

2021 Health Care Transactions

# Resource Guide





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# Defining Private Equity Transactions in Healthcare and Understanding Deal Options for Medical Groups

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Over the years, there have been numerous options for medical groups in considering different transaction types, structures, and valuations. At the same time, the actual types of partners that groups could consider for participating in a transaction also have expanded. As many practices have explored options with potential buyers other than hospitals, the number of deals where practices are selling to private equity (PE) firms (or PE-backed platform companies) has increased significantly.

These deals can often entail unique structures, terms, and outcomes; thus, it is important for those considering such transactions to be aware of and understand the various factors that can often be unique to PE transactions. Coker has published numerous articles on PE transactions with medical practices, but discussions with physicians and practice executives across the country have made clear that an important and distinctive question related to this topic is “what exactly is private equity?”

The presence of PE within the healthcare services industry is nothing new. But one thing we have found is that there is a rather broad reference in the term “private equity,” which has likely resulted in some confusion, or at the very least a lack of clarity, around what people actually mean when referring to PE deals.

People often use a number of monikers and categories of terms when referencing private equity. For the general concept of PE buyers, terms like investment banks, venture capital, hedge funds, investment funds, proprietary investors, merchant banks, institutional investors, etc. are often used. By the same token, people describing transactions or firms involved in transactions often refer to the parties involved as PE buyers, though what they are really talking about is a platform or operating company that is backed by PE capital. And while there is a significant amount of overlap in many of these different terms and references, there is little room for questioning how easy it is to be unclear about what exactly is going on in the overall discussion of PE investors, specifically within the healthcare services space.

In the simplest of explanations, PE firms are privately held (meaning they are not publicly traded investment firms) entities that manage capital raised from institutional investors, which is deployed into targeted markets, sectors, and business segments. PE firms acquire companies, which are typically also privately held. While there are cases where PE investors will expand their investment profile to

include the purchase of publicly traded securities and/or derivatives, this is beyond the scope of the discussion.

The primary, and in many cases singular, goal with these investments is to grow the businesses in a firm’s portfolio through organic and non-organic (i.e., add-on acquisitions) means, thus increasing the value of those assets over a period of time. And while expanding value over time can be an attractive investment strategy in its own right, the real return of value on an investment for PE firms is through an exit, of which there are generally two likely pathways: (1) a liquidity event where portfolio assets are sold to another buyer; or (2) a sale of such assets on the public market via an initial public offering (IPO) or similar vehicle. Again, this process varies, so this is a general explanation of what ultimately happens in these types of transactions. However, the discussion above covers the majority of what people are typically referring to when discussing PE investments, especially in entities such as medical practices.

More specifically, the following example illustrates the most typical scenario of PE transactions with medical groups.

A PE firm—let’s call them “ABC Capital”—manages a pool of capital from various institutional investors. ABC Capital’s focus is investing in healthcare services, and the firm’s leadership identifies medical practices as a primary opportunity for value in a market where there is ample room for growth and plenty of eager buyers for a future liquidity event. ABC Capital ultimately identifies a primary target in “AmeriMed,” which is a multi-specialty medical group consisting of 75 physicians across a certain geographic area of the United States that specializes in an effective mix of primary care and surgical sub-specialty medical services.

In a process consisting of significant time, effort, and compromise, which entails far more nuance than detailed in this high-level illustration, ABC Capital ultimately closes on a transaction to acquire and operate AmeriMed.<sup>1</sup> At this point, AmeriMed is the “platform investment” into this space on which ABC Capital will ultimately attempt to build and expand its value within this specific space.

Over the course of approximately five to seven years, ABC Capital will focus on two general objectives for this investment. First, ABC Capital will bring in the necessary personnel and operational and financial resources to maximize AmeriMed’s efficiency and profitability. Again, this is almost a laughable description of what actually goes

into this effort, but for the sake of this simple illustration, we will avoid getting into the weeds on what that process really entails.

Second, ABC Capital will work with AmeriMed's management to identify, pursue, and ultimately complete additional acquisitions of other attractive targets that can be incorporated into the platform. These add-on acquisitions are key to expanding the value, because optimizing the foundational entity and pursuing organic growth options can only go so far, not to mention the fact that such organic growth typically takes more time to achieve significant benchmarks. However, adding on other attractive entities to an efficient, well-functioning, and stable platform means that value is achieved in what can often be measured in exponential metrics, where acquired profits essentially drop to the bottom line of the core entity almost overnight.

Fast-forward five or so years down the road, after ABC Capital and AmeriMed have stabilized the platform and added earnings value through add-on acquisitions. At this point, ABC Capital is ready to explore how to achieve the maximum value potential on its original investment. This is where an exit or liquidity event comes into play, and ABC Capital will consider its options. As previously noted, there are a number of different ways this exit or liquidity event could ultimately play out, but for the sake of this basic example, let's assume that ABC Capital will consider selling the entire enterprise to another buyer, or selling the asset on the open, public markets through an IPO. While IPOs are not exactly rare, in the cases of PE-backed medical group entities, it is far more common for such assets to be sold to another party. And once again, there are many factors to consider and understand for these types of scenarios, but to keep the example simple, assume that AmeriMed—now much larger and representing a significantly greater value than when ABC Capital first acquired it—is sold to another buyer.

Who would be a likely buyer of AmeriMed in a case like this? It could be another PE firm, likely one that is larger than ABC Capital and that has existing assets in a similar space, where AmeriMed could be integrated with an existing platform. Other types of institutional investors also might be interested in the space, including hedge funds or publicly traded investment firms. Similarly, but with distinctive nuance, more of a strategic acquisition could occur, whereby AmeriMed is acquired by a large healthcare services entity, which could integrate the company in an existing operation. In some cases, we have even seen alternative types of strategic transactions occur where large hospital systems acquire such entities, integrating them within their established networks of medical services. And of course, there are many other possibilities, but those described above are a few of the more common examples in the current marketplace.

While the above example is general and admittedly oversimplified, it is intended to help illustrate some of the more common characteristics of what occurs when referring to private equity investors acting within the healthcare marketplace, specifically in relation to deals with medical practices. There are many additional details and varied considerations within each of the key elements discussed above. Coker has a wide range of content available that provides more in-depth discussions on many of these issues. But hopefully this article is a starting point to better understanding this unique and growing component of the healthcare marketplace for those considering—now or at some point down the road—the possibility of exploring opportunities with private equity.

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### Endnotes

<sup>1</sup> For more information and resources on the structures, terms, and economic considerations involved in this process, see <https://cokergroup.com/>.

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