Current Perspective

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Private Equity: An Introduction

Whenever I'm speaking to a group of ophthalmologists, I can count on someone asking, "What is the Academy position on private equity [PE]?"

I always start my response by saying, "The Academy doesn't have a position on PE purchase of ophthalmology practices, but…" The "but" is that the Academy cares very much that each ophthalmologist who is considering PE has done complete due diligence and understands the economics, the nonfinancial terms, and the operational and professional implications. The Academy believes that the structure, operation, and sustainability of each member's practice is critical to her/his professional satisfaction and to the best patient care.

Occasionally, I will encounter colleagues who have entered into negotiations without understanding the fundamentals of a business relationship with a PE firm. They seem to assume that it means getting a big check followed by "business as usual." Others assume that it is exactly the same as all the Physician Practice Management (PPM) companies in the 1990s. Neither is correct. Here are a few things to consider:

PE isn't new. PE firms have been purchasing equity in physician practices for over a decade, including dermatology, dentistry, gastroenterology, urology, primary care, emergency medicine, and cardiology. We can learn a lot from their experience.

What do PE firms seek? A healthy return on their investment—ideally north of 20%. And then a sale to another investor/company in three to seven years. Particularly attractive practices are those that are poorly run, fixable, and leaving money on the table; those successful high-profile practices that can be leveraged as "platform practices"; those with revenue streams that don't depend on insurance (think cosmetic oculoplastics and refractive); and those positioned to take advantage of a growing market. What we have seen in other specialties suggests that PE interest tops out at about 20% of the practice market.

What does the upfront cash distribution represent? This is a key question. It reflects anticipated future earnings. So upfront cash will be offset downstream by PE taking a percentage of future earnings. Upfront cash is calculated as a multiple of EBITDA (earnings before interest, taxes, depreciation, and amortization) and is typically adjusted for physician compensation. It generally creates a substantive liquidity event. As the most strategically valuable practices leave the market, the multiples frequently decrease.

Will my practice run the same way with PE as a partner? It's not likely to do so. The PE company intends to grow the net income. That occurs in only a limited number of ways—increasing revenue (better payer or procedure mix, adding doctors, or simply adding patients), decreasing expenses (particularly staff), or paying you less. This may be good or bad, obviously.

What happens when the PE firm wants to sell the practice? You likely won't have any veto powers over a change in control. And the new owner/manager may do things differently than the previous owner/manager.

What ophthalmologist profile benefits the most? Generally (but not always) the senior ophthalmologist who is within five years of retirement. The early- to mid-career ophthalmologist may, however, garner more of the upfront cash as more of their future income has been sold. Future potential partners may be most economically vulnerable and less enthusiastic about joining the practice. On the other hand, if the PE firm can "grow the pie," everyone may win.

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Academy CEO

It's clearly a very complicated issue. Fortunately, there are many resources available to help you learn about the PE issue in much more detail—including at the upcoming AAO 2019 in San Francisco, where there will be many courses and lectures. The Academy urges every physician who is considering a PE practice equity acquisition to perform careful due diligence and seek good counsel. And, as when acquiring another practice, remember that cultural fit can be at least as important as the economics.