

Nearly half a million patients in the U.S. suffer from advanced chronic kidney failure known as End Stage Renal Disease in the U.S. and receive dialysis as a critical life-sustaining treatment in more than 5,000 dialysis programs around the country. This chronic patient population is separate and in addition to the thousands of patients each year who receive acute dialysis treatments in connection with hospitalization for a trauma or other illness, which some industry experts estimate to be up to 25% of patients in an intensive care units and up to 4% of all hospital patients. From the mega LDOs (large dialysis organizations) to more moderate MDOs (mid-sized dialysis organizations) to the typically local hospitals and other SDOs (small dialysis organizations), these companies provide dialysis services to U.S. patients in what has grown to be a multi-billion dollar industry.

The vast majority (between 80-85%) of reimbursement for dialysis treatments has come from Medicare since 1972, when Congress initiated the ESRD payment program to pay for dialysis treatments and related supplies, drugs and services. To date, ESRD is the only diagnosis that confers Medicare eligibility regardless of age or financial need. The remaining 15-20% of reimbursement across the industry comes from self-pay and commercial payors, and while this is a small portion of the reimbursement for nearly all dialysis companies, the types and amount of such non-Medicare reimbursement is one critical indicator of the financial viability of the particular company.

The two largest dialysis companies, Fresenius Medical Care (FMS) and DaVita Inc, (DVA) are both publicly-traded and jointly account for the vast majority of the market share, collectively treating nearly 300,000 patients and owning roughly 80% of all dialysis programs. However, there are a number of successful MDOs and SDOs, and private equity investors have been active in these smaller players for decades. In fact, with the industry's seemingly endless consolidation and resulting FTC-mandated divestiture cycle, new opportunities for private equity investors continue to arise. Of the largest dialysis companies in the U.S. (based on published data of program patient and location size) at any given time, roughly half of such companies are private equity-backed. Currently, the largest of the dialysis companies with private equity investors are as follows:

- 1) DSI: In 2011, Frazier Healthcare Ventures and NEA invested in DSI to purchase the 30 dialysis clinics divested following the 2011 DaVita-DSI Renal merger. Since the initial purchaser, DSI has continued to acquire and develop additional clinics and now treats over 6500 patients across the country. DSI Renal (a separate company from this newer DSI but involving much of the same management team) was formed in 2006 with backing by private equity fund Centre Partners to purchase clinics that were at that time divested pursuant to the Fresenius-Renal Care Group merger, one of the major consolidations and divestitures of the past several years.
- 2) U.S. Renal Care. Founded in 2000 and based on Dallas, U.S. Renal Care (USRC), is another MDO dialysis company that involves private equity investors. USRC comprises a network of nearly 90 dialysis centers as well as home and specialty hospital dialysis programs, with facilities in Arkansas, Georgia, Maryland, New Jersey, Ohio, Oklahoma, Pennsylvania, South Carolina, Texas and Virginia. Like many other SDOs, MDOs and LDOs, the company also manages a number of acute-setting dialysis programs in conjunction with community hospitals. USRC includes among its financial partners long-time healthcare investor Cressey & Company as well as SV Life Sciences, Salix Ventures and Select Capital Ventures..
- 3) Innovative Dialysis Systems. In 2008, private equity firm Lindsay Goldberg invested in Ambulatory Services of America (ASA). Focused on outpatient services, ASA has, among other subsidiaries, a renal subsidiary that it acquired in 2007, Innovative Dialysis Systems, which serves over 6,000 patients in fourteen states around the country. IDS itself is based in Long Beach, California and has been lead by industry veterans since its inception in 1984.
- 4) Renal Ventures Management. In 2011 Goldman Sachs invested \$30 million in Renal Ventures Management (RVM) to fund growth initiatives including additional treatment center acquisitions, de novo center openings and expansion into related services. RVM has been an active developer and acquirer of clinics around the country for the last several years, employing the purely joint venture model that many of the newer mid-size and smaller companies are currently using. RVM is head-quartered outside Denver and treats over 2,000 dialysis patients.

In addition to these current private equity investors, the following is a brief and non-exhaustive list of PE firms who have either exited dialysis ventures in the last few years or who have more recently entered the market backing smaller start-up dialysis companies:

- a) In 2012, new dialysis provider Corva Clinics LLC, backed by private equity firm Flexpoint Ford LLC, entered the market and immediately began acquiring existing dialysis clinics. Corva is a partnership between Flexpoint, the former CEO of Renal Management Inc. Jerry Simonsen, and other senior managers that is focused on acquiring, developing, and operating dialysis clinics. Flexpoint is committed to invest \$75 million into the venture. And to help you trace the history of these various companies and their executives, we should note that Simonsen's company Renal Management had been acquired by Gambro Healthcare in 2001, and the combined entity was then merged into DaVita Inc in 2005 in one of the largest consolidations of the past decade.
- b) In an example of two PE-backed companies combining, Bain Capital Ventures and KRG Capital invested in Liberty Dialysis, which in 2011 then acquired Welsh Carson-backed Renal Advantage. The combine entity quickly then sold the entire combined company to Fresenius. As with other consolidations, that three-party merger resulted in the divestiture of approximately 50 dialysis clinics nationwide due to FTC antitrust concerns.
- c) In 2010, private equity firm Pamlico Capital (formerly Wachovia Capital Partners), completed the sale of American Renal Holdings (ARH) and its affiliate, American Renal Associates Inc. to Centerbridge Partners. ARA owns and manages more than 120 facilities in a purely physician joint venture model and serves over 8,000 patients.
- d) In 2011 we also saw the partnering of American Dialysis Corporation with Jefferies Capital Partners, headed by Thomas K. Langbein, former Chairman of formerly publicly-traded Dialysis Corporation of America (DCAI). This is just one example of the myriad smaller but growing PE-backed dialysis companies joining a still very robust industry.

Clearly, private equity interest in the dialysis industry remains strong, and the industry continues to grow despite reimbursement methodology shifts, strict government oversight and other financial constrictions faced by many healthcare sub-sectors. As with any healthcare investment, investors should understand the key regulatory issues and reimbursement pressures facing the dialysis industry, which we will address more fully in future articles.