

## Value Creation Strategies for Private Equity Investors and Their Portfolio Companies Across the PPM Ecosystem



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Understanding the current landscape and dynamics across physician practice management entities (“PPMs”) and how they partner with value-based care (“VBC”), primary care (“PC”) and multispecialty providers is key in developing strategies to accelerate value creation for private equity (“PE”) firms in the current global macro environment.

With sticky inflation, continually high interest rates and challenging operational performance driven by limited integration of tuck-ins and add-ons inside existing platforms, PE-owned companies are struggling to achieve the synergies they underwrote and the required profitability to move their

portfolio companies closer to an exit. This has led to extended hold times, decreased valuations and a need to reconsider value-creation strategies.

In this article, our experts discuss how PE investors can accelerate their path towards profitability and address challenges in the PPM sector amidst a challenging economic and regulatory environment. Key considerations include driving profitable top-line growth across business lines, optimizing both corporate and network operational cost structure across portfolios, and enhancing use of capital. When properly executed, these strategies can bolster portfolio companies, accelerate the path towards an exit and enhance returns for investors, especially for those PE firms with assets that have longer hold times.

## Insights and Trends Shaping the Current PPM Sector

Physicians and PPMs continue to experience downward reimbursement pressure from payers who are fighting to mitigate escalating costs.<sup>1</sup> Simultaneously, PPMs have continued to acquire independent physician practices as physicians trade autonomy for higher perceived compensation and less administrative burden, despite slower deal flow due to rising interest rates and valuation gaps.<sup>2</sup>

The strategy of shifting to value-based arrangements is expected to continue, driven by payers who seek to transfer risk, lower costs and align provider incentives.

An ever-evolving regulatory and funding environment requires constant attention, with corresponding mitigating strategies. Key regulatory developments include:

- Changes to the Stark Physician Self-Referral Law and Anti-Kickback Statute regulatory framework could provide more flexibility in structuring physician compensation, improving physician productivity and retention for PPMs.<sup>3</sup>
- The No Surprises Act increased pressure on PPMs that have out-of-network revenues.<sup>4</sup>
- Regulatory scrutiny of PE-backed healthcare providers has increased, building off recent pressure from FTC and Congress.<sup>5</sup>
- High debt service levels put cost containment and cash management at the forefront of focus.

## Assessing Specialty Performance and Consolidation Potential in PPMs

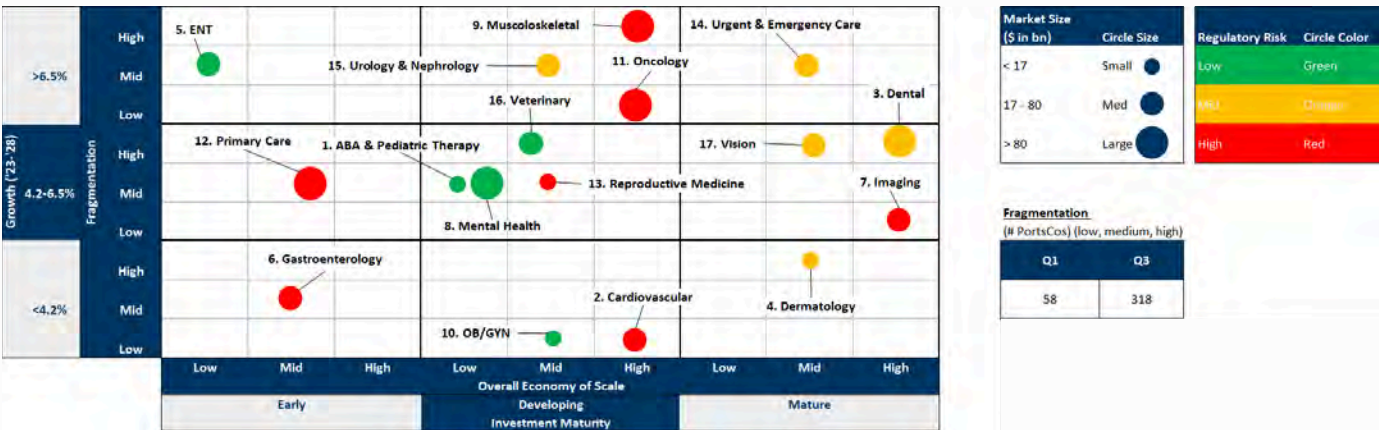
Despite steady consolidation, the PPM industry still has pockets of fragmentation. Independent practices continue to seek scale to benefit from the improved negotiating power and added administrative efficiency of PPMs.

Scale is critical, especially for smaller, physician-owned practices that struggle with fluctuations in demand, pressure from lower reimbursement rates, challenges meeting regulatory requirements,

and minimal access to capital markets.

The chart below provides a “state of play” ranking of PPM specialties across multiple dimensions, including industry growth rate, fragmentation, maturity, market size, reimbursement and regulatory risk, and potential for achieving economies of scale.

Chart 1 – Physician Practice Management – State of Play Heat Map<sup>6</sup>



While signs of stress and distress exist across PPM specialties such as dental, behavioral health and vision practices, other specialties may have potential for platform and tuck-in opportunities. Opportunity may exist in specialties with early to developing maturity, low regulatory risk, medium to high fragmentation, and medium to high growth and size, including ENT, urology and nephrology, ABA and pediatric therapy, mental health and veterinary.

Private Equity’s Impact on PPM Merger & Acquisition Activity

PPM merger and acquisition (M&A) activity driven by private equity peaked in 2021-2022, with veterinary, dental and vision being among the most active specialties.<sup>7</sup> Despite a slowdown in deal flow during 2023, private equity firms continue to seek strategic assets to bolt on to their PPM portfolios to support revenue and EBITDA growth that will drive exit multiples.<sup>8</sup>

Current regulatory scrutiny of PE acquisition, however, could make larger acquisitions more difficult.

Over the past year, there has been an increased focus on operational strength and platform integration to drive cash flow improvement. Minimal activity in 2024 has been driven by regulatory risk (headline and DOJ risk, shifting from V24 to V28 risk adjustment model), valuation gaps and margin compression.<sup>9</sup>

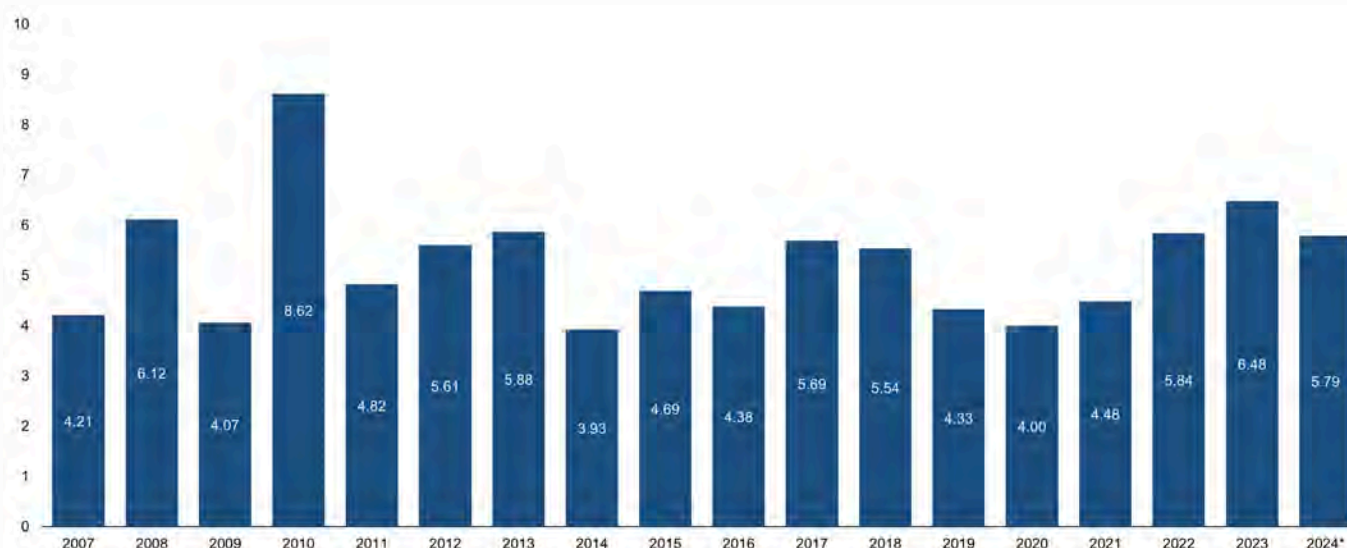
Chart 2 – Summary of PE Healthcare M&A Activity by Year<sup>10</sup>

Specialties	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Grand Total
ABA and pediatric therapy	1	1		6	14	23	25	25	25	9	6	135
Cardiovascular	1			2	1	1	1	4	12	18	1	41
Dental		2	4	36	60	61	73	123	146	124	30	659
Dermatology			1	51	55	45	34	37	49	46	16	334
Ear, nose, and throat				1	9	5	10	14	10	11	2	62
Gastroenterology		1	2	7	4	21	13	31	23	11	1	114
Imaging				4	4	6	9	16	8	8	3	58
Mental health	1	3	1	33	38	25	50	57	47	23	5	283
Musculoskeletal	2	1	3	41	48	46	50	83	86	38	3	401
Obstetrics and gynecology				1	2	3	14	7	9	7	1	44
Oncology			1		3	4	3	4	4	4		23
Primary care			3	6	15	12	14	22	11	18	3	104
Reproductive medicine		1		2	7	3	6	20	10	10		59
Urgent and emergency care		1	1	3	10	7	6	13	10	6	3	60
Urology and nephrology		1	1	3	5	2	6	12	16	12	1	59
Veterinary	2			29	53	95	169	222	169	34	4	777
Vision			3	25	44	71	87	117	69	25	2	443
Grand Total	7	11	20	250	372	430	570	807	704	404	81	3656

Hold Time (in Years) is derived by subtracting deal date from 4/5/2024 (as of date) and dividing by 365.

**Color coding legend:** Color gradient by specialty identifies relative levels of M&A activity across specialties for each year, with dark green indicating most active specialty, and dark red least active. For the Grand Total, color coding gradient identifies relative levels of M&A activity by year across all specialties, with dark green indicating most active year, and dark red least active.

### Chart 3 – Global Healthcare Services and Value-Based Care PE Hold Times<sup>11</sup>



### Achieving Success in the PPM Sector

Although transaction activity has slowed since the 2021 highs, particularly inside the PE-owned PPM space, it is likely to rebound.<sup>12</sup> As sponsors digest historical acquisitions and focus on liquidity management and performance improvement initiatives, activity is poised to pick up, especially in those medical specialties where portfolio companies have longer hold times. In the meantime, success in the PPM space will be dependent on:

- Effective merger integration:

Collaboration and integration activities should be a keen focus because much of the value creation and long-term profitability will be derived from efficiencies and ongoing operations.

Laying the groundwork for a successful integration requires a comprehensive analysis of each organization to identify potential synergies and capitalize on improved efficiency and cost savings. Key areas of focus primarily include shared service departments (human resources, supply chain/purchased services, pharmacy, IT, revenue cycle, finance, IT, legal, etc.), clinical operations, and medical group.

By prioritizing synergies across key functional areas, organizations can take a proactive approach to their 100-day integration plan prior to deal close.

- Connecting PPM providers with the value-based care (VBC) ecosystem:

While PPM providers can participate in various VBC programs, including ACO REACH, MSSP (Medicare Shared Savings Program) and other capitated models, successfully operating inside a VBC model requires integration of three key components: clinical services, operations, and the management of financial performance.<sup>13</sup> The graphic below provides additional detail on what is included in each.

## Chart 4 – Value-Based Care Capabilities<sup>14</sup>



- Primary care and Medicare Advantage are often the first to come to mind when contemplating attractive VBC investments, but there are several payer or specialty care options that should also be considered. Investors should pay close attention to where experimentation on payment models, particularly by government payers, is occurring, as well as specific clinical conditions that have:

Mature care standards and protocols

Defined treatment plans with clear beginning and end points

Potential to improve care delivery and outcomes from the current state

Potential to eliminate waste by reducing unnecessary utilization and costs to deliver care

While some PE sponsors will invariably explore creative exit or fund-extension strategies, others will continue both platform creation in growing and fragmented markets as well as bolt-on and tuck-in acquisitions with an investment thesis that includes optimization of the PPM platform inside the VBC ecosystem. For the PE firms that are looking to increase value in anticipation of a sale, there will be a continued focus on improving practice integration and realizing efficiencies by joining PPM platforms. Value-based care programs in select specialties can be pursued as a way to meet patient needs while creating new revenue streams and driving bottom-line enhancement.

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#### Footnotes:

1: “[2024 Physician Payment Outlook: How to Manage Higher Costs, Declining Reimbursement](#),” Medical Economics (2024).

2: ["Healthcare Services Report"](#), Pitchbook (August 6, 2024).

3: Centers for Medicare & Medicaid Services, ["Modernizing and Clarifying Physician Self-Referral Regulations: Final Rule CMS-1720-E,"](#) CMS (2023).

4: Flynn, Brian, Pemberton, Clay, Principe, Ryan, and Hersom, Abby, ["Balancing the Scales: Exploring the Provider-Side No Surprises Act,"](#) FTI Consulting (2023).

5: Holland & Knight, ["Healthcare Private Equity Transactions Under Scrutiny: Midyear Review,"](#) Holland & Knight (August 2024).

6: ["FTI – Healthcare Services M&A Activity with investors.xlsx"](#), Pitchbook (March 28, 2024).

7: Ibid

8: ["FTI Consulting – VBC ACV Deals with Verticals.xlsx"](#), Pitchbook (April 10, 2024).

9: Ibid

10: Ibid

11: ["PitchBook - 20240702 - FTI Consulting - Global PE Healthcare Services & Value Based Care Hold Times and Multiples.xlsx"](#), Pitchbook (July 2, 2024).

12: Ibid

13: Fish, Mark and Van Ert, Mark, ["Value-Based Care: Operational Context Matters"](#), FTI Consulting (June 30, 2023).

14: Ibid

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