PitchBook

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INDUSTRY RESEARCH

Quantifying PE Investment in Healthcare Providers

PitchBook is a Morningstar company providing the most comprehensive, most accurate, and hard-to-find data for professionals doing business in the private markets.

Key takeaways

- Considerable confusion about the scope and emphasis of PE's current involvement in US healthcare is circulating widely in news articles, white papers, and even government missives. Our aim in this note is to lay out pertinent, objective information in order to contribute to fact-grounded future discussion.
- PE-backed providers represent less than 4% of the US healthcare provider ecosystem by revenue.
- PE investment in healthcare providers is neither new nor surging. Such investment grew as a proportion of overall PE activity between 2000 and 2018 but has declined proportionally since then. Year-over-year growth in the total number of PE-backed companies has slowed steadily over the past six years, dipping below 1% in the first quarter of 2024.
- The growth in physician employment is not primarily PE driven. More than half of all physicians, and more than 70% of all employed physicians, are employed by hospitals.
- Current PE deal activity in hospitals and skilled nursing facilities is near zero. There has not been a major PE investment in a US hospital or health system since 2018.
- The primary goals of inorganic growth ("roll-up") strategies are multiple arbitrage and operational leverage, not market consolidation and price increases.
- PE investors currently shy away from out-of-network investment. While investors chased higher out-of-network rates in the past, they now avoid them assiduously in categories including acute-care physician staffing, SUD treatment, and EMT.

Introduction

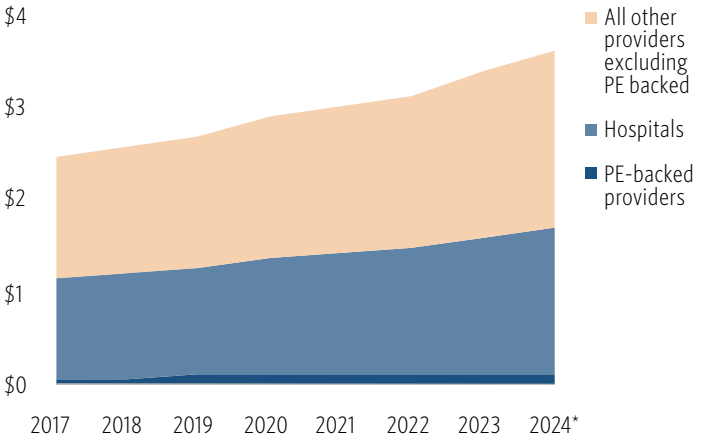
Although PE investment in healthcare provider organizations in the US dates back to the earliest days of the asset class, it has attracted growing political and media attention within the past two years and particularly within the past six months. We have been discussing the evolving regulatory landscape and its effects on PE healthcare deal activity via our quarterly Healthcare Services Report and various conference recap notes.[1]

Considerable confusion about the scope and emphasis of PE's current involvement in US healthcare is circulating widely in news articles, white papers, and even government missives. In this note, we are not trying to address critiques of PE's involvement in healthcare, especially regarding clinical outcomes, which would require different datasets and analytical tools than we have. Rather, as the leading provider of PE healthcare deal flow data, our aim in this note is to lay out pertinent, objective information in order to contribute to fact-grounded future discussion.

Our sources of information for this note include our own data; publicly available third-party data; and our frequent interactions with PE investors, PE-backed companies, and a wide range of service providers in the PE ecosystem.

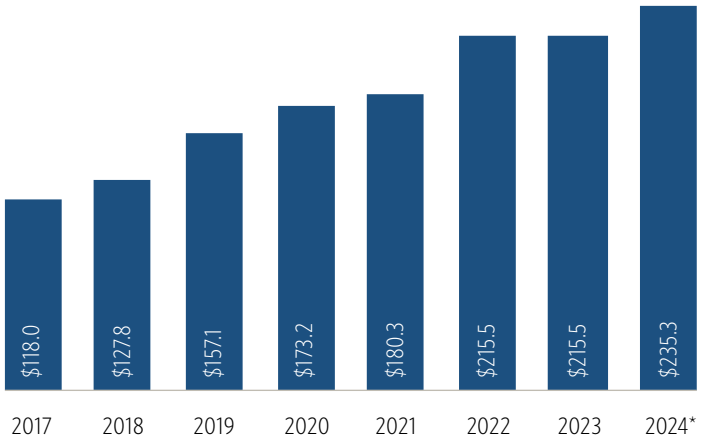
PE-backed providers represent less than 4% of the US healthcare provider ecosystem by revenue

Annual healthcare provider spending by type ($T)



Source: CMS National Health Expenditure Data • Geography: US
*As of March 31, 2024

Estimated cumulative enterprise value (EV) for PE-backed healthcare providers ($B)



Source: PitchBook • Geography: US • *As of March 31, 2024

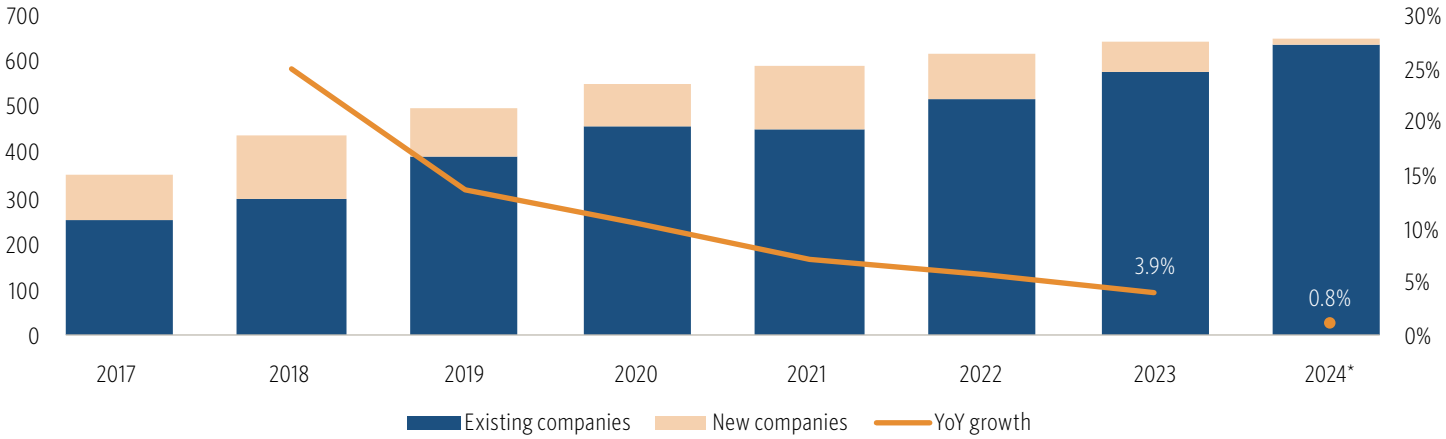
In general, the role of PE investment within the broader US healthcare ecosystem has been vastly overstated. According to the Centers for Medicare & Medicaid Services' National Health Expenditure data, total annual US spending on healthcare provider categories is projected at about $3.5 trillion for 2024.[2] Care provided in

1: See our Q1 2024 Healthcare Services Report and our recaps of the HCMIS, McGuireWoods, and McDermott Will & Emery conferences.
2: "National Health Expenditure Data," Centers for Medicare & Medicaid Services, December 13, 2023.

hospitals accounts for 43.6%, or $1.6 trillion, of this figure. By contrast, we estimate the aggregate revenue of PE-backed healthcare providers in the US at $117.7 billion for 2024, 3.3% of total US healthcare provider spending. We arrived at this figure by estimating the cumulative EV of PE-backed provider companies in the US and assuming an average 2.0x EV/revenue multiple. For comparison, Optum Health, the healthcare services arm of UnitedHealth Group, reported $95.3 billion in revenue in 2023,[3] while Kaiser Permanente, a nonprofit vertically integrated health system, reported $100.8 billion in revenue in 2023.[4]

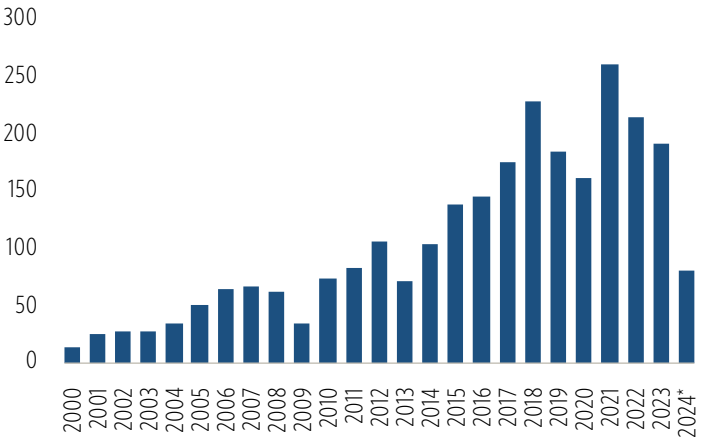
PE investment in healthcare providers is neither new nor surging

Healthcare provider PE company inventory



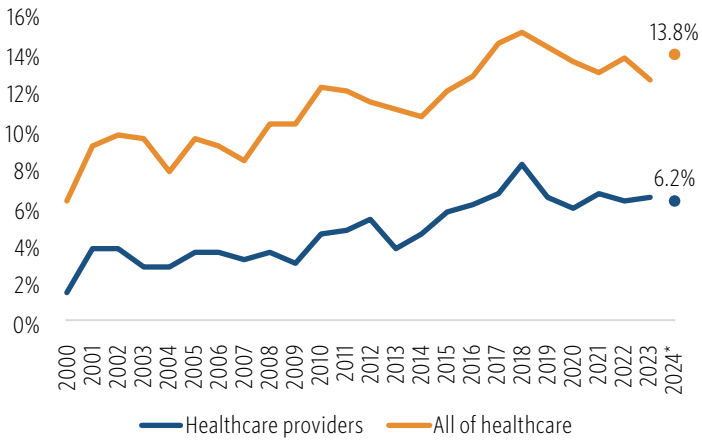
Source: PitchBook • Geography: US • *As of March 31, 2024

Healthcare provider PE platform and minority deal count



Source: PitchBook • Geography: US • *As of June 24, 2024

Share of PE platform and minority deal count by sector



Source: PitchBook • Geography: US • *As of June 24, 2024

3: "Optum's 2023 Financial Performance," Becker's Health IT, Naomi Diaz, January 12, 2024.
4: "48 Health Systems Ranked by Annual Revenue," Becker's CFO Report, Alan Condon and Andrew Cass, April 10, 2024.

Some public commentary has implied that PE investment in healthcare is a recent or rapidly growing phenomenon. PE investment in healthcare dates back to the 1980s and has grown in terms of absolute transaction volume (number of deals, including minority and add-on deals) since the beginning of our reliable data availability in 2000. This growth can be attributed both to the growth of the PE asset class overall and to an increase in healthcare providers as a proportion of PE deals, from an average of 3.1% in 2000 to 2002 to a peak of 8.1% in 2018. Since 2018, healthcare providers have in fact declined as a proportion of overall PE deal count, with the three-year rolling average currently sitting at 6.3%.[5] As we have written previously, PE firms are actively pivoting away from investing in healthcare providers and are instead seeking investments in other areas of healthcare, such as healthcare IT and pharma services.

Another way to gauge the scope of PE investment activity in the healthcare provider landscape is to look not at the number of transactions but at the number of PE-backed companies at any given time. This is helpful because transactions can include follow-on investments in the same company as well as sales of a company by one PE firm to another. This number has increased from 350 companies in 2017 to 648 as of the end of Q1 2024. However, the year-over-year growth rate in the PE company inventory has slowed from 24.9% in 2018 to less than 1% in Q1 2024. This is a result of the PE healthcare provider ecosystem maturing, with sponsor-to-sponsor deals making up a growing proportion of platform activity.

The growth in physician employment is not primarily PE driven

Statistics regarding the growing proportion of employed physicians in the US are often cited to emphasize PE's role in healthcare. According to analysis of IQVIA OneKey data by the Physicians Advocacy Institute, approximately 503,100 physicians, or 77.6% of physicians in the US, are currently employed by either hospitals or "corporate entities."[6] Corporate entities include both PE-backed groups and nonbacked strategics such as UnitedHealth/Optum, HCA, Fresenius, or McKesson/US Oncology. Of these employed physicians, 71.1% (or 55.1% of all physicians) are hospital employed, while 28.9% (or 22.5% of all physicians) are employed by corporate entities. Therefore, while corporates account for a modestly growing share of physician employment (up from 24.6% in 2019), the majority of employed physicians are still employed by hospitals/health systems.

There are many reasons why physician-owners sell their practices to hospitals and corporate entities. Physician-owners nearing retirement often have a significant proportion of their personal wealth tied up in the value of their practice, and they may sell the practice (often continuing to practice for another five years or so as an employee) in order to liquidate this wealth. Physician-owners of all ages may decide that they can gain better access to technology, operational resources, and administrative support—and dedicate much less of their time to managing these nonclinical aspects of running a practice—as part of a larger corporate or hospital-owned entity.

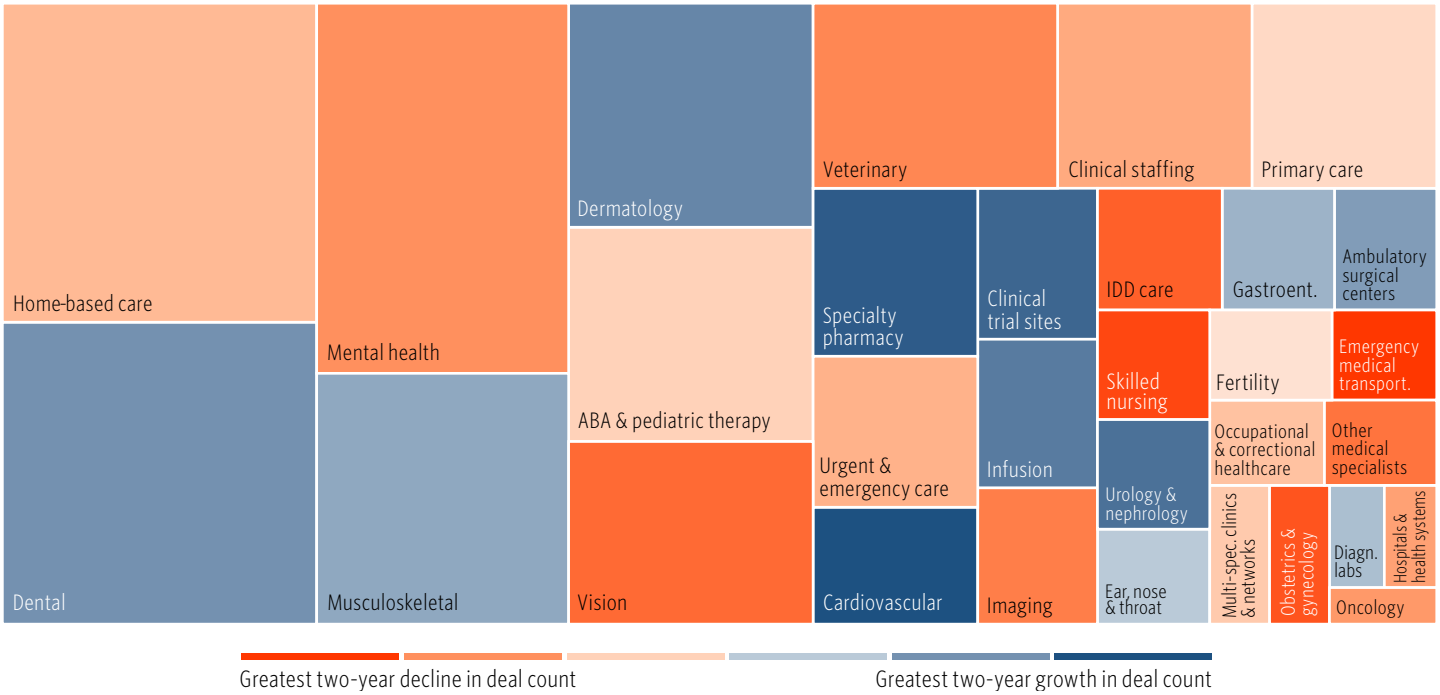
Finally, many newly trained physicians prefer employment over starting their own practice. Because the median medical student now graduates with around $200,000

5: We excluded add-on deals from this analysis in order to control for lower data disclosure rates before the past decade, and to ensure an apples-to-apples comparison between healthcare services, which is an add-on-heavy sector, and PE as a whole.
6: "Physician Employment Trends," Physicians Advocacy Institute, April 2024.

in student debt,[7] taking on additional debt to open a new clinic is often impractical for professionals entering the workforce today. Additionally, many younger physicians prefer employment over independent practice because it gives them greater flexibility for vacation, parental leave, or reduced hours.

Current PE deal activity in hospitals and skilled nursing facilities is near zero

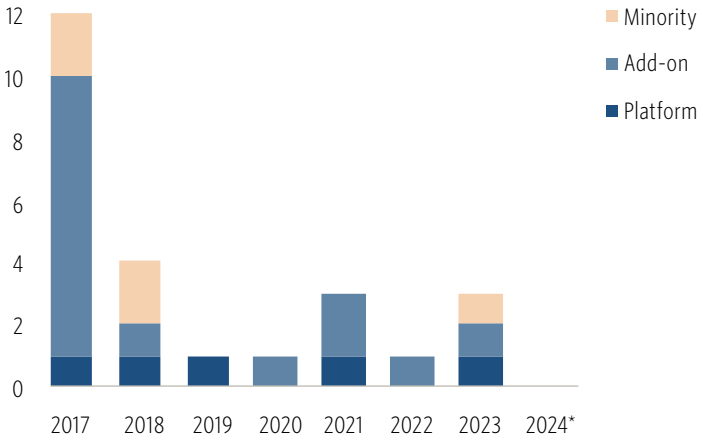
Current PE-backed healthcare provider company inventory by category*



Source: PitchBook • Geography: US • *As of March 31, 2024

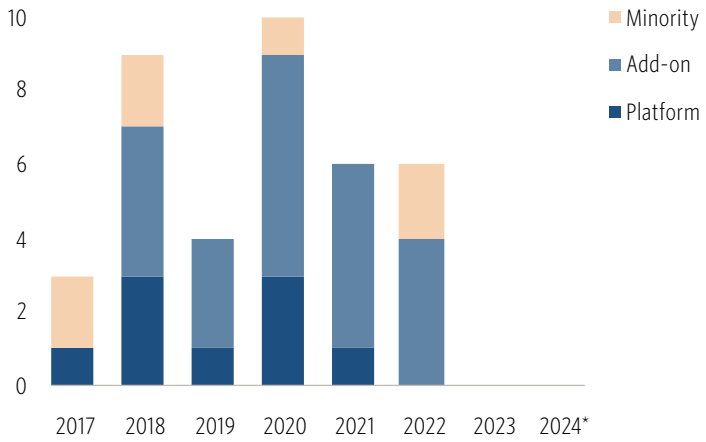
Note: Box size equates to the number of current PE portfolio companies in the category.

Hospitals & health systems PE deal count by type



Source: PitchBook • Geography: US • *As of March 31, 2024

Skilled nursing PE deal count by type



Source: PitchBook • Geography: US • *As of March 31, 2024

7: "Medical Student Financial FAQ: Insight on Loan Forgiveness, Repayment," AMA, Brendan Murphy, June 3, 2024.

Significant attention has been paid to academic studies that investigated the clinical impacts of PE acquisitions of hospitals and skilled nursing facilities (SNFs) that primarily occurred in the 2000s and early 2010s, and to the recent high-profile bankruptcy of Steward Health Care, which was acquired by Cerberus Capital Management in 2010. These examples have led to incorrect assumptions to the effect that PE is still rapidly acquiring hospitals and SNFs. In fact, there has not been a significant PE acquisition of a US hospital since Apollo Global's acquisition of Lifepoint Health in 2018. (Note that REITs and other real estate investors are not included in our data or analysis, only firms that buy corporate equity.) Recent deal activity has comprised add-ons by existing PE-backed assets and sales of existing PE-backed assets.[8]

Since PitchBook began covering healthcare PE in 2021, we have never encountered or heard of a serious PE investor expressing interest in a hospital or health system deal.[9] Interest in SNFs is also extremely low. Instead, 98.0% of currently PE-backed companies are in categories other than hospitals & health systems and SNFs, while 99.1% of deals since 2022 have been in other categories. Based on investor sentiment and the investment opportunity landscape, we have no reason to think that this will change within the foreseeable future.

Why are PE investors no longer interested in acquiring hospitals and SNFs? First, it is clear, and has been clear for some time, that healthcare's momentum is toward treating patients in the lowest-acuity site of care possible—the ambulatory surgical center, the outpatient clinic, the retail clinic, the home—in order to improve access and reduce costs. Most PE firms seek to invest in growing industries with long-term demand tailwinds and are therefore attracted primarily to outpatient care delivery. Second, the economics of hospitals and SNFs are generally unattractive from a PE deal underwriting perspective. The median hospital has notched a mere 3.8% YTD operating margin as of April 2024.[10] The number of SNFs has also been declining in the face of reimbursement and labor cost pressures, with 0.79% of facilities closing each year on average between 2011 and 2021.[11]

The primary goals of inorganic growth ("roll-up") strategies are multiple arbitrage and operational leverage

Some commentators have characterized the "roll-up" as primarily aiming to reduce competition in order to increase prices. In fact, the main mechanism of returns in a PE inorganic growth strategy is known as "multiple arbitrage," or "blending down" the purchase multiple, and does not require market concentration to be effective. This is true not only in healthcare but also across many fragmented industries where

8: Additionally, Das & Co., a family office, made an undisclosed minority equity investment in cancer centers associated with Asante, a nonprofit system, in approximately 2023.

9: The exception that proves the rule is the announced acquisition of Summa Health by General Catalyst, an early-stage VC firm. We have written about this deal at length and consider it fundamentally different from the older PE hospital investments. General Catalyst has also been at pains to emphasize that the deal was not a PE-style LBO.

10: "National Hospital Flash Report," Kaufman, Hall & Associates, April 2024.

11: "Rates of Nursing Home Closures Were Relatively Stable Over the Past Decade, But Warrant Continuous Monitoring," Oxford Academic, Health Affairs Scholar, Kelly Hughes, et al., August 2023.

PE invests, ranging from insurance brokerages and registered investment advisors to car washes and HVAC companies.

Privately held companies are valued based on a multiple of EBITDA. For instance, a $20 million multisite dental group might be valued at 10x EBITDA, giving the group an EV of $200 million. The multiple is simply an expression of what the market is willing to pay for a given asset at a given time based on recent precedent transactions, underlying industry growth, and specific characteristics of the asset, such as tech enablement and operational sophistication.

In general, the market assigns higher multiples to larger companies. "Multiple arbitrage" takes advantage of this by aggregating smaller companies into larger ones. For instance, consider what happens if our $20 million EBITDA dental group acquires four smaller dental groups, each with an EBITDA of $5 million:

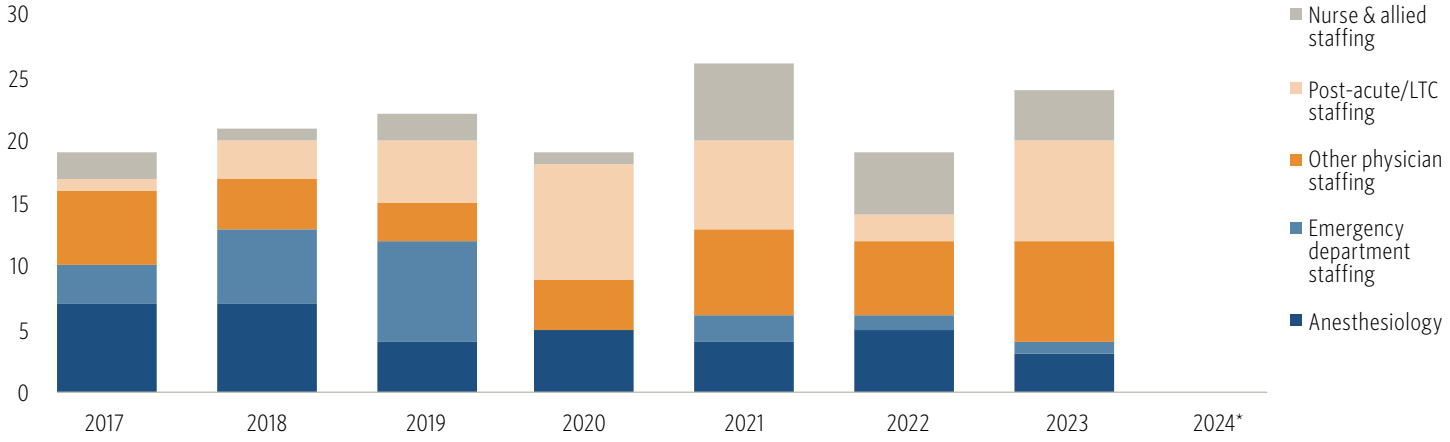
	EBITDA	Multiple	EV
	$20 million	10x	$200 million
	$5 million	5x	$25 million
	$5 million	5x	$25 million
	$5 million	5x	$25 million
	$5 million	5x	$25 million
Total:	$40 million	7.5x	$300 million
At exit:	$40 million	10x	$400 million

The result—without any organic growth or increase in per-dentist profitability—is a $40 million EBITDA group. This consolidated group has been acquired for a cumulative 7.5x EBITDA multiple ("blending down"), even though the initial investment was at a 10x multiple. Additionally, if the group is then sold at a 10x multiple (a conservative assumption), it would be sold for $400 million—a $100 million, or 25%, increase on the cumulative EVs of the acquired practices at entry. This is a highly simplified example, but it communicates the basic mechanism.

In reality, most PE investors will expend considerable energy integrating and improving the various entities that have been acquired, including by centralizing back-office functions, negotiating better supplier contracts, implementing enterprise-grade technology across the organization, and hiring more providers to enable organic growth. If they do not, the asset will be less attractive to future buyers. They will also try to leverage the group's growing scale and sophistication to negotiate more favorable payer contracts or to enter advanced arrangements such as value-based care contracts. However, in general, the contribution to bottom-line deal returns resulting from reimbursement rate improvements is very small compared with the contributions resulting from organic growth, multiple arbitrage via inorganic growth, and financial leverage.

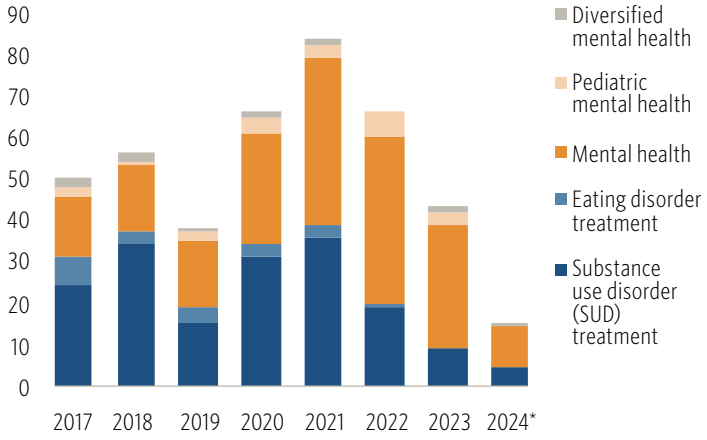
PE investors avoid out-of-network reimbursement

Clinical staffing PE deal count by subcategory



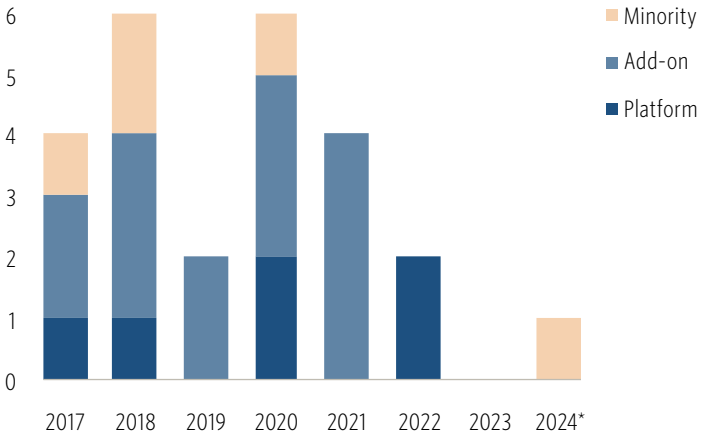
Source: PitchBook • Geography: US • *As of March 31, 2024

Mental health PE deal count by subcategory



Source: PitchBook • Geography: US • *As of March 31, 2024

EMT PE deal count by type



Source: PitchBook • Geography: US • *As of March 31, 2024

Drawing primarily on Blackstone's 2017 acquisition of Team Health Holdings and KKR's 2018 acquisition of Envision Healthcare as examples, some have characterized PE as chasing high out-of-network reimbursement rates. This was historically a characteristic of some PE deals in specific categories, particularly in the 2000s and early 2010s, and in a few more recent cases (including Team Health and Envision). However, most PE healthcare investors now assiduously avoid acquiring businesses that rely on out-of-network reimbursement.

The primary categories that historically involved significant out-of-network billing were physician staffing (such as anesthesiology), SUD treatment, and EMT. Out-of-network billing by physician groups was the subject of intense contention between physician groups and payers—with payers succeeding in significantly reducing their out-of-network payments—for years prior to the No Surprises Act, which went into effect in 2022 and banned "balance billing" for services performed in in-network

facilities nationwide. We have seen deal activity for physician staffing groups slow considerably, and deals that are getting done are for smaller and regional groups that have prioritized in-network contracts.

In the early 2010s, PE firms backed numerous "luxury rehab" SUD treatment facilities, which tended to fly in patients from out of state and to bill out of network. Due to payer pushback and the clinical inadequacies of this model, PE investment in SUD treatment and other mental health models swung in the late 2010s toward acquiring in-network, in-state, medically focused providers almost exclusively, as out-of-network reimbursement is considered too risky and volatile to underwrite.

Finally, PE investment in EMT, an area that has often billed out of network historically, has declined in recent years. Although not all EMT companies are subject to the No Surprises Act, PE firms have recently prioritized investing in companies with primarily in-network revenue in order to reduce underwriting risk.