

# The Dermatology Market: A Tidal Wave of Private Equity Investment

A beginner's guide to the complex world of mergers and acquisitions.

BY CLINT BUNDY

Over the past seven years, there has been an explosion in acquisition and investment activity in the dermatology market. The acquisition and investment trend in dermatology has been driven by financial investment funds known as private equity groups. As Jack Resnick, MD stated in a January 2018 *JAMA Dermatology* article, "Consolidation of practices fueled by private equity investments has begun to transform dermatology."<sup>1</sup> Furthermore, the demand from private equity buyers continues to surge, resulting in a barrage of phone calls and emails from private equity groups to practice owners from California to New York requesting meetings. While opinions can vary among dermatologists on the attributes of private equity groups, one thing is clear: these investors are a force in the dermatology market and are here to stay.

Private equity groups are funds of money, managed by finance and operating professionals, that are usually focused on acquiring a majority ownership position in private companies. The original practice owners and/or management team usually retain a minority equity interest. After an initial, or platform, investment in the dermatology market, the private equity group and its physician partners then seek to accelerate the growth of the practice through various means. This could include enhancing services of the practice, adding new locations and completing "tuck in" acquisitions of other dermatology practices. After an investment period of three to seven years, the private equity group and its physician partners aim to sell the practice and receive back two to five times the amount of equity that it originally placed into a transaction.

There has been a rush of private equity capital into the dermatology market over the past seven years. In 2011, there

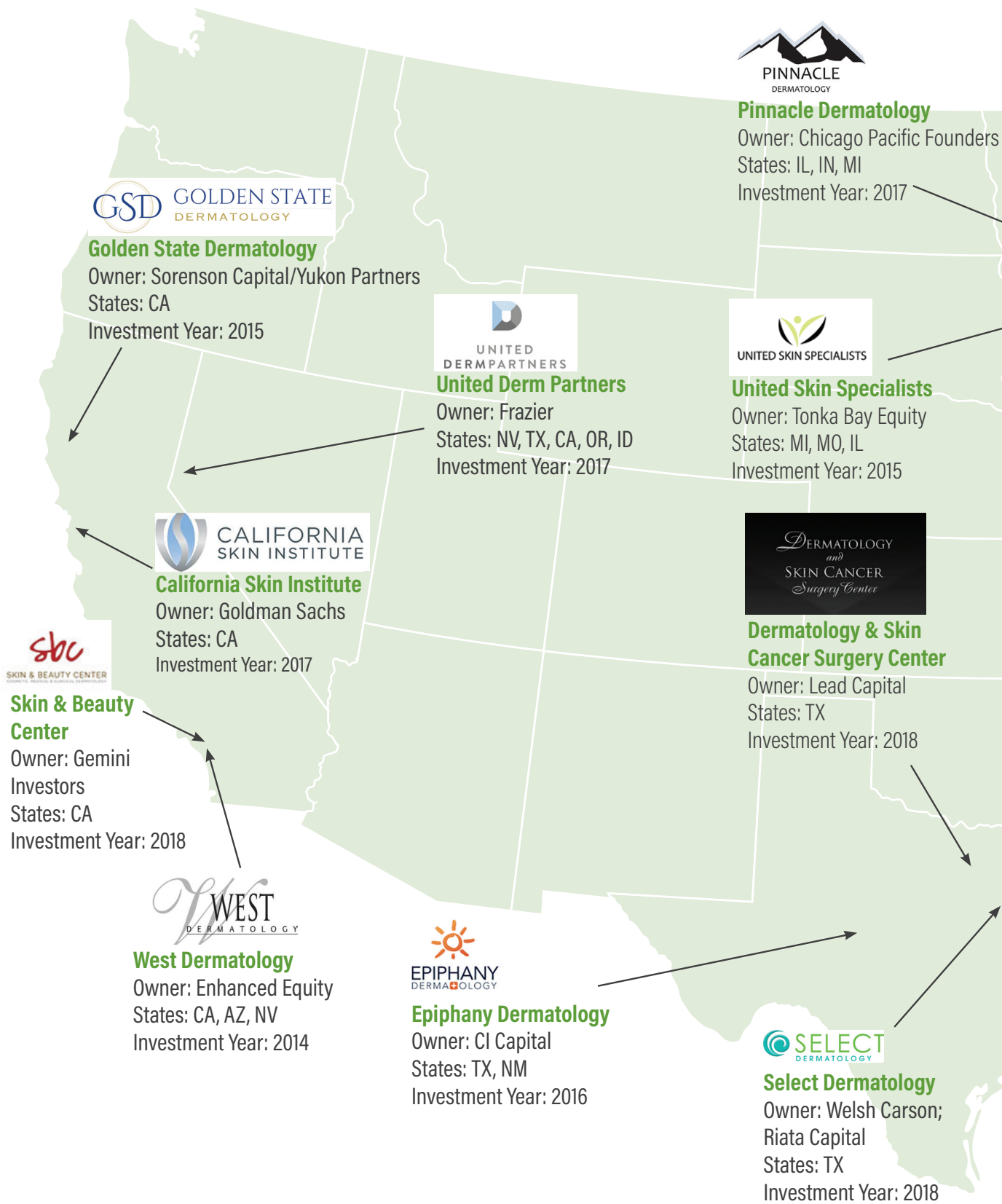
was only one private equity investor in the dermatology market, yet by 2018 there were more than 30 private equity groups active in the segment.<sup>2</sup> From January to July 8, 2018, there were 36 transactions in the dermatology market, almost all of which involved a private equity group.<sup>2</sup> While this market evolution has created some cause for concern in the community, many dermatologists have been intrigued and receptive to this trend. Clifford Perlis, MD states that private equity investment into dermatology practices, "Adds value to practices, creates more practice options, enhances advocacy, and better manages the complexity" of practices.<sup>3</sup>

## A MARKET PERSPECTIVE

There are a number of reasons for this explosion of private equity capital into the dermatology market:

**Growth Market.** The dermatology market is a \$16 billion market that is expected to grow at a 2.3 percent compounded annual growth rate through 2021.<sup>4</sup> These attractive market characteristics are a natural pull for return-driven investors focused on growing markets.

**Durable Market.** Private equity groups, focused on protecting their capital, gravitate towards recession-insulated industries. These investors understand that the dermatology market weathers recessions better than many other industries. Tom Ferkovic, Managing Director with Medic Management, a medical management and operational consulting firm, stated that during the depths of the Great Recession, "Well-run, disciplined dermatology practices that understood their market advantage were not hurt" by the economic downturn. Furthermore, Mr. Ferkovic noted that, "Unlike other medical specialties, dermatology has multiple product lines and revenue sources. If one of the revenue lines, such as cosmetic, shrinks [due to a recessionary climate],





**Summit Dermatology Partners**

States: IN  
Investment Year: 2018



**DERMATOLOGISTS OF CENTRAL STATES**

**Dermatologists of Central States**

Owner: Sheridan Capital  
States: OH  
Investment Year: 2016



**Northeast Dermatology Associates**

Owner: OTPP, Century Equity  
States: MA, ME, NH  
Investment Year: 2017



**Adult and Pediatric Dermatology**

Owner: Waud Capital  
States: MA, NH  
Investment Year: 2017



**Tricenna**

Owner: The Riverside Company  
States: NJ, NY  
Investment Year: 2016



**NavaDerm**

Owner: BelHealth  
Investment Partners  
States: NJ, NY  
Investment Year: 2018



**Forefront Dermatology**

Owner: OMERS  
States: WI, IA, IN, KY, MI, OH, VA, MD, NC  
Investment Year: 2016



**Platinum Dermatology Partners**

Owner: Sterling Partners  
States: TX, AZ  
Investment Year: 2016



**Anne Arundel Dermatology**

Owner: New Mainstream Capital  
States: MD, VA, TN  
Investment Year: 2018



**Schweiger Dermatology Group**

Owner: LLR Partners, LNK Partners  
States: NY, NJ, PA  
Investment Year: 2016, 2018



**Sona Dermatology & MedSpa**

Owner: Pharos Capital  
States: NC, AR, DC, MD, TX, VA  
Investment Year: 2016



**QualDerm Partners**

Owner: Cressey/Apple Tree  
States: NC, VA, OH, TN  
Investment Year: 2013, 2016



**Advanced Dermatology and Cosmetic Surgery**

Owner: Harvest Partners  
States: 14  
Investment Year: 2016



Owner: Gemini Investors  
States: FL  
Investment Year: 2017



**Skin & Cancer Associates**

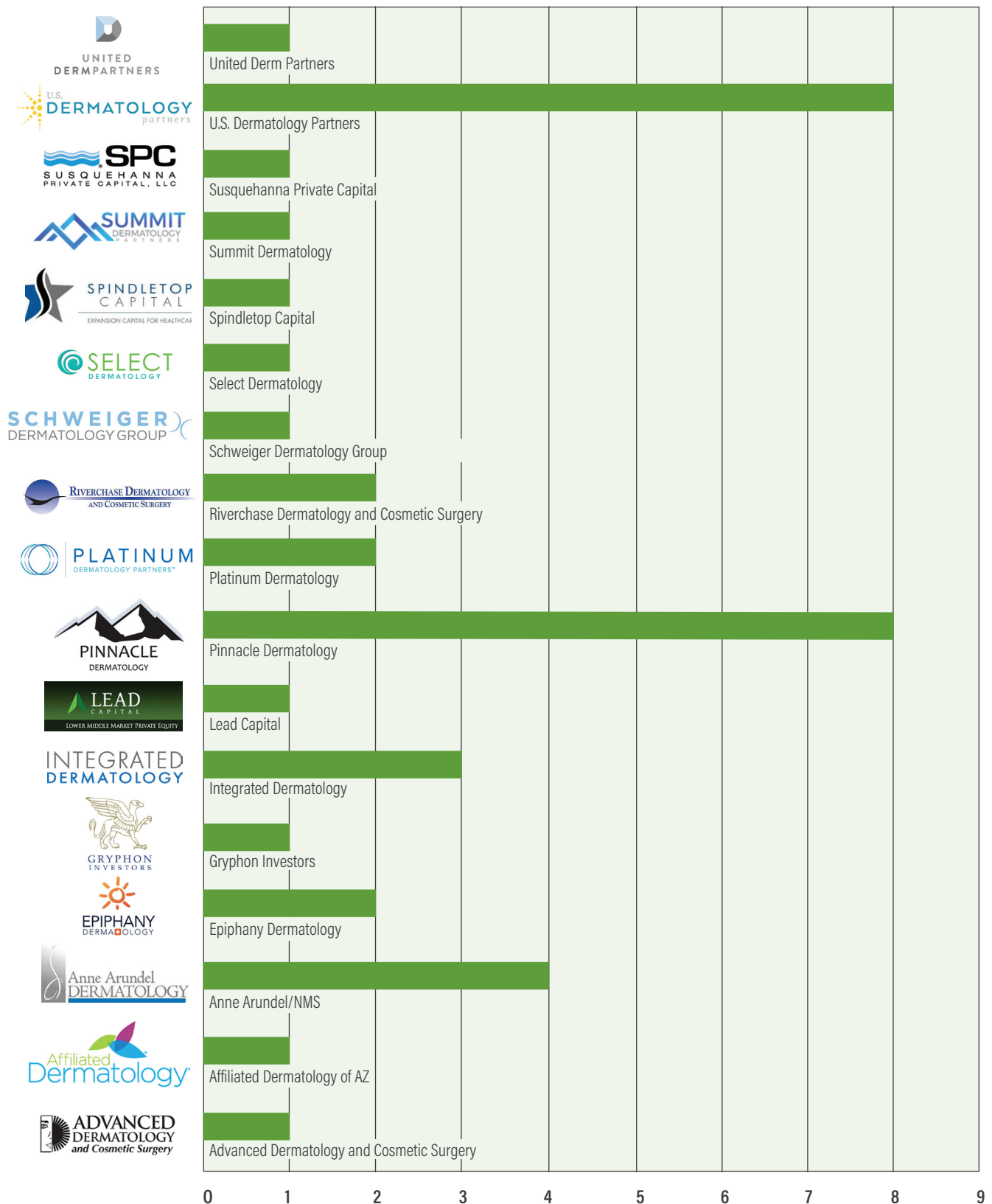
Owner: Susquehanna Private Capital  
States: FL  
Investment Year: 2018



**Riverchase Dermatology**

Owner: GTCR  
States: FL  
Investment Year: 2018

**Year-to-Date July 2018\* Mergers & Acquisitions Buyer Activity: Dermatology Market**



\*As of July 9, 2018. Note. With the exception of Affiliated Dermatology of AZ and Integrated Dermatology, all of the above transactions involve either private equity groups or private equity-backed platforms.

**STELARA®** (ustekinumab)

ustekinumab in pregnant monkeys were greater than 100 times the serum concentration in patients treated subcutaneously with 90 mg of ustekinumab weekly for 4 weeks. In a combined embryo-fetal development and pre- and post-natal development toxicity study, pregnant cynomolgus monkeys were administered subcutaneous doses of ustekinumab twice weekly at exposures greater than 100 times the human subcutaneous exposure from the beginning of organogenesis to Day 33 after delivery. Neonatal deaths occurred in the offspring of one monkey administered ustekinumab at 22.5 mg/kg and one monkey dosed at 45 mg/kg. No ustekinumab-related effects on functional, morphological, or immunological development were observed in the neonates from birth through six months of age. **Lactation Risk Summary** There are no data on the presence of ustekinumab in human milk, the effects on the breastfed infant, or the effects on milk production. Ustekinumab was present in the milk of lactating monkeys administered ustekinumab. Due to species-specific differences in lactation physiology, animal data may not reliably predict drug levels in human milk. Maternal IgG is known to be present in human milk. Published data suggest that the systemic exposure to a breastfed infant is expected to be low because ustekinumab is a large molecule and is degraded in the gastrointestinal tract. However, if ustekinumab is transferred into human milk the effects of local exposure in the gastrointestinal tract are unknown. The developmental and health benefits of breastfeeding should be considered along with the mother's clinical need for STELARA® and any potential adverse effects on the breastfed child from STELARA® or from the underlying maternal condition. **Pediatric Use** The safety and effectiveness of STELARA® have been established in pediatric subjects 12 to 17 years old with moderate to severe plaque psoriasis. Use of STELARA® in this age group is supported by evidence from a multicenter, randomized, 60-week trial that included a 12-week, double-blind, placebo-controlled, parallel-group portion, in 110 pediatric subjects 12 years and older [see *Adverse Reactions and Clinical Studies (14.2) in Full Prescribing Information*]. The safety and effectiveness of STELARA® for pediatric patients less than 12 years of age have not been established. **Geriatric Use** Of the 5884 subjects exposed to STELARA®, a total of 306 were 65 years or older (183 patients with psoriasis, 65 patients with psoriatic arthritis and 58 with Crohn's disease), and 34 subjects were 75 years or older. Although no differences in safety or efficacy were observed between older and younger subjects, the number of subjects aged 65 and over is not sufficient to determine whether they respond differently from younger subjects. **OVERDOSAGE:** Single doses up to 6 mg/kg intravenously have been administered in clinical studies without dose-limiting toxicity. In case of overdosage, it is recommended that the patient be monitored for any signs or symptoms of adverse reactions or effects and appropriate symptomatic treatment be instituted immediately. **PATIENT COUNSELING INFORMATION:** Advise the patient and/or caregiver to read the FDA-approved patient labeling (Medication Guide and Instructions for Use) before the patient starts using STELARA®, and each time the prescription is renewed, as there may be new information they need to know. **Infections** Inform patients that STELARA® may lower the ability of their immune system to fight infections and to contact their healthcare provider immediately if they develop any signs or symptoms of infection [see *Warnings and Precautions*]. **Malignancies** Inform patients of the risk of developing malignancies while receiving STELARA® [see *Warnings and Precautions*]. **Hypersensitivity Reactions** • Advise patients to seek immediate medical attention if they experience any signs or symptoms of serious hypersensitivity reactions and discontinue STELARA® [see *Warnings and Precautions*]. • Inform patients the needle cover on the prefilled syringe contains dry natural rubber (a derivative of latex), which may cause allergic reactions in individuals sensitive to latex [see *Dosage and Administration (2.4) in Full Prescribing Information*] **Immunizations** Inform patients that STELARA® can interfere with the usual response to immunizations and that they should avoid live vaccines [see *Warnings and Precautions*]. **Pregnancy Registry** Inform patients that there is a pregnancy registry to monitor fetal outcomes of pregnant women exposed to STELARA® [see *Use in Specific Populations*]. **Administration** Instruct patients to follow sharps disposal recommendations, as described in the Instructions for Use. **REFERENCES:** <sup>1</sup>Surveillance, Epidemiology, and End Results (SEER) Program (www.seer.cancer.gov) SEER\*Stat Database: Incidence - SEER 6.6.2 Regs Research Data, Nov 2009 Sub (1973-2007) - Linked To County Attributes - Total U.S., 1969-2007 Counties, National Cancer Institute, DCCPS, Surveillance Research Program, Surveillance Systems Branch, released April 2010, based on the November 2009 submission. Prefilled Syringe Manufactured by: Janssen Biotech, Inc., Horsham, PA 19044, US License No. 1864 at Baxter Pharmaceutical Solutions, Bloomington, IN 47403 and at Cilag AG, Schaffhausen, Switzerland Vial Manufactured by: Janssen Biotech, Inc., Horsham, PA 19044 US License No. 1864 at Cilag AG, Schaffhausen, Switzerland © 2012, 2016 Janssen Pharmaceutical Companies Revised: 06/2018

other lines, such as medical dermatology, will still maintain a strong pipeline due to the lack of available appointment slots." Between 2007 and 2009, the dermatology market grew at approximately a

2.1 percent compounded annual growth rate while the US GDP decreased 4.3 percent from Q4 2007 to Q2 2009.<sup>4,5</sup>

**Consolidation Opportunity.** There are more than 11,000 dermatology practices in the United States, and approximately one-third of those practices are owned and operated by solo practitioners, and 41 percent are single-specialty group practices.<sup>1,4</sup> Furthermore, the three largest dermatology players only represent approximately 3.3 percent of the dermatology market.<sup>4</sup> As practices are acquired and consolidated, owners and providers can gain efficiencies. These efficiencies, or synergies, can be gained through better vendor pricing for supply costs, increased reimbursement rates obtained through improved negotiating leverage with insurance payors, cross-selling of services, and sharing of administrative resources. These combination benefits often lead to higher profits, which then result in higher valuations for dermatology owners.

**Recurring Revenue.** The buyer's market places a heavy premium on businesses that have repeatable customers and revenue. To that end, a buyer will focus on practice attributes, such as attrition rate of patients, backlog of patient appointments, history of procedures per patient, and frequency that the average patient visits the facility. Andrew Henoach, a Managing Director with Alvarez & Marsal's Transaction Advisory Group, states, "Many dermatology practices are innovating to increase their top-line opportunities. Specifically, we've seen dermatology practices pursue service-line expansion into repeatable offerings such as cosmetics, cosmeceuticals and other elective procedures. In addition, practices are also seeking vertical integrations of dermatopathology lab and more highly acute oncology-based service offerings. These factors, coupled with an aging and expanding patient-base in the US, create compelling investment opportunities for private equity sponsors."

## THE PRACTITIONER'S PERSPECTIVE

So why are dermatologists increasingly either selling a majority or 100 percent equity position in their practices? Reasons include:

**Regulations.** The regulatory environment continues to place more burdens on dermatologists. The independent physician group especially bears the administrative and resource training brunt. Michael Sherling, Co-founder of Modernizing Medicine, stated that that "The percentage of dermatologists reporting symptoms of burnout is skyrocketing: from 31.8 percent in 2011 to 56.5 percent in 2014."<sup>6</sup> He added that, "A major cause of burnout is loss of autonomy over how physicians spend

their time, which is at least in part due to large amounts of documentation burden.”<sup>6</sup>

Bart Walker, a healthcare and M&A legal specialist with McGuire Woods, an international law firm, provided additional insights. Mr. Walker stated that, “Fraud and abuse statutes governing compensation methodologies and ancillary investments, licensing and reporting obligations imposed by state regulatory authorities, and regulations governing permissible uses of patient health information have continued to become more complex over the past five to 10 years.” Furthermore, he added that, “Large group practices, whether backed by outside investors or grown organically through physician investment, can provide the necessary resources to understand and comply with these increasingly complex regulatory schemes.”

**Focus On the Patients.** In the book *Good to Great*, author Jim Collins defined the hedgehog concept as where a, “Hedgehog reduces all challenges and dilemmas to simple...indeed almost simplistic...hedgehog ideas. For a hedgehog, anything that does not somehow relate to the hedgehog idea holds no relevance.”<sup>7</sup> Many dermatologists are embracing the hedgehog concept by shedding as many business and administrative duties as possible in order to focus almost exclusively on patient service delivery. As a part of a sale, the physician relies on the new owner to institute a structure and team to manage these non-clinical aspects of the operations after the close of a transaction.

**Personal Financial Goals.** In a practice sale that could generate an attractive all-cash payment for a dermatologist, sellers can quickly bolster their retirement nest egg. In addition, dermatologists can obtain an attractive compensation agreement from the new owners, allowing them to continue to share in the production that the dermatologist generates. Finally, under a private equity structure, physicians have the opportunity to retain or earn equity in the dermatology practice. The dermatologist then has the ability to receive a “second bite of the apple” when a resale of the practice occurs in the future.

## OPPORTUNITIES AND RISKS

While the influx of capital into the dermatology market can offer dermatologists many advantages, including cash offers for their businesses and partners to support them on growth, there can be risks. This could include enhanced pressures on dermatologists to grow the practices, loss of decision-making control for the dermatologist, and the risk of too much debt being placed on a practice as a result of an acquisition, which could lead to bankruptcy. In addition, there are voices within the dermatology community

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that are concerned that “investor-owned conglomerates” could create too much of a business-like atmosphere and commoditize “the treatment of patients.”<sup>1</sup> While it is too early to tell the outcome, the presence of private equity in the dermatology market will certainly have an impact on the industry.

For each physician owner, there is an analysis to complete that weighs the benefits and costs of a sale to a private equity group, or a private equity-backed dermatology platform, before pursuing a course of action. Regardless of one’s decision, private equity groups are expected to be an ever-present option for dermatologists for the foreseeable future. ■

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