Les Levinson
Partner, Co-chair,
Transactional Healthcare Practice,
Robinson + Cole

How Healthcare Reimbursement Is Changing PE Deals

Private equity is increasingly looking to specialized areas of healthcare such as dermatology for investments because of their resistance to reimbursement pressures

Privcap: What specialized areas of healthcare is PE interested in?

Les Levinson, Robinson+Cole: Let's talk about a couple of sectors where there's been a lot of activity in 2014, leading up through 2015 and certainly continuing in 2016. Behavioral health is a still an area that continues to attract a lot of private equity interest; we'll talk about the whys in a minute. Home care, hospice and dental are also attracting a lot of interest. Also, some sectors of the physician practice area continue to attract a lot of private equity interest. Two examples there would be anesthesia and dermatology.

What kinds of transactions are you seeing within those sectors?

Levinson: We're seeing outright purchases of companies, completely. We're seeing some minority investment alone, not as much as one might think, but traditional private equity coming in and making an acquisition in areas they think are attractive. One other sector of note is revenue-cycle management. Data management and warehousing are other areas that continue to be interesting to private equity.

In the past year, have you seen any changes in the types of transactions?

Levinson: I would go back and look a bit deeper at some areas where private equity, perhaps, we thought would be more interested in and have shied away from that. One big example of that is hospitals. Caritas Christi [Health Care] is a good example that was converted from a not-for-profit to a for-profit system in Boston several years ago. Cerberus Capital did that conversion and we thought that might be a harbinger of other large conversions. There were a couple—I think two or three—that were done, but there really hasn't been a bellwether that we thought.

Hospitals continue to be under pressure from a reimbursement perspective. There's a lot of regulation there. There's a bit less freedom to do some of the things that perhaps private equity firms would want to do. One of the things that's appealing to private equity in this area is that, of course, healthcare continues to be a very large chunk of our GDP. It's about 18 percent and, when the government talks about removing waste, fraud and abuse, it's really hard to move the needle. So, there's still a lot of money flowing into that sector and I think we're going to continue to see that.

Where has private equity been investing in healthcare outside of hospitals?

Levinson: Private equity has certainly been investing in urgent care centers and alternative site opportunities. I think it has to do more with the fact that the cash flow is a little less predictable and private equity still needs to be investing in opportunities where cash flow is predictable, where the financial risk is a bit more certain. In some of the sectors we've talked about, there's more private pay and less reimbursement pressure. Some of the services that are being provided through dermatology or other healthcare providers, for example, are private pay situations. So, you're not going to be at risk for private insurance or government insurance and those are much more important to private equity.

↓ CONTINUES ON NEXT PAGE

What areas of healthcare does PE see as challenging at the moment?

Levinson: Historical areas that have been under reimbursement pressure are going to be less favored by private equity. To some extent, facility-based situations that have a lot of brick and mortar—a lot of sunk costs into them that may not necessarily be easily recouped—are going to be a bit more challenging as well. I think things that create opportunities for synergies, for roll-ups, for management to create some of the value that private equity is known for are going to be more interesting.

What areas do you see opportunities for these synergies and roll-ups?

Levinson: Behavioral health, I think, has been a long-standing favorite of private equity. If you look at some of the charts, you can see that deal flow continues to be active there. What it means, in large measure to private equity, is addiction, treatment centers—the kinds of things that are not necessarily covered fully or covered at all by insurance, so that you're getting a lot of private pay.

For example, there are many procedures that are done in dermatology offices that are cosmetic, that are not necessarily going to be reimbursed by insurance. So, you know that the dollars that are attributable to that procedure are going to be fully paid by the patient and private equity is going to be able to enjoy those benefits more than they would be where there's an insurance cap on a particular procedure. So, [there's] a little less competition for the dollars.

What does PE find interesting about dermatology specifically?

Levinson: It's principally the predictability of cash flow. It's not an area that has been rolled up fully yet, so you're seeing a lot more activity where you can consolidate practices in a particular geographic area or areas. We've seen a lot of that in the West Coast and the middle part of the country. That leads to synergies and the ability to have more centralized management from a top-down level—the kinds of things you can do where perhaps if you're going into a market where maybe all or many of the primary care doctors have already been consolidated, there's less opportunity to do things for that.

What parallels are you seeing between the services and clinical sides of healthcare?

Levinson: An interesting parallel between the services side of the business and perhaps the more clinical side, like physician practice, is [that] I think you have a bit more scale in some of these healthcare and hospice companies. They've already gone through some of the pain of reimbursement cuts, so there's definitely more stability. Three, four, five years ago, if you talked to private equity about home care or hospice, there wasn't a lot of appetite in that. Now, you see tremendous competition for good assets in that space, particularly when they're competing against strategic buyers. Private equity is definitely looking to continue the acquisition mode there and to continue to grow in that space.

As that part of the sector matures, you're beginning to see trading where you're having one private equity firm selling to another. That's a relatively newer phenomena and it means that values have continued to grow and the PE firms feel like it's now an opportune time to exit.

Are there trends in PE healthcare transactions you see going forward?

Levinson: I think the insurance consolidation has been a bit troubling in the sense that consolidation is under attack by the government. The government is going to continue to be vigilant from its perspective in making sure they think there isn't monopoly power in some sectors.

You've seen also some hospital acquisitions of physician practices that have been challenged by the government. So, I expect private equity is going to be a little wary of wading into areas that may be high on the government's radar.

As you get new technologies coming into the market—perhaps new payment systems, new ways of managing data or providing security—all of those are always going to be interesting to private equity. And I think we'll continue to see heightened interest in that in the balance of this year and into 2017 and '18. ■