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Industry Flash Report – Physician Groups

March 2018

The U.S. physician group sector includes approximately 200,000+ physician groups with combined 2017 revenues of $265 billion, up 3.1 percent from 2016. The sector has seen annualized growth of approximately 2.8 percent since 2012, due to key factors such as a robust U.S. economy, increased demand for care from an aging population, and, until recent disruptions, increasing numbers of insured patients. Factors tempering industry growth include higher out-of-pocket healthcare costs, payment declines for specialty providers, and instability due to uncertainty about federal policy changes and funding.

Implications

Today, about one-third of U.S. physician groups are independent, compared with approximately 57 percent in 2000. Physician group transactions were robust in 2017, up 37 percent over 2016 and nearly double the number of deals recorded just two years ago. Remaining independent physician groups are evaluating their strategic options and long-term growth opportunities, and weighing them against pressures to remain competitive in an operating environment that continues to move toward value-based payments and coordinated care delivery.

Managing billing and implementing electronic health records (EHRs) can be complicated for smaller practices without adequate financial and technical resources, leading independent physician groups to join larger organizations that can provide administrative and technology support. Access to capital and operational experience is also key for practices aiming to gain scale and deepen clinical expertise, and considering partnering strategies as a means for attaining those goals. Physician group shareholders and operators should consider potential partnership opportunities within their local and regional markets that provide opportunities to cut costs, generate new revenue, and build infrastructure, scale, and expertise.

Overview of Physician Group Sector

The U.S. physician group sector continued a strong trend of consolidation in the second half of 2017, driven in part, by the Medicare Access and CHIP Reauthorization Act (MACRA), which alters Medicare payments for physicians. While final MACRA rules issued in late 2017 ease or delay some of the impacts on small practices, patient outcomes are much more important under MACRA, driving the need for strong data collection/analysis infrastructure and capabilities, and contributing to the trend of physician practices seeking to join larger, more developed, and better capitalized entities.

Hospitals and health systems historically have been the primary buyers of physician groups, with the goals of expanding their regional presence and ensuring comprehensive care networks. Large physician practices and provider management companies also have emerged as buyers given strong return-on-investment potential and opportunities to lower overhead, gain efficiencies, and improve third-party arrangements.

Private equity buyers looking for recession resistant investments continue to acquire physician groups, particularly certain specialties with attractive financial profiles and scalable multi-site opportunities, such as dermatology, urology, dental, and ophthalmology. Large multi-specialty practices with strong management and significant growth opportunities also are appealing targets.

Major Publicly Traded Players and Market Multiples

DaVita HealthCare Partners, Inc. (NYSE:DVA)

- One of the largest U.S. operators of medical groups and physician networks, with affiliated multi-disciplinary physician networks throughout Arizona, California, Nevada, Florida, New Mexico, and Colorado

MEDNAX, Inc. (NYSE:MD)

- National medical group and leading provider of neonatal, anesthesia, maternal-fetal, and pediatric medical services; includes more than 1,100 neonatologists and 1,725 pediatric sub-specialty physicians

Envision Healthcare Holdings (NYSE:EVHC)

- Offers a range of hospital-based physician staffing and related management services; includes more than 10,000 physicians and 18,000 paramedics

Surgery Partners, Inc. (NASDAQ:SGRY)

- Surgery Partners, Inc., owns and operates surgical facilities, multi-specialty physician practices, urgent care facilities, and other ancillary services in the U.S.; operates approximately 150 locations in 29 states.

	Valuation		Latest 12 Months		LTM Multiples	
($ in millions)	Market Capitalization	Total Enterprise Value	Revenue	EBITDA	TEV/Rev	TEV/ EBITDA
DaVita Healthcare Partners, Inc.	$13,052	$23,044	$10,884	$2,399	2.1x	9.6x
MEDNAX, Inc.	$5,100	$6,882	$3,458	$583	2.0x	11.8x
Envision Healthcare Holdings	$4,598	$11,430	$7,819	$1,192	1.5x	9.6x
Surgery Partners	$ 773	$4,049	$1,313	$215	3.1x	18.8x

Source: S&P Capital IQ

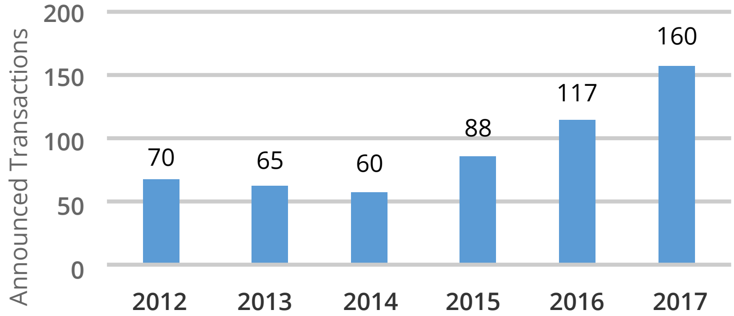
For more information, please contact Kristofer Blohm at 224.724.3182

Kaufman, Hall & Associates, LLC 5202 Old Orchard Road, Suite N700, Skokie, IL 60077 847.441.8780 (phone) / 847.965.3511 (fax) / kaufmanhall.com

Select Transaction Activity

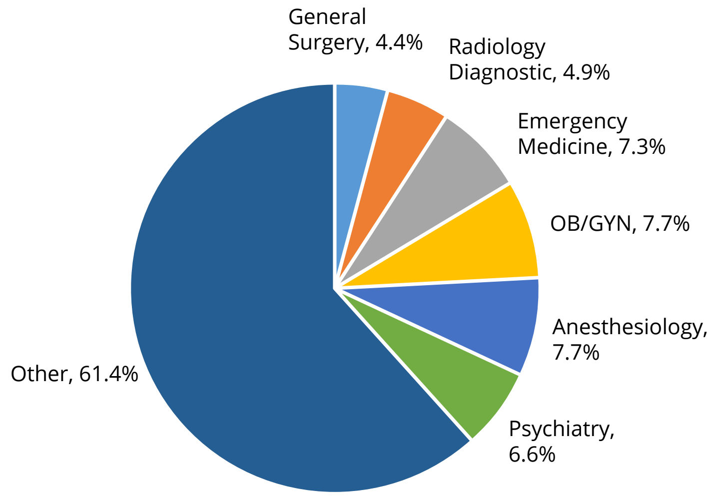
- M&A activity in the physician group sector was strong in 2017 with 160 announced transactions compared to 117 in 2016
- In January 2017, Optum announced its $3.28 billion acquisition of Surgical Care Affiliates, in a transaction meant to position the combined organization as a comprehensive provider of ambulatory care services
- In July 2017, Dermatology and Skin Surgery Center ("DSSC") was acquired by Dermpath Lab of Central States, via its financial sponsor Sheridan Capital Partners, through a $50.7 million LBO. DSSC operates dermatology and skin surgery centers in Michigan and Indiana
- Los Angeles-based private equity firm Ares Management announced in August 2017 its $1.45 billion acquisition of DuPage Medical Group, an independent multi-specialty physician group with over 600 physicians who manage over 1.1 million annual patient visits
- The $4.9 billion acquisition of DaVita HealthCare Partners, Inc., by Optum was announced in December 2017, continuing the trend of payer/provider vertical integration
- 2017 continued to be an active year for private equity investor and financial sponsors, as evidenced by significant interest in a number of high margin and scalable specialties. Notable transactions include:
  - The acquisition of Maryland Dermatology Associates LLC, a provider of general, surgical, and cosmetic dermatology services, by Anne Arundel Dermatology Management, a portfolio company of New MainStream Capital
  - The recapitalization of Dallas-based EyeCare Services Partners Holdings LLC, an ophthalmologic services company, by Harvest Partners, LP and Varsity Healthcare Partners
  - Private equity firm Sentinel Capital Partners' announced new partnership with MB2 Dental Solutions, a rapidly-growing dental service organization with a unique physician-centric ownership model
- 2018 activity, while early, is robust. In February, Envision Healthcare announced its intent to explore strategic alternatives for its physician-led services segment, among others.

U.S. Physician Group M&A Transactions by Year



Source: Irving Levin M&A HealthCare Report 2016 -2017

Physician Group Segmentation by Speciality (2017)



Source: IBIS World Report, U.S. Specialty Physician Groups, November 2017.

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