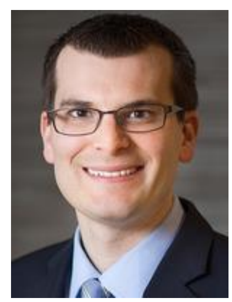
Why Private Equity Has Eyes On Vision Care

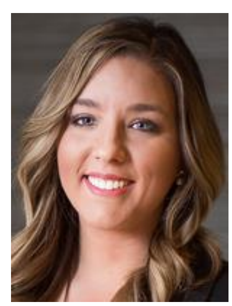
By **Holly Buckley, Thomas Zahn, Timothy Fry and Amanda Roenius** (November 27, 2018, 1:02 PM EST)

Holly Buckley

Thomas Zahn



Timothy Fry



Amanda Roenius

The U.S. ophthalmology, optometry and related optical service industry remains ripe for investment by private equity firms. With an aging population, increased incidence of diseases that exacerbate certain eye conditions — such as diabetes and obesity, significant cash-based premium business opportunities, and a highly fragmented industry, the vision space should continue buoying enthusiasm well into 2019.

Recent Investments

Over recent years, private equity has been active in eye care, with a number of successful investments occurring in recent months. A few examples of such investments are as follows:

CEI Vision Partners: In May 2018, Revelstoke Capital Partners entered into a strategic partnership with Cincinnati Eye Institute, one of the largest and most reputable ophthalmology practices in the country, to form CVP. In October 2018, CVP announced the acquisitions of Dayton Eye Associates and Retina Physicians & Surgeons of Dayton.

Eye Health America: In March 2018, LLR Partners announced the formation of EHA, which included the concurrent acquisition of The Eye Associates, Clemson Eye and Piedmont Surgery Center. Since its formation, EHA has acquired numerous additional businesses, including Montgomery & Riddle Eyecare, Stephen A. Updegraff, M.D., LLC, The Surgery & Laser Center at Professional Park, and Tampa Bay Eye Surgery Center LLC.

Ridgemont Equity Partners: In August 2018, Ridgemont Equity Partners entered into a strategic partnership with a Michigan-based ophthalmology platform.

SightMD: In September 2018, Chicago Pacific Founders and SightMD announced a partnership to expand SightMD's patient-centric care model to patients, providers and payers across the New York, New Jersey and Connecticut tri-state area.

EyeSouth Partners: EyeSouth Partners was formed by Shore Capital partners through a strategic partnership with Georgia Eye Partners in February 2017. Since its formation, EyeSouth has expanded in Georgia and into Florida through affiliations with Georgia Retina in July 2017, Georgia Ophthalmology Associates in November 2017, Gainesville Eye Associates in February 2018, South Georgia Eye Partners in June 2018, Florida Eye Microsurgical Institute in August 2018, Cobb Eye Center in October 2018, and Georgia Eye Associates in November 2018.

Acuity Eyecare: In March 2018, Riata Capital Group's portfolio company Acuity Eyecare acquired two new regional eye care groups: (1) One Hour

Optical of Denver; and (2) 20/20 Image Eye Centers, which is based in the Phoenix market.

Chesapeake Eye Care Co.: In July 2017, Centre Partners completed an investment in Chesapeake Eye Care Company, combining two leading mid-Atlantic ophthalmology practices: (1) Chesapeake Eye Care and Laser Center; and (2) Whitten Laser Eye. Then, in March 2018, the group acquired Maryland Vision Institute.

American Vision Partners: In June 2018, HIG Capital-backed American Vision Partners acquired Miles Eye Center. American Vision Partners was founded in April 2017 with the affiliation of Barnet Dulaney Perkins and Southwestern Eye Center. American Vision Partners operates in Arizona and New Mexico.

Omni Eye Services: In January 2018, Omni, a portfolio company of New MainStream Capital, announced that it affiliated with the Phillips Eye Center. Several months later, in April 2018, Omni also announced that it acquired Kremer Eye Center.

Great Lakes MSO: In January 2018, Great Lakes MSO added Shoreline Vision, a Muskegon, Michigan-based practice. This Sterling Partners-backed platform was formed in May 2017, with an affiliation with Grand Rapids Ophthalmology, a larger West Michigan-backed practice with nearly 12 office locations.

Spectrum Vision Partners: In October 2017, Ophthalmic Consults of Long Island, one of the leading ophthalmology practices in the U.S., partnered with Blue Sea Capital for an investment in Spectrum Vision Partners, a management services organization formed to administratively support leading eye care providers in the tri-state region and other geographies.

EVP EyeCare: In December 2017, Cortec Group recapitalized Denver-based Icon Eyecare and renamed it EVP EyeCare. EVP EyeCare's subsequent July 2017 acquisition of Phoenix-based Swagel-Wootton Hiatt Eye Center included two clinics and a surgery center.

Comprehensive EyeCare Partners: Comprehensive EyeCare Partners was established in February 2018 through Gauge Capital's acquisitions of Nevada Eye Physicians, New Eyes of Southern Nevada and Shepherd Eye Center.

NJ Retina: In September 2018, Quad-C Management announced it had closed on a joint investment with NJRetina in NJEye LLC, a regional eye care administrative services organization.

Unifeye Vision Partners: UVP was formed by Waud Capital Partners through a strategic partnership with Minnesota Eye Consultants in February 2017. Since its formation, UVP has acquired Pacific Eye Institute in February 2018 and Northwest Eye in October 2018.

Market-Dynamic Considerations

The eye care industry should continue to present attractive opportunities for private equity investment. Investors evaluating eye care opportunities should consider the following market dynamics:

Three Tiers of Care

The eye care industry is comprised of three core levels of patient care: (1) optical retailers, (2) primary care or optometrists, and (3) ophthalmologists. Vision businesses frequently offer more than one level of care, yet all three tiers remain highly fragmented. Investors should consider whether growth in one tier impacts its relationships in another. For example, ophthalmology-focused platforms may find that downstream investments in optometry and optical businesses threaten relationships with referring optometrists.

Outpatient Focus

Ophthalmology and optometry practices are not dependent on hospitals and, thus, are unlikely targets for hospital acquisitions. Independent practices are prevalent in the eye care space, with 2017 estimates depicting independent practices held 68 percent of the market share.[1] This highly fragmented market continues to present optimal opportunities for consolidation.

Reimbursement

In general, traditional Medicare does not cover optometry services other than for certain conditions, such as diabetes or glaucoma, or specific demographic groups. However, there is increasing commercial coverage for optometry services through commercial/employer plans, as well as coverage in certain Medicare Advantage plans. Medicare reimburses for ophthalmic services through the physician fee schedule for physician services and the ambulatory surgical center, or ASC, prospective payment system for surgical services.

Demand for Services

Favorable demographics, such as the significant decrease in the uninsured patient population as a result of the Affordable Care Act and the nation's aging population, present significant opportunities for potential increases in the volume of ophthalmology and optometry services. Further, as chronic diseases that increase risk for vision problems continue to grow in prevalence, so too will the demand for related ophthalmic services. Further, the National Institutes of Health's National Eye Institute estimates that while more than 24.4 million Americans over the age of 40 had cataracts in 2010, this number will likely double to 50 million by 2050.[2]

Premium Services

In addition to chronic conditions, there is a steady demand for cash-based, premium eye care service offerings, such as LASIK, premium intraocular lens (IOL) and dry-eye treatments. These cash-based services provide reimbursement diversification and often healthy margins.

Surgery Centers

Many ophthalmology practices own or are affiliated with a surgery center. Surgery center ownership presents additional opportunities for cost containment and better access to care for patients while, at the same time, increasing independence from hospitals.

Physician Shortage

As is the case in numerous other specialties, the number of retiring ophthalmologists outpaces physicians starting their careers in this space. This dynamic sets the stage for innovative delivery models, compensation challenges and competition for transactions.

Regulatory Compliance Considerations

Private equity firms considering investments in vision businesses should understand the industry's unique regulatory issues, including but not limited to the following:

Referral Relationships

Ophthalmology practices rely heavily on referrals from local optometrists to sustain and grow their business. Thus, a common area of risk for ophthalmology practices is financial relationships with referring optometrists (i.e., an ophthalmology practice provides a benefit to a referring optometrist in order to induce referrals). Naturally, this creates risk under federal and state fraud and abuse laws. These financial relationships can include meals and entertainment, the provision of continuing medical education, holiday gifts, and real estate rental relationships, among others. Investors should carefully diligence any financial relationship with a referral source to determine whether such relationship violates applicable law.

Co-Management Arrangements

Optometrists and ophthalmologists frequently co-manage surgical patients (i.e., an ophthalmologist sends a surgical patient back to the optometrist for post-surgical care, and the fees are divided accordingly). Co-management of a surgical patient is often clinically appropriate; however, if not structured appropriately, these arrangements can pose risk under the federal and state fraud and abuse and self-referral laws.

Practice Ownership

A majority of states prohibit nonlicensed individuals from owning a medical practice or directly employing licensed professionals who will provide medical services. This prohibition is based on a legal principle called the corporate practice of medicine doctrine. Notably, many states have an analogous prohibition related to optometry. In states in which an investor desires to acquire or establish an optometry or ophthalmology practice, determining whether such state has a corporate practice of medicine/optometry prohibition is a key consideration in determining how to structure the transaction. There are several mechanisms through which nonphysicians participate in vision businesses in states that prohibit corporate practice — for example, formation of an administrative services company, which enters into a contract with a professional practice to assist with the nonclinical aspects of the business. There are a number of nuanced legal issues involved with using this model that should be carefully considered during the transaction and, just as critically, subsequent operation of the business after the transaction closes.

Ancillary Services

Vision practices often have interests in ancillary businesses, such as ambulatory surgery centers and optical shops. These ancillary businesses can be lucrative, but they often pose risk under federal and state fraud and abuse laws. Investors should be aware of how owners in an eye care practice are compensated from such ancillary businesses and how these ancillary businesses fit within the larger organizational structure of the practice.

Drugs

Wet age-related macular degeneration, or AMD, is responsible for approximately 90 percent of all AMD-related blindness. Left untreated, wet AMD leads to blindness for most individuals within two years. Several injectable anti-vascular endothelial growth factor, or anti-VEGF, drugs have nearly halved the incidence of AMD blindness and in some cases restored the patient's vision. The three most commonly used anti-VEGF drugs for wet AMD are ranzibizumab (brand name Lucentis), aflibercept (brand name Eylea) and bevacizumab (brand name Avastin). The first two are approved by the U.S. Food and Drug Administration to treat wet AMD, while Avastin is off-label and was developed for certain cancers. Due to Avastin's off-label status, Medicare's (and other payors') reimbursement rates for Avastin are less than Eylea or Lucentis. As Medicare reimburses providers the average sale price of the drug plus 6 percent, this reimbursement differential could incentivize providers to recommend the more expensive Eylea or Lucentis over Avantis. Investors should review a target's utilization of these drugs to determine whether utilization is consistent with industry norms.

Billing and Coding

As with all physician practices, billing and coding errors can create legal risk and can artificially inflate a practice's value. Ophthalmology introduces nuanced billing and coding decisions, including whether to select one of five evaluation and monitoring codes or one of two eye codes, which have various reimbursement, coding and appropriate exam differences. Investors should consider a billing and coding audit as part of transaction diligence.

Physician Compensation

Ophthalmologists and optometrists are considered physicians for purposes of the federal self-referral law, commonly known as the Stark Law. As such, physician compensation, and the share of ancillary revenue and drug revenue (both described above), as well as the share of the many imaging codes utilized in eye care, must comply with the Stark Law. Investors should carefully scrutinize historic compensation methodologies to determine if the methodology complies with these nuanced rules and ensure that the methodology is appropriate following the investment.

Without a doubt, private equity interest in the eye care space remains strong, and, despite certain regulatory challenges that the eye care industry faces, robust opportunities exist for quality private equity investment. However, as with any health care investment, investors should continue to closely analyze reimbursement pressures for the sector at large and each target's existing compliance profile prior to making any investment.

Holly Buckley and Thomas E. Zahn are partners and Timothy J. Fry and Amanda K. Roenius are associates at McGuireWoods LLP.

Disclosure: Zahn represents Revelstoke Capital Partners and Eye Health America.

[1] See Vision Market Update, Harris Williams & Co. (Mar. 2017), available at https://www.harriswilliams.com/system/files/industry_update/vision_industry_update_hcls_0.pdf.

[2] NIH National Eye Institute, Cataracts (last visited Oct. 28, 2018 11:03 AM), https://nei.nih.gov/eyedata/cataract#5.