The Future of Private-Equity-led Medical Care Centers in Germany

Challenges and Opportunities under the Influence of Legal Changes and the Need for Operational Efficiency

The new regulation Versorgungsgesetz II (Care Act II) is expected to be introduced by the end of this year in Germany, creating new settings for the establishment and operation of MVZs.[1] In the meanwhile, increased costs and limited potential to significantly augment revenues in the short term put pressure on owners of MVZs to define new strategies to boost profitability. With Private Equity (PE) now accounting for a significant portion of investments in the MVZ landscape, PE houses are expected to be firstly impacted, and, at the same time, lead the way to extract value in such challenging environment.

This article provides an assessment and an outlook on how Private-Equity-led MVZs (PE-MVZs) could develop in the future. Our journey in this intriguing segment of the German health care system starts from the impressive growth of MVZs since the introduction of the GKV-Versorgungsstärkungsgesetz (GKV-VSG, Statutory Health Insurance Strengthening Act) and then continues on key topics every manager at a PE should keep in mind when assessing the own investment.

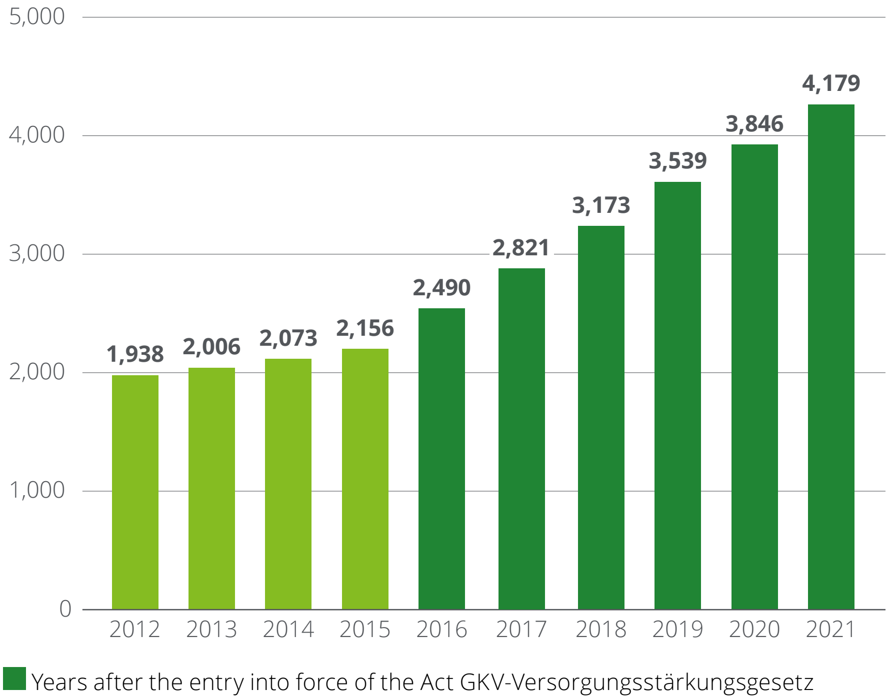
[1] An MVZ (Medizinisches Versorgungszentrum) is a German healthcare facility which provides a platform for various medical specialties to collaborate, bolstering outpatient care as well as treatment coordination and resource sharing. MVZs can be uniquely established by either authorized physicians, officially recognized hospitals, service providers of non-medical dialysis, or non-profit enterprises engaged in the provision of contract-based medical services, all operating under government sanction or validation. Furthermore, municipalities and private entities, under the supervision of a hospital as the primary provider, are also eligible to establish MVZs.

The Significance of the GKV-VSG for the MVZ Market and the Role of Private Equity Firms

In 2015, Germany passed the GKV-VSG to enhance the provision of healthcare services. Key objectives included strengthening outpatient care, promoting prevention, improving healthcare in rural regions, and enhancing patient rights. The amendment removed the term cross-specialty from the Social Security Code, which de facto represented a limiting factor for the growth of MVZs. Prior to the implementation of the GKV-VSG, it was essential for MVZs to incorporate at least two unique medical fields, creating obstacles for operators, who needed to find the right partners to launch their practices. With the new regulation, MVZs became also an attractive business venture. In effect, it facilitated a significant increase in the genesis of new MVZs, and the considerable growth potential in this sector attracted the attention of PE firms. The chart below illustrates this evolution, highlighting the years post the enforcement of the GKV-VSG in dark green. The chart encompasses all MVZs across Germany, independent of their ownership status, and as the figure shows, the number of MVZs has nearly doubled between 2015 and 2021.

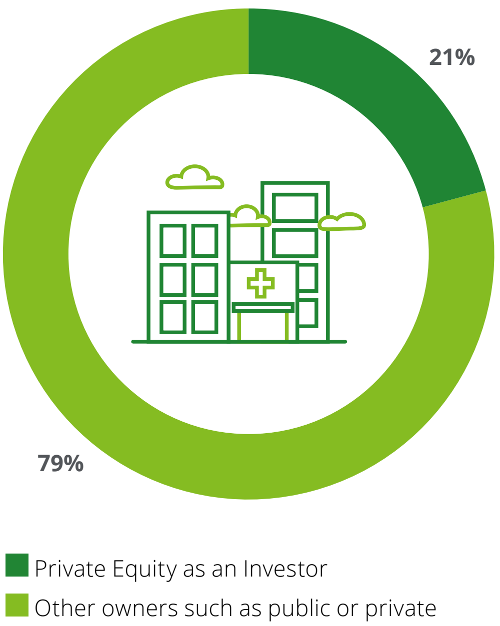
Over time, also the involvement of PE in the segment increased. According to our estimates, approximately 21% of the 4,179 MVZs existing in Germany in 2021 were owned by PE firms, with a relatively large portion of them (ca. 20%[2]) being dental practices. In addition to the dental sector, PE houses have been investing the most also in ophthalmology, radiology and orthopaedics. These investor-led centers are typically established with a hospital as the carrier. In particular, PE firms showed interest in acquiring MVZs in fields offering good opportunities given a realtively constant or even growing demand, and the potential to scale a business fuelled by the confluence of an aging population and chances for strategic consolidation within a dispersed healthcare market. In effect, most of the PE firms followed a strategic approach focused on expanding their MVZ network through a "buy-and-build" strategy already in the past years.

Fig. 1 – Total number of MVZs per year in Germany



Source: KBV Healthcare Data MVZ 2021

Fig. 2 – Share of Private Equity investment in MVZs in 2021



[2] IGES Institute 2020.

High Depreciation and Personnel Costs Impact Margins at PE-MVZs

The quick expansion via buy-and-build came at a cost though, and this can be seen when observing the performance of some players in the field. We selected the 20 largest PE-MVZs in Germany for which financial statements are publicly available.[3] The analysis of their key figures revealed that while on average such MVZs generate operating profits, these are not enough to cover all the expenses related to depreciation and interest charges. Such results can be attributed to mainly two factors:

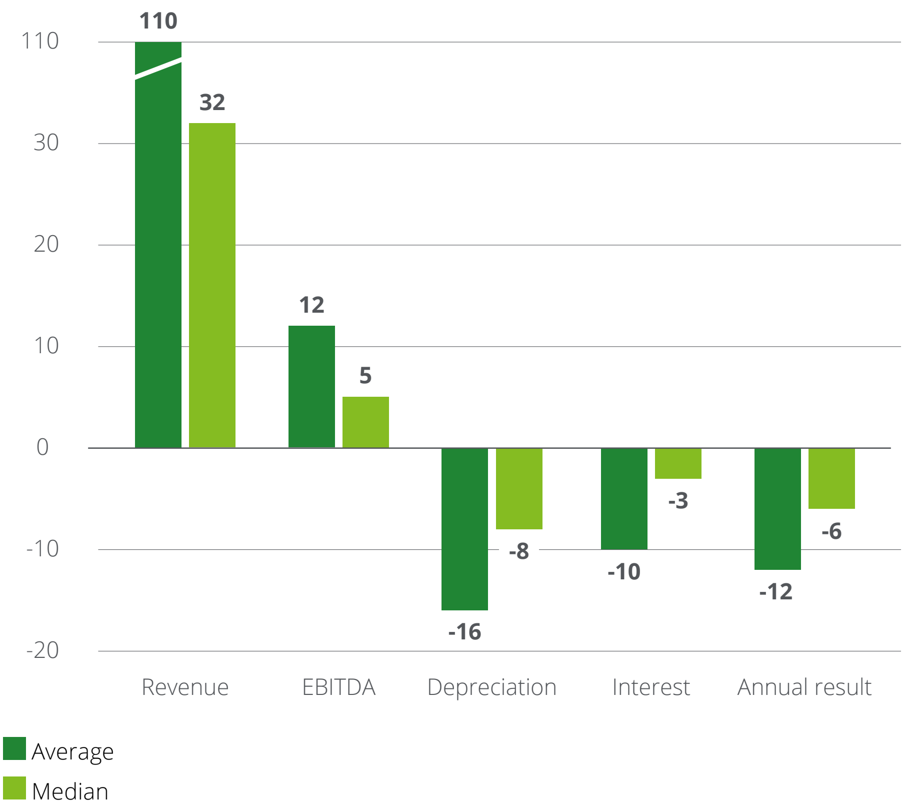
01. The continual addition of practices in line with the buy-and-build strategy induces significant depreciation, thereby imposing a substantial burden on the bottom-line results. This primarily stems from the depreciation of goodwill, which typically spans approximately about ten years. On average, the analysed PE-MVZs have depreciation expenses of € 8 m, which appears significantly higher than comparable MVZs not owned by PE.

02. Significant interest expenses due to the high level of leverage further impacted profits, and when considering the current high interest environment, such charges are not expected to diminish in the short term.

Improving the situation does not appear to be easy, especially since PE-MVZs are already much more productive than their peers with on average 1028 treatments compared to the 726 of non-PE-MVZs per year[4], a factor which is even leading a portion of current owners of medical centers to not see positively the possible sale of the center to a PE.[5] In addition, despite PE-MVZs respond to the demand for more flexibility from young doctors, the incentive for doctors to increase productivity at PE-MVZs is limited as they do not have a direct ownership in the medical center.

Finally, the intensity of treatments and the need for highly qualified professionals combined with inflationary pressures will put also current operating margins under pressure. The only way to increase profitability for PE-MVZs appears to be through increased efficiency and operational improvements, especially in the back-end processes and supporting functions.

Fig. 3 – Key figures of the PE-MVZs in € m for the year 2021



[3] Some of the largest PE-MVZs are not included in our representations due to missing or inaccessible financial statements.
[4] IGES Institute 2019.
[5] National Association of Statutory Health Insurance Physicians (Kassenärztliche Bundesvereinigung, KBV).

The Future of the PE-MVZ Landscape: Shaped by Demographic Changes, High Interest Charges, Regulatory Reforms, and particularly Operational Efficiency

Looking forward, the future of the PE-MVZ landscape will be influenced by four factors:

01. The demographic change, with an aging population, will lead to increased demand for medical services. At the same time, many older doctors are choosing retirement, providing good acquisition opportunities for PE-MVZs and thus promising growth prospects for the future. Furthermore, new acquisition opportunities arise due to the fact that non-PE MVZs also face cost problems. For PE, this is an alternative. To cash-in on such opportunities might be difficult in the short term as the aging population might require more time to manifest its full potential as compared to the shorter term of exits from their investments most PE might envisage right now.

02. Furthermore, the Federal Ministry of Health (Bundesministerium für Gesundheit, BMG) is planning to pass the Care Act II towards the end of the year, which aims to further develop the regulations for the establishment, licensing, operation, and transparency of MVZs, especially concerning PE-led MVZs. In principle, it will still be allowed for investors to operate MVZs. However, increased transparency in this area is expected. This means that approved MVZs must register the sponsor, economic beneficiary, and the medical director in a dedicated register. Additionally, investor influence on medical decisions could be reduced with protection against dismissal and termination. Capping the market share of MVZs is also possible, and there might be also regional restrictions for MVZs, limiting their scope to the vicinity of the sponsoring hospital. The initiative of the ministry might also encompass the establishment of health kiosks and eventually foster a new scenario where a myriad of health-related services and information can be offered by municipalities in regions lacking adequate healthcare coverage. Envisioned as easily accessible public outlets, health kiosks are intended to offer a basic set of medical services. These services can be adapted according to need. Serving as platforms for health education and potential check-in points within healthcare facilities, they aim to render healthcare more approachable and user-friendly.

03. As previously mentioned, the current interest rate environment is unlikely to change rapidly and will continue eroding the bottom line of PE-MVZs, putting even greater strain on annual results in the upcoming future.

04. If then achieving increased profits by further enhancing productivity (which is already higher at PE-MVZs) presents a challenge and prices for operating expenses are not expected to be lower any time soon, unlocking the full potential at PE-MVZs entails optimizing process structures and back-end activities. This would help to empower doctors with more flexibility for patient treatment, and, at the same time, create value through the realization of synergies hidden in the only partially integrated PE-MVZs across the country because of buy-and-build strategies. Improved cost efficiency through profitable unit economics based on outsourcing/centralization of non-core functions as well as enhanced support of technology to streamline processes will pave the path forward and make the difference between successful and mediocre investments.

How can Deloitte support you?

Deloitte, a leading global consulting and auditing firm, is here to support you with a wide range of services. We can help you develop your business model, support you in analyzing the operat-ing model of your business and help realize cost synergies across your entire network to reduce the overall operating costs and establish the necessary process infrastructure to meet new re-quirements. Additionally, we offer expert assistance in identifying potential acquisition targets, conducting due diligence, and supporting you in mergers and acquisitions. Our Value Creation Services provide comprehensive support throughout the entire M&A process, enabling you to gain a competitive edge by accelerating value enhancement and uncovering hidden value. Our experienced specialists will help you optimize your business, significantly increase profitability and overall company value. Feel free to reach out to us for more information about our services.

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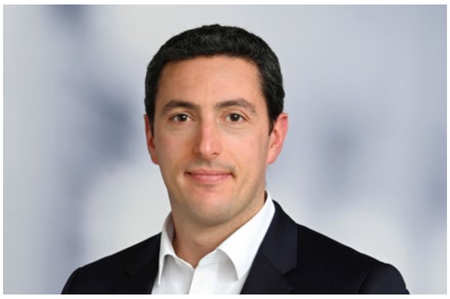

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