“Private Equity and the Private Practice of Medicine”

Physicians now have 3 general options to practice Medicine. The first is traditional private practice. Over the last few decades, many physicians have chosen to become hospital employees. They may have an MD behind their name, but are lumped together as “providers,” just one more cost center to be controlled, no different than an X-Ray tech, or how much it costs to repave the parking lot. Many find out, invariably the hard way, that they can also be fired and unemployed if they do not please the hospital CEO.

Another option that has come along recently is for physicians to sell their practice to private equity. (My comments are general, all deals are structured differently). Your practice can be valued in many ways, the most common based on EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization). Say the $30 billion private equity firm RMD Capital Partners buys your group’s practice for $10 million. The private equity firm typically utilizes leverage of 3-4 to 1. They put up 20 to 30 cents of their own money and borrow the rest. Your share is $1 million.

But you don’t receive a cashier’s check for $1,000,000. RMD Capital purchases 5 other cardiology practices in your area and rolls them up into Dianz Cardiology Associates. You receive a check for $750,000 (you must discuss with your personal advisor how this is taxed), and the remaining $250,000 comes back to you as shares in Dianz. RMD Capital wants an alignment of interests. They want you to have “skin in the game,” to encourage you to want the venture to succeed. This is where details matter—a lot. How are the dividends on the shares determined? How are the shares valued when it is time to sell?

How does private equity make their money? In general, by bringing business expertise to the practice; improved efficiency, economies of scale, and muscle. Supplies can be purchased for less, and you now have more leverage when negotiating fees with payers. Coding and documentation specialist improve billing and reimbursement.

What are the positives of selling your practice to private equity?

1) It is a great way for senior physicians to cash out. It may not be the most favorable for younger physicians, or senior employees (see below), but the senior physicians tend to have more influence.

2) It allows a physician to diversify their investment by monetizing your practice. You receive cash up front for a portion of your future income stream. This is an extremely important point. If this money is invested wisely, it could be one of the best investments of your life; you use it to pay off debt, and put the rest in solid investments. If you’re not careful with the money, and blow it (some physicians think the big money will continue forever), you will never make it up.

3) There is the potential that efficiency will be sufficiently improved that your income will increase (but don’t hold your breath).

I will enumerate more potential negatives than positives. Everyone is happy when things go well. A general focus of my writing is to protect you when things go badly. I am willing to accept a slightly smaller return to prevent the chance of a disaster.

1) The physicians selling their practice are told by the private equity purchasers that “we make the business decisions, you make the clinical decisions.” In real life, if they own 50.1% or more of the practice, they are the boss. The physicians have varying degrees of input, but when it comes down to it, if they own a majority of the practice, they make the final decisions—on everything. In the end, the physicians are employees.

2) The higher-salaried, senior nonphysician employees might not be as nimble as younger employees, and are especially vulnerable to the inevitable cost cutting. These people gave you years, or even decades, of loyal service. I believe it is your responsibility to protect them.

3) The majority of the time it is the aim of private equity to exit the deal in 3-5-7 years with a cash-on-cash return of 3-5 X. Who are the buyers?

0002-9149/© 2020 Elsevier Inc. All rights reserved.
https://doi.org/10.1016/j.amjcard.2020.06.072

A The hospital you did everything to avoid. Not often, but it can happen. Ouch!
B A big health care chain, such as United Health Care (UNH, a component of the Dow Jones Industrial Average). You are now an employee of the "Suits". Again, a situation you hoped to avoid.
C Another private equity company.
D As a general point, you must ask yourself "If our practice is doing so well, why are we being sold? Why are the seller's selling, and why are the buyers buying"? These are some of the world's most sophisticated investors. They are not the kind of people who like to leave money on the table, or overpay for an asset.

In summary:

1) A sale to private equity is a great way for senior physicians to cash out.

2) For the remaining physicians, some will come out ahead, and some won't.

3) No matter what you are told during the negotiations, if they own 50.1% of the practice, you are an employee. They make the final decisions.

4) The average holding period for private equity is about 5 years. Ask yourself: where will this practice be in 2025, 2030, 2035, or 2040? If I were a young physician, I would be quite hesitant to join a practice owned by private equity.

5) If you are willing to work hard, like 55 or 60 or more hours per week (my regular work week was 68 to 70 hours), stick with traditional private practice. I believe you will be better off, and more importantly, you will be your own boss.

6) Even better. Form large groups, either single-specialty or multispecialty. You will gain some of the advantages of going with private equity, such as economies of scale and leverage. Consider a structure similar to large law practices: One person, typically a senior, well-respected physician with business skills who continues to practice, can be lead partner. You can hire your own business expertise. This would be perfect for an MD, MBA.

Disclosure

Dr. Doroghazi is not a registered financial advisor under federal law or any state law. The advice provided is of a general nature, and should not be interpreted as personalized or individualized to your specific portfolio.

Acknowledgment

Dr. Robert Doroghazi is a retired cardiologist who trained at the University of Chicago, the Massachusetts General Hospital, and Barnes Hospital. Warren Buffett said his book *The Physician's Guide to Investing: A Practical Approach to Building Wealth* should be "required reading at med schools". To sign up for a free trial to *The Physician Investor Newsletter,* visit www.thephysicianinvestornewsletter.com

Robert M. Doroghazi, MD*
The Physician Investor Newsletter, Columbia, MO
* Corresponding author: Tel: (573) 443-0893. (rdoroghazi@yahoo.com).