



15 Private Equity Subsectors in Healthcare – An Updated Review of Selected Niche Investment Areas

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15 Private Equity in Healthcare – An Updated Review of Selected Niche Investment Areas

Private equity investment in healthcare has continued to grow considerably from when we examined various niche investment areas on April 11, 2016, in the article titled “Private Equity in Healthcare – A Review of 15 Niche Investment Areas.” This article provides updated observations and insights on key investment niches, many of which were discussed in the 2016 article. It also provides some initial thoughts on the market as a whole.

Each market sector addressed is listed here, with a note indicating whether it is a new category that was not included in the 2016 article, and whether we perceive that there is less, roughly equal (i.e., steady) or more private equity interest in that sector as compared to the last year or two.

1. For-profit hospitals and health systems (less)
2. Healthcare IT, EHRs and HUB services (slightly more)
3. Laboratory businesses (steady, significant risk factors remain)
4. Medical devices (steady)
5. Behavioral health (more)
6. Urgent care (slightly less, but steady)
7. Dental practice management (steady)
8. Ambulatory surgery centers (steady)
9. Dermatology (steady)
10. Anesthesia (steady)
11. Compounding and specialty pharmacy (steady)
12. Ophthalmology and optometry (more)
13. Various newer PPM models (podiatry, allergy, urology, etc.) (more)
14. Vet (steady)
15. Telemedicine, remote patient monitoring, etc. (more)

Overall, there is a strong amount of interest in the following sectors: physician practice management models (dental, dermatology, pain, ophthalmology and more); health IT companies (including telemedicine, remote monitoring, etc.); and behavioral health. By contrast, we are seeing less activity in the for-profit hospitals and health systems sector. Several sectors are holding steady, including veterinary care, anesthesia, laboratory, medical device, urgent care, ASCs and pharmacy.

Further, we note the following:

1. Some niches are commanding very high multiples – this generally reflects the significant competition for viable provider service platforms but also suggests a robust pipeline of secondary acquisition targets (at generally lower multiples). This dynamic puts increased pressure on investors to service debt if there is a market downturn or a general interest rate increase. These multiples also leave less room for error and narrow the pathway for investors to exit for a profit down the road.
2. Also reflecting the competitive nature of the industry, it is becoming more and more common to see buyers obtain R&W insurance to absorb some or all of the historic risk from acquired businesses, allowing the selling shareholders to walk away with much less risk than under traditional indemnity constructs.
3. Investment banks have become increasingly skilled at presenting pro forma EBITDA numbers that reflect a best-case scenario. This in turn leads to higher prices. Buyers in this highly competitive market must either decide to accept this best-case scenario and make a competitive bid, or walk

- away. In the same spirit, lenders also must decide whether to compete, and if they decide to do so, provide leverage off such best-case pro forma statements.
4. There does not appear to be any slowing of the provider consolidation trend both in existing and newly explored sectors. If anything, the market is creating larger platforms and more midsize platforms while targets continue to be plentiful even if transactions can be challenging to complete.
 5. One question many are asking is, when will the market slow down? It seems inevitable that the deal volumes we have seen the past few years cannot continue indefinitely.

I. Healthcare Investment Overview

Healthcare has long been an active investment area for private equity funds. It has ranked among the top three industries in terms of returns every year since 2011, according to data from Cambridge Associates. Generally speaking, growth in healthcare has continued to be fueled by large and powerful trends such as aging populations, evolving regulations, advances in key technologies impacting consumer interfaces, and back-office functions and low interest rates.

Healthcare is often defined, for investment purposes, to include several broad categories and dozens of niches. Healthcare includes: (1) entities that actually serve patients such as providers and health systems, which includes all PPM models as well as hospitals/health systems, behavioral health providers and ancillary service providers such as labs; (2) healthcare-related or healthcare services, e.g., health IT and revenue cycle management companies, or organizations that sell into or provide services to providers; and (3) life sciences, i.e., medical device and pharmaceutical companies.

Consolidation and competition remained prevalent themes in the healthcare market in 2017. Longer transaction hold times resulted in approximately a 20% decline in completed mergers and acquisitions (M&A) transactions in healthcare across Europe and North America from 2016 to 2017, with add-ons accounting for approximately 65% of all buyouts. Growth investing volume between 2016 and 2017 remained flat. However, according to RSM US LLP (RSM), aggregate M&A spending in 2017 was still relatively strong, at just shy of \$200 billion with a new high of \$82 billion in aggregate private equity healthcare deal value in North America. Median M&A deal size peaked at a new high of \$110 million in the fourth quarter of 2017, far surpassing the next-highest quarterly median of \$72.8 million in the 3rd quarter of 2015. The peak was bolstered in large part by mega-deals such as Bain & Company's (Bain) purchase of Surgery Partners for \$3 billion, and in fact, it has been noted that the number of private equity mega-deals in 2017 was significant with 12 such deals closing at \$1 billion or more. There has been a gradual decline in financial sponsor-backed selling since its peak in 2015. However, PE-backed selling has remained healthy overall, due in significant part to secondary buyouts through sponsor-to-sponsor sales.

Additionally, according to Bain, from 2012 to 2017, the number of deals involving retail health companies, which are defined as companies that operate freestanding health-related outlets like dental clinics or urgent care facilities, has soared, increasing at a compound annual rate of 34% in the North American market. Interest in retail health has expanded beyond a niche set of investors. The success of firms like Audax Group, Abry Partners and Summit Partners has caught the attention of a broad range of players—from large, diversified funds like Warburg Pincus to institutional investors such as OMERS and Teachers' Private Capital. These success stories have drawn more activity, which inevitably puts upward pressure on multiples. As a result, some investors are seeking opportunities in newer areas of this sector, which we describe further below.

II. Investment Areas

1. For-Profit Hospitals and Health Systems (less)

Over the past few years, there have been headwinds faced by large, for-profit hospital chains. However, there is still activity in this field, and substantial success has been enjoyed by HCA Healthcare, Inc. (HCA), one of the for-profit hospital operators, as well as significant growth in two of the private equity-funded hospital chains. Starting with PE-funded chains, each Steward Health Care (funded by Cerberus Capital Management) (Steward), and RegionalCare Hospital Partners (funded by RCCH HealthCare Partners (RCCH)) (RegionalCare), have grown a great deal. Steward bought into additional markets with its acquisition of Iasis Healthcare in September 2017, while RegionalCare bought Capella Healthcare, Inc., in 2016, forming RCCH. RCCH acquired St. Joseph Regional Medical Center from Ascension on May 1, 2017, and on February 8, 2018, RCCH announced that it will partner with the University of Washington through UW Medicine to own and operate a number of community hospitals. Also notable is the controversial agreement among two private equity firms – TPG Capital (TPG) and Welsh Carson, Anderson & Stowe (Welsh Carson) – and Humana, Inc., to acquire Kindred Healthcare, Inc. (Kindred), with TPG and Welsh to take over Kindred’s long-term care hospitals (and inpatient rehabilitation facilities).

A 2016 story in *The Wall Street Journal* titled “PE Firms Shy Away from Traditional Hospital Deals, Despite Sector’s Size” sheds light on PE’s waning interest in large hospital deals over the last few years (Amy Or, Jan. 27, 2016). Another article titled “Flurry of HealthCare Deals Reflects Shift Away From Hospitals” also highlights the increased interest of healthcare investors in areas outside of traditional hospitals (Anne Wilde Mathews and Melanie Evans, Dec. 20, 2017).

Community Health Systems (CHS) and Tenet Healthcare Corporation (Tenet) have used the strategy of selling off hospitals in recent years, to pay down debt or go private. Hospital operators that have excelled over the last few years have largely relied on having strong local market positions versus simply a great number of hospitals in total. HCA has great regionally and locally strong positions and has done relatively well. There seems to be stronger private equity interest in regionally strong operators and operators that can partially win a market than national behemoth operators.

It has been predicted that micro-hospitals (also referred to as neighborhood hospitals) will gain increased popularity. Most micro-hospitals are small-scale, fully licensed inpatient facilities. They typically have core sets of services, the ability to tailor their other services to the specific community and higher reimbursement rates than urgent care centers. They have been viewed as a lower-cost entry into smaller markets, with the ability to expand services as needed. Currently, Emerus Holdings Inc. is the largest operator of micro-hospitals in the nation, and it has more recently been expanding its footprint by forming strategic partnerships with larger healthcare organizations, including, for example, Allegheny Health Network, Dignity Health and Baptist Health.

Finally, the new Secretary of the U.S. Department of Health and Human Services, Alex Azar, has indicated that he is open to rethinking the ban on physician-owned hospitals. If these ownership restrictions are lifted, this could present significant opportunities for private equity investors.

2. Healthcare IT, EHRs and Hub Services (slightly more)

Healthcare IT continues to be of ongoing interest to PE investors and continues to reflect an area of nearly immeasurable opportunity, but continues to also face high valuation and incredible competition.

Attractive healthcare IT plays rarely now involve simple electronic medical records (EMR) companies, although cloud-based, specialty-specific EMR platforms continue to be of interest. Data analytics companies, particularly when coupled with EMR solutions, have emerged as more exciting opportunities for investors seeking to capitalize on real opportunities.

And in the wake of a serious and apparently continuing evolution in payor acquisitions, IT solutions focused on payor services has become an especially interesting area for investors. For example, as noted in Bain's annual reports for 2016 and 2017, payor HCIT assets drew significant interest in those years, propelled, in part, by the priority many PE firms have placed on making IT investments across industries, including healthcare. The series of private equity investor recaps of MultiPlan leading up to Hellman & Friedman's recent \$7.5M purchase demonstrates this buyout theme.

3. Laboratory Businesses (steady, significant risk factors continue)

Investors continue to show some interest in laboratory businesses, but those opportunities tend to be focused on specific niche approaches (rather than broad, generalist toxicology or pathology labs, for example). In some parts of the lab industry, continued downward pressure on reimbursement is forcing providers to find more creative business models to maintain margins and market share. Because the lab sector is so heavily regulated, a lot of these newer models demand thoughtful and relatively sophisticated analysis to avoid inadvertent legal problems. For example, there tends to be a misconception that private pay-only or non-governmental payor business models have less regulation (and therefore less risk) than all-payor lab arrangements. This is not necessarily true. There are often state laws that mimic the effect of the federal Stark Law and Anti-Kickback Statute, and commercial payors are becoming increasingly aggressive in combating competitive upstarts they perceive as taking more aggressive approaches.

For example, in January 2017, UnitedHealth Group Inc. (United) filed suit against Texas-based Next Health, LLC, alleging that the company had defrauded United over several years through a physician referral scheme. United had previously filed suit against Sky Toxicology Ltd in Florida and made similar allegations. Finally, last year also saw the Missouri State Auditor allege that a rural hospital had acted as a shell that allowed a third party to bill under its contracts for services that were not actually provided by the hospital. Reimbursement rate relief does not seem to be coming any time soon. Of the three core segments – toxicology, pathology, and genetic and esoteric testing – specialty/niche pathology and esoteric/genetic testing seem to have the most promise.

4. Medical Devices (steady)

The outlook for medical devices is generally positive. Manufacturers are beginning to actualize the benefits of big data and analytics, artificial intelligence and new digital tools presenting opportunities for increased growth. By 2030, the global medical device market is expected to more than double and reach \$800 billion. However, those in the field have hypothesized that, due to increasingly unsustainable healthcare costs and growing competitive forces posed by new-technology players, strategic changes will likely be required to remain successful. Such changes may include an increased focus on connecting directly with consumers by integrating customized services and intelligence into offerings and shifting the focus from cost to value as a means to avoid the “commodity trap.” Other approaches discussed have included forming strategic alliances with others along the supply chain. Cybersecurity will continue to be a growing focus in this area demanding additional attention to prevent costly breaches that the U.S. Food and Drug Administration (FDA) has warned could pose a real threat to patient health and safety (e.g., outside interference with a user's device).

In 2017, device M&A activity continued at a relatively steady pace with a focus on early-stage companies in the areas of minimally invasive devices and next-gen visualization/imaging companies. While activity has not escalated back to its peak in 2014, looking forward, emerging market expansion, positive demographic trends and product innovation have been attributed to continued growth in the medical device sector. Additionally, postponement of the medical device tax for another two (2) years was a boon to industry participants and investors. Per the Advanced Medical Technology Association lobbying groups, this tax had a significant negative impact on the industry. It remains to be seen whether the tax is fully eliminated or resumed after the two-year (2-year) suspension period, which is set to end on December 31, 2019. For now, though, the deferral will encourage activity in this space.

Private equity group EQT Mid Market US (EQT), reached a deal in October 2017 to buy Clinical Innovations of Salt Lake City, Utah (manufacturer of suction devices and other devices used during women's labor and delivery of babies), for \$250 million. In December 2017, TPG acquired Beaver-Visitec International (global developer, manufacturer and maker of specialized eye surgery devices), from RoundTable partners and in February 2018, TPG closed a \$737 million go-private acquisition of Exactech, Inc. (Exactech), an orthopedic implant device maker. The fund reportedly paid approximately \$49.25 per share in the Exactech transaction which was more than its initial offer due to a last-minute, unsolicited bid from another private equity firm.

Two notable platforms were also established recently through strategic alliances. In April 2017, GTCR, LLC, entered into a partnership with CEO Robert "Chip" Hance and business development executive Mark Weishaar forming Regatta Medical Holdings LLC (Regatta Medical). It was announced that Regatta Medical made a strategic investment in Resonetics, a company specializing in laser micro-manufacturing for interventional medical devices in February 2018. On May 2 2017, KKR & Co., L.P. (KKR) and Aisling Capital LLC formed Ajax Health to manage a portfolio of medical device companies under the leadership of Duke Rohlen, a longtime medical device executive. Later that day, the newly formed company led a \$45 million round for Advanced Cardiac Therapeutics (designer and manufacturer focused on developing a next-generation ablation catheter).

5. Behavioral Health (more)

We typically hear "behavioral health" in investment circles and quickly need to ask several additional questions to narrow the scope – the term "behavioral health" has become a broad umbrella that encompasses a wide range of providers, including inpatient psych hospitals, substance abuse rehab facilities, methadone clinics, inpatient and outpatient eating disorder programs, and autism and educational therapy, among other areas. Mental health parity continues to fuel interest and investment in the sector. In particular we have seen strong interest in business strategies that bring together several different types of treatment modalities to a specific target population or demographic (such as autism care, senior care, or more comprehensive programs aimed at Medicaid-covered populations). From our perspective, most of the activity has been focused on addiction, eating disorders and outpatient rehabilitation programs. In certain markets, higher-end cash pay or out-of-network providers remain viable and are pushing further into consumerism-driven care. Many of these types of businesses also have a laboratory or monitoring component, an area in which extra caution is warranted, as described further in Section 3 above, regarding Laboratory Businesses. Some recent notable transactions include Lee Equity Partners' acquisition of Summit Behavioral Healthcare from Flexpoint Ford (October 2017); The Halifax Group investment in Delhi Behavioral Health Group (October 2017); Behavioral Innovations acquisition by Shore Capital; TRT

acquisition of Origins Behavioral (mid-2017); and Ridgemont portfolio company Perimeter Healthcare's acquisition of WoodRidge Behavioral Care (late 2016).

6. Urgent Care (slightly less, but solid)

The urgent care sector remained active in 2017, but overall deal volume has decreased over the last few years. The core trends we are seeing are as follows: (i) hospitals and health systems are becoming more prevalent in the urgent care space, primarily through joint ventures with private equity-backed urgent care companies; (ii) the retail urgent care sector remains strong with continued consolidation; and (iii) private equity funds are exiting initial urgent care investments, and funds are focusing on creating market density rather than just overall scale.

For hospitals and health systems, urgent care deployment: (i) introduces healthy patients to its provider network, (ii) keeps patients out of emergency rooms, and (iii) defends against competitors deploying urgent care centers in their backyard. However, for many health systems, rapid deployment of urgent care centers is not a core skill and lack of access to capital can prohibit a quick rollout. Accordingly, many hospitals and health systems are partnering with urgent care companies on joint venture urgent care models. For example, Physicians Immediate Care, backed by LLR Equity Partners, operates joint venture urgent care clinics with various health systems, including OSF Healthcare and Presence Health, and urgent-care developer GoHealth Urgent Care, backed by Norwest Equity Partners, has partnered with various health systems, including Northwell Health in New York and Dignity Health in California.

Retail-based urgent care clinics continue to thrive and expand. A retail clinic is a type of urgent care that offers convenient walk-in healthcare and often is located inside large retail stores, such as supermarkets and department stores. These clinics benefit patients in many ways by offering extended hours, treatment in a location that is convenient for patients' other daily activities, such as shopping, and shorter wait times. Retail urgent care clinics often treat lower-intensity illnesses or infirmities. They can be staffed by non-physician personnel, such as nurses, nurse practitioners and physician's assistants, further keeping their operational cost down. In December 2017, MedExpress, an Optum company, and Walgreens Boots Alliance announced that they will launch a series of urgent care centers attached to Walgreens stores.

Despite continued activity, the industry remains fragmented. We anticipate another wave of consolidation to occur entrenching key dominant regional players. Like in other healthcare spaces, investors are likely to look to purchase add-on facilities to their current chains until they reach a critical size enabling a more lucrative exit from the market. CityMD is a great example of this. In April 2017, Warburg Pincus bought a majority stake in CityMD for an undisclosed price. Reuters valued the urgent care chain at \$600 million. In February 2018, CityMD announced that it signed a definitive agreement to acquire STAT Health, which had partnered with Spanos Barber Jesse & Co in a 2016 control recapitalization.

7. Dental Practice Management (steady)

It would seem that private equity funds and private equity-backed platforms have an almost insatiable appetite for dental investments. Interest in this field has remained strong and deal volume high. One could argue that no other sector of healthcare services has been as attractive over the past 3 years. The transaction activity has largely been fueled by fragmentation in the industry (still greater than 85% by most estimates), a relatively favorable commercial payor environment (as compared to other sectors), inelastic demand and shortages of quality dentists in some markets. In the contest between solo offices versus group practices, it appears that group practices are winning

(for the moment). One commonly cited reason for this is that new dentists are entering the field with large debt loads and do not have an appetite to start a new office or buy into an existing (often retiring) provider's practice. Either scenario usually involves a significant investment of capital in improvements and equipment. At the same time, we are seeing larger practice chains roll out affiliated labs or on-site CEREC technologies, which can be difficult to do in a solo platform.

Valuations continue to be strong in what has become a long-running sellers' market. A few valuation break points have emerged – for one- to three-office practices, transaction pricing is approximately 2 to 4 times EBITDA (accounting for pro forma changes in provider compensation), or even a percentage of overall revenue. For practices with 5 to 12 locations (depending on the infrastructure) sellers can often access multiples up to 6 or 8 times EBITDA. Finally, the biggest dental services organizations (DSOs) in the country have traded for mid-teen valuations. Admittedly, the somewhat premium valuations attached to the “best in class” platform transactions have created unrealistic expectations for some sellers (especially those further down-market).

We have also seen a trend toward operators forming DSO structures without a clear purpose or reason (as opposed to continuing to operate as a multisite practice). We recently hosted a webinar with PlanetDDS (makers of the Denticon cloud-based practice management software) on the topic “Should You Form a DSO?” A recording is available upon request.

On the regulatory front, we have seen continued efforts to modernize state laws to account for newer DSO models. For example, recently we have seen significant changes proposed or enacted in Washington, Texas, Virginia, Kansas and Connecticut.

Some recent notable transactions include KKR's purchase of a majority stake in Heartland Dental from OMERS (announced March 2018); Linden Capital Partners' investment in SmileDoctors (October 2017); Sentinel Capital Partners' acquisition of MB2 Dental Solutions (October 2017); Pouschine Cook Capital Management's acquisition of Southern Dental Alliance from SourceCapital (August 2017); Brentwood Associates' acquisition of Jefferson Dental (April 2017); New Mainstream's acquisition of CORDENTAL Group (March 2017); and Roark Capital Group's acquisition of Great Expressions Dental Centers from OMERS Private Equity (late 2016).

8. Ambulatory Surgery Centers (steady)

Despite the overall lack of total growth in the ambulatory surgery center (ASC) market, the interest of private equity funds in ASCs remains very significant. In the past couple of years, we've witnessed several different transactions. This past year, KKR invested in growth-oriented Covenant Surgical Partners, the owners and operator of 37 gastrointestinal and ophthalmic ASCs and physician practice locations in 17 states. Physicians Endoscopy remains partially owned by a private equity firm after several growth investments over the years. Bain Capital bought out the stake of H.I.G. Capital in Surgery Partners. Surgery Partners has rolled up National Surgical Healthcare and Symbion and others over the years. On the seeming flip side, Welsh Carson exited United Surgical Partners International (USPI) after several years when USPI sold in part to Tenet. AmSurg (now Envision Healthcare), still a major ASC operator, transformed itself to become less dependent on ASCs with major acquisitions and mergers in the physician practice area. Surgical Care Affiliates, Inc. (SCA), once private equity-funded by TPG, sold itself last year to United's OptumCare. There is also new and significant interest in the ASC world via private equity funds investing in PPM platforms in ophthalmology and orthopedics where the practices are also tied to ASCs. For example, in late 2017, Harvest Partners, LP acquired a majority interest in EyeCare Services Partners Holdings from Varsity Healthcare Partners, a company that provides comprehensive PPM services

to over 100 ophthalmologists and optometrists in its 46 clinics and 7 ASCs. All in all, after a long run in ASCs, there remains a ton of interest in the area.

9. Dermatology (steady)

The pace of dermatology consolidation continues to be strong despite the common complaint amongst investors that multiples have reached an unprecedented level of insanity. Dermatology remains a highly fragmented market, and the multisite, multi-unit structure of group practices is ideal for pursuing buy and build strategies. Elective, cash pay, ancillary services in cosmetic dermatology allow for direct-to-consumer marketing, while medical dermatology provides a solid foundation for recurring cash flows. Practice branding lends well to physician transition, unlike other medical specialties where the practice goodwill resides predominantly with the physicians. Scale is key, not only in terms of geographic reach but also number of providers. Achieving a certain level of scale affords the ability to bring pathology lab services in-house and provide additional ancillary services and products.

We are seeing funds struggle to find platforms of scale, with many “platforms” not having the requisite characteristics to support the definition, i.e., no infrastructure or centralized functions. Many funds are demonstrating a willingness to build from scratch and consolidate without a true platform as a starting point. Aside from the lack of available platforms, motivating dermatologists post-transaction, where much of the incentive is taken off the table by exchanging future compensation for sales price, is a key challenge. In response to this we are seeing funds develop equity and compensation models to attempt to align incentives between physicians and investors. Investors are also looking for opportunities to create an academic affiliation for the platform, either in the form of a fellowship program or other academic relationship.

2017 saw significant investment activity in this space, with notable transactions such as QualDerm Partners’ investment in the Center for Surgical Dermatology & Dermatology Associates, and Sheridan Capital Partners’ investment in Dermatologists of Central States (DOCS). Already in 2018, Platinum Dermatology Partners, backed by Sterling Partners, has acquired Center for Dermatology & Plastic Surgery, an Arizona-based dermatology practice. New MainStream Capital announced that it recapitalized Anne Arundel Dermatology Management. Pantheon also participated in the transaction and has acquired a minority ownership stake in ADM, and United Derm, backed by Frazier Healthcare Partners, announced it has brought on board Bend Dermatology Clinic in central Oregon.

10. Anesthesia (steady)

Investments in anesthesia have run hot and cold over the last several years. Regulatory pressures forced many companies to modify some structures and operating practices, which tilted the buyer population in favor of strategics instead of financial investors. Some of that pressure is easing and financial buyer interest in anesthesia consolidation is very much back in play. The market continues to be heavily influenced by the aggressive acquisition strategy of several strategics (think large aggressive consolidators like US Anesthesia Partners, Mednax, etc.), but private equity investment in new platforms in the space continues.

Private equity investment in 2018 is likely to continue as larger platforms become more realistic buyers of a longer list of smaller platforms, mirroring trends that have repeated across numerous sectors.

11. Compounding and Specialty Pharmacy (steady)

The hottest buzz in the pharmacy industry concerns Amazon and speculation around the likely impact of its entry into this space. However, the jury is still out on what and when Amazon will do. In February 2018, private equity-based grocer Albertsons Cos Inc said it would buy drug store chain Rite Aid Corp to create a company with \$83 billion in annual revenue, giving it more clout to compete with bigger chains in an industry fearing the entry of Amazon.

In the meantime, we are seeing funds invest in the pharmacy sector, including compounding/specialty pharmacies. Discussions around compounding pharmacies still frequently prompt mention of the integrity and clinical issues raised by the New England Compounding Center's far-reaching recalls in late 2012. However, investors are still interested in this space, although adherence to appropriate quality systems and FDA rules is critical. In addition, pharmacies must navigate the complex web of state regulation if they operate in more than one jurisdiction. We are seeing more focus on expensive/niche compounding, such as infectious disease, cancer and intrathecal pain management drugs – these are areas where big manufacturers are less likely to create profits. Recent transactions in this space include TA Associates' December 2017 strategic growth investment in Healix, a provider of outsourced alternate-site infusion therapy management services and Enhanced Healthcare Partners October 2017 investment in SCA Pharmaceuticals, a sterile compounding leader specializing in preparing sterile pharmaceuticals customized for hospitals, pharmacies and healthcare facilities nationwide.

12. Ophthalmology and Optometry (more)

Interest in Ophthalmology and Optometry continued in 2017 at a furious pace. Affiliation investments by Waud Capital Partners in Minnesota Eye Consultants, Sterling Partners in Grand Rapids Ophthalmology, HIG Capital in Barnet Dulaney Perkins Eye Center, New Mainstream Capital in Omni Eye Services, and Centre Partners in Chesapeake Eye Care Company only scratch the surface.

In most of 2017, the only limiting factor on investment in the sector was the availability of platforms of sufficient scale to absorb the more professional, growth-oriented infrastructure of a private equity-backed company. As often as not, transactions were structured immediately upon consolidation of several smaller practices or the transaction itself was the driver of a consolidation of several smaller practices. That is a difficult way to launch a platform (in negotiation, deal execution and post-closing operation), but for many financial buyers, this has been the price of admission to the ophthalmology space.

The market has been reacting to that shortage, and industrious groups have been consolidating on their own to provide a growing list of acquisition targets. It is expected that 2018 will see a continuation of aggressive consolidation in the space.

13. Various Newer PPM Models (more)

The big question is always this: “What is the next sector that is ripe for consolidation?” The real answer is that the sectors with the lowest barriers to consolidation are already in play. The sectors with high unit economics (dermatology, ophthalmology, etc.) or lots of de novo green space (urgent care, dental, etc.) are not done but also not newcomers to the consolidation world. The sectors that have not seen as much consolidation often have challenges that make the execution of a strategy more complicated but certainly doable.

Sectors like podiatry with lower unit economics show a lot of promise but present challenges. Navigating the compensation reset conversations with doctor owners that are making less current compensation can be complicated and often requires more elaborate physician alignment strategies to keep physicians engaged and motivated.

Sectors like allergy, which often reside within larger primary care groups (other than in larger cities), present challenges around execution of a consolidation strategy. Peeling targets out of larger existing groups is not easy and limited targets in major cities make the market dramatically smaller than larger sectors.

In areas like urology, the size of the market (similar to dermatology) and fragmentation coupled with a few larger platforms is leaving people racing to build regional platforms. Interest in this sector will only grow.

In all of these newer areas, questions around the ultimate buyer in 3-5 years following an acquisition persist. If history is a guide, though, even smaller sectors can be extremely fruitful for early movers and those able to solve the difficult physician alignment challenges.

14. Vet (steady)

Private equity interest in the veterinary services sector has remained steady over the last several years, and we see no reason for the interest and deal volume to let up. Investors have been attracted to increasing trends in pet ownership and ongoing American willingness to prioritize spending on pet health and pet products. Although there is some pet insurance revenue, it is a predominantly cash pay business, with much less regulatory oversight on ownership structures than physician provider service businesses focusing on human medicine (allowing direct private equity investments into professional veterinary businesses), thus making it attractive to a wide range of investors, including those who typically avoid reimbursement risk investments. Further, the industry remains quite fragmented, so there are still great efficiencies that are possible. The 2017 successful exit by HIG Growth Partners from Community Veterinary Clinics, LLC, has been an example to investors of potential in the space.

One of the most significant PE-backed veterinary companies is National Veterinary Associates (NVA), the largest independent owner-operator of veterinary hospitals, pet boarding and daycare centers. After Ares Management acquired NVA from Summit Partners in 2014, it then brought in additional private equity from OMERS Private Equity. And VetCor, backed jointly by Cressey & Company and Harvest Partners, has been an extremely active acquirer of pet hospitals over the last several years. A sampling of other notable investments includes Tyree & D'Angelo's investment in Heartland Veterinary; Latticework Capital's investment in American Veterinary Group; Shore Capital Partners' investment in Southern Veterinary Partners; Morgan Stanley Global Private Equity's investment in Pathway Partners; and Cortec Group's investment in Community Veterinary Partners.

We also expect investors to continue to pursue opportunities in pet health-related businesses such as pet health biotech and devices, practice solutions and analytics IT, over-the-counter health products businesses and pharma/pharmacy businesses such as New Harbor Capital's investment in Wedgewood Pharmacy.

15. Telemedicine, Remote Patient Monitoring, etc. (more)

Over the last decade, telehealth moved from a startup, nascent area to a very significant part of health care. It started with discrete areas like tele-radiology and has expanded to where major health systems like Kaiser Permanente now estimate that more than 50% of all visits occur through virtual

care or telehealth. In this same period of time, there has been large growth in companies such as Teladoc and American Well. Teladoc went public on the NYSE in 2015. American Well reported raising \$80 million in a Series C round as both healthcare institutions and financial institutions became partners in the company. In January 2018, American Well reported that it was “taking telehealth global” with new backers Philips and Allianz Group, which included a \$59.2 million strategic investment from Allianz. The parties conveyed that they hope to build unprecedented growth in United States video consultations between physicians and patients fueled by the addition of health insurance coverage of such visits from Anthem, Aetna, United and most Blue Cross and Blue Shield plans. Telehealth vendors also see some of the same promise outside the United States as commercial and government insurers become more receptive to reimbursement of video consultations.

The global telehealth market was estimated at \$2.51 billion in 2016 and is expected to grow to \$12.13 billion by 2022, according to PRNewswire on August 31, 2017. See “Why Telehealth is so Attractive to Investors” by Charlie Barrow, dated May 18, 2017, via Wamda Capital. Telemedicine companies have also been very active in fundraising. See, for example, a Modern Healthcare piece titled “Two Telemedicine Companies Raise \$61 Million in Latest Finance Rounds” by Erica Teichert July 12, 2016, discussing raises by Teladoc and Avizia. More recently, EpicMD raised \$3 million in Series A fundraising, Modernizing Medicine (maker of a mobile-based EHR for specialists) raised \$231 million from Warburg Pincus, eazyScripts (provider of e-prescribing software for telemedicine) completed \$2 million in Series A financing through Bluff Point Associates and 98point6 (provider of chat-based healthcare platform) raised \$19.5 million in third-round funding. Also see “VC Backed Telehealth Hires New President in PE Hub” and “How Telehealth is Transforming the Healthcare Industry” by Berkeley Noyes. To further explain investors’ interest in telehealth, Health IT News reported that top health IT areas of investment are wearables, analytics, telemedicine, mHealth apps and consumer health information.