

A train that's left the station

Well, they are calling it the golden age of rectums!

The trends are **simple** and **straightforward**.

First, baby boomers and beyond are aging and staying alive longer. The gut, a hidden culprit in many ailments, requires continuous maintenance. Colonoscopies. EGDs. Things that require services of gastroenterologists (GIs) who are always in short supply.

Second, gastroenterology (GI) practices are fragmented like hotels were before Hilton. Regulatory, technological, insurance complexities are weighing GI doctors down. Frustrated with the burden of running practices, many doctors join hospitals. And then they discover that it's difficult to survive under the thumbs of demanding hospital administrators.

Third, there's plenty of new money in private equity (\$453 billion in 2017). Healthcare, one of the biggest problems of our times, is attracting PE interest, albeit quietly. PwC reported that 2018 quarterly deal volume broke records, totaling to 1,182 deals in the year. Unlike earlier decades when IPOs were the main forms of exits, PE companies can now find exits by selling "rolled up" portfolios to larger PE firms. More over, PE firms follow each other around creating momentum for an investment thesis.

Fourth, specialties such as gastroenterology can indeed improve revenues by streamlining billing, negotiating insurance contracts, adding ancillary services, and building strong leadership. All of these are possible with economies of scale and capital.

Given that physician partners don't usually align, a third-party facilitator such as a PE firm would find it easy to lead the way.

The question really isn't about whether PE involvement would be right for gastroenterology or even medicine as a whole.

It's too late in the day to ask that question. The train has already left the station.

Read: [Why private equity is turning towards gastroenterology](#) (Becker's ASC)

Read: [How Private Equity is Helping to Underwrite the Transformation of Healthcare](#)

How did we get here? Where are we going?

Long time ago, gastroenterologists ran smaller solo or group practices. Despite the myriad challenges of running a medical business, doctors enjoyed the independence that private practices offered.

But over the years, everything got too complicated. From insurance reimbursements to regulatory compliance to even patient demands and behavior. It just became tougher to stand alone. Younger physicians hardly consider going solo today. Most join groups or hospitals.

Smaller groups became bigger. Demand for GI procedures fueled the growth of free-standing ambulatory surgery centers.

Hospitals sensed the opportunity. And began luring gastroenterologists to gain access to their patients and to bring home revenues. Some hospitals created competitive pressure to persuade doctors further to give up private practice.

As hospitalists, doctors lost their independence. The burden of monolithic EHRs and administrative complexities didn't help either.

Read: Why doctors hate their computers (by Atul Gawande in The New Yorker)

Well, the market's shifting again.

It's warming up. The ice is melting. A little quickly now. New rules are forming. No one knows what exactly those rules are. But they are forming anyways. And when they form, the lake will begin to freeze again.

Roll ups

Even before the advent of private equity, GI groups have been consolidating. Small groups (e.g. 4-8 doctors) merged to form mid-size groups (e.g. 8-20 doctors).

Mid-size groups came together to create large groups (e.g. 25-50+). Consider the largest GI group in Memphis, Tennessee: Gastro One, which was formed by the merger of two large groups in the area (33 MDs).

Some large groups expanded into super groups (80-200+ gastroenterologists). Consider mega groups such as Washington Gastroenterology or Minnesota Gastroenterology.

Involvement of PE is fueling a trend that's already underway. By providing capital for recruiting other groups, buying new medical equipment, removing administrative burdens and inefficiencies, streamlining technology and starting ancillary services. They are courting doctors by offering them independence in a way that hospitals can't.

How would super groups expand? I learnt that the pipeline goes all the way to 1,000 GIs operating under a single entity. Such GI practices don't exist today.

Private equity (PE) companies refer to this as a "roll up" strategy.

These roll ups will create a different kind of market dynamic. A tailwind of ancillary opportunities (imaging, pathology labs, nutrition counseling and so on) will emerge.

In March 2016, Audax Group recapitalized Gastro Health, which was founded in 2006 with the merger of two groups in Florida. It was a first for GI. But what Audax Group actually did was to simply reapply a successful investment thesis from dermatology (and other specialties).

In October 2011, Audax invested in Advanced Dermatology & Cosmetic Surgery (ADCS), a company with strong presence in Florida and Ohio. For the next 5 years, ADCS completed 40 acquisitions and added five new clinics and expanded to 11 states. It consolidated a fragmented dermatology market by developing a footprint in 140 locations. In May 2016, Audax recapitalized ADCS with Harvest Partners, retaining a minority stake. During the investment period ADCS quadrupled its revenues to \$200M.

Read: Case study: Advanced Dermatology & Cosmetic Surgery (Audax Group website)

During the last quarter of 2018, gastroenterology saw the announcement of two more deals. Texas Digestive Disease Consultants and Waud Capital created The GI Alliance. Atlanta Gastroenterology and Frazier Healthcare Partners created United Digestive.

There are approximately 14,000 GIs in the US today. Present consolidation trends indicate that these deals would cover a large proportion of practicing gastroenterologists.

What happens next with 1,000 MD super groups is anybody's guess.

Would a tech giant (e.g. Google) be interested in buying a super group for the data it generates? Would a pharmacy (e.g. CVS) be keen to lock-in gastroenterology? Would an insurance company (e.g. United Healthcare) look at GI as a growth avenue? Or, would PE companies vertically stack a 1,000 MD GI group with similar sized ophthalmology, orthopedic, dermatology groups and create a multi-specialty private practice with 5,000 MDs?

This is not entirely new to healthcare. As a case in point, think of Kaiser Permanente, a non-profit founded in 1945. It has 22,000 doctors on staff serving 12.2 million members with revenues of \$72.7 billion (2017).

With PE in gastroenterology, the story has just begun.