DealReader

Physician Practice Support Organizations

May 2017

We are seeing significant M&A activity and private equity interest in the physician practice support organization ("PPSO") sector. In this issue, we provide:

- An overview of the many PPSO sub-sectors;
- Primary factors driving M&A activity and industy consolidation;
- A listing of recent M&A transactions; and
- Our persepctives on the sector going forward.

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Defining the PPSO

Our physician practice support organizations ("PPSO") DealReader considers sub-sectors of healthcare services that have the following core characteristics:

- Physician driven;
- Clinic and / or center-based service delivery models; and
- Operate with a management company and affiliated Professional Corporation ("P.C.") structure, whereby the management company provides administrative practice support services to the affiliated physician owned P.C., and allowing affiliated physicians to focus on exclusively on patient care.

The following table highlights the PPSO sub-sectors included in the written and statistical work of our report:

PPSO Sub-Sectors

Cardiology	Gastroenterology	Podiatry
Chiropractic	Multi-Specialty	Urology
Dental	Oncology	Vein Care
Dermatology	Orthopedic	Vision Care
ENT	Pain Management	Women's Health

PPSO Value Proposition to the Physician

PPSOs offer an attractive value proposition to independent physicians and physician groups. The following highlights the key value drivers of partnering with a PPSO:

Focus on Patient Care
PPSOs handle the administrative, non-clinical functions of the organization so that physicians are able to spend more time providing direct patient care.

Higher Income
Physicians are able to see more patients and the practice is more efficient in operations and revenue cycle management.

Strategic Leadership
Assistance navigating newer forms of service and payment models (e.g., bundled payments; ACOs; capitation).

Payer Relationships
Better access and more negotiating leverage with commercial payers to improve rates and revenue cycle.

Access to Capital
Greater access to capital and a strategic/capital partner for necessary capital investments (e.g., practice improvements, de-novos and acquisitions; IT investments; new equipment, etc.).

Career Opportunities
More career options and paths and greater career flexibility for physicians.

Working Capital
Better revenue cycle and payer denials management.

Marketing Expertise
Lower patient acquisition cost and better return on marketing spend.

Vendor Management
Lower overall operating costs through better contracting with vendors and suppliers.

Factors Driving Sector Consolidation

In addition to the attractive physician provider value proposition, the following macro-factors are also driving consolidation across the PPSO sector.

Operational Complexities

- Physicians are navigating a more complex business environment.
- Challenges and opportunities include multiple reimbursement schemes, sector and geographic driven regulatory differences/complexities, new service and payment paradigms, and growing need for IT and quality-of-care related investments.

Payer Dynamics and Payer / Provider Convergence

- Given the ongoing, strong development of IDNs and ACOs and the build-out of increasingly larger, more diverse physician-based platforms, there are today also more strategic acquirers of physician practices than in years past.
- This trend is further driven by the growing demands of payers for improved integrated care, chronic care management as well as payment bundling solutions and provider penalties (e.g., hospital re-admission penalties), among many other factors.

Changing Physician Demographics

- The number of new physicians entering certain sub-sectors is in decline, which is leading to physician shortages in certain markets.
- Interest in practice ownership is also declining given the operational challenges, reimbursement and regulatory challenges and capital risks and administrative responsibilities required.
- New physicians are entering the workforce with significant student loans, reducing their ability to acquire / invest in a local practice.

Capital Availability

- Private equity investors view the PPSO sector as an attractive way to invest in healthcare services.
- Lenders are also interested in PPSOs.
- There have been a large number of successful investments in PPSOs with few failed investments.
- There is substantial opportunity to deploy capital and an established "playbook" for improving operations and driving economies of scale.

Limited Same-Store Practice Growth

- While PPSO sub-sectors benefit from favorable tailwinds such as the aging of the population, longer life expectances and increasing incidents of chronic conditions; same-store volume growth for most practices are in the low single digits.
- Larger group practices and private equity-backed platforms are utilizing M&A as a vehicle to drive growth and capture market share.

Pressure on Reimbursement Rates and Practice Margins

- Reimbursement rates, from both government and commercial payers, are under pressure as the payers seek to reduce costs while maintaining care quality and care access.
- Given the potential for a flat-to-declining reimbursement rate environment, consolidation offers the potential to increase economies of scale, share resources and increase practice and corporate earning margins.

Value Creation Opportunities

Each PPSO sub-sector has its own unique attributes and trends that result in somewhat different value creation paths. The following table highlights a few of the key operational, financial and other value drivers available for most PPSO businesses. Given these and other value creation opportunities available to PPSOs, it is not uncommon to see high quality platform PPSO businesses trade in the range of 8-12x EBITDA.

Operational Value Creation Drivers

	Attributes of Emerging Businesses	Value Creation Activities	Attributes of Platform Businesses
Model Consistency	Operations vary from location to location	Develop standardized, replicable best practices	Operations standardized and consistent across locations
Geographic Diversity	Single state / market	Prove out model in multiple states / markets	Regional / national footprint
Patient Focus	Catch and release (low lifetime value and higher patient acquisition costs)	Develop lifetime patient model, if possible	Multi-year care model (lower patient churn)
Services Model	Single service offering	Add complementary services	Multi-service offering, including higher value and differentiating specialty services
Growth Strategy	Opportunistic approach to new location development	Develop de novo / acquisition growth model and hire Chief Development Officer to execute	Defined growth strategy with dedicated team responsible for executing
Payer Contracting	Rate taker with payers	Develop direct relationships with payers	Dedicated professional focused on payer contracting and negotiating rates with payers
Collections Management	Accept higher rates of denials due to staff limitations	Professionalize revenue cycle functions	Dedicated and sophisticated billing and collections team with capacity to actively work denied claims

Industry Metrics by Sub-Sector

The following table provides an overview of several of the larger and higher growth sub-sectors and includes market statistics, number of providers, patients served, annual spend (which may include medical and societal costs), selected medical conditions treated and related therapies/services.

Industry Metrics for Larger, Higher Growth PPSO Sub-Sectors

Sub-Sector	Market Size (U.S.)	Provider Market (U.S.)	Patient Dynamics (U.S.)	Example Conditions Treated	Example Service Areas
Dental	$127B+	> 195,000 Dentists 80% of practices are solo practitioners	Aged 2-17: 83% visited the dentist Aged 18+: 62% visited the dentist	▪ Tooth decay ▪ Gum disease ▪ Exposed tooth root	▪ Fillings ▪ Teeth whitening ▪ Crown & bridge ▪ Root canals
Dermatology	$14.3B	> 13,800 Dermatologists	35M patients 65% medical treatment, 25% surgery, 10% cosmetic (AAD)	▪ Acne ▪ Skin cancer ▪ Eczema	▪ General dermatology ▪ Cosmetic dermatology ▪ Mohs surgery
Vision Care (Ophthalmology)	$12.0B	> 18,300 Ophthalmologists	Cataracts: 24M+ Americans over age 40 Glaucoma: 2.7M Americans over age 40 AMD: 2.1M Americans over age 50	▪ Advanced AMD ▪ Glaucoma ▪ Diabetic retinopathy ▪ Cataracts ▪ Poor vision	▪ Eye exams ▪ Medical eye care ▪ Surgical eye care ▪ Plastic surgery ▪ Refractive surgery
Pain Management	$300B+ (total annual spend on chronic pain)	> 2,600 pain clinics	116M people with chronic pain	▪ Chronic pain ▪ Back pain ▪ Post-op pain	▪ Medication management ▪ Injections ▪ Nerve blocks
Chiropractic	$15B+	> 77,000 Chiropractors	35.5M US adults actively seek chiropractic care	▪ Back / spine pain ▪ Neck pain	▪ Spinal manipulation ▪ Corrective exercises ▪ Physical therapy

Sources include: NIH, CDC, Health Affairs, IBIS World, ASPS, AMA, among others

Summary M&A Perspectives & Sub-Sector Outlook

2016 Bellwether Year.

The number of global PPSO deals was up 21% in 2016, growing from 121 in 2015 to 146 in 2016. The growth in 2016 was primarily driven by increases in Dental and Dermatology transactions.

Dental Services Deal Activity.

M&A activity in the dental services sub-sector continues to be strong in both the U.S. and internationally. Private equity is the primary catalyst with platform investments and PE-backed platforms driving consolidation activity. Given annual sub-sector organic growth is in the 3-5% range and the large number of independent dentists, M&A is the primary growth path for most private equity-backed and independent dental platforms.

Dermatology Deal Activity Continues.

Dermatology deals are showing a pronounced acceleration from the eight deals in 2013 to 33 deals in 2016 (with Q1 2017 activity suggesting a further growth).

2016 Banner Year for Vision Care.

2016 was a banner year for Vision Care M&A and activity in this niche is expected to continue.

Active International Market.

PPSO deals are also taking place outside of the U.S. Sub-sectors that are active internationally include dental care, vision care, and specialist medical groups.

2017 Another Strong Year.

Interestingly, year to date in 2017 (through Q1), there have been already 27 transactions in these markets. Activity over the year-to-date period seems to indicate that activity in these PPSO sectors continues to be strong in 2017

M&A Activity by Sub-Sector

The following exhibits highlight the strong M&A and recap investment activity taking place in the PPSO arena, both in the U.S. and internationally. Based on our analysis of PPSO markets (excluding those sub-sectors noted above), our data-run indicates that there have been more than 560 transactions in the 2012-Q1 2017 period, with an average of 100 transactions per year between 2012 and 2016.

M&A Activity by Sub-Sectors

	U.S. M&A Transactions							Non U.S. M&A Transactions						
	2012	2013	2014	2015	2016	Q1 2017	Total	2012	2013	2014	2015	2016	Q1 2017	Total
Primary Care	6	5	5	2	5	2	25	2	0	1	2	0	0	5
Multi-Specialty	9	11	8	7	6	2	43	3	4	3	2	2	2	16
Dental	8	12	11	5	23	2	61	15	13	25	10	21	0	84
Dermatology	5	7	12	17	28	10	79	0	1	1	2	5	0	9
Pain	5	3	8	5	2	0	23	1	0	1	0	0	0	2
Vision	3	5	8	2	9	1	28	4	4	6	3	1	0	18
Chiro / Occ Health	7	5	6	12	4	2	36	3	1	3	4	3	0	14
Other Specialties	19	19	19	13	19	4	93	3	9	7	5	5	2	31
Total	62	67	77	63	96	23	388	31	32	47	28	37	4	179

Sources include: Capital IQ; Lincoln International Healthcare

Other Specialties include audiology, cardiovascular, cosmetic surgery, ENT, fertility, gastroenterology, OB/GYN, oncology, pediatric, podiatry, urology and vein care.

Example Global M&A Transactions

The following includes a listing of example global M&A transactions in the PPSO sector

Year	Target Company	Target Category	Target Country	Acquiring Company
2017	Oakland Dermatology Associates PC	Dermatology	United States	Advanced Dermatology & Cosmetic Surgery Inc.
2017	Dental Partners Inc.	Dental	United States	Dynamic Dental Partners Group
2017	Dallas Dermatology, LLC	Dermatology	United States	Epiphany Dermatology PA
2017	HealthSource Chiropractic Clinic	Chiropractic	United States	HealthSource Chiropractic, Inc.
2017	The Village Medical Centre	Multi-Specialty	United Kingdom	GP Care Services Ltd
2017	Middletown Cardiovascular Associates, Inc.	Cardiovascular	United States	Premier Health Specialists, Inc.
2017	Texoma Dermatology Clinic, P.A.	Dermatology	United States	Texas Dermatology Associates, P.A.
2017	Interamerican Medical Center Group, LLC	Primary Care	United States	Comvest Partners
2017	Mountain View Medical Group, P.C.	Multi-Specialty	United States	DaVita Health Plan of California, Inc.
2017	Scottsdale Dermatology Ltd.	Dermatology	United States	Advanced Dermatology & Cosmetic Surgery Inc.
2017	Centre Clinique de la Porte de Saint-Cloud	Oncology	France	The American Hospital of Paris
2017	MDR Advanced Medical Associates, Inc.	Chiropractic	United States	HealthSource Chiropractic, Inc.
2017	Millennium Healthcare Management, Inc.	Primary Care	United States	Ochsner Health System
2017	Advanced Dermatologic Surgery	Dermatology	United States	Dermatology Associates of DFW
2017	Southlake Dermatology	Dermatology	United States	Platinum Dermatology Partners, LLC
2017	Stephen P. Castle D.O., P.C.	Dermatology	United States	Advanced Dermatology & Cosmetic Surgery Inc.
2017	New York Eye Specialists	Vision - Refractive	United States	Vision Group Holdings, LLC
2017	Howard K. Scott, M.D. & Associates P.C.	Pediatric	United States	Pediatric Alliance P.C.
2017	The Medical Group Of Ohio	Primary Care	United States	OhioHealth Corporation
2016	Santee Cooper Primary Care	Primary Care	United States	Colonial Family Practice LLC
2016	Corporate Health Center, LLC	Occupational Health	United States	Concentra, Inc.
2016	Altima Dental Canada, Inc.	Dental	Canada	Sentinel Capital Partners, L.L.C.
2016	Eye Academy of America Ltd.	Vision - Refractive	United States	Cortec Group Inc
2016	Twin Cities Occupational Health & Rehabilitation	Occupational Health	United States	U.S. Healthworks, Inc.
2016	AAGAARD Klinik	OB/GYN	Denmark	Virtus Health Limited
2016	Pain Management Clinics of St. Augustine and Palatka	Pain	United States	Champion Pain Care Corporation
2016	Jack Dunlevy Orthodontics	Dental	United States	Spring & Sprout Support Services, LLC
2016	Dayton Vision Center	Vision - Optometry	United States	Wing Eyecare Inc.
2016	Finger Lakes Bone and Joint Center, LLP	Orthopedic	United States	Rochester Regional Health System
2016	Don M. Lunn, DDS, P.C.	Dental	United States	Marquee Dental Partners, LLC
2016	Physicians of Atlantic Gastro SurgiCenter, LLC	Gastroenterology	United States	Physicians Endoscopy L.L.C.
2016	Skin Care Center of Southern Illinois, L.L.C.	Dermatology	United States	United Skin Specialists LLC
2016	Denver Sports Performance Enhancement Center	Orthopedic	United States	University of Colorado Health
2016	Southwest Women's Healthcare Associates	OB/GYN	United States	DuPage Medical Group, Ltd.
2016	Konikoff Dental Associates, Inc.	Dental	United States	Dental Care Alliance, LLC
2016	Riverchase Dermatology and Cosmetic Surgery	Dermatology	United States	GTCR, LLC; GTCR Fund XI LP
2016	Q & M Dental Group (China) Pte. Ltd.	Dental	Singapore	Q & M Dental Group (Singapore)
2016	Global Laser Vision Centers Inc.	Vision - Refractive	United States	Vision Group Holdings, LLC
2016	Dermatologikum Hamburg GmbH	Dermatology	Germany	ECM Equity Capital Management GmbH
2016	Fisher Eye & Laser Center	Vision - Refractive	United States	Vision Group Holdings, LLC
2016	Oncología del Sur S.L.	Oncology	Spain	Genesis Care Ltd
2016	The Orthopedic Institute of New Jersey	Orthopedic	United States	IVYREHAB Network, Inc.
2016	East Valley Foot & Ankle Specialists, LLC	Podiatry	United States	Orthopedic Specialists of North America, PLLC
2016	Capitol Dermatology	Dermatology	United States	Dermatology Associates of Tyler
2016	American Dental Group, Inc.	Dental	United States	Roark Capital Group
2016	DDS General Dentistry	Dental	United States	Marquee Dental Partners, LLC
2016	Mid Tennessee Dentistry LLC	Dental	United States	Marquee Dental Partners, LLC
2016	Dent-a-Medical Spólka Akcyjna	Dental	Poland	Beata sp. z o.o.
2016	Two Dermatology Clinics in Western Pennsylvania	Dermatology	United States	Advanced Dermatology & Cosmetic Surgery Inc.
2016	MAIDA Custom Vision, Inc.	Vision - Refractive	United States	Florida Eye Specialists, P.A.
2016	STX Healthcare Management Services, Inc.	Dental	United States	The Guardian Life Insurance Company of America
2016	Dermatology Clinic, P.C.	Dermatology	United States	Advanced Dermatology & Cosmetic Surgery Inc.
2016	Maternal Fetal Medicine of Southwest Florida, P.A.	OB/GYN	United States	MEDNAX, Inc.
2016	Philadelphia Institute of Dermatology, LLC	Dermatology	United States	Advanced Dermatology & Cosmetic Surgery Inc.
2016	Kameen Eye Associates	Vision - Ophthalmology	United States	Katzen Eye Group PA
2016	Cosmetic Laser Dermatology	Dermatology	United States	West Dermatology Med Management, Inc.

Sources include: CapitalIQ; Lincoln International Healthcare

Global Industry Groups

Aerospace & Defense
Automotive & Truck
Building & Infrastructure
Business Services
Chemicals
Consumer
Distribution
Electronics
Energy & Power
Financial Institutions
Food & Beverage
Healthcare
Industrials
Packaging
Technology & Media

Global Locations

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Chicago
Dallas
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