

A New Era of Consolidation

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Over the past year, while the debate over repeal of the ACA and Medicaid expansion grabbed the headlines, the healthcare industry has been quietly experiencing a wave of consolidation that is likely to significantly impact both patients and traditional health systems.

This consolidation is coming from two sources – the first is managed care providers acquiring primary care and outpatient service providers in order to gain greater control over the direction of patient care, and the second is private equity investors seeking to consolidate highly fragmented sectors of the healthcare industry that are benefitting from the converging trends of consumerism and a push to move care out of the traditional inpatient setting. Each of these trends is likely to result in new regional and national healthcare delivery platforms that will alter the traditional relationship between payers and health systems.

Managed Care Acquisition Activity

Since the Department of Justice denied the mega-mergers of Aetna-Humana and Anthem-Cigna two years ago, managed care providers have quietly been acquiring a range of primary care, pharmacy benefit and urgent care providers. United Healthcare's Optum subsidiary is now the largest employer in the U.S. of primary care physicians after its recent acquisition of Davita Physician Group. Aetna announced in December it was acquiring CVS, providing it not only with the CVS pharmacy Benefit Management capabilities but the CVS Minute Clinic urgent care network as well. Humana announced in December 2017 its intent to acquire Kindred Healthcare, the largest provider of home health and inpatient rehab facilities in the U.S. Humana followed the Kindred announcement with its announcement in March 2018 to acquire Express Scripts, a leading pharmacy benefit manager. In May 2018, Anthem announced its intention to acquire Aspire Health, a leading provider of palliative care.

Each of these acquisitions provide the managed care acquirer the ability to insert itself into a critical link in the continuum of care in an effort to more efficiently manage patient care. Managed care providers that own networks of physicians and ambulatory care services can theoretically provide primary and post-acute care to their members at lower costs than health systems while gaining leverage in rate negotiations with health systems.

Private Equity Investment

It's no secret that private equity firms are continuously on the lookout for the next big idea and that healthcare has historically attracted a significant share of private equity investors. However, over the past year, the healthcare industry has attracted a growing number of PE firms that typically focus on other industries such as retail, manufacturing and business services. The factors attracting these investors include an aging population, emerging technologies that allow care to be delivered and monitored outside of traditional healthcare facilities and consumer demand for a more customized approach to care. These trends are creating significant growth opportunities where traditional PE firms are seeking to employ the strategies and tools they usually employ in

other industries. Some of the healthcare sectors that have received significantly more attention over the past year include dermatology, home health, ophthalmology and physical therapy.

Dermatology

The dermatology sector has been attracting an accelerating level of investment over the past few years. It benefits from a number of positive trends including aging demographics who are more likely to have complications like skin cancer, high fragmentation (over one-third of the 11,000 dermatologists in the U.S. are in solo practice, according to a report from IBISWorld), and significant growth opportunities with high-margin cosmetic services. There are currently over a dozen private equity backed dermatology platforms. Recent transactions include LNK Partners investing in Schweiger Dermatology in May of this year, Harvest Partners' acquisition of Advanced Dermatology & Cosmetic Surgery, GTCR's investment in Riverchase Dermatology, Omers' acquisition of Forefront Dermatology, and Sterling Partners' acquisition of the Center for Dermatology & Plastic Surgery. These PE firms are generally seeking to scale these platforms by using retail and labor management strategies developed from other consumer investments to build out geographic networks and introduce new products and services.

Home Health

Home Health is also benefiting from demographic trends, changing reimbursement strategies and technology developments that are driving rapid growth. In addition to the aging population (since the over 65 population is the biggest user of home health), home health is benefitting from changes under the ACA which result in hospitals and post-acute facilities reducing lengths of stay and discharging patients with higher acuties into the home setting. This, along with the emergence of bundled payments, which ties reimbursement for many surgeries to long-term outcomes, has significantly increased the demand for home health services. Home health is also benefitting from emerging wearables technology and telehealth innovations which are allowing care to be better delivered and monitored in the home setting. There are currently dozens of private equity backed platforms as well as public companies in the home health industry. However, given there are over 5,000 home health agencies, we expect consolidation to continue to accelerate. Recent private equity transactions include Tailwind Capital's acquisition of Abode Healthcare, BelHealth's acquisition of CareAdvantage, and Blue Wolf Capital and Kelso Capital's acquisition of Jordan Health.

Optometry and Ophthalmology

Similar to dermatology, ophthalmology benefits from intrinsic demand from an aging population (cataract treatments) and high growth opportunities with cosmetic services (laser vision, fashion eyewear, contact options) and remains highly fragmented. In fact, given the high level of fragmentation, much of the initial PE activity has involved merging multiple individual practices to create a single platform. Recent activity includes LLR Partners forming its own practice management services company for eye care practitioners by acquiring two ophthalmology practices and an ambulatory surgery center, Flexpoint Ford acquiring Southeast Eye Specialists, H.I.G.'s acquisition of Southwestern Eye Center and Centre Partners' portfolio company One Vision Eye Partners acquiring the Maryland Vision Institute, a large ophthalmology provider.

Physical Therapy

Physical therapy is also benefiting from many of the same trends as home health including aging demographics, the increased prevalence of outpatient surgery and the desire to treat patients with alternatives to surgery and drug (opioid) therapies. In addition, the same bundled payment reimbursement programs for many types of orthopedic surgery have elevated importance of post-surgical rehabilitation and the critical role of physical

therapy. There are currently over a dozen private equity backed physical therapy platforms. Recent transactions include BDT Capital's acquisition of Athletico, Gryphon Partners' acquisition of Cora Health and Revelstoke's acquisition of Upstream Rehabilitation and Drayer Physical Therapy.

Unlike traditional consolidation by health systems of these outpatient services, this recent payer and private equity driven consolidation is increasing the number of large regional and national specialized delivery platforms while employing operational efficiencies and management techniques of their private equity sponsors. The ultimate result is consumers having greater choice and convenience, with enhanced quality and standardization of care at lower prices.

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