THE PE HUB NETWORK

Why PE firms are buying orthopedic and ophthalmology practices

August 3, 2017

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Specialty physician groups continue to garner significant interest from private equity investors, with orthopedic and ophthalmology practices joining dermatology and dentistry as particularly attractive in the current market.

The past few months have seen a number of transactions involving these physician-led practices. And that activity is likely to continue because these operations are finding ways to enhance profitability within niche healthcare markets that are enjoying favorable demographics.

Investors are attracted by the combination of prudent, routine medicine and the ability to perform highly profitable procedures, such as elective sports medicine and laser eye surgeries. The result is a premium valuation on high-performing, well-positioned practices.

A case in point is the investment in **CORE Institute**, an orthopedic practice, by **Frazier Healthcare Partners** and **Princeton Ventures**. When the deal was announced in January, CORE's chief executive, **David Jacofsky**, an orthopedic surgeon, summed up the attractiveness of the sector: "Musculoskeletal care is the fastest growing segment of inpatient hospital admissions in the U.S. This exponential growth is expected to continue for the foreseeable future."

While details of the CORE deal were not announced, well-run orthopedic and ophthalmology practices can fetch premium valuations consistent with recent dermatology transactions, implying multiples of trailing 12-month EBITDA of 10x or more.

And while larger practices are generally valued more aggressively than smaller ones, investors appear to have an appetite even for those that employ only a handful of doctors.

A typical strategy PE firms employ is to partner with an established practice group and augment that investment by acquiring and rolling up smaller practices to establish regional and national brands.

These larger groups are better positioned to confront changes in the evolving healthcare landscape and to offer significant resources to doctors who wish to focus on the delivery of care. These structures enable doctors to recognize some economic benefits while maintaining ownership and the ability to work in “democratic” physician-led practices.

Orthopedics is among the fastest growing healthcare segments: Orthopedic conditions generate more than 137 million visits to physicians’ offices, hospital outpatient clinics, and emergency departments annually.

Two factors, back pain and an aging population, are the primary drivers of this growth. Back pain costs the American economy as much as $100 billion annually and is the second most common reason to visit a doctor behind upper-respiratory infections. Disability caused by back pain is rising 14 times faster than the population growth rate.

And an aging population means more and more Americans are having joint-implant surgery. In 2013, about 1 million knee and hip replacements were done in the U.S., and that number is expected to quadruple by 2030, according to the National Institutes of Health.

In the ophthalmology sector, the recent trend is illustrated by **Waud Capital Partners**’ investment in **Minnesota Eye Consultants** to form **United Vision Partners**. The restructured company plans to build a national network of providers. Minnesota Eye Consultants had grown into a business with 28 doctors practicing in operating rooms in six locations.

Demographics make the ophthalmology sector appealing to investors as well. The **American Academy of Ophthalmology** estimates that more than 24.4 million Americans over age 40 have cataracts, including half of those over age 75. About 50 million Americans are forecast to have cataracts by 2050, spurring increased demand for cataract surgery. Elective laser surgery to obviate the need for prescription glasses is also growing in popularity.

Orthopedic and ophthalmology practices also enjoy a comparative advantage over other practice areas from a reimbursement standpoint.

Common orthopedic and ophthalmic procedures are typically well-reimbursed by insurers. And these practices have the potential to perform a number of elective procedures that don’t rely as much on discounts made to insurance providers. In recent years, private equity cash has snapped up dermatology and dental practices for similar reasons.

Another appealing attribute of these practices, especially within orthopedics, is the ownership of ambulatory surgery centers. By owning and controlling the operating environment, practices are able to function outside hospitals, leading to better physician economics, improved cost containment and better access to care for patients.

From an investor perspective, this makes these practices the medical equivalent of a big-box retail chain — a business model in which an efficient practice perfected in one location can be replicated elsewhere. In fact, the practices that are most attractive to investors are ones that have developed strategic plans to compete against regional health systems, creating critical mass by building out facilities and acquiring smaller practices.

While many doctors may have viewed the full or partial sale of their practices as a loss of independence or control, many now see a PE partnership as the key to remaining independent.

In a world where reimbursement pressures, escalating malpractice premiums and required investments in back-office functions have driven many physicians toward hospital employment — the true loss of independence — the PE-led consolidation wave is giving many doctors new hope. And more than a few take pleasure in the added bonus of being able to spend more time with patients.

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