



Private Equity Interest in Orthopedics Grows

By Eric Yetter

Compared to other medical fields like dentistry and dermatology, private equity involvement in orthopedic practices has been relatively small. But that's been changing over the past few years and is likely to continue to grow moving forward.

Between 2004 and 2019, 41 orthopedic practices and surgeon groups in 22 states were acquired by 34 PE and other investment firms, according to the Journal of the American Academy of Orthopaedic Surgeons. But there have been more deals recently, including 15 alone in 2022. Likewise, the number of PE firms invested in orthopedics has nearly doubled in the past few years, from eight in 2020 to 14 in early 2022, according to the Journal of Orthopaedic Experience & Innovation, with that figure expected to top 20 this year.

What's driving this interest? Most obviously, there's the growth opportunity.

Orthopedics is one of the fastest growing segments of the healthcare industry, generating more than 137 million annual patient visits and \$110 billion in revenue, driven largely by a growing—and aging—population. The Census Bureau estimates that more than one in five Americans will be 65 or older by 2030. Millions of them will need to be treated for arthritis and pain management to more serious ailments, from spinal surgery to knee replacements.

That dynamic is exacerbated by the relative imbalance between the high demand for orthopedic care and a relatively low supply of surgeons, which creates an additional long-term sustainable growth scenario attractive to private equity investors.

Despite the recent rash of M&A deals, the orthopedic business, like other medical fields, remains highly fragmented. That's a situation ideal for private equity, which thrives on opportunities for consolidating far-flung businesses in order to create economies of scale to increase efficiencies, reduce costs, boost profitability and enhance the value of the enterprise.

PE investors also provide professional management so doctors can concentrate on their patients instead of running a business. They manage business functions including administration, purchasing, marketing, billing, and reimbursement. And they pursue growth opportunities while doctors focus on providing care to their patients.

PE also provides the capital needed for expansion (including ambulatory surgery centers and other ancillary revenue sources) or to purchase modern equipment. Scale can also allow practices to negotiate better contracts with insurers and get better deals on supplies and equipment. The Kaiser Family Foundation calls orthopedic practices a “tantalizing line of business” because they can provide a “lucrative array of service lines,” including ambulatory surgery, physical therapy, diagnostic imaging, pain management, and sports medicine.

PE ownership could also lower costs and improve the quality of care for patients by allowing doctors to move more procedures to outpatient facilities, which are cheaper and have less overhead. Similarly, as the changing healthcare ecosystem continues to shift toward outpatient, price-transparent fixed-payment models, PE groups can help orthopedic groups adopt value-based care (VBC), in which providers are paid based on the health outcomes of their patients and the quality of services rendered.

From a self-interested perspective, partnering with PE has a lot of financial benefits for orthopedists.

In the medical field orthopedists are perceived as perhaps more business savvy than other practitioners, making them more receptive to a PE pitch. According to KKF Health News, orthopedic surgeons, “long seen as fiercely independent ... hope to grab a bigger chunk of the surging market in outpatient surgery and maintain their position as one of the highest-paid specialties in medicine.”

Importantly, PE provides business owners and practitioners with an avenue to monetize the value of their practices or an exit ramp to cash out at retirement. “For older doctors, the upfront cash payout and the potential second payout when the business is flipped offers the promise of a posh retirement,” the American Academy of Orthopaedic Surgeons said.

Indeed, with so many practices already consolidated and others eager to partner with PE, there’s been something of a “fear of missing out” among some orthopedists who worry that if they don’t hook up with a PE firm soon, they may lose out.

Armed with anywhere between \$2 trillion and \$4 trillion of “dry powder”—with about half of that targeted to healthcare—PE firms have plenty of money to continue to consolidate the orthopedics business. But that doesn’t mean they’ll blindly acquire just any firm, especially in the current economic environment of higher interest rates—which makes deals more expensive—the possibility of a recession, and continued pressures on lowering costs and tougher government and insurance reimbursement policies. PE investors are focused mainly on large, best-in-class practices with brand equity and solid reputations, as well as smaller add-ons.

By the same token, orthopedists need to choose a PE partner who puts patients and the practice first, so a good cultural fit is critical. An experienced investment bank with a focus on the sell-side of M&A deals can help physician groups find the right partner and maximize the terms of a deal.



Eric Yetter

Managing Director, Healthcare Team Leader

eric.yetter@focusbankers.com

615-477-4741



About FOCUS Investment Banking LLC

With more than four decades of experience, [FOCUS Investment Banking](http://www.focusbankers.com/) is a trusted name in M&A advisory services worldwide. FOCUS works to understand each client's strategic and financial objectives, craft the best plan to achieve these goals, and deliver success. Whether helping to sell, buy, or raise capital, FOCUS strives to maximize the value of every transaction to the benefit of its clients. FOCUS bankers are seasoned operating and financial executives with extensive transaction experience. Securities transactions conducted by FOCUS Securities LLC, an affiliated company, registered Broker Dealer member FINRA/SIPC. For more information on FOCUS, please visit <http://www.focusbankers.com/>.

© 2023 FOCUS Investment Banking LLC