Now & Next
Healthcare Alert

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Healthcare trends we're watching

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We expect these business trends to influence the healthcare transactional landscape in 2024.

What's the impact?

- Joint ventures can provide access to capital but may open the door to regulatory scrutiny.
- Buyers and sellers are keeping an eye on interest rates and exploring revenue growth through both traditional M&A activities as well as joint ventures and options.
- Distressed transactions require extra caution to minimize risks.

As the healthcare industry continues to pivot and evolve, the intricacies of healthcare transactions play a crucial role in how effectively healthcare systems can provide services and shape the overall patient experience. We explore the business trends that will steer the course of healthcare businesses in 2024.

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Joint ventures between platforms and with hospitals

We expect private equity backed Management Service Organizations to continue entering joint ventures with hospitals. These sorts of joint ventures provide hospitals with needed access to capital, a requisite for a hospital's expansion that is frequently a critical barrier to growth. We anticipate transactions in this space to remain robust as hospitals seek to grow their footprint and as the economy strengthens.

Entering into new markets certainly poses risks and benefits to all parties involved: the private equity backers, the hospital, and even the physician partners when the cachet of the physician practice is notable. Reputable physician practices bring expertise, credibility, and a recognizable brand within their specialty. Hospitals, looking to strengthen their focus in that area of specialty, can capitalize on that expertise through a joint venture with the physicians, such as through establishment of a new line of business leveraging the MSO's expertise. In exchange, the parties benefit from economies of scale, allowing for improved clinical care management, resource utilization, and better management of value-based reimbursement contracts. These joint ventures frequently include an investment opportunity in the MSO for the health system. These ventures, when paired with private equity's valuable access to capital, can make for a mutually beneficial and successful arrangement.

One unpredictable risk arising from such arrangements is the continued scrutiny and regulation of the healthcare space, particularly with respect to private equity involvement. Unlike pure private equity investment in healthcare, these types of joint ventures are precisely the public-private partnerships that policymakers so frequently invoke when seeking to promote investments in an industry in which the government limits its own investment.

As the year unfolds, expect to see more such joint ventures occur.

Healthcare M&A outlook

Many economists, attorneys, and other professionals are hopeful that interest rates will start to lower in 2024 and are cautiously predicting a stronger year for M&A in general, but will that apply to healthcare M&A? Just like 2023, it depends on the strength of the seller, the risk tolerance of the buyer, and many other considerations.

While a number of the factors that slowed down healthcare M&A in 2023 still exist (rate suppression, antitrust enforcement, union activity, lasting effects of the great resignation, and so on), buyers have also found creative ways to pursue these transactions in an environment with larger risk and higher interest rates. For private equity buyers, these often involve deals with larger amounts of rollover equity or looking more closely at earnout structures. For small physician practices, buyers may focus on acquihires—recruiting physician practices as employees as opposed to a fulsome acquisition with an asset purchase agreement and traditional representations and warranties. Other healthcare industries, such as telehealth, are under duress

and consolidating at a fast factor, creating opportunities for strategic buyers. In short, buyers have tended to be more conservative on target choices and have an increased focus on due diligence, but have not closed the door on M&A activities.

Acquiring or establishing ambulatory surgery centers

Recently, hospitals and private equity backed platforms have looked to a number of areas to grow revenue outside of traditional M&A activities. One path that continues to be very popular is acquiring or establishing an ambulatory surgery center.

These are often structured as joint ventures with a group of physicians. However, structuring the joint venture can be tricky. Management rights between the physician group, on the one hand, and the hospital or platform, on the other, need to be carefully navigated. Buy out provisions for physicians that desire to withdraw or redemption rights for bad actors are often heavily negotiated, including what purchase price should be paid based upon the reason for withdrawal or redemption. Establishing a new ambulatory surgery center contains additional risks. For example, obtaining third-party financing may require the physician group to provide guaranties after already making an initial capital contribution, which is not always popular on the physician side.

These joint ventures require striking a balance between properly negotiating each group's rights and obligations with making sure the entirety of the physician group appreciates the risks involved.

Due diligence in distressed healthcare transactions

In 2023, many health systems and providers were involved in distressed healthcare matters ranging from out-of-court workouts and acquisitions to chapter 7 and chapter 11 bankruptcy cases.

We believe that healthcare providers will continue to face tremendous financial pressures as a result of rising labor costs, reimbursement rates that have not kept pace with inflation and increased costs of care. The "merge-or-die" wave whereby providers consolidate to reduce back-office costs and increase the size of the patient population with a goal to improve profitability is probably ending.

In 2024 we will see an increasing number of transactions at distressed prices effectuated through "no cash" deals where the physicians are given notes in exchange for their practices or receive equity in the new venture. In return, the physicians hope that the new structure provides additional stability ensuring the continued viability of their practice and allow them to focus on patient care rather than the bottom line.

While due diligence in distressed transactions is crucial, we will continue to see parties seeking to close deals on tight timelines with limited due diligence and representations and warranties to realize a perceived "bargain" price. Even though a deal may appear to be a bargain on its face, issues of successor liability or third-party payor claims can sink a newly acquired practice. On the other hand, identifying common weaknesses in practices can allow investors to create a model that can be easily replicated and maximize their return on investment.

What's next?

Despite economic factors affecting business growth and increasing government oversight in the healthcare space, private equity buyers, hospitals, and others continue to look at healthcare businesses for top returns. Nixon Peabody's healthcare transaction attorneys can help you navigate healthcare's complex regulatory and business landscape and help you maximize new opportunities for growth and success in the new year.

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