Franchising IVF and the Changing Business Model for Laboratory Operations

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Disclosures

- Like everyone else, I am a professional and get paid to practice Reproductive Endocrinology
- CEO of IVI RMA Global which operates more than 40 laboratories around the world
- Founding partner of RMANJ, RMANY, and several others

I do not have an MBA and do not really want one….

Early Days of Reproductive Medicine Practice

Clinical Practice

- Outpatient practice
- Much like medical endocrine
- Patients admitted to the hospital for surgery
- Ultrasound not used routinely
- Diagnostic blood work sent to hospital

The hospital provided the laboratories and retained that revenue

Evolution of the Reproductive Medicine Business Model – a small health care system

Imaging Company

Clinical Practice

Andrology / Endocrinology Laboratory

Mental Health

Surgery Center

Embryology Laboratory

Plus group purchasing organizations, financing, billing, real estate, EMR, and many others

Genetic Counseling

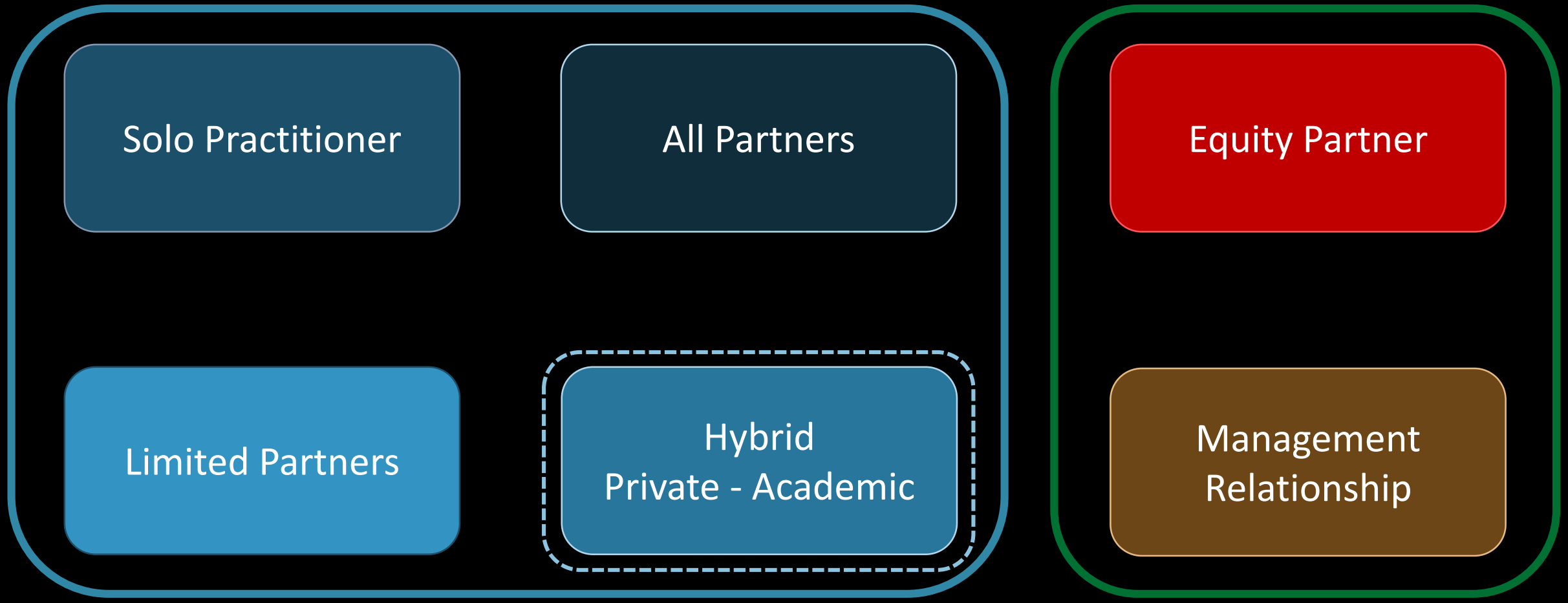
PGS, PGD, and Diagnostics

Long term cryo storage

Academic Medicine

Much like a giant cargo ship…

Basic Business Models



Variants of Traditional Private Practice

Capitalizing Private Practices

Lab Ownership Models

- Contained within the practice
- Embryologists
  - Partners
  - Employees
- Possible bonus plans
  - Volume
  - Lab performance
  - Clinic performance

- Centralized laboratories
- Physicians from independent practices bring patients for care
- Relatively uncommon
- At risk for volume

What is Driving the Industry Consolidation and Interest from Non-Medical Equity Partners

- High start up costs
  - Lack of traditional funding sources
- Trapped Equity
  - Many of the “founders” approaching retirement age
- Anxiety about future access to patients
  - Insurance companies
  - Benefit management companies
  - Hospital acquisition of referring physician practices

More Difficult to Start a New Practice

You have:

- Talent
- Enthusiasm
- Market

Now what?

What does it take to start an IVF Program?

- People
  - Physician
  - Embryologist
    - May cover Andrology/Endocrinology
  - Laboratory Director
    - May be Embryologist, Physician, or off site
  - Nurse
  - Patient services (front desk, patient scheduling)
  - Billing
  - Payroll / bookkeeper
  - Marketing

Very difficult to start with less than 5 people

What does it take to start an IVF Program?

- Physical Plant
  - IVF laboratory
  - Procedure Room / Operating Room
  - PACU
  - Utility rooms
    - Clean
    - Dirty
  - Gas Manifold / Liquid N_2 Storage
  - Exam Rooms
  - Physician Offices
  - Nursing Offices
  - Admin Offices
  - Counseling Offices
  - Phlebotomy
  - Andrology / Endocrinology Laboratory
  - Electrical closet
  - IT (Computer Servers / Phone / Routers)
  - Biohazard waste
  - Much more….
- Equipment
  - EMR / Software
  - Furniture
  - Computers
  - Ultrasounds
  - Laboratory
    - Endocrine analyzers
    - Microscopes
      - Dissecting
      - Inverted
    - Hoods
    - Incubators
    - Storage tanks
    - Refrigerators
- HVAC System
- Much more……

$2,500,000 to $4,000,000

And then there are initial operating losses

Are Regulatory Restrictions a Problem

- New Jersey
- No new surgical practices / facilities without prior approval from the state
- No new licenses provided in the last five years
- Limited pathways forward
  - You have to buy an existing surgical practice or surgery center
    - You retain all of their liabilities
  - Affiliate with a hospital (they are exempt)

How does impact the value of current practices?

How do partners capitalize their equity while they remain in practice?

- Timing is everything
- At what multiple of EBITDA?
- Does it take into account any prior investment?

Recognize Sweat Equity

Cash

Future Earnings

Loan

Business Reality

It comes down to simple math..

- Traditional buy out models
  - Multiple of profits
  - MD frequently remained part-time as an employee physician
  - Paid by pre-distribution (and pre-tax) earnings
  - All risk retained by original equity holder
- Contemporary buy out models
  - Practices are often worth more than our younger colleagues may be afford to pay
  - Medical practices are considered poor credit risks – Loans are hard to attain
- Interesting to private equity groups
  - Access to capital
  - Believe they can manage more efficiently
  - Large investors satisfied with very modest rates of return

The Intrinsic Conflict When an Equity Partner Wants to Retire?

This will be all of us someday….

Retiring Partner

Other Partners and Employee Physicians "buying-in"

"I have worked hard and the practice has real value."

"Take whatever we offer, no matter how little, or keep working forever."

What plans are put in place to help practices resolve this intrinsic conflict?

- Absolute monetary value
- Multiple of PDE or EBITDA or EBIT
  - Fixed formula
  - Number established by group in advance
  - Blended average
- Duration of the payments
- Handling conflicts if everyone wants to leave in a short period of time
  - *Beware of practices all the partners are the same age!*

How might one deal with a "rock star" practice?

Why consider partners other than physicians in the practice?

???

Solo Practitioner

All Partners

Hybrid
Private - Academic

Limited Partners

Variants of Traditional Private Practice

Equity Partner

Management
Relationship

Capitalizing Private Practices

So what are the models?

- Management organizations
  - Typically are service providers
  - Do not provide a robust exit plan for retiring partners

- Private Equity groups
  - Well funded
  - Frequently want to pay for some of company with stock
    - Benefit if goes well
    - Deferring much of the risk back to original owners with disproportionally small share of the upside
  - Rarely reinvests in the programs or industry
  - Shorter horizon to equity event

- Physician owned groups
  - May have funding limits (ask)
  - Research and Educational programs
  - Timing of an equity event

Capital Partners
Buying future earnings

- There are many options

- ***Most of these organization have little or no intrinsic medical, laboratory, or research expertise***
  - They arrange for member practices to share information
  - But the expertise is within the members - not those who are making the money

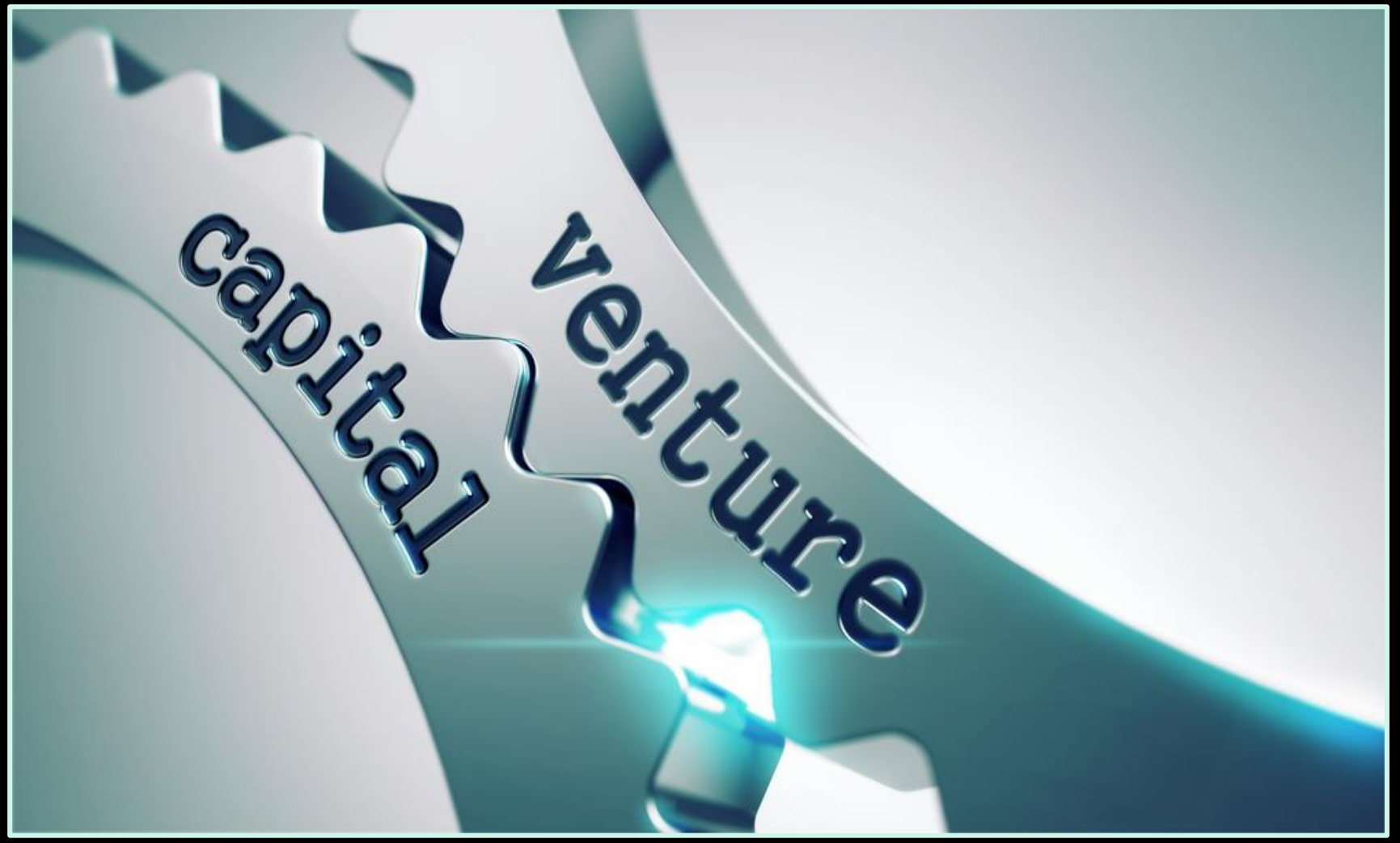
- Can be a great source of capital as traditional avenues of lending are difficult

- Main reasons practices do this:
  - Fund start up or expansions
  - Attain cash for current partners
    - They are selling future earnings
  - Capitalize a buy out

Operational control is retained by members of the practice

How is venture capital different than a traditional capital partner?

- ***Equity***
- Control
- Goal is to flip ownership in 5 years or less (typically)



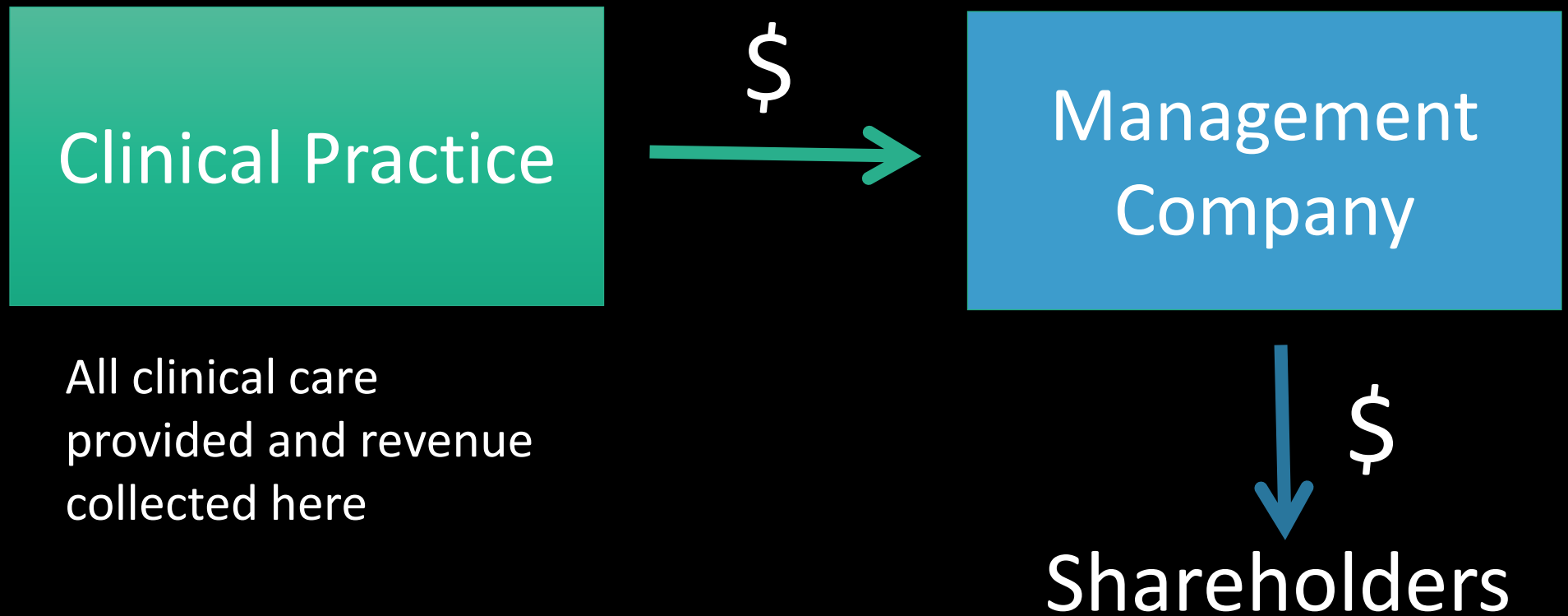
Not run by practicing physicians or scientists

Why are equity investors so interested in our field?

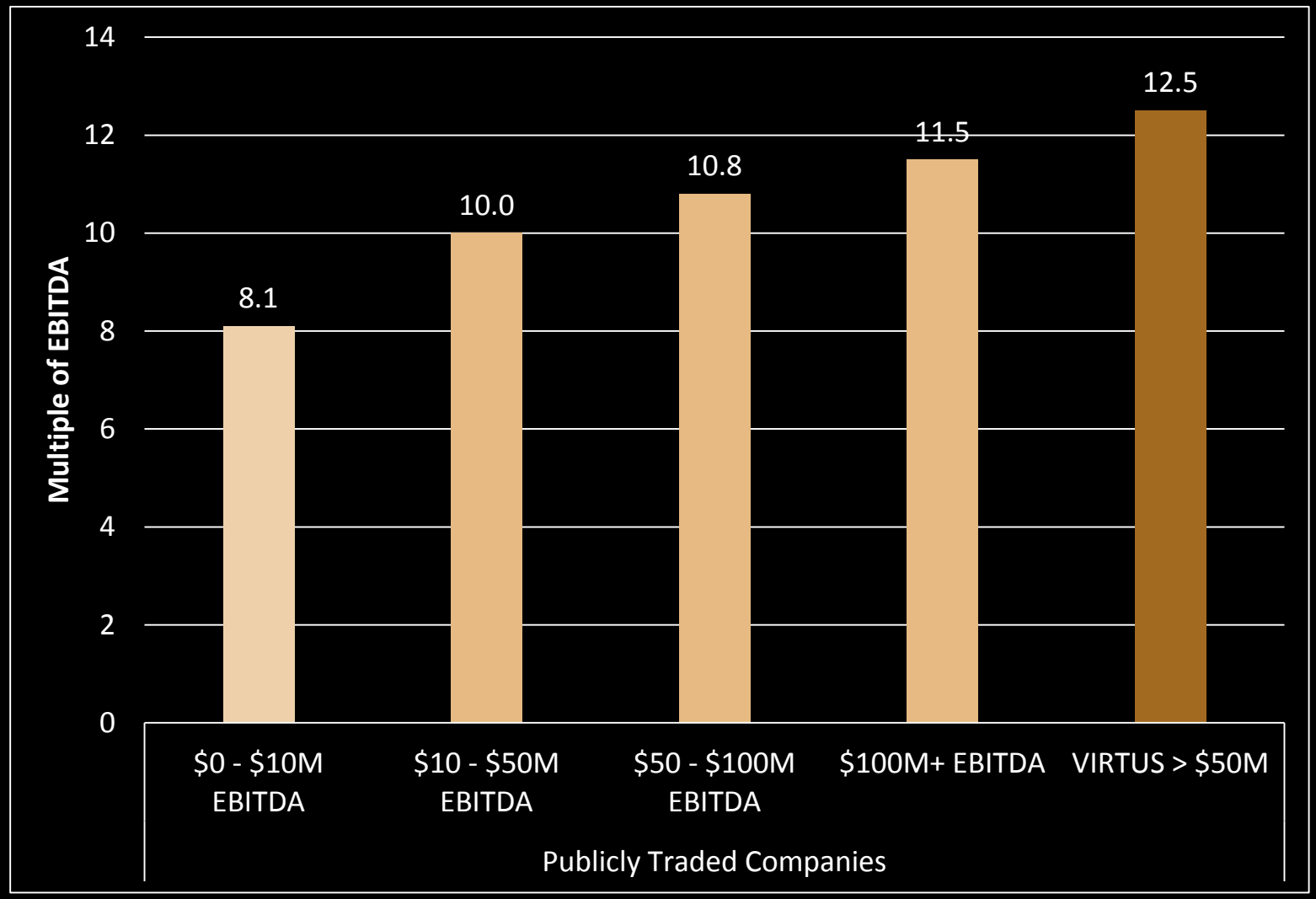
- Large number of partners approaching retirement age
- Less influenced by insurance (especially Medicare/Medicaid)
- Low rates of return through traditional investing
- Large pools of capital which “need” investment opportunities

The “Friendly PC” Model

Some variant works in almost every state



Industry Consolidation
Increased Earnings Enhance Valuation



Health care may do a little better…

What is used in the valuation?

PDE versus EBITDA

Pre-Distribution Earnings (PDE)

EBITDA

Where does the capital partners share come from?

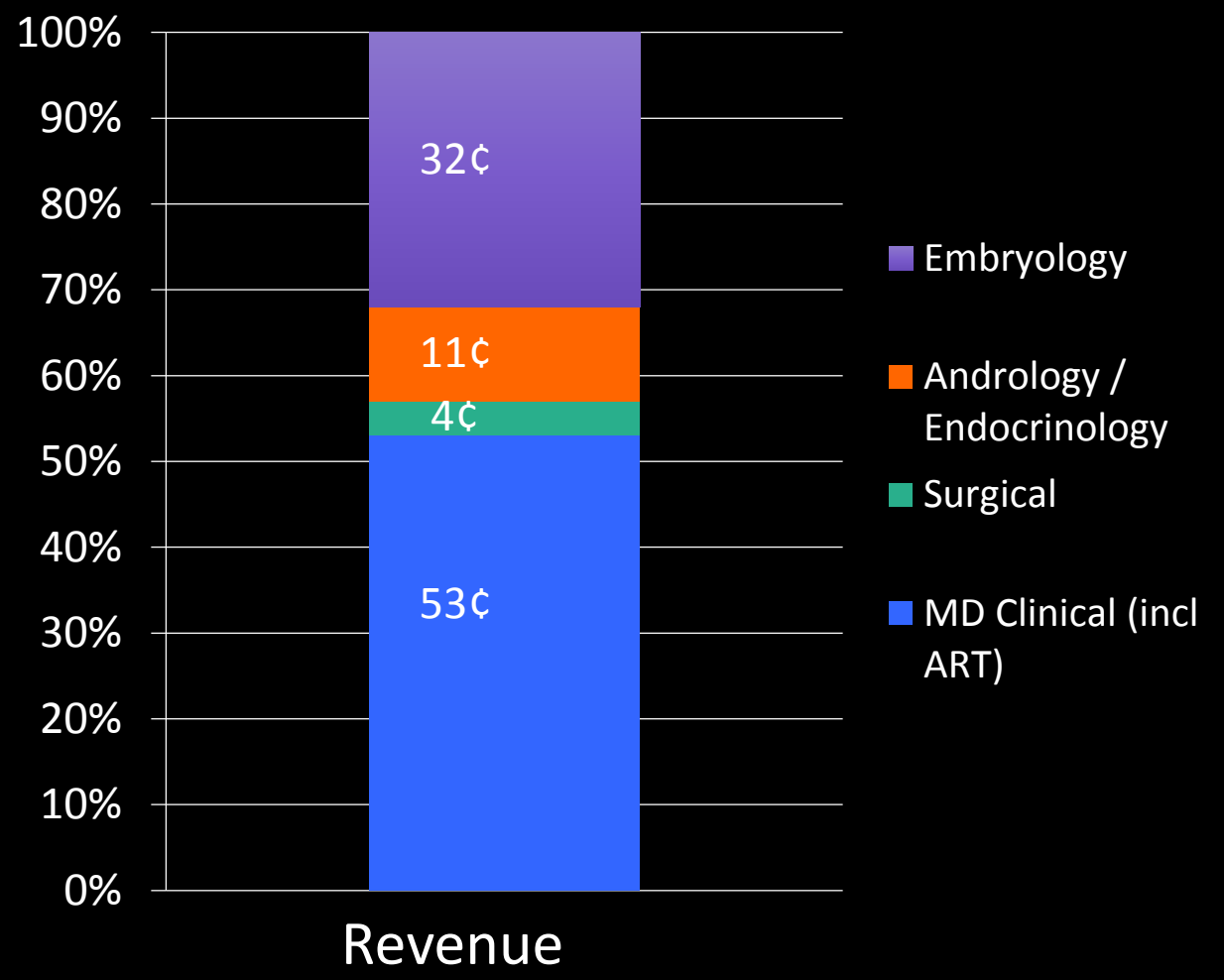
Equity Investors

- What do they want to the acquire?
- The entire practice
- Embryology
- Andrology / Endocrinology
- PACU

Private Equity purchase of the Laboratories

- Limits ***their*** investment / exposure
- Disproportionally transfers risk to the original equity owners
  - Avoids clinical investment
  - ***Reduced*** liabilities
  - Straightforward management metrics
- Typically involves
  - Equity
  - Control
- Reporting
  - Lab team may report to outside company

When a practice ***collects*** a dollar (revenue), where does that dollar come from?



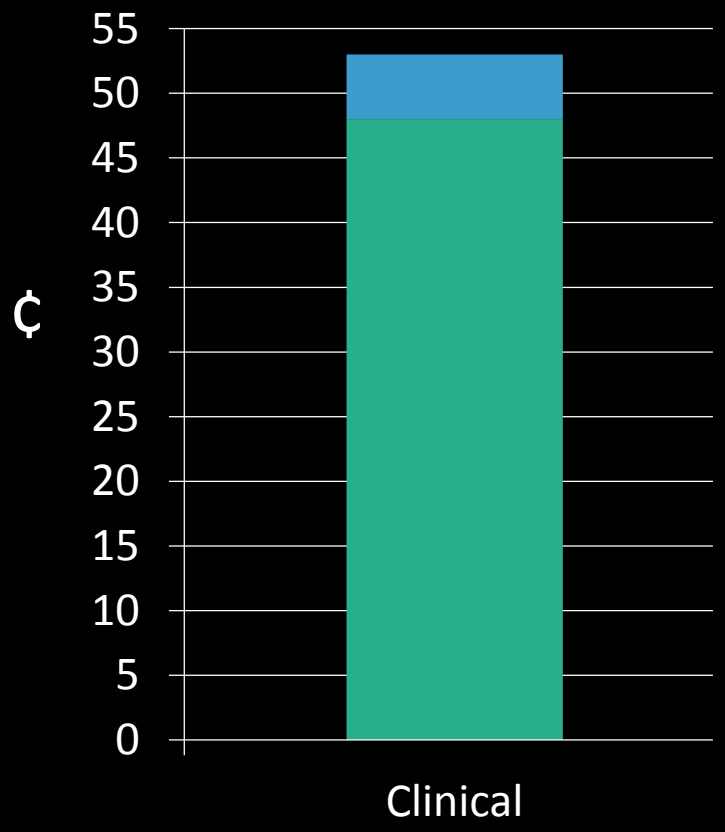
Physicians are the "big earners"

When a practice collects a dollar, how much goes to PDE?

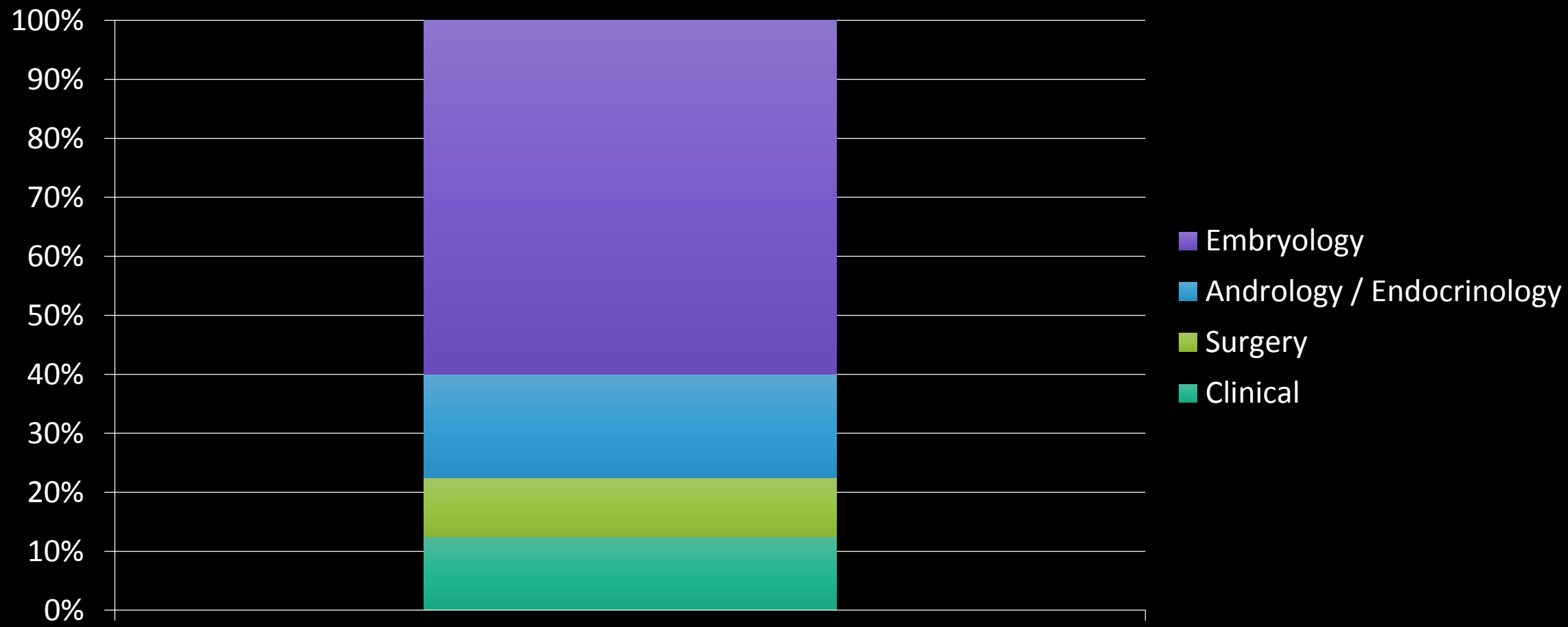
PDE percentages are influenced by many factors:

- % managed care
- Efficiency
- Competitiveness of the local marketplace

Which dollars contribute most to the PDE?



Proportions of Profit



Where does money really come from?

New Patients

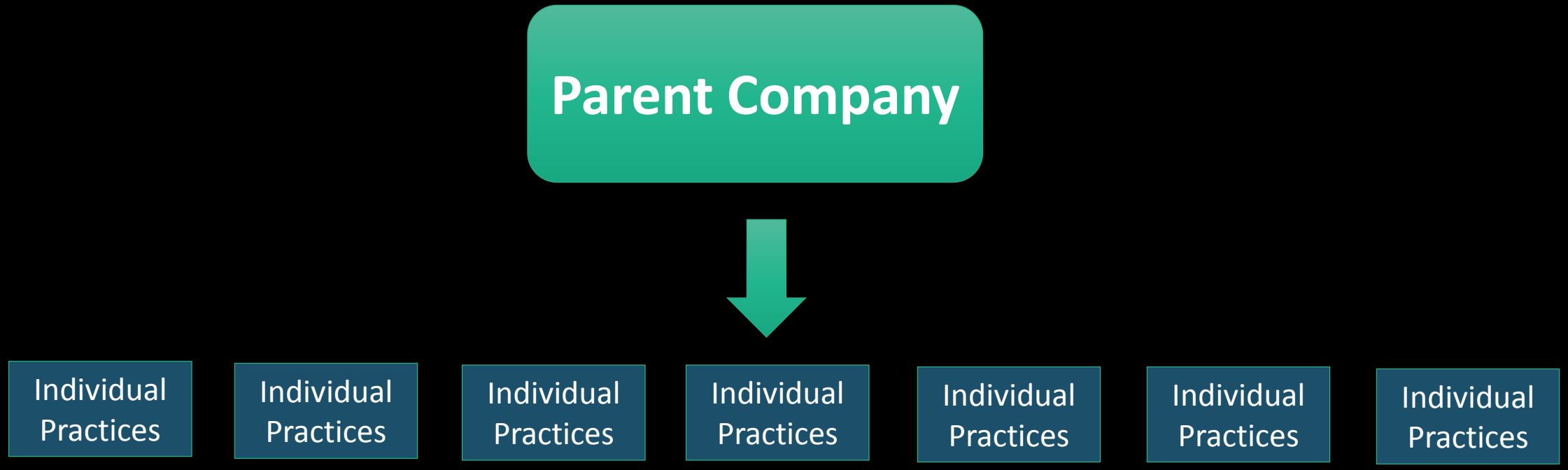
Major Issues with Private Equity

- Start up versus acquisition
- Buy in
  - Cash
  - Stock
  - Multiple paid
- Timing to equity event
- Value added

Hybrid Business Models

- Bring expertise
  - Medical
  - Laboratory
  - Research
  - Business
- Provide funding
- Typically controlled by physicians
- Invests in entirety of practice
  - True partner with equity
- May still look for future equity event – but may retain Clinician and Scientist control

Alternative Equity Structures



- Practitioners hold equity in Individual practices
- Tag Along rights at time of equity transaction
- Some equity reserved for future members

Rights

- Tag Along
- Pull Along
- Control
  - Manage
  - Money

The day after the transaction, you still go to work…
Who runs your practice?

Whoever controls the staff

Whoever controls the money

To whom does your staff report?

A very important question?

Who Controls the Money?
Business Operations

- Staffing levels
- Salary levels
- Managed care contracting
- Major program initiatives
- Academic / clinical relationships

Other major control issues

- Bonuses
  - Straight volume
  - Percentage of collections
  - Percentage of profits
    - Do the partners pay themselves an administrative salary?
- Non-competes
  - Investment in you
  - Investment in the practice
  - Always the most difficult issue

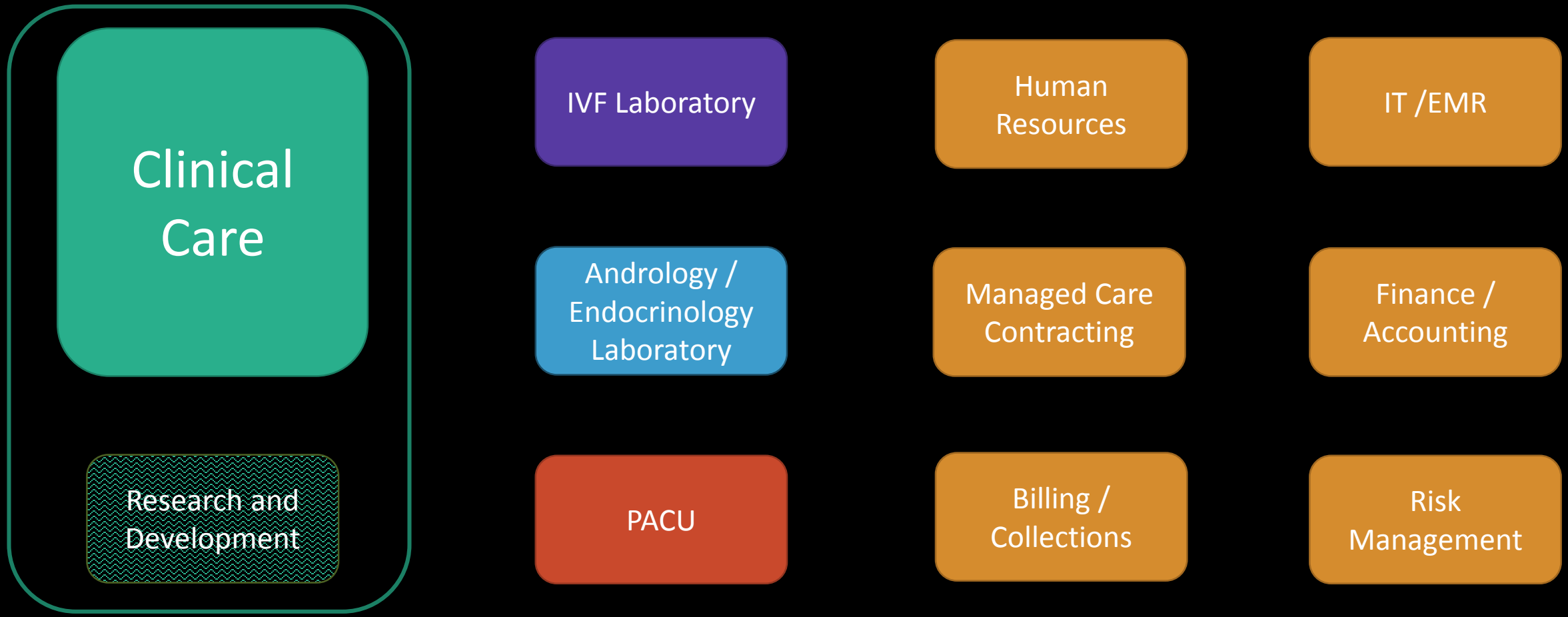
Who Controls the Money?

Investment when you are not retiring

- Capital Investments / Projects
  - New office
  - New physicians
  - New major equipment
- Loans
  - Financing capital projects
  - Capitalize future earnings
- Mergers / Acquisitions

Who is really running your practice?

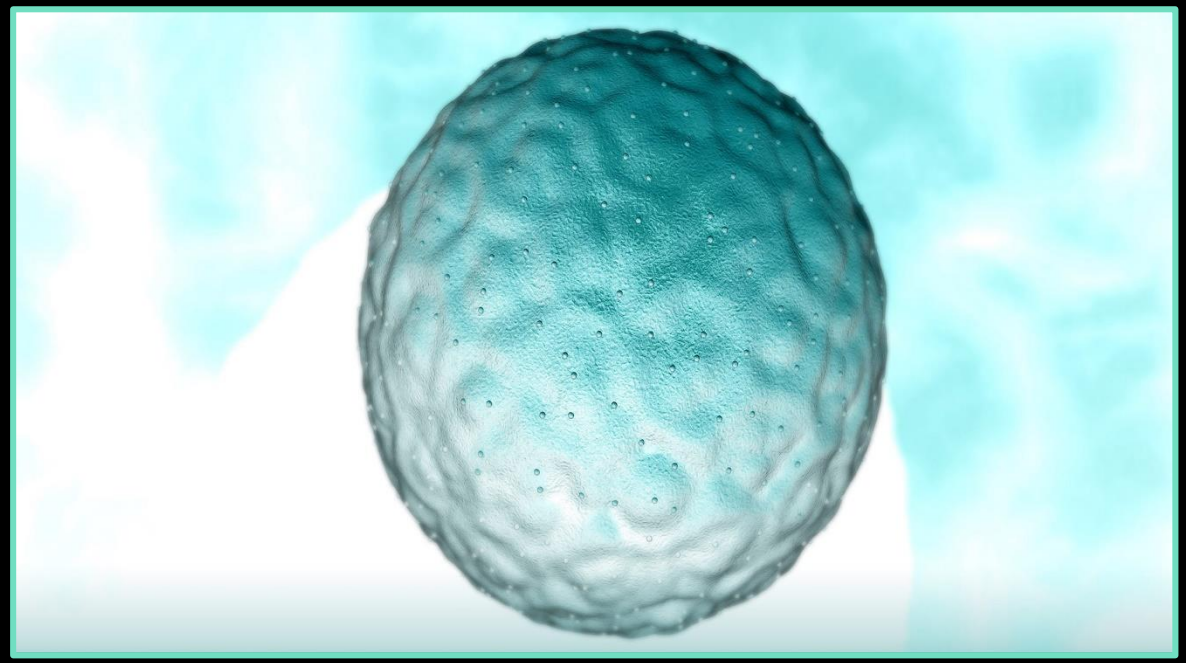
Start with understanding all the pieces of an established practice…



Adjacencies

Used to facilitate growth of the practice

- Diagnostics
- Anesthesia
- Mental health
- Genetic counseling
- Media / supplies



The future of RE practice

- Complex organizations
- Complex marketplace
- Evolving future
- Partnerships are growing rapidly
  - Physician operated
  - VC operated
- Successful practices routinely targeted by investment bankers / venture capitalists

Questions?