Medline buyout may set off private equity investment wave

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The buyout of the medical supply company Medline may signal the next wave of private equity investment in healthcare, industry observers said.

A trio of private equity firms—Blackstone Group, Carlyle and Hellman & Friedman—reportedly purchased a majority stake of Northfield, Ill.-based Medline in a deal that valued the company at more than $30 billion, as first reported by the Wall Street Journal. While the healthcare supply chain hasn’t been the primary target of private equity firms, the COVID-19 pandemic underscored the importance of a resilient supply of personal protective equipment and excess distribution capacity, experts said.

“I think this is the start of an explosion of private equity deals in healthcare,” said Richard Scheffler, health economics professor at UC Berkeley, adding that he wouldn’t be surprised if investment increases by 30% to 40% next year. “Everyone made a bundle in the Trump stock market; these firms are sitting there with capital and have to do something with it.”

Estimated annual private equity deal values have nearly tripled from $41.5 billion in 2010 to $119.9 billion in 2019, according to a white paper that Scheffler co-authored. Their primary target has been the outpatient sector, with the number of related buyouts more than doubling from 2016 to 2020, according to the paper. In addition to bundling fragmented physician practices, private equity has also invested in elder and disabled care, inpatient services and pharmaceuticals.
"The Medline transaction signals private equity’s continued confidence in the healthcare sector, both in the U.S. and globally," said Angela Humphreys, co-chair of the private equity team at Bass, Berry & Sims.

Private equity firms borrow heavily—sometimes four to five times the company’s equity—to increase the organization's liquid assets and boost the potential returns. They typically cut expenses to generate a return over a three- to five-year period.

That strategy has caught the attention of Congress, which has called for more transparency and regulation. Policymakers have asked for more information about how private equity’s ownership model of nursing homes has impacted patients, pointing to studies that link that short-term turnaround model to worse outcomes.

Medline, which makes masks, surgical gowns, drapes, gloves, diagnostics and other medical supplies and equipment for providers, reported $17.5 billion in sales in 2019—around $2 billion of which came from overseas, the family-owned company said. It will remain under the leadership of the Mills family if the deal clears the regulatory process, as experts expect.

"(The investors) were willing to let the management team stay in place, which gave us a good level of comfort," Medline CEO Charles Mills told Modern Healthcare, adding that it wouldn't change operations. "They are willing to see us make more investment in the business and not necessarily try to get something quick out of it."

The infusion of capital will allow Medline to accelerate the expansion of its international operations and supply chain, Humphreys said, noting the federal tax law changes on the horizon.

The private equity investors may be seeing cheaper and more affordable equipment, new technology to boost the distribution of those products and other ways to leverage economies of scale, Scheffler said.

"In this line of business, unlike other parts of healthcare, there are economies of scale in this production model," he said. "As you get bigger, draw more capital and develop new technology, the cost per unit drops."

Medline opened eight distribution centers over the past three years to help health systems centralize their distribution network, with plans to add more than 10 million square feet in warehouse space over the next four years.

It is now manufacturing face masks out of its Georgia plant, in part, thanks to a $6 million contract with the Defense Department. Medline looks to produce 36 million face masks per month. Overall, the company has invested $1.5 billion in domestic manufacturing and distribution from 2018 and 2020.

The transaction, which is subject to regulatory approvals and customary closing conditions, is expected to close in late 2021.

"Private equity in general has been trying to invest and grow many (healthcare-related) businesses. I think they will be a good partner," Mills said.

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