Orthopedics • This Week

Funding Your Practice Expansion

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Would you like to expand your practice? But wonder how to pay for it?

Our guest editorialist this week is Robert April, an analyst with Provident Healthcare Partners, a healthcare investment firm based in Boston and Los Angeles. Mr. April offers both a framework within which to tackle this very important question and discusses an increasingly viable option for funding growth—Private Equity Partnerships.

Source: Wikimedia Commons and Dewitt hospital community affairs

Is Private Equity Funding an Option for Orthopedic Practices?

As 2017 draws to a close, many practice leaders are shifting their focus to the strategic initiatives they hope to pursue over the next year—if they can find the funds.

Looking to secure their practice's future in an uncertain healthcare universe, more and more orthopedic groups are asking about alternatives to either debt or selling to a larger entity. One option is private equity.

Private equity consolidation in physician services is nothing new, but it is comparatively rare in the musculoskeletal space.

Private equity consolidation became a popular option for many dental groups in the early 2000s, when private equity firms began to work with multi-site, provider-based businesses. Other healthcare sectors that also gravitated to private equity are interventional pain management, dermatology, and ophthalmology.

Over the years, dozens and dozens of private equity transactions have helped nearly every large provider in these specialties.

An Alternative to Merging With Other Practices

Joining a health system or merging with a local competitor has been a reasonably common strategic option for practices that wish to grow. The obvious downfall of these options is that they have left many groups looking for a better path.

In contrast to merging with another practice, private equity is based on a partnership structure with management and physicians and a mutual execution (with the private equity funder) on a long-term growth plan.

While many groups fear that partnering with a financial sponsor will result in loss of control, in fact, such a partnership can empower the practice to execute on many different growth strategies that they otherwise would not have had the time or capital to accomplish on their own.

The Mechanics of a Private Equity Strategic Partnership

Having been employed successfully in several other healthcare sectors, the private equity partnership model is well proven and is a very viable alternative for orthopedic practices.

Here is how it works.

Transactions in orthopedics are structured very much like the time tested and successful transactions in other sectors of physician services.

It all starts with valuation.

Valuation is determined by a "multiple" applied to adjusted EBITDA (earnings before interest taxes depreciation and amortization).

A practice's adjusted EBITDA is calculated using a predetermined, acceptable reduction in compensation for all shareholder physicians. A typical private practice will distribute nearly all of its profits to the shareholders, resulting in an annual net income of zero. Private equity groups will look to acquire a profitable business. To create one, shareholder physicians will forego a piece of their compensation/distributions to create a "profit" in which they will receive a multiple of in the form of deal proceeds at close. Most private equity groups will generally look to acquire anywhere from 55 – 80% of the practice, with the remaining equity kept by the physicians.

These transactions commonly provide groups with a significant cash proceeds event, no threat of claw back on these proceeds, and, importantly, equity in a growing business backed by a large financial institution.

Private equity partners do not expect to take over the day-to-day operations of the business, and prefer to rely on existing management to run that side of the business. They will look to collaborate with the management team to make board level decisions on the best way to grow the practice.

Most private equity investors approach a clinic investment as a way to use their capital to refine internal antistructure and thereby support a larger enterprise. The key element in all this is working with the current management team to understand what additional support they need, what additional locations through both de novo expansion and acquisitions make sense and how to capitalize on ancillary service offerings at all locations (such as ASC, MRI, urgent care centers, PT locations, DME, pharmacy, etc.).

Strong private equity backers can help practices pursue all the above strategies in some capacity, and will work with the shareholders to determine which initiatives will have the most meaningful impact on the business.

Recent Orthopedic Private Equity Transactions

The first orthopedic private equity transaction was put together in April 2017 when Boston-based Candescent Partners recapitalized The Southeastern Spine Institute (SSI) in Mount Pleasant, South Carolina (Provident Healthcare Partners represented the shareholders of The Southeastern Spine Institute in this transaction).

Southeastern Spine was a 12 physician, 1 location, spine focused orthopedic practice outside of Charleston.

Prior to the transaction, SSI was the largest provider of spine care to the state of South Carolina, but had its sights set on a much grander scale. The shareholders at SSI with the help of Candescent partners, are now able to expand from their one location into neighboring cities and states through both acquisition as well as de novo expansion.

The focus of the partnership is highly tailored to SSI and the region. Its goals are to offer convenient locations for patients to seek treatment and ancillary services so that SSI can provide the highest level of care to a broader range of communities in the region.

Candescent Partners has significant experience with healthcare private equity financing. It made the first investment in the ophthalmology space with its platform, Claris Vision, back in 2014.

In addition to its investments in eye care, Candescent has collaborated with dental, dermatology, and women's health practices (Aspen Dental, Dermatology Associates, and Solis Women's Health, respectively). The firm is very comfortable working with physicians and has years of experience growing multi-site physician practices.

In November, Varsity Healthcare Partners (Varsity) completed a transaction with Gainesville, Florida-based Orthopaedic Institute. The Orthopaedic Institute is a 33 physician, 6 location orthopedic practice that offers its patients general orthopedic services including walk-in clinics, ambulatory surgery centers (ASCs), physical therapy, and many other ancillary services.

As one of the largest orthopedic providers in the state of Florida, The Orthopaedic Institute will leverage the expertise and experience of Varsity to grow in their region and beyond.

Varsity Healthcare Partners has established itself as one of the most successful investors in physician services and has a strong track record of working with physician-led teams.

With successful exits in the ophthalmology and dermatology spaces (EyeCare Services Partners and Forefront Dermatology, respectively), Varsity has a deep understanding of how to grow a multi-site, provider-based business.

Varsity and The Orthopaedic Institute plan to aggressively expand their geographic footprint over the next three to seven years (average investment horizon for a private equity group).

Typical with any private equity investment into a physician group, Varsity's approach to accomplish this will include making acquisitions of independent orthopedic practices in surrounding geographies and rolling them into The Orthopaedic Institute platform. In addition, the partnership will look to expand the breadth of ancillary service offerings across the entire network of locations.

While Candescent Partners and Varsity Healthcare were the first two private equity groups to enter orthopedics, there are dozens of other firms with similar levels of expertise and experience.

Over the next 12 to 18 months these firms will be actively looking for strong orthopedic practices to partner with and grow. Given the uncertainty surrounding reimbursement and the direction of healthcare, partnering with a private equity group may not only be the best financial decision for many groups, but the best strategic one as well.

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