12 Reasons to Tread Cautiously with Private Equity in Healthcare

1. **At the outset, private equity was composed of experts in business growth.** Most private equity today are people that started funds right out of Ivy League schools or after a brief stint at Goldman Sachs. They have no experience or expertise actually building a business. Their expertise is spreadsheets and theory.

2. **Spreadsheets do not make a business.** It's easy to look at numbers and come up with a math formula for growth. "All we need is 100 admissions a month at a cost of less than $500 per admission and we'll be incredibly profitable!" **The heart of a business is the product/service it provides, not the numbers on a spreadsheet.** Numbers on a spreadsheet can provide directional insight, but are not the core element that determines success or failure. The product/service is always the true growth engine.

3. **There is too much money chasing too few deals.** Private equity has to spend the money or return it. This incentivizes PE to find something to buy, even if the business isn't all that great or the price is too high.

4. **Unlike older, more sophisticated PE, most small-medium sized firms today bet on momentum**, which is dangerously close to speculation. Instead of buying a business at a great price, they overpay for a business and hope the next PE firm desperate for a deal will pay even more.

5. **They don't understand the product or service.** Instead, they're focused on KPIs such as TAM, EBIDTA, and CAC. These numbers are important, but only after you've understood the fundamentals of the product/service being provided.

6. **They're involved in a multitude of random businesses.** They've got a consumer packaged goods company, an insurance provider, and a behavioral health business all in their portfolio. **They don't have expertise in any of these areas**, but, based on the spreadsheet analysis, think they can "make the numbers work."

7. **They're willing to pay a multiple of 8 or higher for a business.** While this is great for the owner exiting, it's very hard to make a decent return when paying high multiples for businesses outside the SaaS space, especially when most of that business was bought with leverage, **so interest payments weigh heavily on margins.**

8. **They're overconfident.** Humility goes a long way in driving success when it comes to M&A.

9. **They don't ask the right questions or, even worse, they don't ask any questions.** We've seen acquirers buy facilities sight unseen. This is a sure sign you're dealing with a firm that is overconfident and rushing through deals.

10. **They're acquiring based primarily on a size multiple thesis.** Small businesses go for lower multiples, but big ones can go for twice as much. The reason for this is that, historically, a bigger business was more successful, it had a defined and sustainable growth engine. **The mistake PE today makes is that it's not the annual revenue or profits that make a good business, it's the component parts that drive the growth engine.** Often what we see these days in the private equity space is what we call HoldCo stacking. The PE firm acquires provider after provider, but does little to nothing to integrate acquisitions into a unified, cohesive operation. Superficially, the numbers look great, but, under the hood, it's just a bunch of mismatched businesses in the same industry shoved under a HoldCo. **Over time, the lack of cohesion brings the entire operation down.**

11. **Time horizons are short, sometimes only 3-5 years.** How many businesses do you know that started 3-5 years ago and are huge successes? It's a very small number. Short timelines are often unrealistic to achieve sustainable growth.

12. **They bring on far too much debt.** Leverage is a great way to juice returns, but it often drowns a business when servicing that debt exceeds cash flow.

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