Health Care Deal Trends Emerge From JP Morgan 2016

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"We're looking for a symbiotic platform that will have a disruptive effect in a rapidly expanding ecosystem." A private equity colleague of ours described this conversation, which he overheard at the most recent J.P. Morgan health care conference in San Francisco. Upwards of 30,000 deal professionals are reported to have descended on the city for the conference, and the town was ablaze in deal analysis and discussion. While perhaps this wasn't exactly the conversation that was overheard, we can report (accurately) that once again we enjoyed, and are thoroughly exhausted from, several days of deal-making and conversation about trends and predictions for the coming year in health care private equity transactions.

All kidding aside, the annual J.P. Morgan conference has proved to be fertile ground for cutting-edge thought leadership and analysis of market trends in the health care and life sciences sectors. Case in point is the robust market for dermatology practice consolidations. When we attended the conference four years ago, we had many conversations with private equity funds that were closely monitoring opportunities for physician practice management in the dermatology sector. The following year, the chatter increased and a smattering of deals were on the radar. Then, less than a year later, the market exploded, with various private equity buyers closing numerous acquisitions.[1] So what began as thought-provoking conversation at J.P. Morgan rapidly evolved into real-world deals.

Deal Trends to Look For

Continued Interest in Provider Services Consolidations: Vision Services

This, of course, begs the question of what deal and market trends will emerge from this year's conference. Over the course of two full days, we had more than 50 structured conversations with health care private equity and investment banking professionals. From those conversations, we think we can divine a few trends on the horizon.

First and foremost is a deep — almost ubiquitous — interest in finding and structuring the next provider services consolidation. The overwhelming interest and success in dermatology consolidations, as well as similar consolidations in the dental services sector, have fueled a strong desire to find the next platform on which that success can be replicated.

That's not to say that the dermatology market has cooled. On the contrary, the market is still hot, with valuations for existing dermatology platforms reaching new heights. But market share in dermatology may start to become limited, and high valuations provide food for thought about new opportunities in different sectors.

We think that optometry and other vision services will be a logical next step in the consolidation market, and many funds are exploring opportunities in that sector, or at least analyzing the opportunity, much like what occurred in dermatology three years ago. The interest seems to be influenced by many of the same factors that drove investment into dermatology: changes in the regulatory landscape causing independent practitioners to seek alternative practice models; the ability to join a large organization so as to focus on patient care, as opposed to administrative duties; the ability to take advantage of large infrastructure and a large community of practitioners; and capital being deployed toward consolidation through roll-up acquisitions.[2] We sense varying degrees of interest and ideas in other sectors — including laboratory-based businesses; anesthesia and pain management; urgent care; radiology; and telemedicine — but none as focused and consistent as the vision sector.[3]

Other Deal Trends

In addition to physician services consolidations, we see strong interest emerging in a number of other health care subsectors. These include the following:

1. Specialty Pharmacy

Specialty pharmacy — pharmacies that dispense highly specialized drugs for the treatment of a wide range of complex conditions — continues to heat up. As we wrote a few months ago, the M&A market for this subsector has been active, with deal activity spurred on by both private equity and strategic investors alike. This subsector has caught additional attention, and we are seeing keen interest in this market. As we **reported recently**, the M&A activity in this sector continues at a robust pace, with particular opportunities for pharmacies that offer expanded capabilities. According to Thomas Bird of Salem Partners, a Los Angeles-based investment bank that focuses on the health care sector, "these sought-after specialized services include disease-specific medication therapy management programs, comprehensive data reporting, advanced patient coaching, and physician engagement programs."[4]

2. Long-Term Care/Senior Care

Although there has been significant M&A activity in these subsectors among the large consolidators, activity in large, blockbuster deals may be waning. Nevertheless, private equity investors continue to be interested in long-term care and senior care transactions, and we had much discussion about opportunities in the middle market. The long-term care industry comprises a number of different business operations. The industry generally services a broad range of needs, including the geriatric population (senior care) and individuals with chronic disease or disabilities. We see many exist in the middle market and had many discussions with deal professionals who were analyzing and exploring various deals. Indeed, recent surveys of executives in these industries suggest a robust M&A market ahead for the middle market.[5]

3. Continued Interest in Autism Care and Other Behavioral Health Services

We continue to see a great deal of interest in various aspects of the behavioral health subsector.

This industry, which comprises many different services and patient populations, has been the focus of much deal attention over the last 18 months. Although high valuations are shutting some buyers out of the market, this is a diverse subsector with different and varied opportunities. We see continued interest in outpatient services for psychiatric patients, autism care and treatment, eating disorder treatment, and drug addiction clinics. Outpatient services (in a variety of areas, including treatment of drug addiction and psychiatric services) seem to be garnering specific attention, as new, cost-effective models of treatment are being tested and delivered with increasingly effective results.

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[1] For instance, in September 2015, it was reported that Audax Private Equity, a division of Audax Group, had completed its 500th transaction with an add-on acquisition of Dermatology of Northern Colorado by portfolio company Advanced Dermatology & Cosmetic Surgery. "Audax Closes 500th Deal with Dermatology Add-On," Mergers & Acquisitions, Mary Kathleen Flynn, Sept. 28, 2015.

[2] Not that dermatology consolidation is without challenges. As we reported in August 2015, private equity investors should consider strategic approaches to a number of challenges presented by dermatology practice investment, including Stark Law and anti-kickback regulation of laboratory services; increased regulatory scrutiny surrounding Mohs procedures; state regulation of the corporate practice of medicine; and licensure concerns over ancillary patient services. "Investors' Interest in Dermatology is More than Skin Deep," Law360, Aug. 14, 2015, Amber McGraw Walsh, Geoff Cockrell, Bart Walker and Kayla Marty, McGuireWoods LLP.

[3] See "Top Physician Specialties for PE Investment," Law360, June 2, 2014, Amber McGraw Walsh, Geoff Cockrell, and Payal Keshvani, McGuireWoods LLP.

[4] See "Specialty Pharmacy Market Ripe for Private Equity Buyers," Law360, Oct. 1, 2015, Amber McGraw Walsh, Geoff Cockrell, and Richard Grant, McGuireWoods LLP.

[5] According to BKD's Industry Insights (March 2015): "In GE Capital's recent survey of 150 executives in the senior living industry, 67 percent of respondents said their chief growth strategy for 2015 was to buy or merge with existing properties or operators. More than a quarter of respondents said they plan to revitalize and upgrade existing properties, while nearly one-third of respondents said current property and business valuations in the industry were sustainable based on the current state of the U.S. economy and the low interest rate environment. Overall, the survey presented a positive outlook from industry leaders for 2015, with plans for growth

through M&A, new construction and renovations and an optimistic view on valuation sustainability." "Long-Term Care & Senior Living M&A Continues to Break Records, Austin Propst, March 2015.