What should he do?
- What is the bottom line?