McGuireWoods

The Top Areas in Healthcare for Private Equity Investment in 2014

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February 2014
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Reimbursement model changes and cost-cutting pressures imposed by the Patient Protection and Affordable Care Act (ACA), a lukewarm economy, and new regulatory challenges within healthcare continue to cause changes in private equity investment. While the overall volume of transactions in 2013 declined from 2012, there was significant growth in certain subsectors of healthcare. The following is a summary of the current status of 19 niches within the healthcare industry that have attracted private equity investments: hospitals and health systems, pain management, anesthesia, ambulatory surgery centers, urgent care, dental practice management, health information technology, rehabilitation and addiction treatment, physical therapy, life sciences, home healthcare, cancer and oncology-driven care, chronic disease, wound care, hospices, skilled nursing facilities, revenue cycle management, physician practices, and imaging centers. We discuss our observations of the areas where we expect to see continued growth and those areas where regulation and payer pressures may hinder further growth.

Hospitals and Health Systems

Hospitals can be an attractive investment as the industry moves from fee-for-service medicine to a mix of payment systems. Hospitals are the providers most likely attempting to develop fully integrated systems that take advantage of the move toward risk sharing. Although very large physician groups may also be able to take on risk for payer dollars in the push for care coordination, hospitals are best-positioned to achieve these goals. In 2013, this attractiveness led to HCA Healthcare's (HCA) share prices soaring (up 53 percent over the year). Rising prices allowed HCA's main investors, including private equity-heavyweight firms Bain Capital and KKR & Co. L.P. (KKR), to sell additional stakes in the public company for billions of dollars. HCA also remained active, acquiring three hospitals from private equity-backed IASIS Healthcare, among other deals. Smaller private equity-backed health systems, including Capella Healthcare, were widely rumored to be takeover targets for other investors such as Apollo Global Management LLC and Thomas H. Lee Partners LP. *See Capella's Leadership Duo Puts Sale Rumors to Bed, For Now, Nashville Business Journal (Dec. 13, 2013).*

In a fee-for-service world, hospitals also benefit from higher Medicare reimbursement rates than those paid to independent physicians and other providers, such as freestanding surgery centers and imaging facilities, for the same services. These healthcare system pressures (i.e., integration and reimbursement disparity) have helped drive hospital acquisitions of physician practices and hospital consolidations. For example, 2013 saw two blockbuster multibillion-dollar deals: (i) for-profit Community Health Systems' acquisition of Health Management Associates, Inc. and (ii) for-profit Tenet Healthcare Corp.'s acquisition of Blackstone-financed Vanguard Health Systems. Smaller private equity-backed health systems are also considering consolidation or affiliation to gain size and scope. For example, Warburg Pincus-backed RegionalCare Hospital Partners, Inc. affiliated Paris Regional Medical Center with the largest hospital system in Texas in 2013, Dallas-based Baylor Scott & White Health.

However, fiscal pressures, including reduced admissions, will require hospitals to significantly reduce costs and expand other business lines that are not as dependent on inpatient admissions in order to remain an attractive investment.

Pain Management

We are seeing a substantial increase in interest in pain management clinics. Nearly 100 million Americans suffer from acute and chronic pain and a large number of dollars is spent each year on treatment. *See Institute of Medicine of the National Academies, Relieving Pain in America: A Blueprint for Transforming Prevention, Care, Education, and Research 1 (2011)*. After modest private equity activity in this space since 2010, including Chicago Growth Partners' acquisition of Advanced Pain Management and Sentinel Capital Partner's investment in National Spine & Pain Centers, significant investments were made in 2013. Prospira PainCare, for example, formed in 2012 with the backing of three significant private equity firms. It acquired a number of pain centers across the country, including The Pain Management Center based in New Jersey and Neuro Pain Consultants based in Michigan. We anticipate these mid-market acquisitions to continue and other private equity firms to get into this nascent trend.

Anesthesia

Anesthesia is another hot area of growth. Private equity groups such as Madison Dearborn Partners LLC, Blackstone Group, Moelis Capital Partners LLC, the Beekman Group, LLC, DFW Capital Partners, Triton Pacific Capital Partners LLC, Provident Healthcare Partners, LLC and Goldman Sachs Private Capital Investing Group have invested significantly in anesthesia practices. *See Nothing's Sleepy about M&A in the Anesthesia Sector*, *The Deal (Dec. 27, 2013)*. This list should continue to grow as more investment goes into the anesthesia market. For example, MedNax Inc., a large multispecialty provider, acquired Holston Anesthesia Associates and Northern Westchester Anesthesia Services last year. Team Health purchased Professional Anesthesia Services and Wolverine Anesthesia Consultants. North American Partners in Anesthesia, after a series of 2012 deals, continued expansion through acquisitions of a Hudson Valley, New York practice and the New Jersey Anesthesia Group. Meanwhile, Sheridan Healthcare added its first California-based anesthesia practice and three more anesthesia groups in New Jersey, meaning it now offers services in 25 states. This space should see more investment in the year to come.

Ambulatory Surgery Centers

Ambulatory surgery centers (ASCs) remain a very good area for investment despite decreasing numbers of surgeons and reimbursement rates. Although these macro factors are slowing ASC growth and harming ASC same-store growth, surgery centers are a true cost saver for Medicare and can be for private payers too. Movement of surgical procedures from hospital outpatient departments (HOPDs) to ASCs reduces aggregate program spending because Medicare pays HOPDs substantially more than ASCs for the same services (78 percent more in 2013). This differential is increasing — HOPDs' 2014 Medicare update is a half percent higher than the ASC update. One needs to look no further for evidence of interest in the prospect of ASCs with their potential cost savings than the successful initial public offering of Surgical Care Affiliates (SCA) this past fall. SCA's share price rose nearly 30 percent post-IPO.

However, ASC expansion has slowed in the face of reimbursement challenges from Medicare, third-party payers and even workers' compensation payments. The number of Medicare-certified ASCs grew only 1.8 percent from 2010 to 2011 (or 5,344 total ASCs nationwide in 2011). That is much slower than the 2006 to 2009 average rate of growth, which was approximately 4.5 percent per year.

See MedPAC, Report to Congress: Medicare Payment Policy (March 2013), hereinafter "MedPAC Report to Congress 2013." ASC revenues also face nonreimbursement challenges as they are wholly dependent on the number of cases performed. ASCs face some erosion in part due to declining numbers of independent surgeons.

Many of the recent ASC deals have been for existing centers rather than for startup centers. For instance, in 2013, private equity-backed Symbion Healthcare increased its ownership in two facilities it already controlled. With numerous ASCs remaining independent of a hospital or institutional partner, including 60 percent of ASCs in Texas, many possible targets remain. *See Northstar Healthcare Exclusive Interview, PRWeb (Dec. 5, 2013)*. These targets will continue to attract investors to the ASC space. For example, SCA's IPO raised $235 million for the company. Even considering the use of some of these funds to repay investors, SCA should have the financial strength to pursue various acquisition strategies. We also anticipate private equity-backed ASC companies, such as Meridian Surgical Partners, to consider new acquisitions in 2014. Further, other private equity-backed ASC companies, such as United Surgical Partners International, have suggested they anticipate increased merger and acquisition activity in the years to come as ASCs partner with other providers to form strong affiliations in the face of healthcare reform challenges. *See ASC Sector M&A Activity: Outlook for 2014, Becker's ASC Review (Dec. 30, 2013)*. Many other privately held chains are also actively engaged in the marketplace, such as Ambulatory Surgical Centers of America, Regent Surgical Health, ASD Management, Physicians Endoscopy, Blue Chip Surgical Partners and Merritt Healthcare. Overall, we expect to see continued investment in the ASC space despite increased pressures.

Urgent Care

The urgent care industry is a rapidly growing healthcare sector that provides cost-effective, convenient medical services to consumers who truly want and need the services. There was an almost 20 percent growth in existing clinics in the past four years, totaling more than 9,400 urgent care clinics. Furthermore, the existing clinics are looking to expand. In 2013, almost 40 percent of these clinics told the Urgent Care Association of America they would be expanding their facilities or adding new locations, up from 18 percent in 2010. *See Private Equity Funds Rapid Growth of Walk-In Clinics, Reuters (March 21, 2013)*. This expansion is not expected to slow; indeed, estimates by IBIS World predict the sector will see more than $18 billion in revenues in 2017 at more than 12,000 clinics, up from $13 billion in revenues in 2012. Millions of private equity dollars from at least a dozen firms have gone to urgent care clinics in the past few years, driving this expansion. For example, in 2013, NextCare Holdings Inc., backed by Enhanced Capital Partners, acquired 11 PrimaCare Medical Centers in the Dallas/Fort Worth area to bring its total to 86 clinics nationwide.

These investments should continue, in part as a response to fiscal pressure by lawmakers and insurers on hospitals to cut costs and the health insurance mandate's potential increased demand. *See, e.g., A Boom in Urgent Care Centers as Entitlement Cuts Loom, Forbes (March 11, 2013)*. The potential positives for urgent care are twofold. First, patients love the convenience of urgent care clinics. Second, these clinics have the advantage of saving significant payer dollars. For instance, a 2010 Rand study found that almost one in five visits to hospital emergency rooms could be treated at an urgent care clinic, potentially saving $4.4 billion annually in healthcare costs. *See Urgent Care Centers Are Booming, Which Worries Some Doctors, Washington Post (Sept. 17, 2012)*. For 2014, we anticipate continued middle-market activity, such as the 2013 CareSpot and HCA Holdings joint venture acquisition of NeighborMD in Tennessee, CareWell Urgent Care (backed by $11 million in venture capital) opening eight clinics in the Boston area in the past two years with more planned in 2014, and private equity-funded MD Now Urgent Care's rapid expansion in South Florida with 12 recently opened clinics and 10 more under construction.

On the other hand, while cost pressures may increase demand for urgent care clinics, these pressures will certainly impact this sector. With such significant expansion, payers will be examining urgent care closely and placing significant pressure on reimbursement per visit. If such reductions gain steam, there may be a moderation in further private equity investments in this area.

Dental Practice Management

Tremendous investor interest remains in the dental practice management (DPM) arena. Dentistry, traditionally comprising only small group practices and solo practitioners, is shifting toward more DPM arrangements, which have the advantage of lower operating costs compared with a clinic's capital costs and revenue. *See Climo, If Pigs Could Fly and Dental Professionals Could Be Turned Bad by Private Equity Investment, Dental Economics (Sept. 20, 2012)*. In the past decade, more than 25 private equity firms have invested significantly in this changing healthcare sector, in which certain large DPM companies already have annual revenue exceeding $100 million. *See, e.g., Private Equity Firms Eye Big Profits in Dentistry (May 30, 2012)*. In 2013, this interest included Monroe Capital providing a $16.6 million credit facility to private equity-owned Smiles Services LLC, a leading DPM in the Pacific Northwest. Such investments are paying off for private equity firms: a Sageworks analysis found DPM investments generated the highest return on equity of the industries it examined. *See Which Businesses Have the Highest Returns?, Forbes (Dec. 15, 2013)*.

The investor interest in DPM companies may grow in 2014 if certain opportunities materialize. First, many state Medicaid programs have supported dentistry fairly well, especially pediatric dentistry. This support allows dental practices to thrive with substantial Medicaid business, unlike other healthcare providers. *See Climo, Don't Be So Quick to Dismiss Medicaid Business (Jan. 3, 2014), available at http://www.drbicuspid.com*. Yet, during the past few years, stretched state budgets forced many legislatures to cut spending on dental care, especially for adults. *See 13 States Cut Medicaid to Balance Budgets, Kaiser (July 24, 2012)*. With state budgets improving post-recession, states may begin to re-fund this sector. Second, the ACA strengthened support for dental services, especially for children, by funding Medicaid program expansions and including pediatric dentistry as part of the essential health benefit packages for individual and small employer plans. On the other hand, increased regulatory scrutiny of DPM structures could put new pressures on the sector. For example, a 2013 Senate committee investigation into DPM practices in the Medicaid program recommended some practices be excluded from Medicaid. *See Joint Staff Report on the Corporate Practice of Dentistry in the Medicaid Program (June 2013)*. Similarly, states such as North Carolina have considered legislation at the bequest of their state dental associations to reduce DPM companies' involvement in Medicaid.

Health Information Technology: Electronic Health Records, Data Analytics and Mobile Health

It comes as no surprise that health information technology's (HIT) share of healthcare private equity deals has risen from 10 percent in 2011 to 15 percent in the first three quarters of 2013. *See Health Care: McGladrey Quarterly Private Equity Deal Flow Profile (Q4 2013)*. Health systems have continued to heavily invest in HIT platforms to take advantage of financial benefits provided by payment reform initiatives in the Health Information Technology for Economic and Clinical Health Act and the ACA. Private equity investment in 2013 centered on electronic health records (EHR) systems and enterprise technology that facilitates office-based operations. For example, Lambert Private Equity LLC recently invested $200 million in Accelera Innovations Inc., a Chicago-based healthcare software company. *See Accelera Innovations Secures $200mln, PE Hub (Oct. 24, 2013)*.

There has also been increased focus of investment dollars on data mining solutions and analytics. Frost & Sullivan projects that 50 percent of all hospitals will use advanced health data analytics solutions by 2016. *See Looking Back to Before Data Was Big, Healthcare IT News (Jan. 2, 2014)*. Providers will likely focus mining efforts on research, marketing and optimization of clinical resources. In 2013, there were several acquisitions in the data analytics space. Allscripts acquired dbMotion Inc., a developer of clinical data repositories, for $235 million and Jardogs, a developer of a personal EHR and in-office kiosk for patient registration and billing. *See Allscripts Acquires dbMotion, Jardogs, Modern Healthcare (March 5, 2013)*. Furthermore, Roper Industries acquired Managed Care Associates, Inc., which provides pharmacy software and pharmaceutical data analytics, for $1 billion. *See Roper Industries Completes $1B Acquisition of Managed Health Care Associates, Modern Healthcare (May 3, 2013)*.

Another continued area of hot investment is in the mobile health sector. According to the Food and Drug Administration (FDA), 500 million smartphone users worldwide will use mobile health applications by 2015. *See Mobile Medical Applications FAQ, FDA (Oct. 22, 2013)*. By July 1, 2013, nearly $850 million had been invested in 90 different mobile health companies. *See Digital Health Investment on the Rise, Healthcare IT News (July 1, 2013)*. Some of these companies focused on emerging areas of investment including remote patient monitoring, wellness and personal health tools, and tracking. One key acquisition from 2013 involved Athenahealth, Inc., a cloud-based EHR provider that purchased Epocrates, Inc., the leading developer of mobile health point-of-care applications, for $293 million. *See Cloud EHR Provider Athenahealth Acquires Epocrates, eWeek (Jan. 8, 2013)*. We expect such activity in the HIT sector to have continued growth in 2014 as provider use of EHR systems, data analytics and mobile health significantly increases.

Rehabilitation and Addiction Treatment

This is a tremendous growth area driven much like the urgent care center sector, in that rehabilitation and addiction treatment is something consumers actually want, and treatment is needed by a significant portion of the population. Results from the 2011 National Survey on Drug Use and Health show that a large treatment gap exists in the U.S. In 2011, "an estimated 21.6 million Americans (8.4%) needed treatment for a problem related to drugs or alcohol, but only about 2.3 million people (less than 1%) received treatment at a specialty facility." *See Center for Behavioral Health Statistics and Quality, Substance Abuse and Mental Health Services Administration, Results from the 2011 National Survey on Drug Use and Health: Summary of National Findings (September 2012)*. This sector is also increasingly reimbursed by payors, and it is the kind of treatment families are willing to expend large sums for, out-of-pocket. From 2002 to 2011, the National Survey found increases in respondents using Medicaid (23.1 percent increase) and Medicare (19.5 percent increase) payments for treatment, and in 2011, 46.4 percent of survey respondents reported using out-of-pocket funds for treatment.

Recent private equity investment by Court Square Capital Partners in Physiotherapy Associates, a national outpatient rehabilitation services provider, was successful, with the company growing to 700 locations across 35 states. *See Strong Vital Signs Draw Private Equity to Healthcare, Forbes (April 30, 2013)*. In the addiction treatment center sector, Bain Capital has been purchasing both large and small addiction treatment centers since 2006 to consolidate into CRC Health Group, which currently has around 140 treatment facilities in 25 states. *See Private Equity's Rehab Roll-Up, Fortune (April 30, 2012)*.

Overall, the U.S. addiction treatment industry revenues are expected to increase by 55 percent from 2005 to 2014 and reach $34 billion by 2014. *See Catherine New, The Real Tab for Rehab: Inside the Addiction Treatment Biz (June 3, 2011)*.

Physical Therapy

Investors continue to be interested in the outpatient physical therapy business. The demand for physical therapy services has grown rapidly in the past several years due to the growing need for outpatient services, including physical therapy, for aging baby boomers, and payors demanding that physicians first refer patients to physical therapists rather than referring cases for surgery, in order to contain costs. The increased growth in this area is drawing more and more attention from investors who find physical therapy companies with a healthy payor mix and diverse referral base attractive to private equity funds. Examples of recent deals in the physical therapy sector include Accelerated Holdings LLC, together with its affiliates and related companies, which in 2012 acquired Newsome Physical Therapy, Premier Physical Therapy and WorkSport Rehabilitation Services, growing Accelerated to 113 locations in the Chicago area. *See Accelerated Bulks Up for Physical Therapy Competition, Claire Bushey, ChicagoBusinesss.com (Oct. 11, 2012)*. In 2012, Orthopedic and Sports Physical Therapy (a portfolio company of Great Point Partners) acquired Millennium Physical Therapy, adding four facilities for a total of 17 current locations throughout New York and New Jersey. *See Professional Orthopedic and Sports Physical Therapy Acquires Millennium Physical Therapy, Great Point Partners (Dec. 31, 2012)*. In 2013, we also saw significant activity in this sector with ATI Physical Therapy's acquisition of Michigan Rehabilitation Specialists, LLC, a portfolio company of Shore Capital Partners LLC. Shore Capital Partners also invested in Quantum Physical Therapy in 2013. Another significant investment happened in November 2013, when 3 Rivers Capital acquired Phoenix Rehabilitation and Health Services, Inc., a provider of physical and occupational therapy services. We expect to continue to see significant activity in this sector for 2014.

Life Sciences: Medical Devices and Biotechnology

Medical device sales are expected to grow by 4.9 percent annually through 2016, driven by consistent innovation in technologies and the demands of an aging population. *See 2013 Global Life Sciences Outlook: Optimism Tempered by Reality in a "New Normal," Deloitte (2012)*. However, the medical device industry continues to face hardships from reduced and bundled reimbursement payments, cost containment initiatives by providers, the ACA's medical device tax (2.3 percent), and the sometimes burdensome FDA regulatory process. However, certain sectors of the medical device industry, such as orthopedics, telehealth and mobile health, have continued to see healthy growth and investment interest. For example, The Carlyle Group is expected to purchase Johnson & Johnson's orthopedic clinical diagnostics division in a deal worth close to $4 billion. *J&J to Sell Slow-growing Diagnostics Unit to Carlyle, Reuters (Jan. 16, 2014)*. Similarly, Water Street Healthcare Partners invested $50 million in RTI Biologics' acquisition of Pioneer Surgical Technology, Inc., the leading provider in orthopedic and other biologic implants. *See RTI Biologics Completes Acquisition of Pioneer Surgical Technology, Business Wire (July 16, 2013)*.

In 2013, the biotechnology sector saw a resurgence with more than 30 IPOs through October 2013, something that had not occurred in the market since 2000. *See Biotechnology Boom Is Here to Stay Investors Say, WSJ Blog (Oct. 14, 2013)*. By the end of 2013, 81 biotechnology companies experienced a doubling of their share prices. *See Risk of Failure Leads Biotech Firms to Seek New Strategies, Boston Globe (Jan. 18, 2014)*. With all the private equity losses during the recessions of the past decade from investments in biotechnology, these are positive signs for the industry. Similarly, major pharmaceutical companies face patent cliffs on many brand-name pharmaceuticals and thus are looking to smaller companies to provide innovative therapies and products. *See Potential for Deals Drives a Big Surge in the Biotech Sector, NYT Deal Book (July 11, 2013)*. However, these innovative smaller companies run the risk of regulatory failure when trying to make life-extending drugs that yield high profits. *See Risk of Failure Leads Biotech Firms to Seek New Strategies, Boston Globe (Jan. 18, 2014)*. Regardless, it is still a seller's market with increasing premiums, as Onyx Pharmaceuticals, Inc. turned down a close-to-$10 billion bid from Amgen Inc. *See Onyx Snubbing Amgen Paves Way for 89% Premium: Real M&A, Bloomberg (July 2, 2013)*. Biotechnology contract research firms have also attracted significant investment. In 2013, KKR bought and combined PRA International and ReSearch Pharmaceutical Services in a two-step deal worth billions to create the largest clinical research organization. *See PRA and RPS to Join and Create Leading CRO with Expanded Service Offerings and Capabilities, MarketWatch (July 31, 2013)*. Similarly, JLL Partners and Ampersand Capital Partners merged BioClinica Inc. and CoreLab Partners LLC in a deal worth $123 million to create a leading clinical trials firm to take advantage of biotechnology companies outsourcing their FDA process. *See JLL Partners Combines BioClinica, CoreLab Partners, Gen News (March 15, 2013)*. While there may be challenges for medical devices ahead, the life sciences niche in 2014 will remain a hot target point for investors.

Home Healthcare

The home healthcare sector continues to see substantial growth due to the need for lower-cost alternatives to hospitals and nursing homes for the care of the aging baby-boomer population. According to the National Association for Home Care & Hospice, on average it costs Medicare approximately $2,000 per day for a hospital stay and approximately $559 per day for a nursing home stay, as compared with only around $44 per day for home healthcare. Medicare and Medicaid spending accounted for approximately 81 percent of total home healthcare spending in 2012 and is expected to continue to increase. *See National Health Expenditures 2012 Highlights, Centers for Medicare and Medicaid [CMS] Services Actuary Office (2013)*, hereinafter "CMS 2012 Highlights." Overall spending for home healthcare agencies is also expected to continue to grow, increasing by 5.1 percent to $77.8 billion in 2012. *See CMS 2012 Highlights*. This growth is not expected to slow. Although this sector is currently fragmented, with the majority of agencies having only been in the business for roughly five years, greater franchising can be expected in the future. For example, FirstLight Home Care entered the business in 2010 and currently has more than 60 franchise locations in 24 states and expects to open numerous additional locations in 2014. *See FirstLight HomeCare Expands Footprint on West Coast, Franchise Business Review (May 23, 2013)*. Additionally, Senior Home Care Inc. is currently in the process of being acquired by Kindred Healthcare Inc. for a purchase price of around $95 million.

However, the ACA calls for base rate reductions to be phased in over four years beginning in 2014, though the maximum cumulative reduction is expected to be approximately 7 percent, which should allow for continuing profit margins for home healthcare agencies that have a substantial footprint. *See MedPAC Report to Congress 2013*. CMS also continues to increase governmental scrutiny of the home healthcare industry due to fraud and abuse concerns. While investment opportunities are currently fragmented, continued growth and franchising could lead to more desirable investment opportunities.

Cancer and Oncology-Driven Care

Cancer and oncology care has consistently made up 5 percent of the national healthcare industry's spending. However, cancer and oncology care spending has shifted over time from inpatient services to outpatient services. This shift has produced significant cost savings for consumers that have subsequently been put toward the emerging industry of cancer drugs. While market pressure may lower drug costs in the future, the total costs of cancer and oncology-driven care will continue to rise as the number of patients with cancer continues to grow. *See Why We Should Be Spending More on the Pricey Cancer Drugs, Forbes (June 10, 2013).*

A substantial amount of money is being spent by health systems and investors on oncology medications, therapies, equipment, devices and treatment centers to combat cancer. Hot areas include radiation therapy, infusion therapy and physician practice management. Recently, in radiation therapy, ViewRay Inc. secured $30 million in funding from Aisling Capital, Kearny Venture Partners, Fidelity Biosciences, OrbiMed Advisors LLC and Cowealth Medical Holding Co. Ltd. to commercialize its ViewRay system that improves accuracy of cancer treatments through simultaneous delivery of MRI and radiation therapy. *See ViewRay Secures $30 Million in Funding, Healthcare Investor (Dec. 18, 2013)*. Similarly, Radiation Therapy Services Inc. (now 21st Century Oncology Inc.) acquired OnCure Holdings Inc. for $125 million, which operates 33 cancer treatment centers in three states. *See Radiation Therapy Services Completes Acquisition of OnCure, Globe Newswire (Oct. 25, 2013)*. In cancer-driven devices, Roundtable Healthcare Partners' portfolio company, Argon Medical Devices Inc., acquired Angiotech Pharmaceuticals, Inc.'s Interventional Products Business, which focused on reusable biopsy products for the diagnosis of cancer. *See RoundTable Healthcare Partners and Argon Medical Devices Complete Acquisition of Angiotech Pharmaceuticals' Interventional Products Business, Yahoo Finance (April 15, 2013)*. Cancer-driven care will remain a hot area for investment as the incidence of cancer continues to rise and providers look for new solutions to give patients a better chance at survival and recovery.

Chronic Disease

The vast majority of national expenditures on healthcare pay for the treatment of chronic diseases such as asthma, diabetes and chronic obstructive pulmonary disease. Most of these diseases can be prevented through wellness initiatives and changes in personal behavior. However, as the current population ages, Medicare spending on chronic diseases and enhanced efforts by federal and state governments to find cost-effective reimbursement strategies will likely increase. Similarly, there has been a significant rise in the number of accountable care organizations (ACOs) to meet the need for coordinated care efforts for patients with chronic diseases. Even Walgreens has entered the market to receive federal financial incentives for coordinating pharmacy and medication management services. *See Melanie Evans, Big Boost in ACO Numbers, Modern Healthcare (Jan. 14, 2013)*. Greater coordinated care comes on the heels of significant pressures on hospitals to reduce costs and properly treat patients with chronic diseases while still receiving reimbursement for care.

Private equity investment has recently followed this consumer and provider trend. For example, Levine Leichtman Capital Partners invested $110 million in Genova Diagnostics Inc., a specialty clinical laboratory that offers a testing approach that is tailored to personalized treatment and prevention of chronic disease. *See CIT Provides Acquisition Financing to Levine Leichtman Capital Partners, CIT (Dec. 17, 2013)*. Other smaller deals include venture capital-backed Singulex, Inc. raising $40 million to fund a fully automated diagnostic instrument that uses biomarkers to combat chronic disease, and Summit Partners' investment of $21 million in COMS Interactive, LLC, whose flagship software product focuses on managing chronic disease profiles of patients requiring post-acute care. *See VC-backed Singulex Closes $40 Mln, PE Hub (Sept. 26, 2013); COMS Interactive Secures $21 Million from Summit Partners, Summit Partners (June 18, 2013)*. Even established medical device companies are investing in chronic disease products. Baxter, Inc. purchased Gambro AB in September 2013 to acquire its product and therapy portfolio geared toward a growing dialysis patient market. *See Baxter Completes Acquisition of Gambro AB and Enhances Global Leadership in Renal Therapies, Baxter (Sept. 6, 2013)*. We expect that investors will continue to invest in chronic disease treatment products and services, as efforts to stem the rising incidence of chronic diseases are still nascent.

Wound Care

The global wound care industry continues to experience substantial growth and might reach $21 billion by 2015, as 7 million Americans currently suffer from chronic wounds. *See Investment Ideas in an Emerging Wound Care Market, MarketWatch (May 17, 2013)*. The growth from $16.8 billion in 2012 comes from an aging population and the rise in chronic diseases such as diabetes and hypertension. To help combat the rising costs of wound care, CMS issued the final CY 2014 Hospital Outpatient Prospective Payment System that packaged payment for some wound care products including skin substitutes. This reimbursement change could put pressure on providers to find more cost-effective wound therapies and move away from some preferred treatment methods for wounds in long-term-care settings. *See New CMS Policies Will Lead to 'Big Change' in Wound Care Practices, McNight's (Oct. 22, 2012)*.

Private equity interest in wound care firms has followed the overall consistent growth of the industry. Recently, Yukon Partners and a group of other firms acquired a majority interest in the second-largest wound care center management company, Accelecare Wound Centers, which operates 120 centers throughout the country. *See Yukon Partners Invests in Accelecare Wound Centers, PE Hub (Dec. 24, 2013)*. There has also been extensive investment interest in new technologies to help improve wound care treatment. For example, the market for a new treatment called negative pressure wound therapy, which speeds up wound healing, will double from $2 billion in 2011 to $4 billion by 2018. *See Investment Ideas in an Emerging Wound Care Market, MarketWatch (May 17, 2013)*. Other wound care technologies that have attracted interest focus on rapid absorption of nutrients and regeneration. We expect this industry to continue to grow with increased spending on chronic disease.

Hospice

Private equity investors have continued interest in the hospice sector, shifting the industry from nonprofit control to for-profit dominance. Between 2000 and 2009, 80 percent of new hospices that began participating in Medicare were for-profit. In 2011, more than 1.2 million Medicare beneficiaries received hospice services from more than 3,500 providers, and Medicare expenditures totaled around $13.8 billion. *See MedPAC Report to Congress 2013*. Further, in 2011, 45.2 percent of Medicare beneficiaries who died that year used hospice services. *See MedPAC Report to Congress 2013*. The hospice sector is benefiting from an aging population and remains ripe for consolidation, creating opportunity for investors to gain market share and make profits as the demand for hospice services increases. However, the significant increase in Medicare spending on hospice services caused the OIG to focus on activities relating to hospice services in 2013, namely inspection of hospices' marketing materials, practices and financial relationships with nursing homes. *See Office of Inspector General, Work Plan Fiscal Year 2013*. Additionally, while there has been a steady increase in the percentage of Medicare beneficiaries who receive hospice services, the rate of increase has slowed. Among private equity funds, the number of mergers and acquisitions for hospice providers declined in the first half of 2012 after seeing a substantial increase in 2009-2011. *See MedPAC Report to Congress 2013*. Investment in hospice was present but slow in 2013. For example, Summit Partners, a private equity firm, acquired a minority interest in Heart to Heart Hospice in March 2013. We expect investment in hospice to continue at a steady pace, but it will likely not have the significant growth we expect to see in other sectors.

Skilled Nursing Facilities

The skilled nursing facility (SNF) business is estimated at close to $180 billion per year, and Medicare spent $31.3 billion on SNF reimbursements in 2011, which constituted around 6 percent of Medicare's total spending. *See MedPAC Report to Congress 2013*. SNFs remain an interesting area for investors, in part fueled by unlimited demand from an aging population, notwithstanding the uncertainty of regulatory investigations and periodic efforts at payment reform. Despite the demand, the great issue that remains in nursing homes and SNFs is payment ability as states wrestle with Medicaid costs. In four years, states have made almost a complete reversal from the number of states providing rate increases (37 in fiscal year 2009) to the current situation of 31 states implementing rate restrictions in fiscal year 2012. *See John K. Iglehart, Expanding Eligibility, Cutting Costs — A Medicaid Update, NEJM 105 (Jan. 12, 2012)*. Medicaid is by far the single-largest payor for SNF services and an area of intense budgetary challenges. Changes in reimbursement and eligibility lead entrepreneurial owners to seek out different types of patients, e.g., developmentally disabled, subacute care and others. In their March 2013 report to Congress, MedPAC noted that "in 2010, the average Medicare margin for freestanding SNFs was 18.5%; it was the 10th year in a row with Medicare margins above 10 percent." *See MedPAC Report to Congress 2013*. Total margins, including Medicare margins, were positive and increased in 2011, and are estimated to be between 4 and 6 percent. *See MedPAC Report to Congress 2013*. Despite Medicare cost reductions, we expect that Medicare patients will continue to be a real focus of SNFs. Major providers of nursing home services include, e.g., Manor Care Inc., Golden Horizons and Kindred Healthcare, operating nearly 500, 300 and 230 nursing homes, respectively.

Revenue Cycle Management

According to market research firm Black Book Rankings LLC, the $2.4 billion hospital revenue cycle management industry for software and services will see double-digit increases in 2014. *See RCM Market Expected to Grow by Leaps, Healthcare IT News (Oct. 20, 2013)*. Causes for this growth will include business model shifts, reimbursement reform, ACO participation, ICD-10 coding challenges, physician practice acquisitions, collection hardships and declining profit margins. "Shifting payment models and regulations are forcing hospital leaders to redirect previously launched budgets, priorities and strategic plans to assess if new RCM solutions can rescue them from imminent hospital layoffs, even bankruptcies," said Doug Brown, managing partner of Black Book Rankings LLC. Similarly, HIMSS Analytics Executive Vice President John Hoyt suggested that it's past time for revenue cycle system replacement since hospitals use technology that is nearly a decade old. However, very few current revenue cycle management systems can actually address the patient-centered, bundled-payment model of care.

While revenue cycle management may see revenue increases in 2014, the potentially booming industry may have to wait for vendors to adapt their products to the new models of care. *See Revenue Cycle Ripe for Radical Change, Healthcare IT News (Dec. 9, 2013)*. One company, Experian Healthcare, expanded its revenue cycle management position in the industry by acquiring Passport Health Communications Inc., which focused on physician orders, scheduling, patient access, patient engagement, population health management and claims management services. *See Experian Healthcare Expands Its Industry-leading Revenue Cycle Management Position With Acquisition of Passport Health, Yahoo Finance (Nov. 21, 2013)*. We expect investors to lead more consolidation in the sector and invest in new products to address post-ACA payment models.

Physician Practices

Spending on physician and clinical services increased 4.6 percent in 2012 to $565 billion. *See CMS 2012 Highlights*. Such services constitute 12 percent of total Medicare spending. *See MedPAC Report to Congress 2013*. Despite the rise in walk-in clinics and urgent care centers, a 2010 Medicare survey found that 74 percent of Medicare beneficiaries continue to receive their medical care from a physician in a traditional physician practice office. *See MedPAC Report to Congress 2013*. For 2014, growth is projected to be 7.1 percent, and 5.5 percent per year for 2015 through 2022. *See National Health Expenditure Projections 2012-2022, Centers for Medicare and Medicaid Services Actuary Office (2013)*. There has been a trend in physician aggregation into larger physician practices, particularly with physicians who file Medicare claims, with 35.6 percent of physicians working in practice groups consisting of more than 50 physicians in 2011 as compared with 30.9 percent in 2008. *See Proportion of Physicians in Large Group Practices Continued to Grow in 2009-2011, Health Affairs (September 2013)*.

However, fees for physicians and other health professionals are expected to decline by roughly 25 percent in 2014 due to revisions to the Medicare fee schedule for physician and other health professional services. *See MedPAC Report to Congress 2013*. Such changes in reimbursement rates have caused many physician practices to be sold to nearby health systems. The current uncertainty with respect to reimbursement rates also makes physician practices open to outside investment. Recent investment in physician practices appears to be focused on specialty practices such as anesthesiologists, radiologists and emergency room physicians, along with emerging specialty areas such as fertility and cosmetic surgery. *See Strong Vital Signs Draw Private Equity to Healthcare, Forbes (April 30, 2013)*. This sector should continue to see steady investment in the year to come, particularly specialty practices.

Imaging Centers

Until recently, imaging centers have been a lucrative business extension for many health systems, hospitals and physician groups. While still profitable, the industry is beginning to consider imaging to be a cost center due to the high overhead of equipment, "construction, annual service, upgrades, peripherals, supplies, staffing, certificates of need and leases." *See Equipment Service: Total Cost of Ownership, Imaging Biz (Dec. 28, 2012)*. Revenues will also diminish due to reimbursement reform, bundled payments and reduced copayments. These payment reductions have paralleled a decrease in total imaging utilization from 2006 to 2010 of almost 5 percent. *See Medical Imaging: Is the Growth Boom Over?, Neiman Report (Oct. 1, 2012)*. Thus, cost efficiencies, enhanced competitive advantages and focused expertise will become pivotal to operating a successful imaging center that is able to compete with hospital operators that have greater resources. *See Lack of Investment in Imaging Equipment Might Contribute to Accelerated Consolidation, Imaging Biz (Aug. 12, 2013)*. Moreover, the recession reduced capital investment in upgrading and replacing imaging equipment, which means that many freestanding providers will have large capital equipment expenditures in their future. Thus, there has been a trend of looking toward increased partnerships and consolidations.

Specifically, over the past several years there have been many imaging center partnerships with large hospitals. One significant transaction occurred in July 2012 when Black Diamond Capital Management LLC led an investment in Insight Imaging to buy out the owners of Center for Diagnostic Imaging. The $231 million transaction led to a combined market presence of 116 fixed centers and 90 mobile MRI and PET/CT units. *See Insight Imaging Merges With Center for Diagnostic Imaging, PE Hub (Aug. 21, 2012); see Lack of Investment in Imaging Equipment Might Contribute to Accelerated Consolidation, Imaging Biz (Aug. 12, 2013)*. While imaging centers will face increasing strains (including payment reductions and hospital competitors), there are still opportunities for investment and partnership engagements.