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Ambulatory-surgery centers can help unlock investment value in orthopedic practices

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By Patrick Krause, MHT Partners

The **Centers for Medicare and Medicaid Services'** change of policy last summer to pay for total knee- and hip-replacement procedures in outpatient settings has made independent orthopedic practices — and in particular those that own ambulatory-surgery centers — an interesting area for investment.

A blueprint for investment in orthopedics has been established by private equity investors who have been investing in specialties such as ophthalmology and dermatology. These investors are looking to leverage their experiences in similar, highly sought-after medical specialties and invest in orthopedic practices.

Hospitals are also keen to ink joint ventures with successful practices to avoid losing total joint procedures, one of their biggest profit centers, to ambulatory centers.

The July 13 CMS proposal allows traditional Medicare beginning in 2018 to pay for total knee arthroplasty in outpatient settings as well as total and partial hip replacements in hospital outpatient departments and ambulatory centers.

In coming years, this will cause procedures to increasingly migrate to ambulatory centers, and that prospect in turn is prompting more doctors who are running orthopedics groups to wonder how to transform their practices into ambulatory centers.

By setting up an ambulatory center that has its own operating rooms, an orthopedics group can both generate more revenue from surgeries and capture facility fees, all the while delivering quality patient care and building their reputations.

In addition, ambulatory centers can control more of a patient's care, from imaging to physical therapy and rehabilitation. This enables them to negotiate bundled deals with insurers to offer services spanning a longer continuum of patient care.

All that can significantly grow revenue, but getting to that point requires significant investment in a practice.

Demographic trends are helping, too. By 2030, an aging American population will have four million knee- and hip-replacement surgeries annually, up from about 1 million operations in 2013.

Indeed, orthopedics is one of the fastest growing healthcare segments, generating more than 137 million visits to physicians' offices, hospital outpatient clinics, and emergency departments annually, buoyed by the growth in back-pain-related procedures and joint-implant surgery.

Since ambulatory centers function outside hospitals, they typically have less overhead and are better positioned to contain costs and control over patient-care quality.

For investors, and for patients looking for more cost-effective care, this dynamic generates the medical equivalent of a big-box retail store — a business where perfecting efficiency in one location can be replicated at others and multiple services can be combined to provide more targeted, integrated care.

Physician groups looking to leverage their ambulatory centers or partnerships to unlock value in their practices have several options: remain independent and raise capital, partner with PE investors, and establish joint ventures with hospital systems.

Going it alone is perhaps the hardest option. Physician groups can raise capital by taking on debt to fund expansion and investment in ambulatory centers and other service offerings.

This option is the least dilutive way to fund growth in the business but also requires the most work, from having to manage the administration of a practice to developing and enacting strategic-growth plans.

Partnering with PE enables partners in a physician practice to both monetize part of the value of their practice today, maintain their salary and earnings, while they also have the opportunity to share in growth.

PE investors enable the doctors to focus on patients while taking over administration and strategy. And they have commercial relationships and strategic expertise that can help grow revenue and profit.

Additionally, some practices might consider partnering with a hospital to form a joint venture. Like partnering with PE investors, this option enables doctors to focus on patients rather than on business and administration.

This option can work well for practices that have a significant portion of their work coming from one hospital — a dynamic where setting up in direct competition with the hospital could imperil revenues.

A knowledgeable investment banker can help facilitate these alternatives, identify suitable investors, and broker optimal deal terms. Whatever option a physician practice decides to pursue, these are exciting times to be growing an orthopedics business.

Patrick Krause co-leads MHT Partners' Healthcare Services industry practice and provides advisory and transaction execution services to healthcare service companies, including a wide variety of physician groups. He can be reached at pkrause@mhtpartners.com.