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Private Equity and Value-Creation in Post Acute Care

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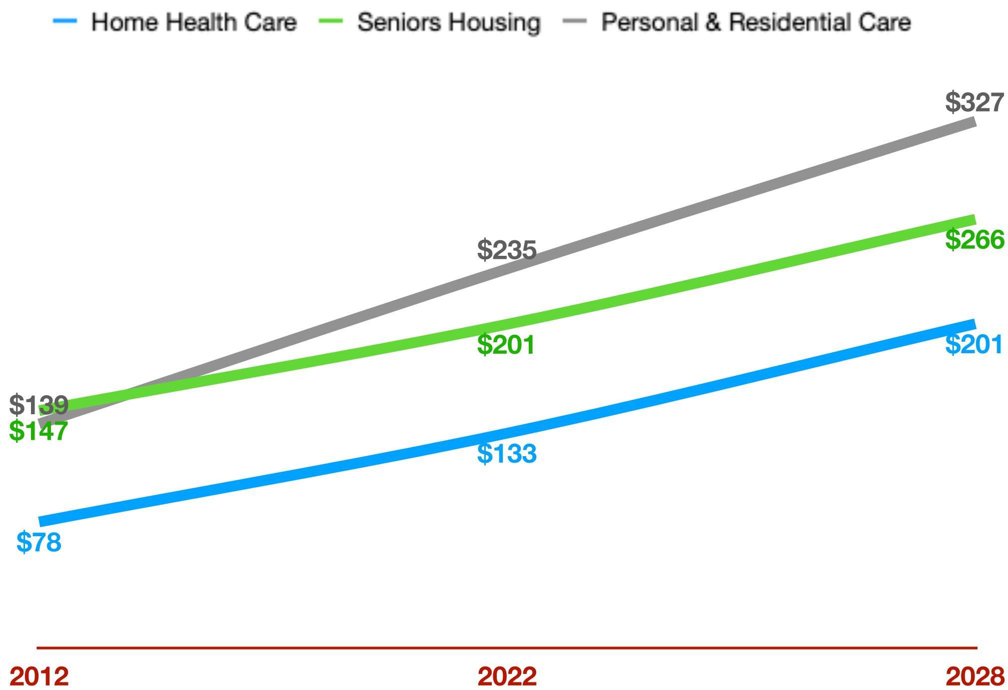
Post-acute care is a vital segment of the US healthcare system, accounting for 10% of the total provider EBITDA of $326 billion.[3] Overall, however, the post-acute care segment chronically underperforms relative to its expected value. Our experience shows that with proper capitalization and operational and strategic support, private equity can improve the performance of post-acute care businesses and deliver value to portfolio companies and investors alike.

Post-acute care involves a variety of medical services that support an individual's continued recovery following a hospitalization or illness, and are also crucial for chronic disease management. Services typically include long-term care, inpatient and outpatient rehabilitation, skilled nursing, medical home healthcare, non-medical home care, palliative and hospice care, and behavioral health services. These services are critical to caring for elderly citizens, many of whom have significant co-morbidities and may require longer recovery time following an acute episode.

On average, post-acute care services make up 20% of all personal healthcare expenditures in the US ($3.78 trillion as of 2022). Due to a rapidly aging population and increase in the prevalence of chronic illnesses within the US population — approximately 60% of US adults is affected by some form of chronic illness, and 80% of those aged 60 years and older deal with at least one chronic illness[1] — we project the post-acute care market to grow at a rate of 6% annually between 2022 and 2028.

US post-acute healthcare expenditures (in $ billions) will grow 6% annually to reach approximately $800B by 2028



Source: Six One Bravo analysis of national healthcare expenditures data

Historically, post-acute care businesses have not grown or operated to their full capacity. Drivers of underperformance within the post-acute care market are multifaceted and dynamic, but four factors warrant critical assessment given their direct link to value-creation:

- **Market Fragmentation:** The post-acute care market remains highly fragmented with competition limited to a handful of large players. Nationally, the combined market share of the top five post-acute care providers is approximately 19%. Select operators may occupy niche positions in their defined service areas, but extensive fragmentation impedes value creation and limits the ability of providers to grow, scale operations, and broaden the reach of their services effectively and efficiently.

- **Access to Capital:** Due to market disruptions spurred by the COVID-19 pandemic, an estimated $6.8 trillion will required to drive investments in digital transformation across all industries.[2] For post-acute care providers in general and small, family owned operators in particular, this dynamic presents a significant challenge since nearly half (49%) of post-acute providers report they lack the capital to implement essential healthcare technologies and innovate service delivery models.

- **Resource Constraints:** Since 2020, the post-acute care workforce has declined more than 22%, costing the industry nearly $20 billion due to persistent understaffing.[4] Delivery of post-acute care service is highly labor intensive, and the ability of service providers to stabilize operations by maintaining ready access to an available and well-trained workforce, for example, is critical to value creation and preservation.

- **Operations Management:** Issues of effective operations management are particularly glaring for post-acute care providers. Due to a noble focus on mission that prioritizes service delivery over business performance, small and medium sized operators in the segment rarely deploy proven management practices that are conducive to high performance, productivity, and effective governance. For the sector as a whole, ineffective management practices reduce operating margins by 8% on average.

As state and federal governments, health systems, health plans, and other stakeholders take steps to meet the increased demand for services, it is important to assess the sector's relevance and value to private equity. A key consideration in this regard concerns the ability of private equity to influence how post-acute care businesses — and in particular small, family owned operators — position their operations to capitalize on positive developments in the sector.

Post-acute care operators generally have been conservative in their embrace of private equity. For the most part, this reservation is the result of owner operators who sought to maintain the family oriented nature of their operations rather than welcome the growth and expansion model of private equity. Consequently, private equity investment in post-acute care remains low compared to investments across other segments of the healthcare ecosystem. As the market evolves and demand for post-acute care services increases, however, private equity may prove to be an indispensable ally to post-acute care operators.

Increase in Private Equity and Venture Capital Investments Across Healthcare, 2014 — 2022[3]

Physician	5.0x
Non-Acute/ Outpatient	4.9x
Health IT	2.8x
Others	2.4x
Medical Products	1.8x
Business Support	1.3x
Post-Acute	0.8x

Private equity is uniquely positioned to partner with post-acute care providers to navigate the deficits and challenges that inhibit growth and sustain underperformance. Through capital infusion and add-on investments, financial and managerial discipline, operational rigor, and provision of strategic advice, private equity can help arrest disruptive forces that prevent the sector from realizing its full potential of serving patients more efficiently. In an environment where demand for services continues to grow and, more importantly, many stakeholders (including consumers) view the post-acute sector as a viable setting for the delivery of high-quality healthcare services, this imperative has never been greater.

Certainly, the context within which the partnership between private equity and post-acute care blossom will require tending and nurturing given historical perceptions of the private equity business model. An innovative private equity firm with relevant industry and segment exposure will understand and appreciate the vision preservation mandate of post-acute care owners. On the other hand, the portfolio company's management must be open to practices and techniques that are essential for value creation, including the implementation of comprehensive growth plans; redesign of governance and organizational structures; and implementation of EBITDA and margin improvement plans, among others. In this regard, the value engineering process is at once absolute and collaborative. But this paradox cannot be circumvented if private equity is to successfully transform operations, augment the quality of services, sustain and expand profitability, and yield expected returns to equity capital.

In sum, a favorable mix of consumer demand, changing demographics, and supportive policies have converged to enhance the growth and return profile of the post-acute care sector. Actualizing these prospects, however, will require proper capitalization and effective management, and we believe private equity has an immense role to play in this process.

Sources:

[1] Hayes, T. O, and Gillian, S. 2020. Chronic Disease in the United States: A Worsening Health and Economic Crisis. *American Action Forum.*

[2] Weinberg, A. 2022. Three Reasons Why Private Equity Will Enable the Post-Pandemic Recovery. *World Economic Forum*

[3] Singhal, S., and Patel, N. 2022. The Future of US healthcare: What's next for the industry post-COVID-19. *McKinsey*.

[4] Oliver Wyman and IntelyCare Research Group. 2022. The True Cost of Post-Acute Care Labor

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