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Private Equity Consolidation of Physician Practices Steady Despite Economic Conditions

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During the past 12 years, private equity (PE) firms have served as major investors in the U.S. health care market, participating in acquisitions and consolidations of physician practices across various specialties. PE involvement facilitates market consolidation and increases resources, improves efficiency and operations, and advances new technologies — this allows physicians and professional staff to focus on what they excel at — the treatment of patients. The current economic climate of high interest rates and increased investment scrutiny has caused PE to refocus and shift to new strategies, but investments have remained strong. Troutman Pepper's Health Care Transaction team is experienced in navigating these new strategies both from the sell-side and the buy-side, and we are excited to help continue to strengthen our country's health care system.

Recent Rise in Private Equity Investments in Health Care

Since 2012, the number of transactions between PE firms and physician practices has rapidly increased from 75 deals in 2012 to 484 deals in 2021.[1] During a similar period, the estimated annual deal value for PE-backed, physician practice acquisitions has risen from about $41.5 billion to $200 billion.[2]

While some of this increase can be attributed to the health care environment, which expanded during the COVID-19 pandemic, the transaction stream continued to remain strong post COVID-19. Although PE health care transactions decreased in 2023 compared to previous years, there is room for pragmatic optimism that increased deal volumes will soon resume. Many PE firms are holding onto large amounts of uninvested capital, and the health care industry, specifically physician practices, is still an attractive target due to its largely fragmented nature and the appetite of owner physicians to de-risk their practice and provide improved patient care.

Structure of Physician Practice Consolidations

Given the current economic climate, PE-backed physician transactions continue to emphasize equity "rollover" strategies rather than all cash purchases. Typically, the buyer will form or use an existing management services organization (MSO) sponsored by the buying PE firm that will manage the nonclinical aspects of the acquired practice's business. The selling physicians would, in addition to cash at closing, receive equity in the MSO. The form of equity varies but typically includes stock options or profit-sharing arrangements. This equity serves a number of purposes including (1) allowing for a reduction in initial cash investment by the PE firm; (2) giving the selling physicians the ability to share in the growth of the MSO as future tuck-ins or acquisitions by the MSO occur; and (3) allowing the PE firm to satisfy certain regulatory requirements prohibiting nonphysician ownership of medical practices and to comply with applicable corporate practice of medicine laws.

Positive Impacts of Consolidations to Physician Practices

A major benefit of these arrangements between PE firms and physician practices is the PE firm's management of the administrative aspects of a practice. PE firms have the expertise and resources to improve infrastructure and operational support for physician practices, which help fuel practice growth and cost-effective solutions. Often, PE firms, through the MSO, handle issues with nonmedical personnel staffing, human resources, employee benefits, contracts disputes, and other similar matters to ensure the practice runs smoothly and that employees are satisfied with the work environment — again, allowing the medical professionals to focus on patient care. PE firms engaging in such transactions also have experience in negotiations with insurance payers, suppliers, and hospitals, which can lead to receiving more favorable deal terms.

Perhaps most importantly, PE investment can provide the necessary influx of capital into physician practices to access new technologies. New technologies are vital to improving treatment results and overall patient care, but such capital is often unavailable to independent practices. This is particularly essential to physicians in highly specialized fields, including cardiology and urology. A September 2022 JAMA Health Forum study found that from 2016-2020, internal spending, especially on new equipment, increased significantly at physician practices owned by PE firms, highlighting the increased resources available for PE-owned practices.[3] Through these investments, PE has continued to spur innovation and improve favorable outcomes for patients.

Future Outlook on PE Investment in Physician Practices

As with most industries, the recent economic environment has brought various challenges to the health care industry. Interest rates have stabilized but remain high, and the U.S. Department of Justice (DOJ) and the Federal Trade Commission (FTC) have increased scrutiny into PE consolidation deals in the health care industry. Specifically, on March 5, the DOJ, the FTC, and the Department of Health and Human Services (HHS) jointly launched a "cross-government public inquiry" into the involvement of private equity in health care.[4] As part of this joint inquiry, these government enforcers will likely investigate more deals involving PE firms and physician practices and closely examine how the PE firms will operate the physician practices post-transaction close. Additionally, the upcoming U.S. presidential election in November may result in new strategies and initiatives relating to PE investments and could create some uncertainty in the market.

However, just as the practice of medicine is constantly evolving, PE firms are also revising their financial models and approach to investing in physician practices. PE firms will continue to capitalize on the owner physicians' desire for economic assistance and de-risking, while also attempting to reduce the initial cash investment through various strategies, including utilizing rollover equity as discussed above. The underlying market fundamentals that drive PE investments in health care remain strong, including the increased aging population, health care labor turnover, and the need for improved access, care, and technologies in physician practices.

PE firms will likely need to be more selective when targeting physician practices to ensure a solid foundational understanding of the target's unique field of medicine. Despite the current economic conditions, however, it is likely these transactions will continue at a steady pace and help to provide improved, more comprehensive patient care.

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[1] https://www.antitrustinstitute.org/wp-content/uploads/2023/07/AAI-UCB-EG_Private-Equity-I-Physician-Practice-

Report_FINAL.pdf

[2] https://www.fiercehealthcare.com/finance/industry-voices-private-equity-investment-healthcare-making-positive-impact-especially

[3] https://www.fiercehealthcare.com/finance/industry-voices-private-equity-investment-healthcare-making-positive-impact-especially

[4] https://www.justice.gov/opa/pr/justice-department-federal-trade-commission-and-department-health-and-human-services-issue

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