

Established Private Equity Healthcare Provider Plays

Analyzing deal trends and strategies in behavioral health, dentistry, dermatology, and vision

PitchBook is a Morningstar company. Comprehensive, accurate and hard-to-find data for professionals doing business in the private markets.

Credits & Contact

PitchBook Data, Inc.

John Gabbert Founder, CEO
Nizar Tarhuni Senior Director,
Institutional Research & Editorial
Dylan Cox, CFA Head of Private Markets
Research

Institutional Research Group

Analysis

Rebecca Springer Ph.D. PE Analyst
rebecca.springer@pitchbook.com
pbinstitutionalresearch@pitchbook.com

Data

Charlie Farber Data Analyst

Publishing

Designed by **Mara Potter, Chloe Ladwig** and
Megan Woodard

Published on December 21, 2021

Contents

Key takeaways	1
Introduction	2-3
The private equity consolidation pattern	3-4
Segment comparison	5-9
Behavioral health	9-16
Dentistry	17-23
Dermatology	23-28
Vision	28-32
Conclusion	33-34

Key takeaways

- Since 2016, behavioral health, dentistry, dermatology, and vision together have accounted for around half of healthcare provider buyout activity.
- Positive reimbursement and demand dynamics have made behavioral health the hottest private equity provider segment. While multiples are expected to remain sky-high for the next several years, Medicaid expansion and telehealth reimbursement rates will shape the behavioral health space in the medium to long term.
- Dentistry has been a staple of private equity investment for two decades, yet the space is still seeing new platforms and strategies emerge. With several private equity-backed DSOs having grown to nationally dominant players, dentistry may see significant terminal exits in the coming years, which could include IPOs and sales to payers or other strategics.
- Dermatology is the only segment profiled in this report that has seen declining deal activity in recent years, a result of a lack of strategy diversification thus far and of strategic missteps by some large platforms. However, the segment may see a reignition of deal activity in the coming years as several significant platforms trade hands for the first time and firms explore greenfield space in pure-play cosmetic dermatology and medical spas.
- Private equity activity in vision continues to accelerate due to myriad opportunities for revenue enhancement up and down the acuity scale. Numerous ophthalmology platforms created in the late 2010s should appear on the market soon, while the largest optometry groups—several of them already national in scale—must differentiate themselves in an increasingly crowded optical retail market.

Note: In this report, it is assumed that the reader understands the basics of how private equity firms pursue multiple arbitrage through add-on acquisitions. [This report](#) provides an introduction and discussion of strategic approaches to platform buy-and-build plays. It is also important to know how private equity firms structure healthcare provider transactions, which is laid out in [this report](#). Throughout this report, “platform” means a provider group or MSO/DSO acquired for the purpose of pursuing significant inorganic growth through M&A and/or de novo site openings. “Add-on” is used to refer to any acquisition by a private equity-backed platform; in practice, these can range from very small tuck-in deals, in which a platform absorbs just one or two doctors as an additional location for an existing practice, to acquisitions of groups with dozens of providers. It should also be noted that our data undercounts small tuck-ins, which are rarely announced publicly.

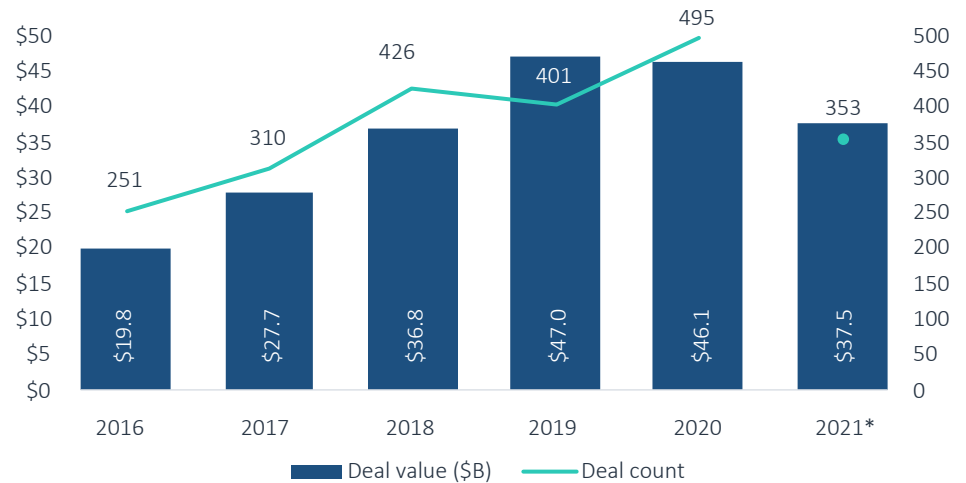
Introduction

Over the past two decades, the private equity healthcare provider playbook has expanded to touch nearly every specialty, from primary care to niches such as cardiology and wound care. However, a handful of specialties still make up the vast majority of private equity healthcare provider deal activity. These specialties offer desirable business model characteristics: acyclical demand patterns, fragmented provider landscapes, long-term demand growth trajectories, attractive margins, and outpatient settings that allow for competitive protection from hospitals. Since 2016, behavioral health, dentistry, dermatology, and vision have been four of the most popular healthcare provider segments for private equity investment. Together, these specialties have accounted for around half of healthcare provider platform buyouts since 2016. Other spaces that have seen extensive private equity activity include home care and hospice, physical therapy, ambulatory surgical centers (ASCs) and, more recently, gastroenterology and veterinary medicine.

For private equity firms, their LPs, and service providers in the private equity ecosystem, understanding deal activity trends in highly developed provider plays is important for several reasons. First, as mentioned above, these segments account for a large portion of the private equity healthcare services landscape, making them critical markets for lenders, healthcare business services companies, and healthcare technology companies. Pick a firm that invests in healthcare services and chances are they have a current portfolio company in one of these segments.

Moreover, because they offer established playbooks, behavioral health, dentistry, dermatology, and vision are often among the initial spaces a generalist firm will explore when considering a healthcare provider play for the first time. Just as importantly, looking at the evolution of established private equity healthcare provider spaces can give insight into how emerging spaces may develop in the coming years. When analyzing established segments, several key themes emerge, including the pattern of platform proliferation, the emergence of substrategies, and consolidation; the tradeoffs between creating integrated and pure-play platforms; and considerations around the mix of inorganic and organic growth. Although every segment is unique, these segments offer important takeaways for any investor in private equity healthcare providers.

Healthcare provider private equity buyout activity



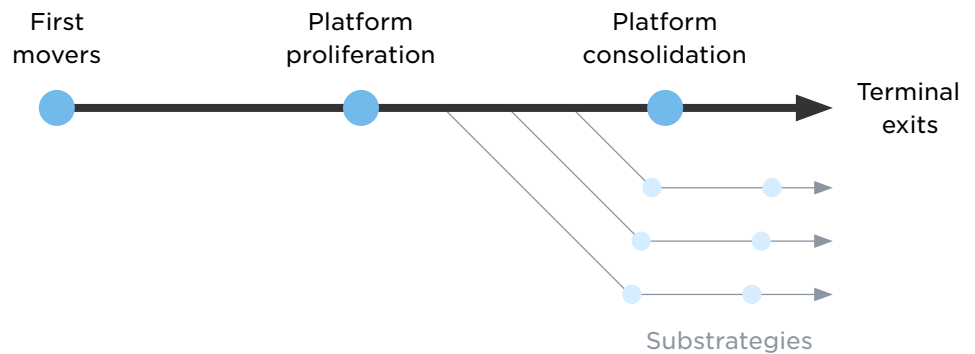
Source: PitchBook | Geography: US

*As of October 31, 2021

Note: Deal value figures are extrapolated from known data.

The private equity consolidation pattern

Private equity activity in healthcare provider specialties follows a somewhat predictable pattern. Typically, two or three firms are the first movers in a greenfield space. They are followed by a growing array of firms that buy or create platforms. As platforms proliferate, firms will seek strategic differentiation, whether by investing in related subsegments, focusing on less crowded geographies, homing in on a certain payment model, or creating multi-specialty or vertically integrated platforms. Examples of each of these types will be discussed in the following pages. At this stage, almost all platforms will be exited in sponsor-to-sponsor transactions since other private equity firms are best equipped to continue integrating and expanding the platform. Today, it is not uncommon for a provider platform to have undergone two, or even three or more, buyouts since it entered private equity hands. Over time, as the market becomes more saturated, the platforms in circulation become larger and begin to combine: The largest private equity-backed platforms begin to buy other private equity-backed platforms. They will also pursue deals for large provider groups that have already consolidated several practices on a local or regional basis without private equity backing. Historically, there have been few examples of terminal exits, in which large platforms exit the private equity investment cycle altogether through sale to a strategic buyer (such as an insurance company or specialist provider network) or IPO, although current market conditions may facilitate more such exits in the coming years.

Private equity healthcare provider consolidation pattern

Source: PitchBook

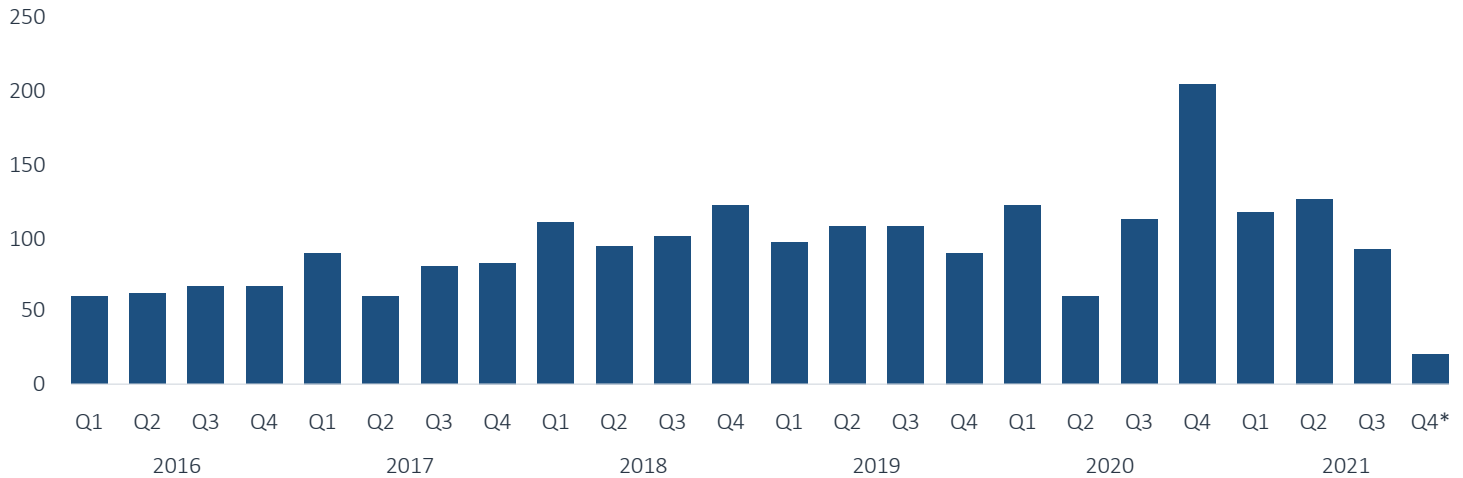
Different specialties vary in how they progress through this process. The extent to which different geographies and patient populations are already served by non-private-equity-backed providers can affect how private equity consolidation in a specialty progresses, as can the role of strategic (non-private equity) aggregators, such as hospitals, health systems, and insurers.¹ Additionally, as private equity presence in the healthcare provider space has grown overall—and as private equity dry powder has accumulated and investment and realization timelines across the industry have compressed—provider spaces tend to move more quickly through the process of first movers, platform proliferation, and consolidation than they did in the past. Finally, regulatory and reimbursement changes and shifting demand can also play a role in accelerating the development of private equity involvement in a healthcare provider specialty. As discussed below, behavioral health provides a clear example of this.

1: Although this report focuses on PE deal activity, it is important to remember that PE represents only part of the broader industry trend toward healthcare provider consolidation. According to data from the Physicians Advocacy Institute, hospitals own more healthcare practices than PE-backed platforms and other corporate aggregators combined.

“COVID-19’s Impact on Acquisitions of Physician Practices and Physician Employment 2019-2020,” Physicians Advocacy Institute, June 2021.

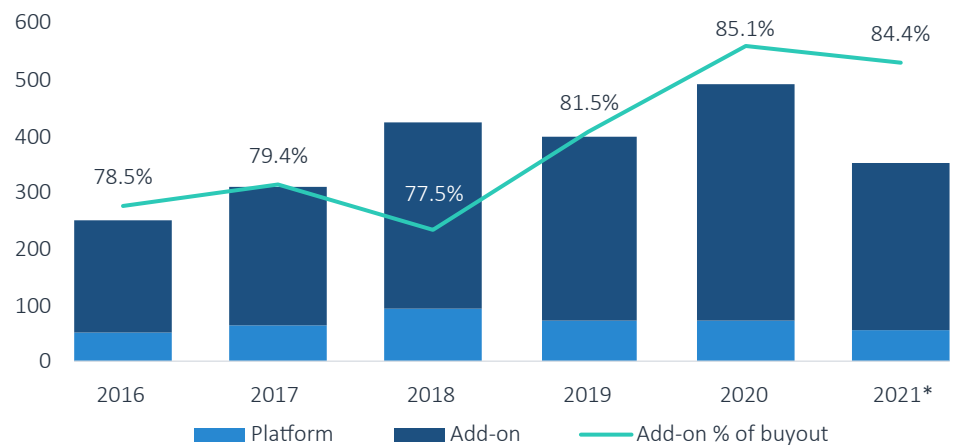
Segment comparison

Healthcare provider private equity buyout count by quarter



Source: PitchBook | Geography: US
*As of October 31, 2021

Healthcare provider private equity buyout count by type

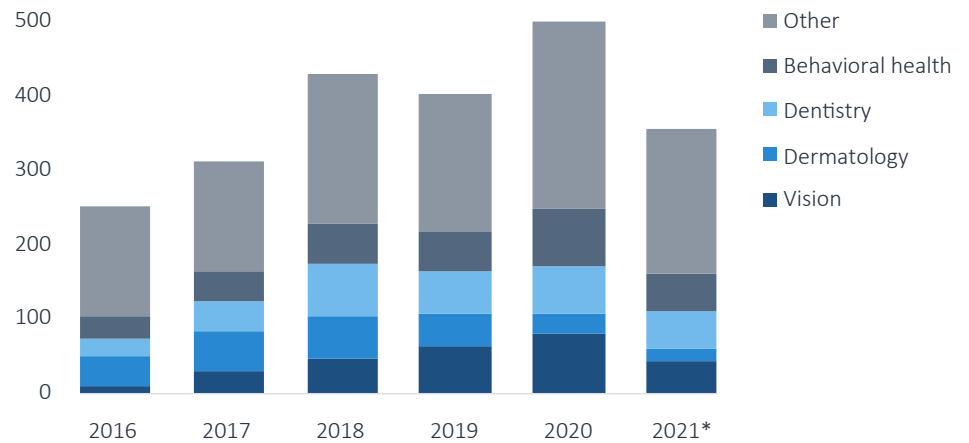


Source: PitchBook | Geography: US
*As of October 31, 2021

Across all provider segments, private equity buyouts of healthcare providers have increased gradually since 2016. The COVID-19 pandemic caused only a temporary delay in deal activity, which resulted in a spike in deal closings in Q4 2020 as firms wrapped up processes that had been disrupted by travel restrictions and economic volatility. To some extent, firms also focused more on growing their existing platforms through M&A than they did on platform transactions in 2020. In an environment of uncertainty, smaller add-on transactions posed less risk than larger platform deals, and many independent providers sought buyers for their practices amid the financial (and psychological) stress caused by pandemic-related lockdowns. However, the growth in add-ons as a

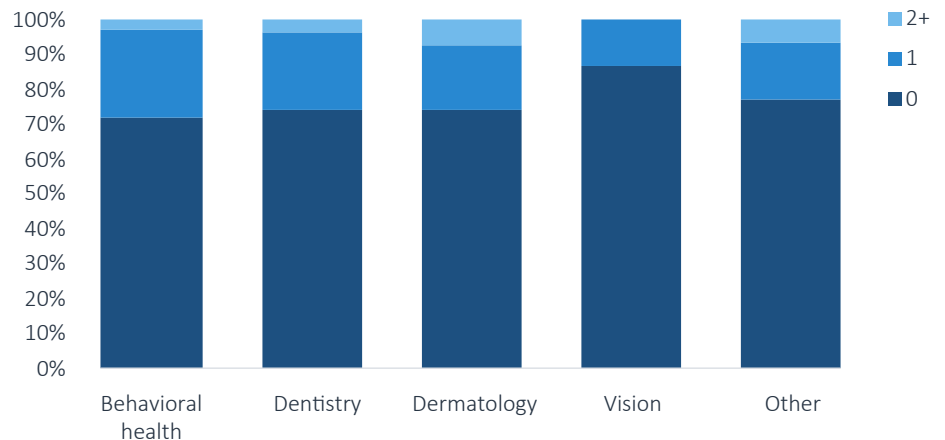
proportion of overall healthcare provider deal activity in 2020 also relates to industry trends that predate the pandemic. As the healthcare provider space has grown more competitive and multiples have risen, firms are pursuing more aggressive growth strategies to ensure favorable exits, and private equity buyers are increasingly willing to value practices based on EBITDA from recently completed add-ons or even acquisitions still under letter of intent (LOI). Additionally, some segments, notably behavioral health, have seen such a surge in popularity that platform buyouts accelerated in 2020.

Healthcare provider private equity buyout count by segment



Source: PitchBook | Geography: US
*As of October 31, 2021

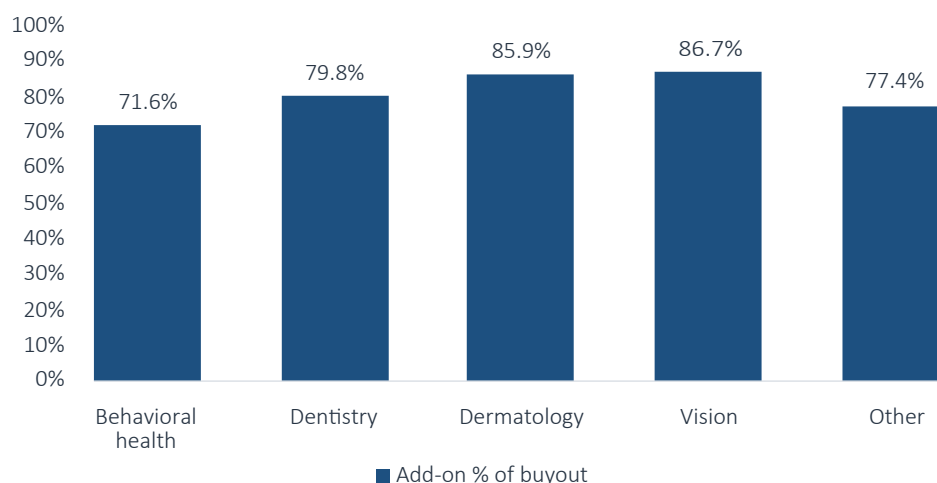
Healthcare provider private equity buyouts (2016-October 2021*) by number of previous buyouts*



Source: PitchBook | Geography: US
*As of October 31, 2021

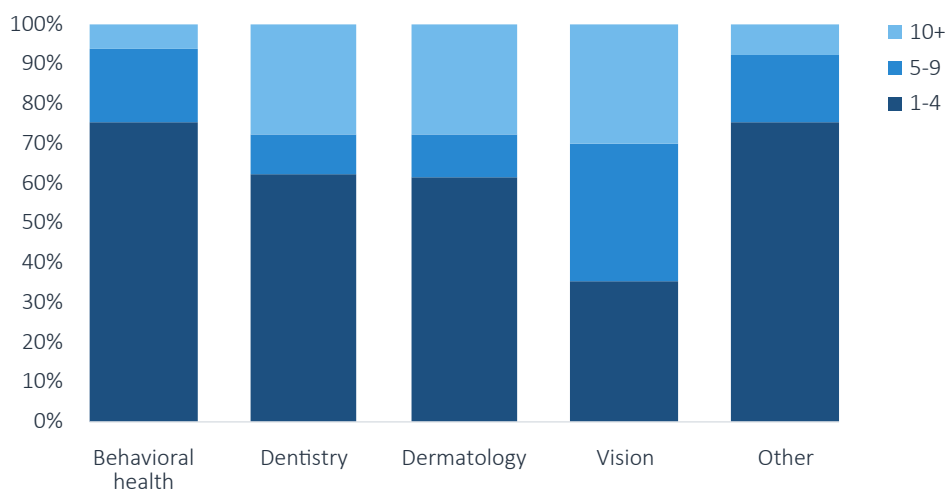
The last half decade has seen dealmaking accelerate across provider segments. Of the segments profiled in this report, vision has been the most recent to mature; many of the most active platforms currently in the market were created in 2017 and 2018 and are now approaching their first exits. Behavioral health has also seen remarkable acceleration since 2016, largely due to new waves of private equity investment in the mental health and applied behavioral analysis (ABA) subsegments. Dentistry, one of the oldest private equity provider plays, also saw an acceleration of dealmaking in the late 2010s as private equity firms increasingly moved from general and multispecialty dentistry into less crowded specialties, namely orthodontics and oral surgery. Dermatology is the only segment profiled in this report that has seen declining deal activity in recent years, perhaps a result of the industry's skepticism toward private equity and of a lack of new subsegment development.

Add-ons as a share of healthcare provider private equity buyouts (2016-October 2021*) by segment*



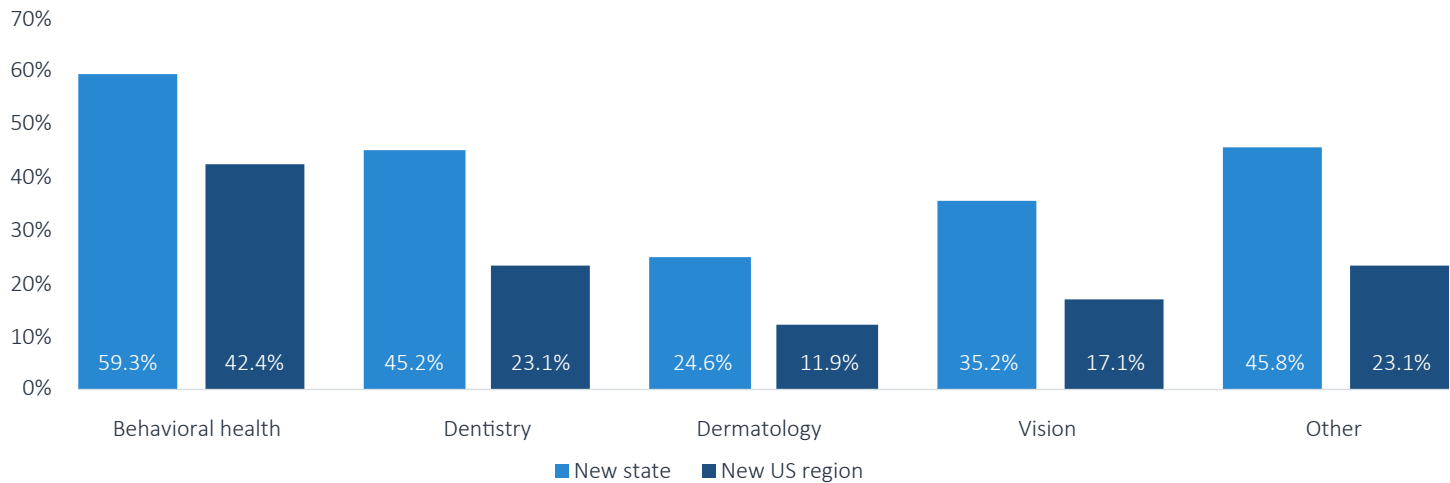
Source: PitchBook | Geography: US
*As of October 31, 2021

Healthcare provider private equity platform buyouts by number of previous add-ons at time of acquisition (2016-October 2021*)



Source: PitchBook | Geography: US
*As of October 31, 2021

Share of healthcare provider add-ons by headquarter location (2016-October 2021*)



Source: PitchBook | Geography: US

*As of October 31, 2021

Note: This chart shows shares of add-ons that are headquartered in states and regions where neither the platform nor a previous add-on by the same platform is headquartered.

Variations in the growth strategies employed in each segment are evident in the data. Vision and especially dermatology platforms are typically density plays. Although all four provider segments featured in this report are fragmented, the dermatology and vision spaces are the most so. Independent practices in these segments can be quite lucrative for their owners, meaning that there is less impetus to consolidate, and private equity penetration in these industries has not yet reached the levels seen in dentistry. This means that dermatology and vision platforms place a relatively heavier emphasis on rapidly executing large numbers of small practice acquisitions, as opposed to de novo location openings or acquisitions of larger provider-owned groups, than do platforms in other provider segments. With a few notable exceptions, most platforms in these two segments are currently regional or even state-specific; they have found plenty of acquisition targets even within a limited geographical area, and they therefore enjoy rapid growth while increasing their bargaining power with payers and limiting the legal complexities associated with entering new states.

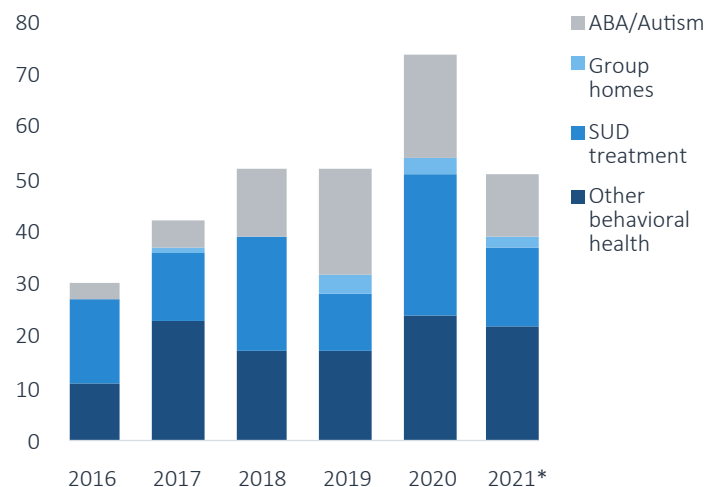
Portions of the dentistry market also exhibit the characteristics of density plays, especially for general dentistry and vertically integrated platforms where brand awareness and market density can be key return drivers. However, because private equity firms have been active in dentistry for over two decades, several platforms have grown to a national scale and now primarily focus on acquiring larger practice groups or other private equity-backed platforms rather than small independent practices. Because there are fewer potential targets at this scale and integration is more involved, acquisitions cannot be completed at the same pace, resulting in somewhat lower add-on deal counts. Dentistry platforms are also more likely than dermatology or vision platforms to utilize de novo growth strategies due to the adequate supply of new practitioners graduating from dentistry school. In mixed inorganic and organic growth models, platforms tend to enter new states or metropolitan areas through the acquisition of a larger practice group before opening new locations in the same market to build density. Finally,

much of the new platform activity in dentistry over the past half decade has focused on referral-based specialties, which lend themselves to national strategies with less local density-building because practices typically join the platform with local referral networks already established.

Behavioral health is unique among the segments featured in this report because although it is a fragmented market with few large players, historical provider shortages mean that the supply of independent practices is limited in many geographies. This makes de novo growth strategies essential for behavioral health platforms because competition is fierce and acquisition multiples are sky-high, even for small practices. As a result, more than half of behavioral health add-ons since 2016 have been new state entries.

Behavioral health

Behavioral health private equity buyout count by subsegment

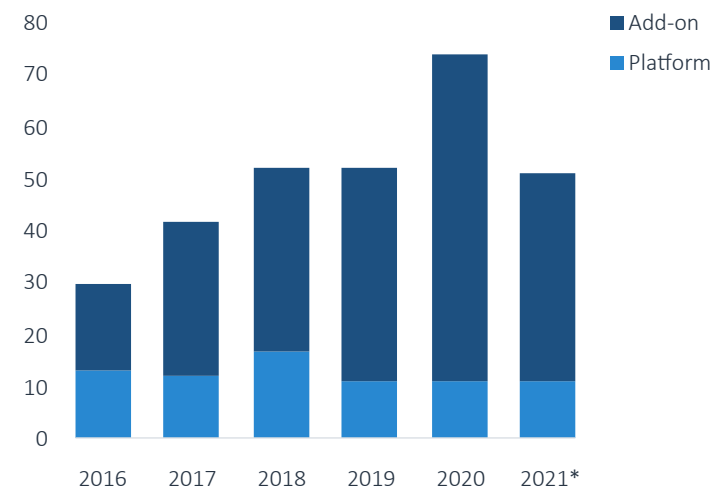


Source: PitchBook | Geography: US

*As of October 31, 2021

Note: "Other behavioral health" includes mental health, eating disorder treatment, and psychiatric care.

Behavioral health private equity buyout count by type



Source: PitchBook | Geography: US

*As of October 31, 2021

Private equity interest in behavioral health providers has been driven by compelling patient behavior and reimbursement tailwinds that present a long runway for future development in the space. In recent years, Americans' awareness of and interest in treating behavioral health issues has risen dramatically. Additionally, the medical field has moved toward a more holistic approach to patient care, including treatment of behavioral comorbidities alongside physical ailments. As a result, demand for behavioral healthcare providers has outstripped supply, especially in rural areas and underserved communities. The COVID-19 pandemic only increased this unmet demand as many struggled to cope with lockdowns, social isolation, and economic instability. In 2020, rates of alcoholism, substance use relapses, and anxiety and depression grew faster than historical trends.

In addition to these favorable supply-demand dynamics, the behavioral health industry has seen a steady and at times dramatic increase in

reimbursement coverage and rates, driven both by legislative mandates at the federal and state level and by payers' growing realization that effective behavioral healthcare can improve the overall health of their patient populations. The key regulatory developments in behavioral healthcare are described below.

The combination of unmet, growing demand and increasingly favorable economic models makes behavioral health unique among the specialties profiled in this report. No other major healthcare provider space has seen such explosive growth in the past five or so years. Whereas the healthcare services space typically sees multiples of 6x to 8x for a business between \$1 million and \$10 million in EBITDA and of 10x and 14x (depending on the specialty) for \$10 million to \$50 million, anecdotal reports suggest that even very small behavioral health providers are trading at no less than 10x EBITDA, with multiples for larger platforms reaching well into the twenties.²



Source: PitchBook | Geography: US

Note: Segment overview includes representative private equity-owned platforms.

2: "Behavioral Health M&A Trends," Expert Webcast, Jeremy Levy, Dana Jacoby, Dexter Braff, and Alex Kasdan, October 28, 2021.

Definitions

Applied behavior analysis (ABA): ABA refers to a type of therapy that can be used to treat a range of developmental disorders, but it is typically associated with the treatment of autism in children. ABA therapy is provided by board-certified behavioral analysts (BCBAs), who must have a master's or Ph.D. in a relevant field and achieve board certification, with the assistance of registered behavior technicians (RBTs).

Eating disorder treatment: Treatment for eating disorders can be provided through inpatient care, residential care, or day programs. Inpatient (hospitalization) care focuses on physiological and psychological stabilization of the most acute cases, often involving the use of feeding tubes. Residential programs provide focused, around-the-clock care to mentally stable patients. Day treatment can take the form of intensive outpatient programs (IOPs) and partial hospitalization programs (PHPs). Patients being treated at one level of acuity often step up or down to another level through referrals, depending on their needs. Eating disorder treatment practices are physician-led with the support of a range of staff, including psychologists, therapists, dietitians, and nurses.

Substance use disorder (SUD) treatment: Also known as addiction treatment, SUD treatment can take a variety of forms. These include daytime, community-based programs; medication-assisted treatment (MAT); intensive outpatient treatment via IOPs or PHPs; and residential programs. Many SUD treatment centers are specifically focused on opioid use. Like eating disorder treatment, SUD treatment is typically overseen by a physician but may be primarily carried out by counselors or therapists and other specialists.

Mental health treatment: Mental health treatment is a broad category. At the lowest acuity level, mental health treatment involves therapy for conditions such as anxiety and depression, or simply to improve a patient's mental wellbeing. Further up the acuity scale, patients may be treated through IOPs or PHPs or in inpatient psychiatric hospital settings. Mental health practices can be overseen by psychiatrists, clinical psychologists, or licensed counselors, depending on the type of treatment they provide. Many private equity platforms integrate SUD treatment or eating disorder treatment with mental health treatment. Practices may also specialize in treating adults and/or adolescents.

Group homes: Group homes are residential facilities where care is provided for people with intellectual and developmental disabilities (IDD). Care includes support with basic daily routines, medication administration, transportation, and group activities and community integration. Services are provided by non-medical care staff who may or may not have professional certifications. Group home providers may also offer day programs, home care, and other support services for people with IDDs.

Development and current dynamics

First movers

Private equity investment in behavioral health has a long history, but the space did not attract widespread attention until the mid-2010s. Several firms made behavioral health investments from the early 2000s until the global financial crisis (GFC), especially in the SUD and mental health space. These included CHL Medical Partners' 2002 buyout of MedMark Treatment Centers, Triton Pacific Capital's 2006 buyout of Meridian Behavioral Health, and American Capital's 2006 buyout of Meadows Behavioral Healthcare. Other behavioral health subsegments saw scattered activity around the same time, including Trimaran Capital's 2004 buyout of ChanceLight Behavioral Health and Education, a provider of in-school therapy services, including ABA, to students with behavioral disorders and developmental disabilities.

However, many of the private equity behavioral health investments made during this first wave of activity—especially those in SUD treatment—came under financial stress and struggled to recover after the GFC. Notably, MedMark, Meridian, and Meadows all experienced decade-long holds following their initial buyouts before finally being exited into a much more favorable and competitive private equity behavioral health market in the mid-2010s. Meridian Behavioral Health, for instance, went through bankruptcy administration in 2011 and was purchased by Audax Partners in 2015. Private equity's pre-GFC foray into SUD treatment focused on high-end, "destination" residential treatment facilities, often located in the Malibu or Miami area. Because these facilities catered to affluent clients who could afford to travel from out of state for care, their revenue derived primarily from out-of-network (OON) commercial payer reimbursement; unlike in-network rates, OON rates are not subject to multiyear contracts between payers and providers. This left the practices with little recourse when payers, concerned by the rising cost of SUD treatment in their patient populations, began to slash reimbursement.

Second wave

Private equity's second wave of behavioral health investment took a different approach. SUD treatment pivoted away from OON residential programs and toward more medically focused facilities that attracted patients from in-state and derived their revenue primarily from commercial payers. Although in-network SUD treatment offers lower margins than OON treatment, it mitigates reimbursement risk and provides access to a much broader potential patient base. (Sandra Zervoudakis, managing director at Mertz Taggart, notes that it is still possible to operate a successful high-end, OON SUD facility if managed correctly, and that firms willing to embark on this route today will find less competition for assets and slightly lower purchase multiples than firms pursuing in-network SUD treatment strategies.³) At the same time, medication-assisted treatment (MAT) became more prevalent in the SUD treatment industry, especially in the treatment of opioid addiction, and many private equity-backed platforms made this a centerpiece of their treatment offerings. Examples include BayMark Health Services, a MAT-focused opioid addiction treatment group that has grown aggressively since its buyout

3: Sandra Zervoudakis, phone interview with Rebecca Springer, August 26, 2021.

by Webster Capital Management in 2015, and Vertava Health, a more diversified provider of SUD treatment and co-occurring mental health disorders that offers MAT, purchased by Summit Partners for \$275.0 million in 2018.

In addition to a new style of SUD treatment, behavioral health saw an explosion of platform activity in autism treatment beginning in 2013 and accelerating through 2018. Most of the platforms dating to this time, including BlueSprig Pediatrics, which KKR (NYSE: KKR) created in 2017, and Center for Autism & Related Disorders, which Blackstone (NYSE: BX) acquired in 2018, are pure-play ABA specialists. However, according to Nancy Weisling, managing director at the Braff Group, the subsegment has also seen a more recent trend toward integrating ABA with other pediatric therapy specialties such as speech therapy, educational therapy, and occupational therapy, or with the treatment of other behavioral disorders.⁴ Private equity investment in mental health held steady through this period before accelerating dramatically beginning in 2020, when the COVID-19 pandemic both increased and called attention to the need for treatment of mood and eating disorders alongside physiological comorbidities. Prominent mental health platforms created during this time include Refresh Mental Health, which has already made eight acquisitions since it was purchased by Kelso Equity Partners for \$700.0 million in October 2020.

Current dynamics

Although ABA platform buyouts have slowed somewhat, this is more a function of the scarcity of platform-scale groups in the market than of a slowdown in private equity interest in the space. Given the extreme seller's market, many of the ABA platforms created in 2016 through 2018 will likely look to exit in the next one to two years, but anecdotal reports about the number of buyers in the space suggest this is unlikely to ease the upward pressure on multiples by much, if at all.

In mental health, an explosion of platform activity since 2020 foretells accelerated consolidation in the years to come. Additionally, given compelling demand trends and the potential to leverage telehealth technologies, some outpatient mental health platforms may be well suited to exits to strategic buyers and public listings. LifeStance Health (NASDAQ: LSFT), which Summit Partners and Silversmith Capital Partners took public in June 2021, is an informative precedent. It is not unlikely that we will see additional mental health platforms undertake terminal exits after only one turn in private equity ownership. By contrast, SUD treatment, the oldest behavioral health segment, should see another wave of private equity investment start as platforms that last transacted in 2015 through 2018 return to the market, and may begin to enter the early stages of platform consolidation in the coming years.

4: Nancy Weisling, phone interview with Rebecca Springer, August 18, 2021.

Strategic considerations

Regulatory and reimbursement landscape

Of the segments featured in this report, behavioral health is unique in the extent to which private equity interest in the space has been driven by improvements in the regulatory and reimbursement landscape. The 2008 Affordable Care Act (ACA) was a watershed for behavioral health because it prompted many states to introduce the concept of “parity,” in which payers must treat behavioral health services in the same way as medical and surgical care with regards to, for instance, annual or lifetime limits, cost sharing ratios, treatment limitations, approval processes, and methods by which reimbursement rates are set. This significantly increased both utilization and reimbursement rates in the sector and, particularly for less acute forms of treatment such as ABA, created EBITDA margins of up to around 25%.⁵ Since 2008, a growing number of states have introduced parity laws, and legal challenges have ratcheted up the pressure on payers to comply. Currently, 47 states and the District of Columbia require at least some degree of insurance coverage for ASD treatment.⁶ Looking ahead, improved enforcement mechanisms resulting from the 2021 Consolidated Appropriations Act should further boost behavioral health reimbursement rates.

Key regulatory developments in behavioral health reimbursement

Year	Act	Impact
1996	Mental Health Parity Act (MHPA)	Required large group health plans to reimburse behavioral health services at parity with other medical services, if they offer them
2008	Mental Health Parity and Addiction Equity Act (MHPAEA)	Extended MHPA to include treatment of SUDs for large group health plans, if they offer them
2010	Affordable Care Act (ACA)	Extended MHPAEA to small group, individual, and Medicaid expansion plans and required these plans to cover mental health and SUD treatment as an essential health benefit
2020	Coronavirus Aid, Relief, and Economic Stability Act (CARES Act)	Required CMS to reimburse telehealth services at the same level as equivalent in-person services
2021	Consolidated Appropriations Act of 2021	Ratcheted up enforcement of MHPAEA by requiring plans to conduct comparative analysis proving compliance

Source: Centers for Medicare & Medicaid Services, US Department of Health and Human Services, US Department of the Treasury, United States Congress | Geography: US

Medicaid is shaping up to be the last significant frontier for behavioral health insurance coverage. Behavioral health conditions affect 20% of Americans who are covered by Medicaid, and Medicaid is currently the nation’s largest payer for behavioral health services.⁷ Although the ACA improved Medicaid reimbursement rates for expansion states, many states still do not cover behavioral healthcare via Medicaid. In other states, the administration of Medicaid benefits via managed care organizations (MCOs) presents significant hurdles for behavioral health platforms as

5: “Behavioral Health Continues to Attract Private Equity Investors,” MergerMarket, Deborah Balshem, June 23, 2017.

6: “Autism and Insurance Coverage State Laws,” National Conference of State Legislatures, August 24, 2021.

7: “Medicaid’s Role in Financing Behavioral Health Services for Low-Income Individuals,” KFF, Julia Zur, et al., June 29, 2017. ; “Behavioral Health Services,” Medicaid.gov, n.d.

they expand, since it can be difficult to gain entry to an MCO's provider network. The combination of these state-by-state inconsistencies and the lower reimbursement rates offered by Medicaid dissuades many behavioral health platforms from taking Medicaid insurance. However, the national trend is undoubtedly toward improved Medicaid coverage for behavioral health treatment—especially as states continue to grapple with the social and economic effects of the opioid crisis. As state-level reforms progress, private equity-backed behavioral health platforms that focus on the Medicaid population will benefit and may proliferate.

A final regulatory issue in behavioral healthcare is the reimbursement level offered by payers for telehealth as opposed to in-person services. Although telehealth can be utilized by many medical specialties, it is particularly important in behavioral health. Because many rural areas lack sufficient behavioral health provision, and because many behavioral health patients struggle to obtain consistent transportation to appointments, the expansion of telehealth spurred by the pandemic has the potential to significantly improve access to care and patient outcomes. Levine Leichtman Capital Partners' (LLCP) Monte Nido & Affiliates, a provider of eating disorder treatment across the continuum of care, has seen improved attendance and treatment adherence for its eating disorder treatment day programs, which are now offered both virtually and in-person. Mental health providers, which are often considered volume plays due to lower reimbursement rates, have also benefited significantly from the efficiencies and improved patient access afforded by virtual appointments.

The 2020 CARES Act required that Medicaid reimburse providers for telehealth services at the same rate as in-person services, and the Centers for Medicare & Medicaid Services (CMS) has proposed to extend this provision, with some exceptions, on a trial basis until the end of 2023. Although the CARES Act provision did not apply to commercial payers, most voluntarily set reimbursement rates for telehealth at parity with in-person services in 2020. However, it is unclear how long payers will continue this policy, especially amid growing concerns of overutilization. Several telehealth reimbursement parity laws that would apply to commercial payers are currently moving through state legislatures. Amid this uncertainty, private equity-backed SUD treatment, eating disorder treatment, and mental health platforms must balance optimizing their use of telehealth and continuing to grow through new physical locations in order to manage reimbursement risk going forward.

Competition from strategics

Because the space has such demographic and regulatory tailwinds, private equity firms investing in behavioral health practices now risk finding themselves in an increasingly crowded marketplace in a few years' time, especially in more populous areas. In addition to private equity activity, behavioral health has attracted the interest of key strategics such as hospitals, which can not only function as direct competitors for inpatient eating disorder and acute psychiatric treatment, but which are increasingly building out networks of outpatient and post-acute clinics. For example, Acadia Healthcare (NASDAQ: AHC) has formed joint ventures with several hospitals, most recently Orlando Health, a nonprofit health system

in central Florida, to expand the hospitals' behavioral health offerings.⁸ If hospitals double down on expanding their behavioral care offerings, private equity-backed platforms will need to either outpace them in building and acquiring clinics in more populous markets or seek opportunities in less populous ones. As specialties such as eating disorder treatment and SUD treatment pivot increasingly toward in-network models and local patient populations, it will be crucial for firms to predict how the landscape of hospitals and health systems within a particular state or metropolitan area will evolve when making investment decisions.

De novo growth in provider shortage subsegments

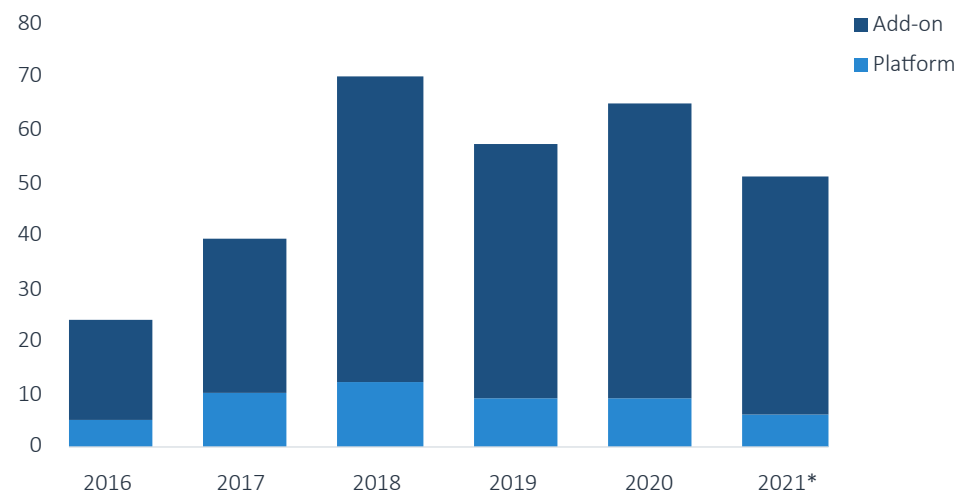
As mentioned previously, in several behavioral health subsegments, a severe shortage of providers in relation to both patient demand and private equity buyer interest has driven multiples sky-high and made purely inorganic growth strategies infeasible. Eating disorder treatment is one example of a vertical that lends itself to de novo growth plays. An estimated 30 million people in the US will suffer from an eating disorder in their lifetime, but residential treatment options are limited, with many facilities running wait lists for admission. Several states, such as Iowa and Nebraska, do not have a single residential eating disorder treatment provider. For this reason, LLCP's Monte Nido put in place a real estate and development team that allows the platform to open around four to five de novo residential treatment centers per year. The platform has at times entered a new state through M&A, then pursued de novo openings in the same state to build market density, ultimately securing more favorable provider contracts. Additionally, unlike most private equity-backed healthcare providers, Monte Nido prefers to own, rather than lease, its real estate, which provides greater flexibility to expand existing facilities.

Some ABA platforms have also seen significant de novo growth. Unlike residential eating disorder treatment, the number of ABA providers (not just private equity-backed) is growing due to favorable reimbursement rates and margins, and the relatively low barriers to entry for entering the profession (obtaining a BCBA requires only a master's degree at minimum, as opposed to an MD). However, demand for ABA treatment still outpaces the supply of providers, and the sudden rush of private equity firms looking to enter the space has driven up purchase multiples for both platforms and add-ons, reducing multiple arbitrage opportunities. As a result, firms are pursuing de novo growth strategies wherever possible. For instance, Acorn Health, an ABA platform which Ontario Teachers' Pension Plan bought from MBF Healthcare Partners in August, announced the opening of six new de novo clinics for H2 2021 in states where it already has a presence and is currently seeking additional therapists and technicians for further expansion. This is compared with just one small acquisition in the same period. Although opening a new clinic does not provide the near-instantaneous EBITDA growth of an acquisition—simply bringing a new location onto an existing payer contract can take one to two years—it often provides a superior return on investment over a multiyear period and facilitates consistency in branding and back-office operations.

8: "Orlando Health Launches Behavioral Health Joint Venture with Acadia Healthcare," Modern Healthcare, Tara Bannow, December 1, 2021.

Dentistry

Dentistry private equity buyout count by type



Source: PitchBook | Geography: US

*As of October 31, 2021

As one of the oldest private equity healthcare provider plays, dentistry provides a model for how private equity-driven consolidation in a segment can progress and, in the coming years, may give insight into exit opportunities for the largest platforms that have grown through two, three, or more successive buyouts. Dentistry boasts a vast addressable market, increased utilization due to expanded commercial payer coverage, and a range of specialties that offer higher margins and more out-of-pocket payments, including orthodontics and oral surgery. At the same time, dentistry has faced declining reimbursement rates for at least a decade. This has driven many independent dentists to sell their practices and affiliate with either dentist-owned or corporate (often private equity-owned) dental support organizations (DSOs) in order to achieve better bargaining power with payers and suppliers and unlock cost efficiencies.



Source: PitchBook | Geography: US

Note: Segment overview includes representative private equity-owned platforms.

Definitions

General dentistry: Also known as family dentistry, this is the most basic form of practice by a Doctor of Dental Surgery (DDS) and involves routine care, such as preventative care, diagnosis, fillings, root canals, and crowns. General dentists may treat children and adults, and some practices specialize in pediatric general dentistry.

Orthodontics: Orthodontic treatment seeks to change the position of teeth in the mouth to improve the patient's bite for aesthetic and medical reasons, using braces, retainers, bands, and other devices. Orthodontists complete an additional two- to three-year residency following dental school.

Oral surgery: Oral surgeons (or oral and maxillofacial surgeons) perform surgical procedures on the face, mouth, and jaw. This includes simple and complex tooth extractions, facial reconstruction, tumor removal, and implant positioning. Oral surgeons must complete a four- to six-year surgical residency following dental school in order to practice.

Periodontics and endodontics. Periodontists specialize in treating gum disease and placing dental implants, while endodontists specialize in tooth pain diagnosis and root canal treatment. Both periodontists and endodontists complete an additional two to three years of schooling after

medical school to specialize. They usually acquire patients through referrals from general dentists for cases that require more advanced care. Unlike orthodontics and oral surgery, periodontics and endodontics have not seen much private equity activity as pure plays, instead being incorporated into multispecialty platforms.

Development and current dynamics

First movers

Private equity firms first entered dentistry in the late 1990s, beginning with APG Partners' buyout of Aspen Dental Management in 1997. Several other firms entered the market in the following years, including Gryphon Investors, which bought Bright Now!, an orthodontics-focused platform that now operates under the name Smile Brands, in 1998. Both Aspen Dental and Smile Brands are still in private equity hands: Aspen Dental is currently owned by Ares Management (NYSE: ARES), Leonard Green & Partners, and American Securities, while Gryphon Investors bought Smile Brands for the second time—the company's fourth turn of private equity ownership—in 2016.

Second wave and subsegment emergence

A "second wave" of dental platform buyouts ensued on the eve of and shortly after the GFC, including Sage Dental, Western Dental, Great Expressions Dental Centers, and DentalOne, all of which remain significant private equity platforms today. In this rapid growth phase, mobile dentistry—in which routine preventative care is provided in pop-up dental clinics at schools, primary and behavioral healthcare settings, senior living facilities, and underserved communities—emerged as a popular niche play alongside general dentistry.

The mid-2010s saw private equity activity in dentistry continue at a rapid clip, with dozens of new platforms created, existing platforms changing hands, and new subspecialty plays emerging. Although some private equity-backed platforms already incorporated orthodontics offerings alongside general dentistry, and Smile Brands was already well-established as an orthodontics specialist, private equity firms became keenly interested in orthodontics at this time, either buying orthodontics groups to integrate into their existing general dentistry platforms or, as in the case of Sheridan Capital Partners' buyout of Smile Doctors in 2015, building pure-play orthodontics businesses. Interest in orthodontics has accelerated in recent years due the fact that the space is less consolidated than general dentistry—about 15% of orthodontists are part of multipractice groups, compared with more than 22% to 23% of dentists⁹—and because orthodontics offers attractive payment models. Payment is primarily out-of-pocket or via commercial insurance, resulting in higher fee/reimbursement rates, and tends to be rendered in fixed installments over multiyear treatment programs, leading to predictable cash flows.

9: "Today's Dental Practice Market and Recent Deal Activity," McGuire Woods, April 20, 2021.

More recently, oral surgery has emerged as another popular private equity investment area. Like orthodontics, several generalist platforms bought oral surgery practices in the mid- to late-2010s. Firms have also sought out multispecialty groups that provide oral surgery as well as orthodontics and other specialized dental care, such as Simply Beautiful Smiles, which took growth capital from The Beekman Group in the mid-2010s before being sold to Sun Capital Partners in 2019. However, significant private equity interest in pure-play oral surgery dates back to within the past couple of years, beginning with deals like RiverGlade Capital and The Thurston Group's formation of U.S. Oral Surgery Management (USOSM) in 2017 through the combination of two Texas-based groups. RiverGlade and Thurston recently achieved an impressive exit of USOSM, now the largest private equity-backed pure-play oral surgery platform, to Oak Hill Capital, selling for over \$700 million on approximately \$50 million EBITDA, which would imply a nearly 15x multiple.¹⁰ Like orthodontics, oral surgery is a high-margin specialty that is less consolidated than general dentistry (around 10%) and offers attractive payment dynamics.¹¹ It also benefits from a strong growth trend as dental implants, as opposed to dentures or bridges, become more popular among elderly patients.

Current dynamics

While niche plays like orthodontics and oral surgery have emerged, general dentistry has seen consolidation among the largest platforms in recent years. In 2020, Aspen Dental acquired ClearChoice, a national dental implant specialist that was purchased by Sun Capital Partners in 2017 but has taken private equity growth capital since 2009. And in 2021, KKR's Heartland Dental Care, the country's largest DSO, acquired American Dental Partners, Inc. (ADPI). ADPI boasts a network of over 200 dentists in 21 states, though it has not grown significantly since its 2012 take-private by JLL partners.

Meanwhile, the pace of new platform creation in general or multispecialty dentistry has slowed, with only eight new platforms entering private equity hands since the beginning of 2019. As the provider landscape becomes more consolidated and already private equity-backed platforms continue to mature, middle-market firms can purchase four- or five-year-old platforms, continue their growth trajectories, and still enjoy multiple arbitrage by exiting to an even larger firm. However, according to John Orr, co-founder and managing partner of Centennial Peaks Capital, we are likely to continue seeing new provider groups enter the private equity landscape as platforms in the lower middle market.¹² Although consolidation in dentistry has progressed further than in most other provider segments, the landscape is still sufficiently fragmented to provide an attractive growth runway for new platforms, and dentist-led groups are continuing to consolidate locally in hopes of attracting a private equity buyer. Dentistry also represents an attractive first entrance into healthcare for generalist lower-middle-market firms because it offers an established playbook that has seen little disruption over two decades of private equity investment.

10: "JLL Partners Completes American Dental Deal," PE Hub, Jonathan Marino, February 10, 2012.

11: Ibid.

12: John Orr, phone interview with Rebecca Springer, December 9, 2021.

Strategic considerations

Terminal exit opportunities

Looking ahead, dentistry will likely become a testing ground for exiting very large healthcare provider platforms. The growth trajectories of general dentistry platforms will inevitably slow as consolidation in the industry progresses, meaning that these platforms will become less suited to investment strategies that seek 20% or higher returns. Heartland Dental provides a case study of one alternative option. Its 2018 buyout by KKR's long-dated Core I fund signals that Heartland has graduated out of its most rapid growth phase, and that the company's primary value to investors is in its ability to generate steady cash flows and compound these to grow at a more modest pace over an extended time horizon. It is possible that other large private equity-backed platforms will follow a similar route, either being purchased by long-dated funds, moved into continuation vehicles, or taking direct investments from pensions or sovereign wealth funds committed to elongated hold times.

Another exit possibility is an IPO. There is no precedent for a successful IPO of a private equity-backed DSO; Smile Brands filed to go public in 2010 but canceled the offering amid broader market volatility. However, private equity exits to public markets have greatly accelerated since 2020, including IPOs by a handful of healthcare providers in primary care, home care, aesthetic dermatology, and behavioral health. It is not unreasonable to think that a platform such as Aspen Dental, which has lately been diversifying beyond dentistry into urgent care, aesthetic dermatology, and direct-to-consumer invisible alignment orthodontics—all of which have been successful themes in public markets in recent years—could launch a favorable public exit.

The final option is a sale to a strategic buyer. Again, there are few precedents for this in dentistry, where the largest DSOs are private equity-backed. However, vertical plays involving either commercial payers or retailers as buyers could emerge. Although there have been no large exits of private equity-backed DSOs to payers, there are a few regional examples of vertical DSO-payer integration. Guardian Life Insurance, which also sells dental insurance, purchased Premier Access Insurance, which owned a network of dental providers, in 2014. Sun Life Financial (TSE: SLF), one of Canada's largest insurance companies, purchased Premier Dental Group in 2017 and in October announced it will acquire DentaQuest Ventures, a subsidiary of Delta Dental of Massachusetts, which purchased multistate provider group Advantage Dental in 2016. Although Delta Dental, the nation's dominant dental insurance provider, is a nonprofit association of state plans and therefore unlikely to buy any of the largest DSOs, other leading dental insurance providers, such as MetLife (NYSE: MET) and Aetna (NYSE: AET), are plausible buyers for mature platforms. Another strategic exit possibility is the acquisition of traditional practices by direct-to-consumer providers. Align (NASDAQ: ALGN) and Smile Direct Club (NASDAQ: SDC), which both sell orthodontic aligners prescribed by employee dentists and orthodontists, could be potential buyers.

Inorganic versus organic growth

Although most private equity-backed DSOs grow primarily through M&A, the segment also has a long history of de novo growth. Aspen Dental, for instance, has grown primarily through de novo clinic openings for most of its 20-plus years as a private equity-backed platform, but many smaller private equity-backed platforms also pursue organic alongside inorganic growth. The type of growth that a platform pursues has important implications for attracting professional talent.

De novo growth strategies often involve hiring young dentists, sometimes straight out of medical school. These dentists are allowed to gain experience in an established practice before being offered the opportunity to help start a new clinic. Compared with previous generations of dentists, who often took out loans following dental school to open their own practices, this model is attractive for many recently-graduated dentists because it affords the stability and flexibility of a salaried position and lets them avoid adding start-up costs onto already significant student loan burdens. However, it also adds a layer of complexity to geographical strategy, since expansion must take place in localities that are attractive to young dentists looking to put down roots. Organic growth is more feasible in dentistry than in some other specialties, such as ophthalmology, where there is a shortage of new providers entering the workforce: The supply of dentists in the US is expected to approximately meet demand over the next one to two decades.¹³

Inorganic growth strategies come in many flavors. Firms must decide whether to target more crowded, populous markets or smaller (but likely less expensive) suburban or rural markets, and must pay attention to regulatory differences among states. For a general dentistry platform, or a multispecialty platform that relies on referrals from its generalist practices, it is crucial to achieve density in a given state or metropolitan market to facilitate brand awareness and keep patients with the group. By contrast, geographical density is less important for pure-play specialist platforms. Instead, these platforms tend to prioritize acquiring specialist practices that already have strong referral relationships with general dentistry providers.

Onsite dental laboratories and 3D printing

Vertical integration of dental laboratories, or even co-locating labs onsite at a clinic, has been a trend in dentistry over the past half-decade or so. Typically, fitted items such as crowns, inlays, onlays, veneers, bridges, dentures, and implants are manufactured by third-party laboratories, sometimes overseas, based on an optical scan. Some are also made from a traditional alginate impression. Integrated labs can eliminate the need for patients to return to the office weeks after the scan or impression to have the procedure completed. However, this innovation may not be cost effective for most practices. Patients are generally more sensitive to the cost and quality of dental procedures than the time it takes to complete them, and third-party laboratories with highly efficient supply chains can generally provide lower costs than a single practice with an in-house lab technician.¹⁴

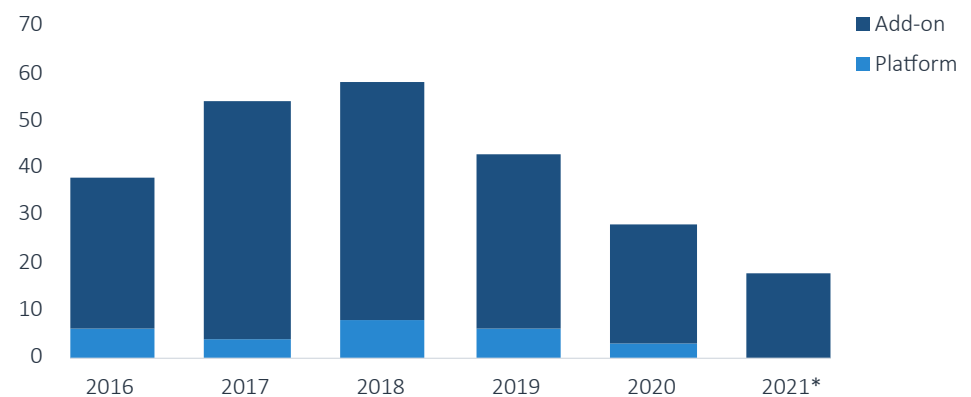
13: "Demand for Dentists: Forecasting the Future of the Profession," Ontario Academy of General Dentistry, Kelly Rehan, July 6, 2020.

14: "Today's Dental Practice Market and Recent Deal Activity," McGuire Woods, April 20, 2021.

The emergence of 3D printing technologies in dentistry may alter this landscape, however. Several companies, such as Formlabs, are working to develop 3D printing applications for dentistry, and the technology is already suited to manufacturing many restorative dental products. 3D printing promises a high degree of accuracy, the elimination of physical impressions, and virtually instant results. In addition, a 3D printer costs significantly less than the digital milling machines typically used in laboratories. As technology improves, the greatest barrier to widespread adoption may be training: It is an expensive proposition for a dentist to take time away from seeing patients to learn a significant new skill, and the alternative—hiring a technician to operate the 3D printer—may also prove too costly compared with outsourcing laboratory work. Nevertheless, private equity-backed platforms will likely lead innovation in this area going forward, especially those that focus on specialties better suited to laboratory integration such as implants, orthodontics, and oral surgery.

Dermatology

Dermatology private equity buyout count by type



Source: PitchBook | Geography: US

*As of October 31, 2021

Dermatology, which includes both medical and cosmetic subspecialties, saw intensive private equity activity in the mid-to-late 2010s. Dermatology practices are highly profitable; a single physician can generate upwards of \$1 million in revenue on a roughly 70% operating expense ratio. As such, there has been relatively little historical impetus for consolidation among providers, and the landscape remains highly fragmented. The space also benefits from favorable consumer demand trends on the cosmetic side and demographic trends on the medical side, as the incidence of conditions such as skin cancer and psoriasis are concentrated among older adults. The vast majority of private equity dermatology platforms combine medical and cosmetic dermatology, resulting in an attractive and highly diversified revenue mix. Medical dermatology is heavily Medicare-dependent and, as a physician specialty, is also broadly covered by commercial payers. Cosmetic dermatology, which involves purely elective procedures, is paid entirely out-of-pocket and can provide a hedge against Medicare reimbursement rates, which have declined for dermatological procedures by 4.8% since 2007 when adjusted for inflation.¹⁵ Private equity groups seek to increase platform

15: "Inflation-Adjusted Trends in Medicare Reimbursement for Common Dermatologic Procedures, 2007-2021," JAMA Dermatology, Rishabh S. Mazumdar, et al., September 15, 2021.

profitability by adding high-margin service lines such as Mohs surgery, dermatopathology, plastic surgery, and cosmetic retail. Since there is a shortage of dermatologists entering the profession, private equity-backed platforms may also increase procedural volume by adding advanced practice providers (APPs) to existing practices.

Dermatology

Multispecialty medical/cosmetic dermatology



Pure-play cosmetic



Source: PitchBook | Geography: US

Note: Segment overview includes representative private equity-owned platforms.

Definitions

Medical dermatology: Medical dermatology focuses on preventing, diagnosing, and treating skin disorders and diseases including skin cancer, acne, eczema, psoriasis, and contact allergies, and is reimbursed by insurance. It is overseen or performed by physicians (DO or MD) who have specialized in dermatology via a four-year residency. Dermatologists may pursue additional training in areas such as dermatopathology, immunodermatology, or Mohs surgery. APPs, who can be nurse practitioners or physician assistants, can also diagnose and treat a more limited range of skin conditions and oversee preventative care.

Dermatopathology: Dermatopathology focuses on the diagnosis of skin disease by examining samples under a microscope. Dermatopathologists may be dermatologists or pathologists who have specialized in dermatopathology through additional training. Much of the work of dermatopathologists relates to diagnosing carcinoma and melanoma (skin cancer). Many private equity-backed dermatology practices incorporate dermatopathology labs.

Cosmetic dermatology: Cosmetic dermatology, also known as aesthetic dermatology, involves elective procedures which patients undertake to achieve desired changes in their skin appearance. Procedures include Botox and other injections, chemical peels, laser hair removal, body contouring, and hair restoration. Like medical dermatologists, cosmetic dermatologists are licensed physicians who have completed residencies and, in many cases, specialist training. However, many cosmetic procedures can be performed by APPs, and some can be performed by nurses and licensed aestheticians under the supervision of a dermatologist.

Plastic surgery: Plastic surgery refers to surgery using transfer tissue. It can be reconstructive (for instance, following a severe burn or accident) or cosmetic. Some dermatology practices incorporate plastic surgeons.

Medical spa: A recent development in cosmetic dermatology, medical spas are clinics that combine nonsurgical cosmetic medical procedures with nonmedical day spa treatments in an environment that focuses on patient experience. Medical spas usually must be supervised by physicians but are primarily staffed by licensed aestheticians.

Development and current dynamics

First wave

Private equity's entry into dermatology dates to the early 2010s, with initial forays including Audax's 2012 buyout of Advanced Dermatology & Cosmetic Surgery; Candescant Partners and Eagle Private Capital's buyout of US Dermatology Partners, then called Dermatology Associates of Tyler, in 2013; and Goldman Sachs and Varsity Healthcare Partners' 2014 buyout of Dermatology Associates of Wisconsin, which was renamed Forefront Dermatology at the time of the transaction.

Second wave

A steady stream of platform buys followed in the mid-2010s, with investment activity peaking in 2018. Prominent acquisitions during this period include CI Capital Partners' deal for Epiphany Dermatology in 2016 and Sheridan Capital Partners' buyout of Dermatologists of Central States in 2017. Unlike other consolidation plays, such as dental and vision, dermatology did not see strategic diversification during its second wave of expansion. Almost without exception, the platforms created in the mid-2010s followed the model of the first wave of private equity investment, combining medical with cosmetic dermatology and incorporating ancillary services such as surgical centers and dermatopathology. Differentiation among platforms has primarily been geographic, since many platforms still operate on a regional scale or across one or two states. Platforms also vary more subtly in their degree of emphasis on medical versus cosmetic dermatology and on whether they target urban or suburban markets. Because dermatologists tend to treat a variety of conditions or perform a variety of procedures within either medical or cosmetic dermatology—in contrast to, for instance, vision, wherein an ophthalmologist may focus their entire career on a single condition or part of the eye—the space does not easily lend itself to pure-play specialty platforms.

Current dynamics

Beginning in 2019, both platform investment and add-on activity in dermatology slowed, and anecdotal reports suggest that the space is not seeing the same level of competition for assets and multiple creep that other segments are currently experiencing. This may be due to a combination of factors, including the lack of strategic differentiation opportunities in the space for most of its development and flagging

growth by some large platforms, potentially a result of failing to achieve market density. More firms may also be pursuing de novo growth for their platforms, especially on the cosmetic side. However, it is possible that we will see a reignition of private equity M&A activity in dermatology in the coming years. Many platforms created in the investment wave of the mid-2010s are nearing the end of their investment periods, meaning that they will soon be exited in sponsor-to-sponsor transactions, and new private equity owners will likely move quickly to put their own growth plans into action.

Additionally, we are finally beginning to see the emergence of a new dermatological substrategy. A few firms have begun to grow pure-play cosmetic dermatology platforms, spurred in part by growth in the medical spa sector. As discussed below, these groups exhibit attributes of consumer brands, with growth patterns and customer acquisition and retention dynamics that differ from most medical practices. One platform, Milan Laser Holdings, a network of medical laser hair removal clinics that sold a majority stake to Leonard Green & Partners in 2019, filed for an IPO in October. The company has a track record of rapid—and, apparently, purely de novo—growth, having expanded from 19 to over 140 locations since 2017. Leonard Green's two-year holding period contrasts sharply with the established private equity provider consolidation playbook and underscores how specialist cosmetic practices—although they are technically medical providers overseen by physicians—break the mold of traditional provider roll-ups. It will be interesting to watch how Potomac Equity Partners' Laser MD MedSpa, also purchased in 2019, grows in the coming years. Currently focused only on the Boston metropolitan area, the practice has made three add-on acquisitions since 2019.

Strategic considerations

Industry-private equity relationship

Compared with the other segments profiled in this report, dermatology's relationship with private equity has been the most fraught. Although the benefits and drawbacks of consolidation are frequently the subject of discussion in virtually all provider specialties, dermatology has been particularly skeptical of private equity's growing influence, with many industry commentators publicly questioning whether firms will interfere unduly with medical decision making or intervene to drive procedural volume at the expense of patient wellbeing post-acquisition. It is difficult to point to a clear cause for this, since the development of private equity consolidation in dermatology has followed a similar timeline to, for instance, ophthalmology, and the latter provider community holds an overall more positive view of private equity activity. However, two recent public relations incidents have deepened the rift, with implications for the ability of platforms to recruit leading physicians. First, a paper which argued that firms tend to acquire practices with elevated volumes of highly reimbursed procedures—which could signal fraudulent upcoding—appeared in the prestigious *Journal of the American Academy of Dermatology* in 2018, but was then quickly retracted by the journal's editors.¹⁶ In the second, U.S.

16: "Why Private Equity Is Furious Over a Paper in a Dermatology Journal," *The New York Times*, Katie Hafner, October 26, 2018.

Dermatology Partners, one of the oldest platforms in the space, defaulted on a \$377 million loan in January 2020, causing Abry Partners to exit to the platform's creditors in a debt-to-equity swap; the default has been widely repeated as a cautionary tale in industry publications. As a result of these challenges, private equity firms in the dermatology space must work harder to differentiate themselves from stereotypes of previous private equity plays and build a reputation for focusing on leadership and patient care.

Medical spas

The medical spa industry has grown rapidly in recent years and is projected to continue expanding at a nearly 12% CAGR over the next decade.¹⁷ Like traditional cosmetic dermatology, this emerging space is highly fragmented, with 83% of medical spa practices operating in a single location.¹⁸ A growing number of multisite cosmetic dermatology practices are also opening medical spa clinics.

Well-run medical spas can be lucrative. Since most procedures are performed by aestheticians, clinical staffing costs—typically a medical practice's greatest expense—are minimal. And, since most of the procedures performed in medical spas can be completed quickly, they can accommodate a high volume of patients. Finally, good medical spas see patients returning every few months for repeat procedures; as a result, some are offering subscription payment plans for specific procedures in order to provide predictable cash flows and increase customer retention. The most profitable practices carefully engineer their procedure mixes to focus on these repeatable procedures and on procedures with low disposable costs. For instance, a practice must purchase injectables such as Botox on an ongoing basis, but laser hair removal and PRP hair restoration procedures incur little operational cost besides staff time and the initial equipment investment.¹⁹

The nascent medical spa industry offers both attractive opportunities and significant risks for private equity firms to build pure-play platforms or add medical spas to their existing dermatology platforms. Many medical spa owners are inexperienced in running a consumer-focused business; as a result, operational levers that are relatively easy for private equity firms to pull, such as improved digital marketing, can have a transformative effect. However, medical spas also sit in a regulatory gray area when it comes to corporate practice of medicine (CPOM), creating regulatory and legal liabilities of which many independent operators are unaware. Specifically, some state medical boards are still working to determine whether medical spas should be regulated as medical practices, although the emerging consensus suggests they should be. To make matters worse, many medical spa entrepreneurs are unfamiliar with CPOM regulations. This has resulted in some practices being illegally owned and/or overseen by non-physicians, or in physicians acting as medical directors in name only without actually supervising patient care, prompting numerous malpractice lawsuits.²⁰ According to the American Med Spa Association, around one-third of

17: "Medical Spa Market by Services – Global Opportunity Analysis and Industry Forecast, 2020 – 2030," Research and Markets, June 2020.

18: "2019 Medical Spa State of the Industry Report," AmSpa, 2019.

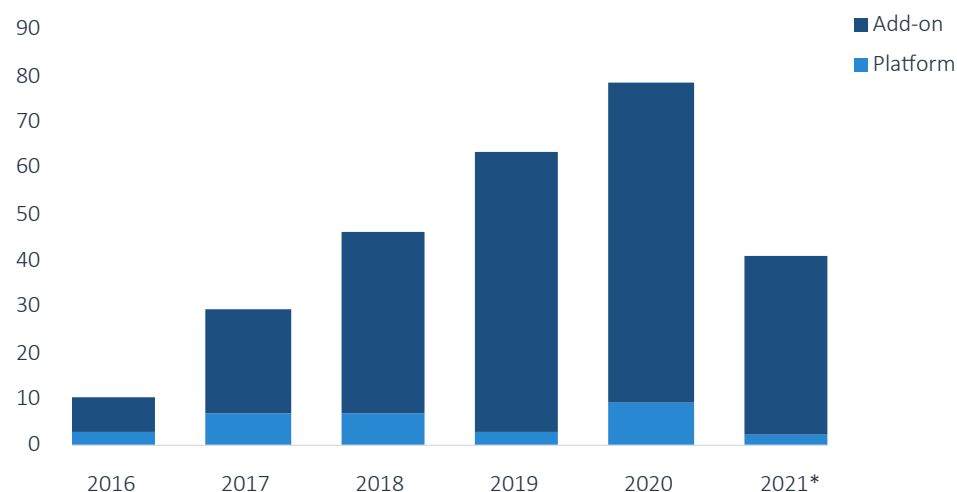
19: "Managing Medical Spa Cash Flow – How To Be Proactive," MedSpa, n.d.

20: "Physician Liability in Med Spas," AmSpa, September 20, 2018.

medical spas have no medical director, an alarming statistic given that all but a few states prohibit CPOM. As a result, firms looking to enter the medical spa space must diligence potential acquisitions carefully for legal and regulatory risk, and they should look to acquire spas that have built successful businesses around medically rigorous care.

Vision

Vision private equity buyout count by type



Source: PitchBook | Geography: US

*As of October 31, 2021

Private equity investment in vision has seen remarkable growth, having accelerated from scattered activity by a few early movers in the mid-2010s to a red-hot market within the last decade. In addition to being a highly fragmented market, vision benefits from favorable demographic trends. As the population ages, vision issues such as cataracts are becoming more common; by age 80, more than half of US adults will require cataract surgery.²¹ This trend particularly benefits ophthalmology (as opposed to optometry), since ophthalmic medical and surgical treatment is covered by Medicare, while optometric treatment generally is not, with the exception of Medicare Advantage plans. Overall, the revenue profile for vision care skews heavily toward commercial insurance and out-of-pocket payment, resulting in practice EBITDA margins of 20% or more. Private equity firms operating in the space seek a range of revenue enhancements for their platforms depending on their specific focus within vision, including retail sales, ASCs, technology-enhanced surgical capabilities, and specialist treatments for conditions such as dry eye and retinal disease.

21: "Private Equity Investment in Vision Care: Creating a Comprehensive Provider," Provident Healthcare Partners, Eric Major, March 2020.



Source: PitchBook | Geography: US

Note: Segment overview includes representative private equity-owned platforms.

Definitions

Optometry: Optometrists provide primary care related to eye health and vision. They diagnose and treat some eye-related diseases and prescribe corrective aids to improve vision. Optometrists achieve a Doctor of Optometry (OD) degree via a four-year professional program and may undertake additional training to gain a specialization, such as in dry eye or glaucoma treatment.

Optical retail: Optometry practices often incorporate retail sales of contact lenses, glasses, and frames. These may be fitted by opticians, who have at least an associate degree or professional certificate, based on an optometrist's prescription. (Retail-only businesses are not included in the data for this report.)

Ophthalmology: Ophthalmology is a surgical medical specialty focused on eye care. The scope of an ophthalmologist's work is similar to that of an optometrist, except that they can diagnose and treat a greater range of conditions and perform advanced surgical procedures. Ophthalmologists must complete at least a one-year internship and three-year residency following medical school and may undertake additional training to specialize in treatment of the retina, cornea, glaucoma, dry eye, oculoplastics, or other specialties.

Surgical centers: Ophthalmologists must perform surgical procedures, including laser surgeries, at hospitals or ASCs. An independent ophthalmologist may have fee-based usage privileges at one or more ASCs, or they may own a minority or majority stake in one or more ASCs. Virtually all private equity-backed ophthalmology platforms also own ASCs where their ophthalmologists operate.

Development and current dynamics

First movers

Private equity's first encounter with the vision space came through buyouts of ASCs, some of which specialized in eye surgery, which occurred sporadically during the industry's nascence in the 1980s and 1990s before becoming more popular in the 2000s. The earliest optometry and ophthalmology plays date to the post-GFC period and include Charlesbank Capital Partners' and H.I.G. Capital's 2010 buyout of Vision Source, now owned by Essilor (PAR: EL); Claris Vision, which a consortium of firms including Plexus Capital and Candescent Partners created in 2011; and Monitor Clipper Partners' 2012 buyout of Capital Vision Services, which manages MyEyeDr. practices. EyeCare Services Partners, which Varsity Healthcare Partners created from Katzen Eye Group in 2014; and Eyecare Partners, a platform created by FFL Partners in 2014, followed. Among these early entrants were both vertically integrated optometry and ophthalmology platforms (Claris, EyeCare Services Partners, Eyecare Partners) and optometry-only platforms with a heavy optical retail emphasis (Vision Source, Capital Vision Services). Unlike in other medical segments such as dentistry, where primary care providers tend to be less profitable than surgical specialists, optometrists enjoy attractive EBITDA margins of around 20% because their revenue comes almost exclusively through commercial payer reimbursement and out-of-pocket payment.

Several of these first movers are now on their second or third turn in private equity ownership. EyeCare Services Partners, which Varsity Healthcare Partners sold to Harvest Partners in 2017, and Claris Vision, which MCG Capital bought in 2017, will likely be put on the market again in the coming years. Capital Vision Services underwent its third buyout in 2019 when Goldman Sachs' Merchant Banking Division purchased it from Altas Partners and CDPQ for \$2.7 billion, while JLL Partners exited Eyecare Services Partners to Partner Group for \$2.2 billion in February 2020.

Second wave and subsegment emergence

Following these first movers, the vision space saw a wave of platform creation in 2017 and 2018, with firms replicating both the optometry/optical retail and vertically integrated optometry-ophthalmology models. In optometry, Imperial Capital Group created Keplr Vision, and Riata Capital Group formed AEG Vision—both in 2017. At the same time, ophthalmology emerged as the dominant private equity vision play due to the attractive margins and projected demand growth of more advanced surgical procedures. Examples of platforms established during this period include Centre Partners' Vision Innovation Partners and Shore Capital Partners' EyeSouth Partners, both created in 2017.

The late 2010s also saw the emergence of pure-play retina specialists, including Quad-C Management's NJRetina (2018) and Webster Equity Partners' Retina Consultants of America (2020). By focusing on a single ophthalmic specialty, these platforms make themselves attractive partners for practitioners looking for professional development opportunities by aligning with similarly focused specialists.

Current dynamics

Most of the platforms created in 2017 and 2018 are still held by their initial private equity owner, meaning that we will likely see numerous platform sales in the next one to three years. Because most of these platforms are currently regional players with significant growth runway ahead of them, they will likely undergo at least one more turn of private equity ownership before public exits become feasible, although exiting to a strategic buyer, perhaps an optical retailer, is a possibility for optometry-focused platforms. Keplr Vision, now a national platform, is rumored to be exploring a sale at a \$1.8 billion valuation—an impressive price tag that implies a multiple in the mid-teens on around \$120 million EBITDA. Given that Riata Capital has already chosen to hold its optometry platform AEG Vision, Keplr's next-largest rival, via a single-asset GP-led secondary transaction, Keplr will likely have the advantage of being the only large optometry platform on the market next year.

Strategic considerations

Ophthalmology reimbursement and revenue drivers

Unlike optometry practices, which derive most of their revenue from commercial payer reimbursement and out-of-pocket payments, ophthalmology practices are heavily dependent on Medicare reimbursement. This is due to the concentration of eye and vision problems requiring surgical correction among elderly people. Medicare reimbursement rates for surgical procedures have trended slightly downward in recent years, including a 3.75% cut to the conversion factor used to calculate payments to physicians that will take effect beginning in 2022.²² However, Medicare facility fee reimbursement rates for ASCs have held steady in recent years, allowing private equity-backed platforms to hedge against the physician fee cuts.

Ophthalmology practices counteract Medicare “stroke of the pen” risk by optimizing their specialty mix toward higher-reimbursement procedures and investing in technologies that allow them to offer premium procedures. For instance, retina care is widely considered the most lucrative ophthalmic specialty due to its combination of high procedure margins—retina specialists may have EBITDA margins as much as 5% to 10% higher than other ophthalmic specialties—and high volume capacity. Additionally, according to Stephen Scott, partner and managing director at Bailey Southwell, private equity-backed ophthalmology platforms which have invested in femtosecond laser technology can provide their patients with high-margin premium services like laser-assisted cataract procedures and as well as premium lenses for more complex cases.²³ Both femtosecond lasers and premium lenses involve an out-of-pocket payment on top of what is covered by Medicare or commercial insurance.

²²: “CMS 2022 Physician Fee Schedule Includes Payment Cut,” *Ophthalmology Times*, David Hutton, July 19, 2021.

²³: Stephen Scott, phone interview with Rebecca Springer, September 7, 2021.

Optical retail

Optometry practices can generate additional ancillary revenue through the incorporation of optical retail. One unique feature of the vision landscape is the outsized presence of corporate optical retailers, including Vision Source, Luxottica, National Vision (NASDAQ: EYE), Walmart (NYSE: WMT), and Costco Wholesale (NASDAQ: COST), in the market. The business model for these large retailers typically involves leasing store space to a local optometrist and operating the co-located glasses and contacts retail operation. According to Jeff Friedman and Matt Brohm, partners and co-heads of healthcare private equity at Arnall Golden Gregory, private equity-backed optometry practices can differentiate themselves from this model by cultivating a more “medical” focus, incorporating experienced optometrists with established patient lists into their platforms and providing more comprehensive eye care such as dry eye treatment and post-surgery care, as opposed to quick in-and-out appointments for lens prescriptions.²⁴

This go-to-market strategy has clearly been successful to date: Capital Vision Services and Eyecare Partners are the fifth and sixth largest optical retailers by sales volume behind Costco. However, the market power of large corporate retailers and direct-to-consumer disruptors such as Warby Parker (NYSE: WRBY) represents a strategic risk factor for medical-optometry-focused platforms. Over time, customers may gravitate toward convenience and savings for optical services on the one hand and cutting-edge ophthalmic procedures for disease treatment and permanent vision correction on the other, leaving providers in the middle of the barbell facing declining demand. However, many believe that the extent of fragmentation and the financial characteristics of the optometric space are sufficient to carry optometry-focused platforms through significant continued growth even in a crowded optical retail market.

Alternatively, private equity firms may see large optical retailers as strategic partners (for instance, for locating practices in retail storefronts) or even as potential acquisition targets. FFL Partners, which made its first vision play with Eyecare Partners from 2015 to 2019, took Canadian optical retail and optometry network New Look Vision Group private in a CAD \$970.0 buyout in May and is expanding the company’s operations in the US by acquiring optical retailers focused on the luxury market. This deal represents a cross-border multiple arbitrage play that is taking advantage of lower pricing in the Toronto Stock Exchange before moving into the US market. Additionally, by focusing on high-end retail in the US, FFL Partners is charting a clear course away from its other vision-related portfolio company, Eyemart Express, a value-focused optical retailer it has held since 2014. It will be interesting to watch how the development of an increasingly crowded optical retail market affects the ancillary revenue opportunities for medically focused optometry platforms.

24: Jeff Friedman and Matt Brohm, phone interview with Rebecca Springer, November 10, 2021.

Conclusion

Over the past two decades, and particularly in the last five to seven years, healthcare providers have become one of the core US private equity investment areas. This trend will likely continue, with the ranks of healthcare specialist firms and healthcare-focused strategies swelling, and with healthcare spending projected to grow as a proportion of US GDP. While private equity firms have now invested in dozens of provider specialties, the most popular provider segments continue to offer attractive investment opportunities while also providing a blueprint for the development of future private equity consolidation plays.

Looking ahead, we believe the cycle of private equity healthcare provider consolidation—from first movers to a second wave characterized by substrategy proliferation to platform consolidation and finally terminal exits—will accelerate in some segments. The last half decade of investment in behavioral health provides a template, while veterinary medicine, which boasts less regulatory risk, growing demand, and increasingly acyclical characteristics, is arguably in the early stage of exhibiting similar dynamics.

There are several reasons for this. Private equity dry powder continues to accumulate, including among a growing cohort of healthcare specialist firms. And firms and service providers alike have become more skilled at quickly executing buy-and-build plays; bankers are marketing platforms with ready-made acquisition strategies and firms are willing to pay high multiples to win platform auctions in part because their operating teams are prepared to begin executing on inorganic growth plans virtually from day one. Moreover, the universe of exit opportunities is expanding. Public listings, once a rarity among private equity exits, have exploded in popularity since late 2020. Payers have become increasingly aggressive in pursuing vertical integration by purchasing healthcare provider networks. Large retailers such as Walmart and CVS (NYSE: CVS) are also increasingly active in primary care, and it is not infeasible that they may branch into medical specialties.

Finally, a new crop of healthtech companies focused on seamlessly connecting patients with providers will likely become important strategic acquirers in the coming years. This includes telehealth platforms, of course, which may take an interest not only in obvious segments such as primary care and behavioral health but in less obvious ones, such as dentistry, where remote patient monitoring and the ability to screen urgent cases via video chat can improve the quality and efficiency of care. It also includes other technology solutions. Late-stage venture-backed Honor Technology is an interesting example that private equity-backed companies may look to emulate. With its acquisition of Home Instead, a leading home care provider network, Honor is now an MSO and a provider-focused home care staffing solution rolled into one. Some of the largest PE firms, traditionally prominent players in the provider rollup space, have lately turned their attention to healthcare technology companies which may eventually look to vertically integrate with providers. Bain Capital's recently created Enhance Health, a Medicare Advantage-focused insurance and care navigation platform, is one example. All of these represent strategic opportunities for PE firms to exit healthcare provider platforms other than in traditional sponsor-to-sponsor buyouts.

In addition to increasingly sophisticated vertical consolidation in the healthcare provider space, we expect to see horizontal or multispecialty consolidation pick up steam. The trend toward integrating various types of pediatric therapy—behavioral, educational, speech, and so on—has already been mentioned above. Another option is the integration of primary care providers into specialist or multi-specialty platforms. Although combining primary care providers with other specialists is intuitive from a care coordination perspective, it has long been challenging to execute due to divergent profitability and compensation dynamics. Primary care is less lucrative than many medical specialties, creating difficult staffing dynamics within platforms. However, we are beginning to see private equity-backed platforms solve this conundrum, especially for platforms that emphasize government-payer revenue and rely less on high per-procedure reimbursement rates. For instance, Clairvest Group’s ChildSmiles, a Medicaid-focused pediatric dentistry platform based in New Jersey, also offers pediatric primary care. Horizontal integration plays are becoming increasingly attractive as the medical industry continues to slowly shift toward population health management and value-based care payment models.

Our future research into the healthcare provider space will examine these themes of accelerated consolidation and vertical and horizontal integration in the face of technological and care model change. It will also dive into physician staffing groups, emerging private equity provider segments, and more.