
Provident Perspectives: Consolidation in Anesthesia

Merger and acquisition activity in the anesthesia healthcare vertical continues to see a large inflow of private equity capital. An everchanging healthcare environment characterized by an aging population and practice consolidation will continue to drive merger and acquisition activity for the foreseeable future.

PROVIDENT'S PERSPECTIVE

As the leading middle-market merger & acquisition advisory firm within healthcare services, Provident Healthcare Partners possesses unique insight into the current trends facing the healthcare industry and how these trends will likely drive future consolidation activity. Provident recently advised Anesthesia Resources in its sale to National Partners in Healthcare following a competitive transaction process. Prior to this transaction, Provident also advised four other anesthesia organizations with various operating models through their respective transactions, encapsulating a wide buyer universe. We anticipate that transactions like this will continue for the foreseeable future, as strategic acquirers and private equity firms continue to take advantage of industry tailwinds resulting in sustainable, long-term sector growth.

Select Anesthesia Engagements

 <p><i>Has been recapitalized by</i></p> 	<p>Desert Mountain Consultants in Anesthesia, P.C.</p> <p><i>Has been acquired by</i></p> 
<p>A Southeastern Anesthesia Practice</p> <p><i>Has been acquired by</i></p> <p>A National Surgery Center Consolidator</p>	<p>New Jersey Anesthesia Group</p> <p><i>Has been acquired by</i></p>  <p><i>A portfolio company of</i> MOELIS CAPITAL PARTNERS</p>
<p>Cascade Anesthesia Service, P.C.</p> <p><i>Has been acquired by</i></p> 	

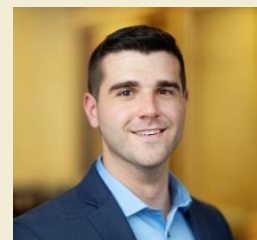
Provident Anesthesia Deal Team



AJ Shekar, Vice President



Abe M'Bodj, Associate



Kyle Daly, Analyst

ANESTHESIA MACROECONOMIC TRENDS

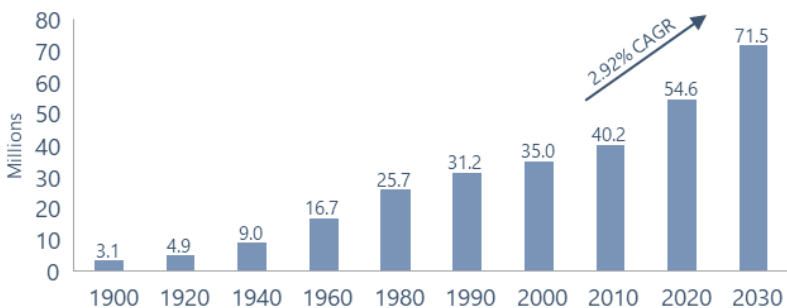
As the healthcare services market continues to experience changing payment models, mandated infrastructure investments, and broader competitive dynamics, many anesthesia practices have begun to seek partnership opportunities with private equity groups and larger practice consolidators to take advantage of growth opportunities and mitigate risk. From an investment perspective, an aging US population coupled with a rise of surgeries, in both outpatient and inpatient settings, will continue to drive market volumes and influence consolidation.

The population of the United States has drastically changed in the last fifty years. As the baby boomer generation approaches retirement age, it is expected that by 2035 there will be over 78 million citizens over the age of 65. This demographic shift, coupled with increased life expectancy, will correlate with a rise in the number of surgical procedures performed annually. By the year 2030, experts anticipate that over 60% of the baby boomers will suffer from more than one chronic condition. This drastic rise in conditions is expected to double the number

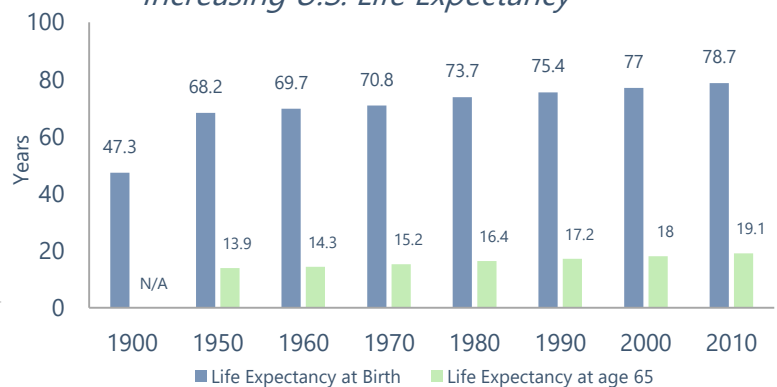
of hospital visits and procedures per year. While many healthcare verticals are poised to grow as a direct result of demographic changes and anticipated growth in total surgical procedures, the lack of alternatives to anesthesia will allow for multi-faceted growth potential for practices in the sector.

According to Envision Healthcare, a leading provider of multi-specialty physician services, the anesthesia services vertical produces \$19 billion in revenue annually. Independent anesthesia practices are poised for growth as hospitals continue to outsource services to not only focus on core facility services, but also to meet the rising number of surgical procedures. This growth provides practices with the opportunity to expand their provider base and facility count by providing services to patients in both an in-patient and outpatient setting. These industry tailwinds uniquely position the anesthesia service vertical to grow and expand for the foreseeable future.

U.S. Population Growth – Age 65 and Over



Increasing U.S. Life Expectancy



Sources: Administration on Aging, IBIS World, CTA Journal, Kalorama Information, Health Affairs, Yahoo Finance, "U.S. ER Visits Keep Climbing." WSJ, 2015; "Benchmarking Survey Headlines Summary." UCAOA, 2014; IBIS World, Becker's Hospital Review

CONSOLIDATION TRENDS IN ANESTHESIA

As the healthcare service industry prepares for a shift in patient demographics, independent practices must position themselves for increased administrative/back-office requirements, costs and facility coverage. Many organizations have considered transactions to mitigate risks posed by these trends, while also taking advantage of the growth opportunities they provide.

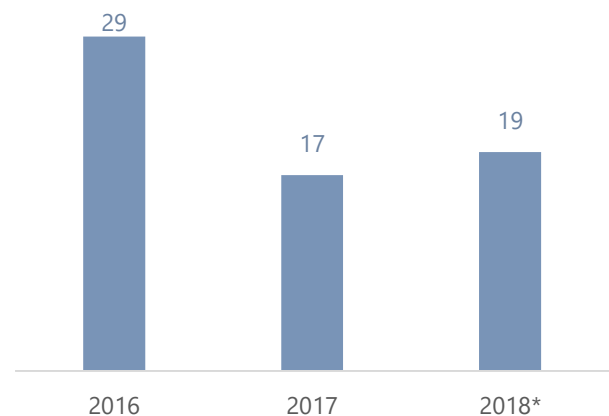
Under the new models of value-based care, providers are required to upgrade their infrastructure, utilizing data analytics and evidence-based documentation methods to stay competitive in payor negotiations. While some practices have sacrificed shareholder income to make required investments to improve their back-office systems, others have sought to partner with larger practices that already have these systems in place. For acquired groups, this not only mitigates shareholder risk, but allows physicians to focus on clinical responsibilities amidst a growing practice.

With the rising number of surgical procedures and focus on lower cost settings, anesthesiologists are seeing more procedures taking place in an outpatient setting. In particular, ambulatory surgery centers (ASCs) and office-based procedures provide patients with more entry points into the healthcare system, while being less costly than hospital-based procedures. This has nationally proliferated the creation of independent and hospital owned ASCs, which contract with outside anesthesia service providers to provide coverage for surgeons at each facility.

For anesthesia groups used to providing hospital-based coverage however, the transition to ASCs can create challenges as volumes are spread across multiple sites, with shorter term contracts and few options for income guarantees. For groups that opt to mitigate contract risk and transact, the resources of a partner can either provide access to a broader pool of providers to sufficiently cover a broader facility network, or the capital resources to hire physicians and CRNAs in a competitive recruiting and salary environment.

While independent organizations can either allocate practice profits (away from shareholder distributions), or personally guarantee bank debt to fund these initiatives, private equity firms can help solve these burdens by assuming market-rate compensation for physicians and providing capital that is free from personal guarantees. As a result, many organizations have opted to explore the partnership opportunities offered by private equity firms and their anesthesia portfolio companies as they navigate the risks and opportunities within today's healthcare environment.

Annual Anesthesia Service Transactions



Notes: *Transactions as of November 15th 2018

PRIVATE EQUITY INVESTMENTS EXPLAINED

Private equity (“PE”) refers to investors and funds of capital that seek to make direct equity investments in privately-owned businesses. General Partners (“GPs”) invest the fund’s capital in businesses that align with their investment thesis, seeking to exit their investments within three to seven years for a substantial return on invested capital. Upon investment, or a “recapitalization”, a private equity firm will acquire a stake in a private business, providing the shareholders with significant liquidity in the form of cash proceeds as well as retained equity in the newly recapitalized company. Post-transaction, private equity firms provide access to capital and expertise as they seek to improve their investments both financially and operationally, building out the infrastructure to provide a foundation for future growth.

The type of growth initiative varies from model to model; in most cases, private equity firms will infuse their portfolio companies with capital to increase geographic density organically through de novo initiatives and inorganically by executing add-on acquisitions to enter into new geographies and increase market share. By expanding through acquisition, these investors create platforms used to integrate newly acquired practices under corporate umbrella.

In the historical model of anesthesia M&A, consolidators sought to buy out practices entirely, accumulating all the profits created by providers. Shareholders, previously accustomed to distributions based on practice profitability & productivity, were paid flat salaries, creating the potential for misaligned growth incentives. As the market evolved, GPs realized the importance of aligning incentives, and that a change was necessary to avoid turnover.

As physician services M&A has evolved, anesthesiologists that align with private equity have the opportunity to retain ownership post transaction while also receiving a large upfront payment taxed at capital gains versus ordinary income rates. This business model allows each provider to share in the equity upside of the practice as it expand through acquisition and de novo initiatives. After a three to seven year holding period, most private equity groups will look to exit their investment while targeting three to five times return on their investment. Upon their sale to a larger platform or private equity group, physicians will have the opportunity to cash out and/or roll equity once again with the next private equity partner. This provides physicians with multiple opportunities for liquidity upon subsequent transaction events in the future.

The Four Stages of the Private Equity Process



EXAMINING RECENT TRANSACTION TRENDS

So far in 2018, the anesthesia market has seen a total of 18 publicly disclosed transactions across the nation. This number highlights a healthy market for merger and acquisitions, driven by low interest rates and market fragmentation.

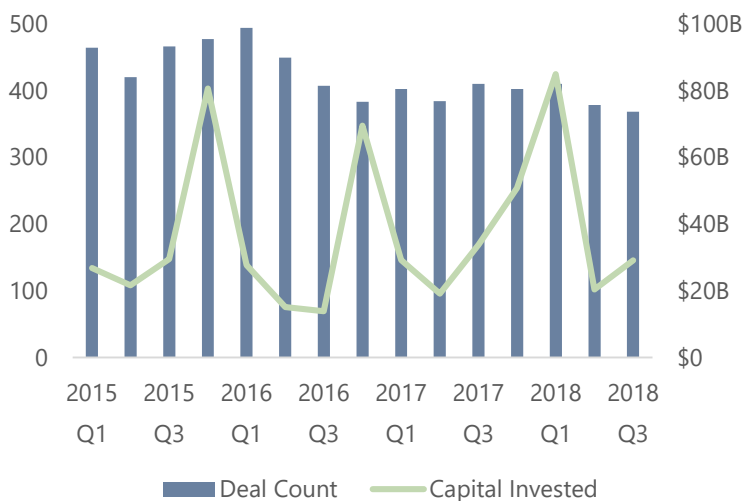
At the start of the summer, Envision Healthcare announced that it took on investment from private equity firm, Kohlberg Kravis & Roberts (KKR), which valued the healthcare services platform at \$10 billion. After spending five years as a publicly traded company, Envision’s shareholders began looking for strategic options to combat their struggling stock performance, partially due to the short-term focus on value creation inherent in public markets.

Envision Healthcare had grown aggressively through acquisition and by utilizing their extensive service offerings as contracting leverage with hospitals and surgery centers. Especially with transformational acquisitions of large organizations like AmSurg and Guardian, this growth model can ostensibly lead to short term difficulties on the path towards long-term value creation.

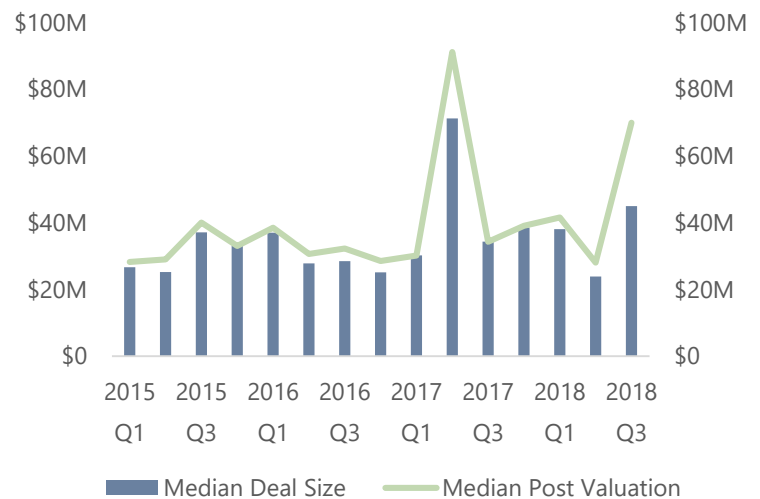
Public investors however, often gauge value on a quarter by quarter basis, which can weigh upon a buy-and-build model. Going private will protect Envision from the short-term natured focus and scrutiny of Wall Street analysts and also open up their flexibility on structuring transactions with rollover equity, which is otherwise difficult as a public company. As a result, management believes that a partnership with KKR would provide them with the autonomy and resources to continue growing, along with KKR’s expertise from other previous healthcare services investments.

This transaction comes on the heels of TeamHealth’s take-private transaction with Blackstone Group in 2017 for \$6 billion – similar to Envision, the transaction will afford TeamHealth the ability to make strategic decisions with Blackstone surrounding growth and acquisitions without the same level of scrutiny from the public markets, including the potential for more flexible deal structures with anesthesia providers. Provident expects these transactions will allow TeamHealth and Envision to resume competing for acquisition targets, leading sustained deal flow within the sector.

Private Equity Deal Flow in North America



Healthcare Service Transaction Values



2018 YEAR TO DATE ANNOUNCED TRANSACTIONS

Month	Acquirer	Target	Target – Number of:		
			Locations	Providers	States
November 2018	PhyMed Healthcare Group	Grand Canyon Anesthesiology	1	17	1
September 2018	CRH Medical Corporation	Lake Erie Sedation Associates	2	N/A	1
September 2018	Envision Healthcare Corporation	Nashville Anesthesia Services	3	N/A	1
September 2018	PhyMed Healthcare Group	AAA Anesthesia Associates	N/A	43	1
July 2018	CRH Medical Corporation	Lake Washington Anesthesia	5	5	1
July 2018	Surgery Partners	Pain Management Associates	5	5	1
June 2018	KKR & Co.	Envision Healthcare Corporation	262	25,000	45
June 2018	The Cranemere Group	NorthStar Anesthesia	150	2,000	20
May 2018	CRH Medical	Western Ohio Sedation Associates	3	N/A	1
May 2018	Spindletop Capital Management	Interventional Pain Management	2	N/A	1
May 2018	Spindletop Capital Management	Tricity Pain Associates	9	15	1
April 2018	U.S Anesthesia Partners, Inc.	First Colonies Anesthesia Associates	7	200	1
March 2018	Physician Partners of America	Capstone Pain and Spine Group	3	2	1
March 2018	Siromed	Anesthesia Associates of Ann Arbor/ Midwest Anesthesia Consultants ("A4")	21	110	1
March 2018	NexPhase Capital	Gulf Coast Pain Institute	11	10	1
February 2018	Pain Treatment Centers of America	Arkansas Surgery & Endoscopy Center	2	1	1
February 2018	American Discovery Capital	American Pain Consortium Holdings	6	5	1
February 2018	Physician Partners of America	Sunshine Spine & Pain, PA	2	5	1

CONCLUDING THOUGHTS

The 18 transactions that have closed so far in 2018 are indicative of a healthy merger and acquisition market. Along with KKR's acquisition of Envision Healthcare, there have been several other notable transactions this calendar year. In March, Siromed acquired Anesthesia Associates of Ann Arbor, an independent practice with a provider base of 110 anesthesiologists. One month later, U.S. Anesthesia Partners completed an investment in First Colonies Anesthesia, a Maryland-based practice with over 200 providers. Finally, NorthStar Anesthesia went through their second private equity recapitalization in June when the Cranemere Group acquired the platform from TPG Growth.

In light of these transactions, independent anesthesia providers should expect different approaches to the transaction process, including equity participation, than historically given the influx of new market entrants and retooling of historical consolidators. Although add-on acquisitions are anticipated to outpace new investors entering the sector, opportunities still exist for independent practices to become private-equity platforms of their own.



Provident is the leading investment banking firm specializing in merger and acquisition advisory, strategic planning, and capital formation for middle-market and emerging growth healthcare companies.

The firm has a vast network of senior industry relationships, a thorough knowledge of market sectors and specialties, and unsurpassed experience and insight into the investment banking process.

Boston:
260 Franklin Street, 16th Floor
Boston, Massachusetts 02110
617-742-9800

Los Angeles:
315 S. Beverly Drive, Suite 504
Beverly Hills, California 90212
310-359-6600