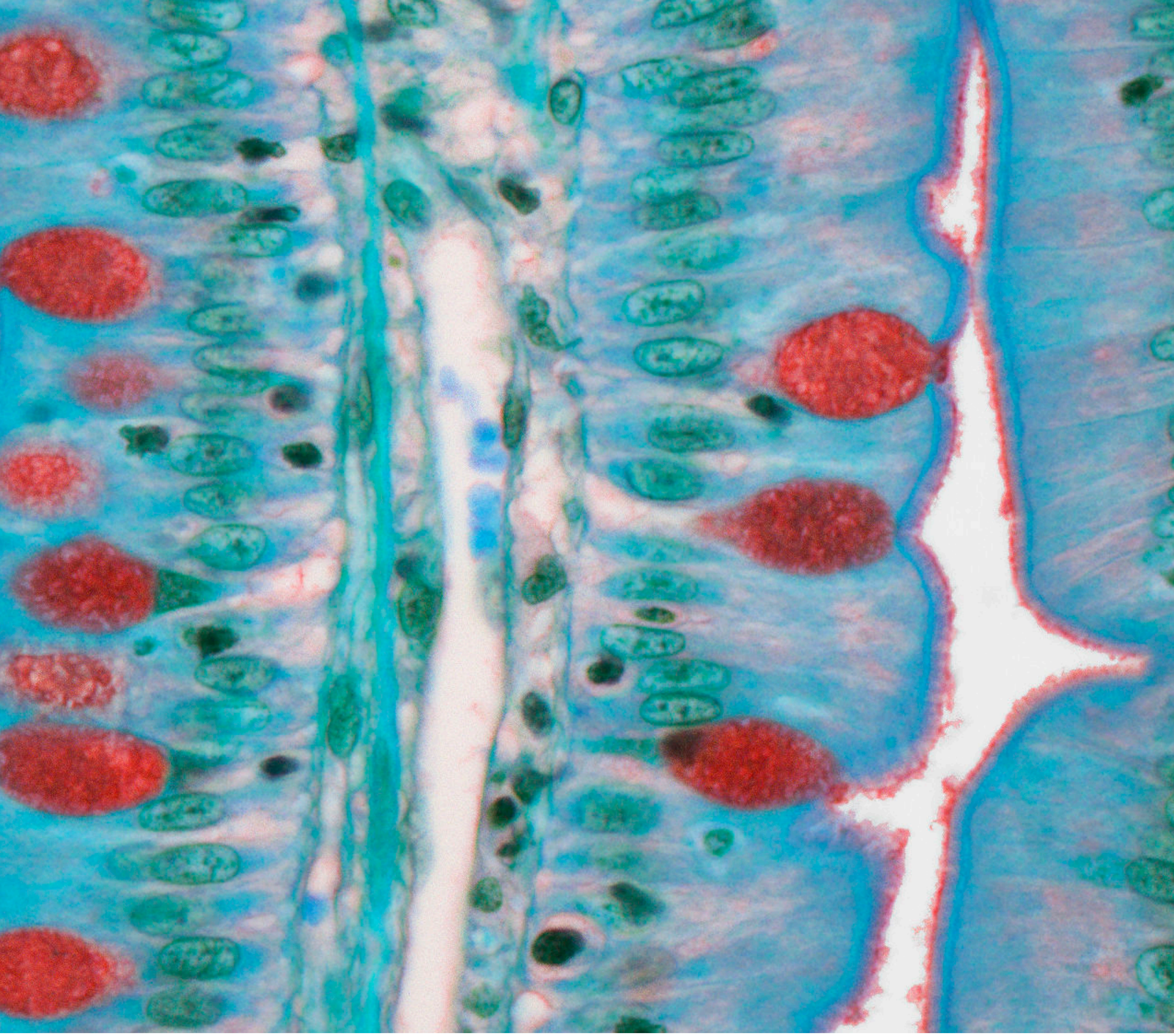


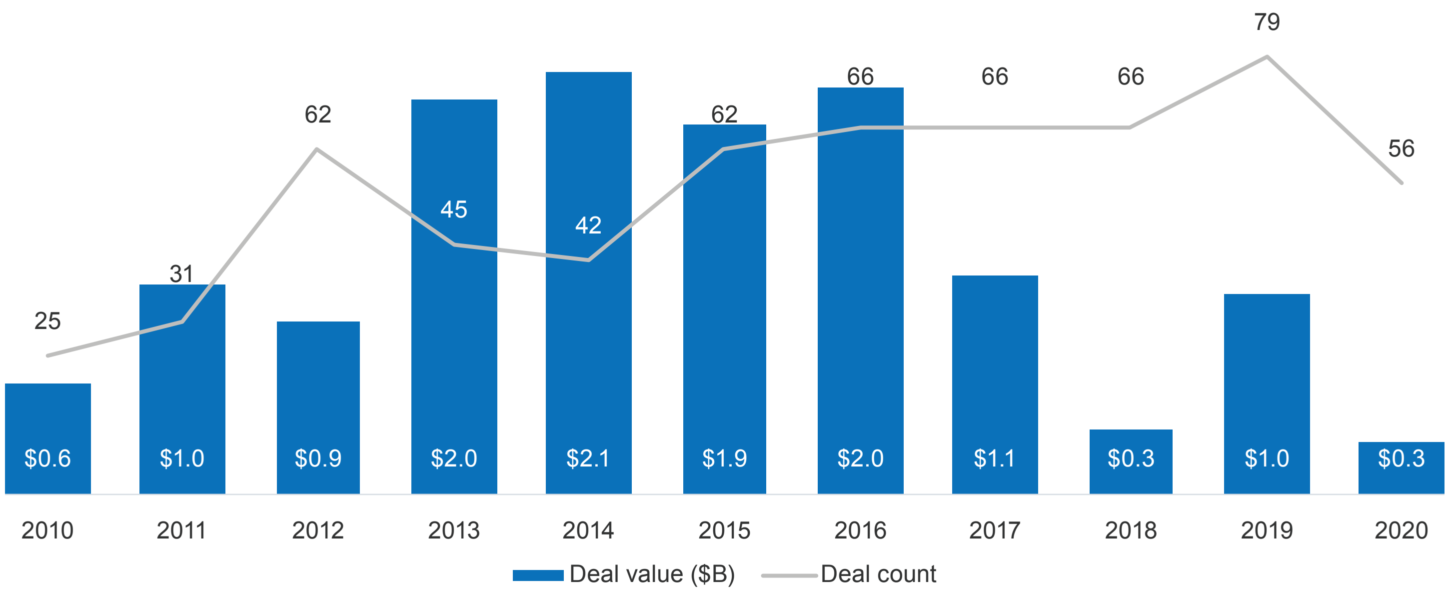
VECTOR MEDICAL GROUP

# PE Accelerating Pace of Gastroenterology Consolidation

*Data provided by* PitchBook

# Resilient 2020 positions GI for record M&A activity in 2021

### Gastroenterology M&A activity




Source: PitchBook | Geography: US

The pace of consolidation across the gastroenterology space has accelerated since the start of 2015, led by a growing number of financial sponsors leveraging platform acquisitions to roll up physician-led practices across the US. Between 2010 and 2020, private equity (PE) dealmaking in gastroenterology has expanded at a compound annual rate of 13%, reaching a record 57 transactions completed in 2019. Despite the impact of COVID-19, PE firms closed another 39 deals in 2020—a return to 2018 totals generating some $300 million of disclosed deal value.

This momentum has already carried over into the new year. After the pandemic forced some to press pause on the acquisition process in early 2020, others waited on greater clarity around the results of US elections in the back half of the year. With those results clear, the lingering political uncertainty around potential changes to capital gains tax policy started to fuel renewed negotiations between physician-led groups and financial sponsors. By mid-January 2021, a handful of deals had already taken place; for example, New Jersey's largest gastroenterology group, Allied Digestive Health, joined forces with financial sponsor Assured Healthcare Partners.

PE firms targeting physician-led gastroenterology practices are responding to several factors that characterize dealmaking across healthcare services in the US. Chief among them:

- Specialty care such as gastroenterology remains highly fragmented, presenting financial sponsors with opportunities to achieve greater economies of scale via add-on acquisitions.
- Retiring physicians represent a reliable entry point for PE firms targeting opportunities to consolidate regional markets primarily dominated by individual clinics.
- Rolling up small, physician-led groups that offer ancillary services can diversify revenue streams by expanding the scope of care available to patients.
- An aging population living longer than ever is creating greater demand for vital gastroenterology services such as colon cancer screenings.

Boston-based Audax Group kicked off the current wave of PE-driven consolidation with its 2016 recap of Miami-based Gastro Health. The group—which was founded in 2006 via a merger of GI Care Center, Gastroenterology Associates, and Gastroenterology Group—had already acquired 16 new centers before partnering with Audax. It has since morphed into a platform for adding on smaller practices, anchoring more than 15 transactions largely across Florida since the start of 2017. The group recently added on Ohio

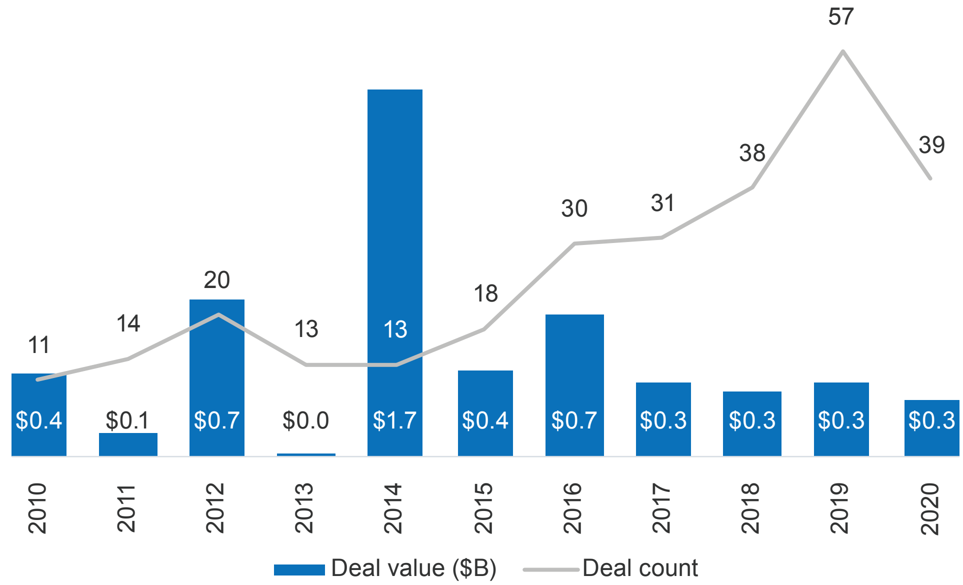
***15K***

*The number of active physicians that specialize in gastroenterology as of 2017 was 14,747, according to AAMC*

***22K***

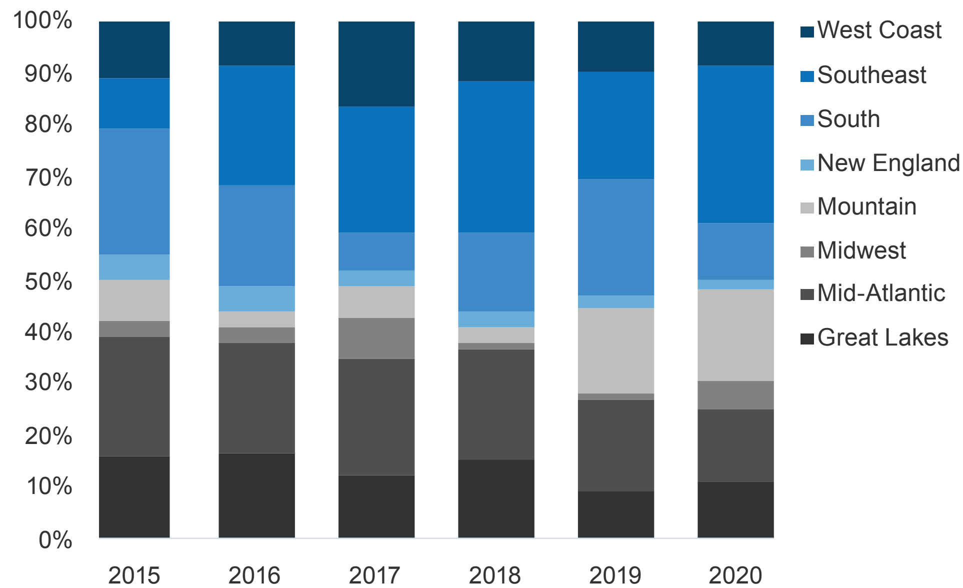
*The number of people per gastroenterologist as of 2017 was 22,087, according to AAMC*

## Gastroenterology PE deal activity




Source: PitchBook | Geography: US

## Gastroenterology M&A (#) by region




Source: PitchBook | Geography: US

Gastroenterology & Liver Institute in a deal that included three ambulatory surgery centers (ASCs).

But the real surge in dealmaking across the gastroenterology space arrived in 2018, when consolidation became an even more palpable trend with the formation of the GI Alliance via the purchase of Texas Digestive Disease Consultants by Chicago-based Waud Capital. Like Audax, the firm has leveraged a buy-and-build approach to create greater economies of scale with the resulting Managed Service Organization (MSO), turning these platforms into regional players capable of providing patients with gastroenterology and parallel services (such as infusions) outside of a hospital setting. For its part, the GI Alliance has become a prolific acquirer in the short time since its formation, with over a dozen deals completed largely in Texas since the start of 2018.

Once formed, PE-backed gastroenterology MSOs also provide physician groups back-office services ranging from managed care contracting and revenue cycle management to electronic medical records support and data analytics. And these platforms have clearly had an impact on regional consolidation over the past decade, with the Mid-Atlantic, South, and Southeast regions far outpacing dealmaking activity in other areas of the US.

Meanwhile, the pullback of corporate acquirers over the past decade now appears nearly complete. Competition from PE firms sitting on record levels of dry powder and their middle-market appeal makes these players almost insurmountable at auction. After closing at parity with PE on 33 deals as recently as 2018, strategic M&A dipped to 31 completed transactions in 2019 before falling to just 24 in 2020. Corporate deals closed over this period generated a combined $721.6 million in value. By contrast, at the height of their activity in 2015, corporates completed 49 acquisitions in gastroenterology worth some $1.9 billion—numbers more redolent of the recent performance put in by PE firms.

### Top investors in US gastroenterology deals, 2010-2020

| Investor name | Investment count |
|---|---|
| Audax Group | 22 |
| Mednax | 15 |
| CRH Medical Corporation | 15 |
| Summit Partners | 14 |
| Waud Capital Partners | 13 |
| Webster Equity Partners | 10 |

Source: PitchBook | Geography: US

***"As a result of technological advances and the ability to customize treatment to a patient's specific genetics, patients are having an entirely different experience during the healing and treatment process."***

*—Dana L. Jacoby, CEO*
*Vector Medical Group*

## Methodology

Gastroenterology practice dealmaking data was generated using a custom list of keywords, including but not limited to gastrointestinal care, endoscopy, and bariatric surgery to identify appropriate companies within the PitchBook Platform's coverage of the larger healthcare services industry. In addition, where appropriate, transactions also involving practices offering parallel services such as anesthesia and infusion related to gastroenterology have been included. Customary PitchBook reports' methodologies for M&A transactions and PE deal flow have been utilized, with M&A value based on reported or disclosed figures, with no estimation used to assess the value of transactions for which the actual deal size is unknown. Therefore, annualized deal values reflect disclosure and transparency requirements for private transactions and, as result, may in some instances reflect aggregate sums lower than those realized on a per transaction basis.

# Q&A with Dana Jacoby

**Dana L. Jacoby**
*CEO*
*Vector Medical Group*

**For much of the past decade, PE firms have grabbed a growing share of overall dealmaking in healthcare—gastroenterology included. What do financial sponsors find so appealing about this specialty and which opportunity sets are unique to this corner of the physician practice space?**

There are a couple of things happening right now. The patient base is getting older, so the sheer number of patients needing healthcare is on the rise. At the same time, our life expectancies are increasing. So, there are more people by number staying in the system longer. Conversely, the average age of physicians is getting older as well, while many are retiring. It's a classic supply-demand crunch: The demand for healthcare is increasing while the supply of practitioners is decreasing. At the same time, the environment is at a cataclysm. Massive consolidation is happening across all facets of healthcare. Hospitals are consolidating due to payor pressure from insurance companies. And the overall infrastructure needed to provide quality patient care is more expensive and difficult. Financial sponsors see opportunity in consolidating fragmented healthcare systems that once had small practices to achieve economies of scale. This is really the only way to compete in the current consolidated market.

**What other dynamics were driving the growth in dealmaking activity across the gastroenterology space coming into 2020? How has COVID-19 affected these trends?**

Certain specialties had remained unconsolidated until recently. This is true in surgical specialties, as well. For example, GI did not have its first PE platform until about three years ago. In late 2019 and early 2020, we saw a ramping up of activity, partly driven by the amount of dry powder in the financial institutions together with a familiarity of PE on the medical practitioner's side of the equation. When COVID-19 hit, practices that were on the fence about joining a platform suddenly realized that they needed to accelerate the decision and make the call. Many of these practices looked at what was needed to survive in a harsh landscape and reconsidered the benefits of joining with a larger group to achieve the economies of scale I referred to earlier.

**Can you outline the key investment risks and related challenges for both buyers and sellers in gastroenterology?**

The dynamics of the marketplace are multifaceted, and everything is uncertain. For example, the recently introduced "Most Favored Nation" proposal was a bombshell that few physicians saw coming at the end of 2020. Every week seems to introduce a new payor/payee formula, so the income stream is in flux. Due diligence is extremely complex because each practice will typically value the assets of the practice differently, and it can be difficult to know exactly what you are buying. And finally, when a practice joins a platform, there is a huge issue around the internal culture, which seems to be the most overlooked risk in the consolidations that I have worked with. It is the people question and that can be the most vexing of all.

**How are PE firms approaching these unique hurdles and how should a prospective seller assess the relative advantages of exiting to a financial sponsor versus a corporate acquirer?**

The PE firms that are doing this well are using a combination of education, strong relationships, and a good roadmap for what life looks like after acquisition. The PE firms that are doing a poor job are the ones that come in, throw numbers around to see what sticks, and remain vague on the details. It is important to take the time to understand the specialty rather than use algorithms that assume all medical practices are the same across specialties. Buying a dermatology practice is not the same as acquiring a dental group or a urology platform. The same is true in the GI space. On the doctor's side of the table, it is important to slow down, ask questions and get to know the PE group, because not all private equity firms are the same, either. It is a sad thing when a group of smart doctors arrive at a decision based on who offers the biggest multiple only to find out their lives are miserable after the deal closes. They can brag about the outcome, but inside they are regretting their decision.

**With some dealmaking put on hold during the pandemic, do you see gastroenterology primed for even more M&A in general, and more specifically, deals involving PE in the year to come?**

Three things have happened because of COVID-19 in the GI space. First, the recovery was "V-shaped," meaning that many patients stayed home at the beginning of the pandemic. As soon as practices began to reopen, they were inundated with cases and patients that really needed medical attention. It was not a smooth return to business-as-usual because of pent-up demand. So, the revenue numbers in these practices are looking very healthy. Second, quite a few deals were ready to close in early 2020, but because of the pandemic, everyone decided to hold until we understood where the market was headed. Now that we can see light at the end of the tunnel, these deals are back on the table and, barring any other unforeseen circumstances, should close in a flurry of activity through 2021. This flurry started in the end of 2020 because of the political uncertainty around capital gains, and it is expected to continue. Finally, COVID-19 caused economic hardships in certain cases, and that means that there are distressed assets. We see this in all sectors of the economy, and the GI space is no different. Combine deal-flow with distressed assets and dry powder, and that had the makings for what could be an explosive post-pandemic market.

**While the COVID-19 pandemic has brought unprecedented devastation to many communities, it has also ushered in an era of rapid advancement and deployment of technology across healthcare. How would you characterize the uptake of emerging tech by practice size or type? How are practices coping with home screenings?**

For the first several months of the pandemic, I spent my time teaching practices how to embrace technology such as telemedicine, coaching them on proper billing, and encouraging them to see these things as opportunities instead of obstacles. We have known for years that we could do things more efficiently using new tools. But the human condition is that too often we resist change until we are forced to accept a new reality. Certainly, some things are difficult to diagnose and treat using telemedicine. A colonoscopy does not work over a Zoom call, at least not currently. But there are tremendous advancements that will remain within our environment moving forward, and for everyone involved, that is a very good thing.

**How is the gastroenterology space evolving from traditional methods of care provision? What other key technical advances are helping transform the space?**

This is a very interesting time to be in medicine, particularly in the GI space. Because of genomics and advances in technology, patients are being identified earlier and their journey is lasting longer. We are teaching good medical practices to better manage that journey by creating a care team that augments and enhances the physician-patient relationship. That is more critical now than ever. As a result of technological advances and the ability to customize treatment to a patient's specific genetics, patients are having an entirely different experience during the healing and treatment process. It may seem like a paradox, but in this time when business across the board is attempting to personalize all things related to customers, we are seeing some exciting trends in providing a more custom experience in medicine because of exponential increases in genetics and genomics. Likewise, the number and type of treatment therapies is unprecedented. And the R&D funnel appears to be more robust than at any other time I have personally witnessed.

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