Physician Groups Today:
OPTIONS FOR CONSOLIDATION 
AND CONTINUED INDEPENDENCE
INTRODUCTION

For many years, physicians served their communities in private practices spread across the country. However, the traditional independent doctor’s office has changed dramatically and a growing number of privately practicing physicians have joined the ranks of hospital employees controlled by large health systems. Key industry changes such as an increasingly complicated reimbursement environment focused on risk sharing and population health management, and the demands of continually increasing requirements for technology investment, drove up the percentage of hospital-employed physicians by almost 50 percent between 2012 and 2015.

Most of the independent physicians and physician groups that desired to be bought by larger systems have been purchased. But are there still options for this remaining group to stay independent—and flourish?

This white paper examines:

- **The drivers** behind physician consolidation
- **Opportunities and options** for independent physician organizations to achieve scale and success in the new value-based world
- **How private and public investors** entered the physician services sector
- **How physicians can create** liquidity in their practices at current cyclically high valuations
DRIVERS OF CONSOLIDATION

Integrated Delivery Model
Early in the consolidation period, health systems were interested in acquiring practices and then employing physicians—thus gaining access to the patient and the ability to offer an expanding complement of clinical services. For example, if a patient visited a doctor complaining of hip pain, it was more likely for an employed physician to recommend an X-ray, CT scan or an MRI at the health system’s affiliated facilities. This clinical integration was the reason why it made strategic sense for health systems to acquire upfront diagnosers. However, that specific rationale for consolidation has begun to slow significantly, says Slava Girzhel, managing director in healthcare investment banking at KeyBanc Capital Markets, where he focuses on physician organizations and practice management.

“Many health systems have come to realize that it’s hard to manage doctors and make money,” Mr. Girzhel says. Further, he adds, a number of physician specialties are less likely to expand the overall patient flow after an acquisition but are critically important to clinical care and hospital operations. Most hospital-based physician specialties such as radiology and emergency medicine would fall in that category. In these instances, the hospitals are able to generate as much value to a health system by contracting with the best groups without the necessary upfront or ongoing investment in the support infrastructure. As a result, larger and more sophisticated physician groups are being organized to more effectively develop tools essential to service a large diverse customer base.

Complexity of Healthcare
The increasing complexity of healthcare created difficulty in operating independently. Change occurred on both sides of the consolidation equation. On the one hand, the costs of managing an independent physician’s practice ballooned as regulatory compliance, technology investments and other management costs increased. On the other hand, health systems began targeting doctors for acquisitions to expand their controlled networks.

Meanwhile, insurance companies have continued to grow larger and more complex. “To properly negotiate with and satisfy these behemoth organizations, physicians need to have scale,” Mr. Girzhel says. “As an independent, you have limited leverage when dealing with large insurance companies to negotiate equitable contracts and secure acceptable payment or even have access to their networks.”

Administrative Burden
The business side of medicine has become an administrative burden to many physician groups. That burden is driven by managed care, Medicare and a gradual shift from fee-for-service to the value-based reimbursement model. “It’s becoming more complex, and there are more metrics you have to track and report to get full reimbursement,” says Jason Gurda, CFA, healthcare equity analyst for KeyBanc Capital Markets. “It’s become more of a challenge for small practices to efficiently compete.”

As administrative challenges increased, a younger generation of doctors preferred to simply practice medicine and not be burdened with the business side of medicine, such as the complexities of payroll, he said. “Many doctors prefer employment to ownership and all the risks that come with that,” Mr. Girzhel adds. “And they want someone else to take care of the business side.”
A 2014 study found the average doctor spends 8.7 hours per week (16.6 percent of working hours) on administration, and doctors who were spending more time on administration had lower career satisfaction, even after controlling for income and other factors.  

This combination of factors caused a growing desire from doctors to be part of a larger entity. “If you have thousands of doctors in an organization, you can hire high quality administrative professionals to support the providers,” Mr. Girzhel says.

**ENTER PRIVATE EQUITY**

Private equity investors have been following the consolidation trend for years and are recognizing an opportunity to affect consolidation and deliver many of the benefits of scale to the independent physician market.

With thousands of private practices and hundreds of thousands of physicians still unaffiliated, Mr. Girzhel says, the private equity market is building a structure that allows physicians to be part of a bigger entity and reap the benefits of consolidation while remaining independent and having an ownership stake that could appreciate over time. How? By building organizations that are designed to excel at administrative services for physicians.

By partnering with a **physician support or medical services organization (MSO)** that is owned by either a private equity group or in case of some of the largest MSOs, a public company, doctors can take advantage upfront of the value of their practice. “The equity of an independent group until the emergence of MSOs was far less valuable than it is now given the breadth of possible transaction partners including private equity and existing support organizations,” Mr. Girzhel says. Additionally, physicians are able to reap the rewards of upfront liquidity for all the ‘sweat equity’ they put into building the business.”

**HOW IT WORKS**

**Operations**

Health service organizations (HSOs) and MSOs operate through a management services agreement which authorizes the supporting organization to act as a non-clinical arm, while the physicians continue to provide all the clinical services. The organization differs from a traditional partnership model, where a physician’s earnings are determined based on the group’s overall profitability by providing a combination of predictable income stream and the opportunity for capital appreciation of the physician’s ownership in the MSO. “By affiliating with an MSO, in addition to an ongoing earnings stream, a partner physician can receive a multiple of the practice’s future earnings upfront at the time the relationship is formed,” Mr. Girzhel explains.

**Payment**

Typically, doctors will continue to receive the market rate for their clinical services. In addition, they may get other benefits such as profit sharing and other incentive compensation, typically not available for hospital-employed physicians. “That’s why it’s attractive. You can get ownership in an
MSO. The doctor gets a doctor’s salary, and certain doctors can participate in the equity upside with their ownership position. In the future, when the investor gets paid and receives a return on their investment, physician partners can receive incremental earnings in the form of distributions as an equity holder,” Mr. Girzhel says.

**Separation of Responsibilities**

In some states, the corporate practice of medicine is prohibited, which essentially forbids business entities from employing physicians to provide medical care. As a result, in an MSO or HSO, physician practices are still owned and managed by doctors. There is a separation created between the healthcare practice and the support organization—all of the non-clinical services are grouped into a separate entity. That entity is then invested in by non-clinical enterprise, including private equity groups or public shareholders.

In return, the non-clinical entity has the exclusive right to offer management services to the administrative side of the practice for a fee. With a private practice, the physician must deal with the clinical side and the business side: hiring, firing, payroll, contracting. Instead, in an MSO those duties are performed by a separate company. “There are tried and true ways of creating value out of the management services organization by making it an efficient and effective partner to the physicians it supports,” Mr. Girzhel says. “The administrative arm that previously represented just cost becomes an ‘investable asset.’ With an MSO or HSO, doctors are taking the necessary business office investment and making an asset out of it.”

Operationally, the practice should not be impacted in a material way. How does life change? “The point of this is to make sure it doesn’t for most physicians,” Mr. Girzhel says. “Hopefully, the only difference is that physicians receive value out of their practice while gaining better control of their future.”

**RECENT MSO ACTIVITY**

Prominent MSOs have recently created valuable public companies trading at high EBITDA multiples. TeamHealth acquired IPC Healthcare in August 2015 to create what TeamHealth President and CEO Mike Snow called “the leading physician services organization spanning multiple specialties.” The all-cash transaction had an enterprise value of about $1.6 billion, or $80.25 per share.

In June 2016, Envision Healthcare and AMSURG merged to create one of the nation’s largest provider organizations offering outsourced physician services in emergency care, hospitalist care, anesthesia, radiology and children’s services. The two companies had combined revenue of $8.5 billion and adjusted EBITDA of more than $1.1 billion for the 12 months ending in March 2016, according to Envision.
In May 2015, Emergency Medicine Physicians, a private company that is majority owned by physicians, joined private equity firm Welsh, Carson, Anderson & Stowe to create U.S. Acute Care Solutions to focus on “building a national leader in emergency medicine and hospitalist services,” according to the investment firm. In September 2016, New Mountain Capital, LLC partnered with Island Medical Management, a leading provider of outsourced healthcare practice management services to emergency departments, hospitalist programs and hospital-based urgent care centers.

CONSOLIDATION OPPORTUNITIES

Among emergency room physicians, 38 percent of doctors are already members of TeamHealth or other national groups, according to data compiled by TeamHealth. Meanwhile, 18 percent of hospital doctors and 20 percent of anesthesia practitioners have already joined TeamHealth or an alternate national group, the company reported.

Overall, more than 50 percent of ER doctors, and approximately 75 percent of hospital physicians and anesthesia doctors are still not part of the MSO model trend. “Within those three key areas, the majority of the practices remain unconsolidated,” Mr. Gurda says. “However, the level of consolidation is increasing each year and we believe that will continue going forward.”

2 Administrative Work Consumes One-Sixth of U.S. Physicians’ Working Hours and Lowers their Career SatisfactionInt J Health Serv October 2014 44: 635-642
5 https://www.usacs.com/usacs-founded
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