

## Private Equity Buying Healthcare

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The Medical Practices that will benefit the most from selling to private equity is opposite from what you might think. Let's look at two fictional examples to understand this apparent contradiction. This will allow you to understand whether pursuing a private equity deal makes sense for your practice or healthcare organization.

A 67 year old physician ("William") has been practicing in the same town for 35+ years. He enjoys a great reputation and has a full schedule including a backlog. His office has adequate equipment but not the latest and greatest. The office decor is satisfactory for the small town in which he practices but certainly not the Ritz. This doctor genuinely cares about his patients and does an above average job in his care.

He toyed with the idea of bringing in an associate off and on over the years but never pursued it aggressively. In addition to his loyal patients, he has a dedicated staff. He makes a solid income, although hospital employed positions in the region pay more for the same specialty. He does not take a lot of vacation time but has an amicable relationship with another solo doc in town and can trade off call coverage.

William has some mild health issues developing. His wife wants him to work less so they have more time to vacation and visit their six grandchildren. Before examining William's options, let's look at Beth's situation.

Beth is 43 and practices in the suburbs of a moderate size Metro area in the Midwest. She currently has 3 locations in her market, as well as 2 full time docs working for her. In addition, she has another part-time doctor working in one of her offices. She has been approached in the past 6 months by 2 other physicians, in the same specialty, about working with her. Both of these docs are late 50s/early 60s and have not had any luck recruiting associates.

Beth practices about 60% time and spends the rest of her work week growing her practice. She has a solid office manager but prefers to do the higher level administrative work herself. Beth has a very modern office and has made wise

choices in her ancillary services. She does not spend a huge amount in advertising but has been adept at using facebook and other social media to bring in new patients.

Beth wants to continue to practice for many years. But she wonders how she will realize value for her practice one day. One of her employed docs mentions buying in but also complains about his student loan debt and has voiced his contentment with his compensation package.

Which physician is in a better position to consider a partnership with private equity? Certainly, William is looking for an exit strategy. He's late in his career and wants to cut back even if not yet ready to retire. How much interest would he receive from private equity groups? Unfortunately, the answer is zero. Although Williams's practice is reasonably successful financially, the ongoing viability of his practice is uncertain if he's going to be practicing less.

Does William have options? Sure - Maybe another practice in his market may buy him out. Maybe a young doc out of training will join and eventually take over the practice. However, demographics show that very few young docs want to own practices - especially small solo practices. William could also turn out the lights and walk away one day. Nothing wrong with that if he's not concerned with getting value for his decades of hard work.

Why would Beth sell an interest in her practice to a private equity group? She's enjoying her practice and her business is thriving. She is making a good income which increases yearly. She certainly could wait 20 or 25 years and then figure out an exit plan.

What will medical practices look like in 20 years? No one knows - and not only that - it's even hard to make an educated guess. There's a lot of uncertainty about the future in all fields of endeavor. However, it's not hard to imagine Elon Musk sending paying customers to another planet on a regular basis. It's also seems very likely that cryptocurrency will play a major role in the world's economy, although whether Bitcoin and Ether will live on is unknown. The two major political parties will likely still be diametrically opposed on almost every important issue. With healthcare, it is extremely difficult to make a reasonable educated guess.

Would a private equity group be interested in partnering with Beth? Absolutely. Does it make sense for Beth? Quite possibly. How would Beth benefit? Firstly, she would maintain much, if not all, of what she likes about her current situation.

She can still see patients and continue to grow her successful practice, What other benefits would Beth realize from such a partnership?

Beth would sell a portion of her practice to private equity. She would likely get a nice lump sum. It might be all cash but it may be part cash and part ownership in the ongoing business. She would still get paid for her clinical activities. She would get “a second bite of the apple” when she sells her remaining ownership down the road.

Many physicians are concerned about the loss of control. Would Beth’s opinion matter going forward? It’s hard to imagine the answer being no. Private equity is interested in Beth’s practice for precisely this reason - she has made excellent business decisions in addition to being a compassionate and competent well-liked doctor.

Can private equity add something to Beth’s successful recipe? The right partner should be quite beneficial. Beth may want more business and back office expertise as her practice continues to grow. She has grown her practice well but maybe it could grow even faster. A strong financial partner may allow her growth rate to increase whether through organic growth, acquisitions, or both.

Beth now has an automatic exit strategy. Although the Private Equity Company will likely want Beth to stay indefinitely (and will probably require her to stay for some period of time), she has flexibility going forward. Could differences of opinion occur down the road? Absolutely, as is the case in any business relationship or any relationship for that matter. However, the downside of doing nothing until she’s ready to retire is likely quite a bit higher.

Although these are both completely fictional scenarios, they illustrate the unexpected. Certainly, William is the physician who is more motivated to sell. Unfortunately, he might not find a buyer - whether private equity, young doc, hospital, etc. Beth would probably do well staying 100% independent, but very conceivably could do much better investigating the option of private equity.

Private equity is currently very interested in Healthcare. Some firms are kicking the tires and others are investing heavily in medicine. No one knows how long this will continue, but there is a lot of momentum presently. Most Private Equity Groups want majority ownership in the 51-60% range. However, there are some groups that like 100% ownership and others that will consider minority ownership.

Even the groups that want to buy a practice outright, will often offer the selling physician a stake in the ongoing entity. This entity will not only include the practice they sold but other practices that will eventually be combined with the seller's initial practice. The ownership stake may be a relatively low percentage, but it may represent a small slice of a much larger pie in the future.

Private equity groups want to grow the practice/business for a few years. What happens then? The practice may be sold to a larger private equity group. This is when the original owner gets the proverbial "second bite of the apple". In addition to cash considerations, the original owner might then own a piece of an even more valuable practice.

Will the physician still be happy practicing medicine? Hopefully and likely so. Private equity is very selective about the practices in which they want to invest. Chasing away a quality physician who started the ball rolling would clearly not be in anyone's best interest.

Is a private equity partnership right for all docs? Not likely. But the very docs who might benefit most are generally not considering the option. I have been consulting with practices on this topic and I am optimistic that the private equity option may be right for many practices. My consulting is 100% complimentary to physicians and other providers. Practices who fit the profile discussed may be wise to get a Consult with a MD who has studied this topic in depth and have met with numerous private equity firms.

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