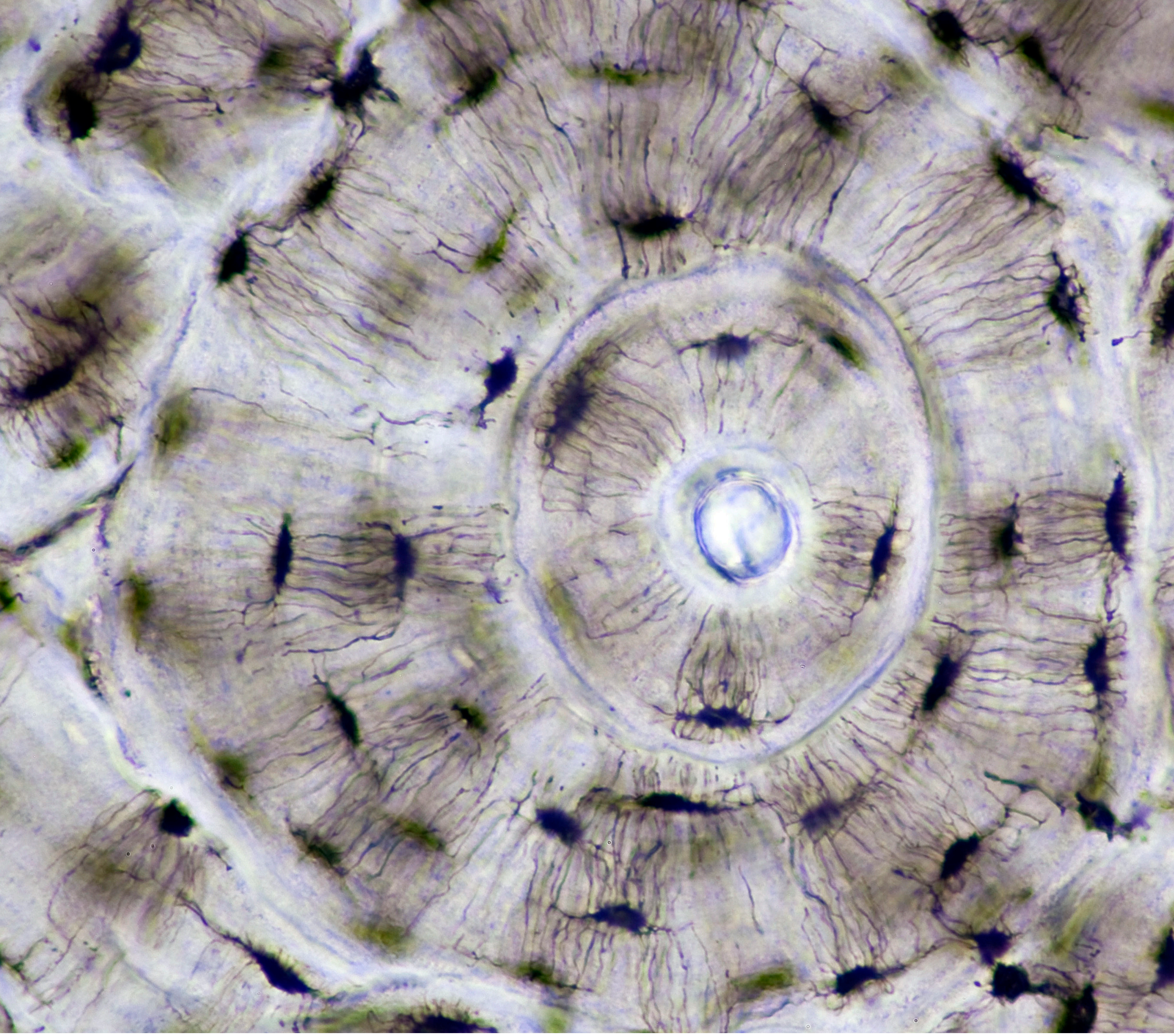


VECTOR MEDICAL GROUP

EPSTEIN BECKER GREEN

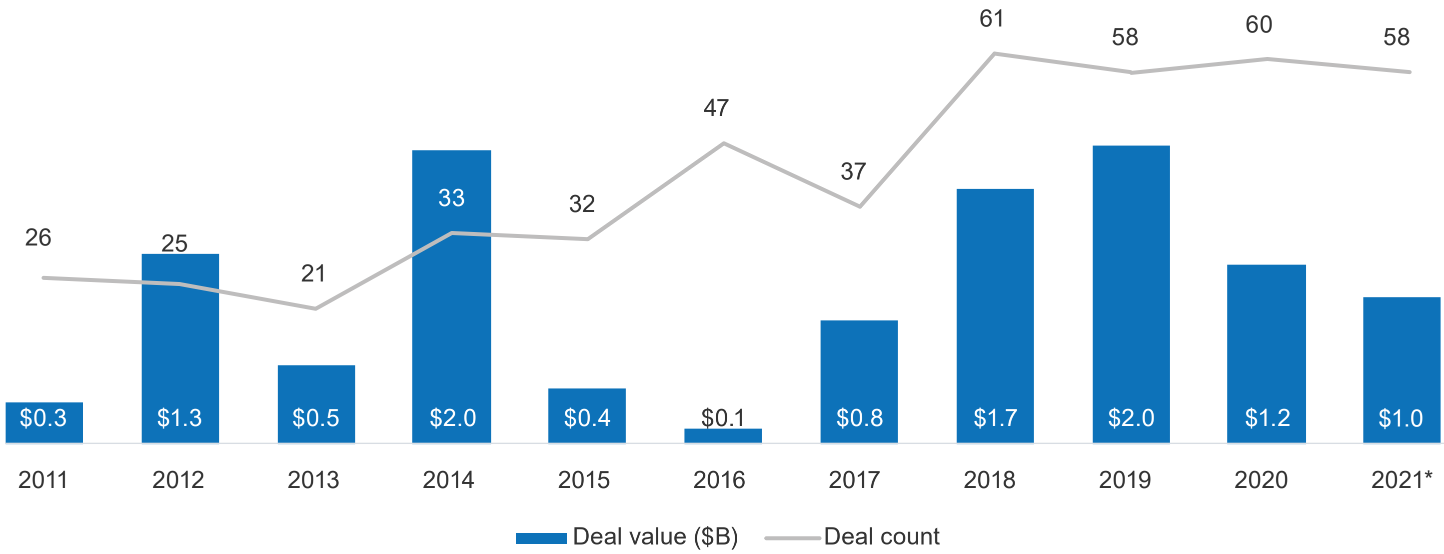
US Orthopedics Deal Activity Shrugs Off Pandemic

Data provided by PitchBook

Vector Medical Group | Epstein Becker Green

Deal volume remains elevated

Orthopedics PE deal activity



Source: PitchBook | Geography: US | *As of December 31, 2021

Private equity (PE) has a long history in the orthopedic space, but PitchBook data confirms PE's presence has grown visibly in the past four years. 58 transactions were completed in 2021, collectively valued at about $1 billion, and the orthopedic market has seen around 60 transactions per year going back to 2018. Altogether, just under $6 billion has been invested since 2018.

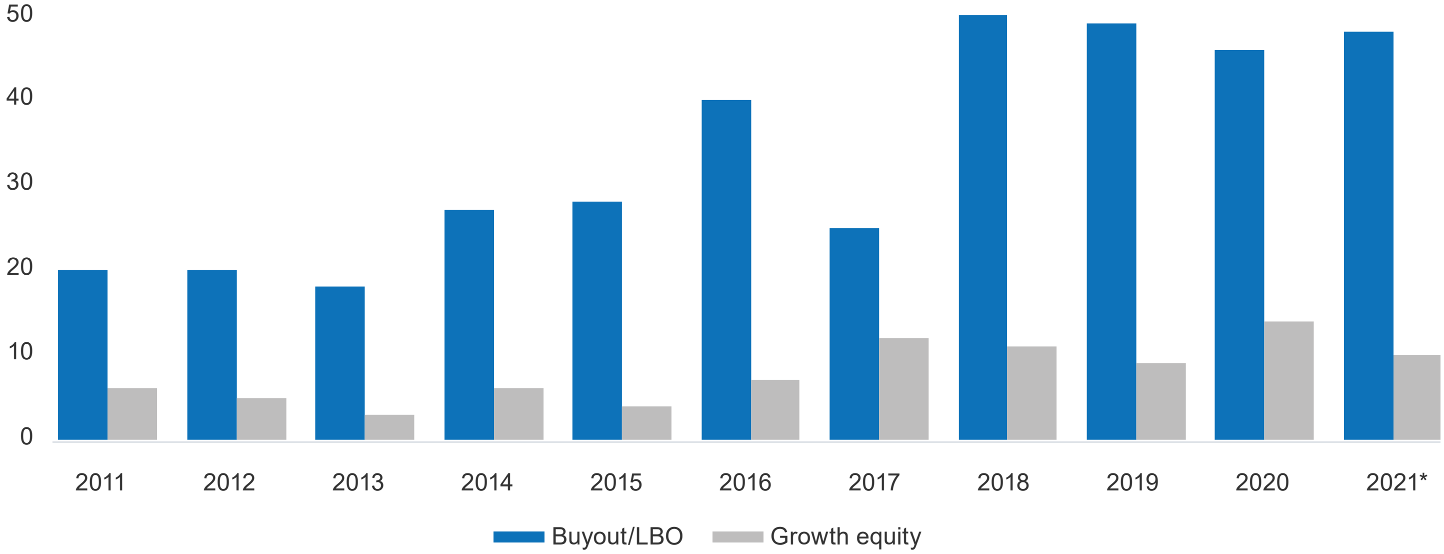
Almost every corner of the healthcare market was affected by COVID-19 in some way. However, deal data shows that PE investors were undeterred in 2020 and 2021, as consolidation efforts, demographic shifts, and heightened demand for orthopedic care outweighed broader market uncertainties. Buyouts remain an integral part of the landscape, though nonmajority growth transactions have become more common in recent years. Add-on acquisitions have also lifted deal volume, as PE sponsors grow their platforms into regional and national players via smaller acquisitions. 2021 even saw a new PE-created orthopedic platform emerge. American Orthopedic Partners, financed by Stone Point Capital, was formed in June. AOP's aim is to recruit physicians while allowing them to keep control of their own practices. If the initiative succeeds, Stone Point's experience may serve as a model for other investors.

Because of the fragmented nature of the orthopedic market, PE firms tend to take a regional approach to consolidation in lieu of national platforms such as AOP. In January, for example, Trivest Partners acquired Kentucky-based Bluegrass Orthopaedics. To bookend 2021, there was another notable buyout: Atlanta-based Resurgens Orthopaedics by Welsh, Carson, Anderson & Stowe. In both cases, the acquired practices were founded about three decades ago, thus highlighting a wave of retirement-induced transactions. Both Trivest and WCAS are aiming to expand the national footprints of their new platforms.

In other cases, perhaps motivated by COVID-19's impact on their lives, physicians opted to sell their practices to focus on other things. As more practices come under PE sponsorship and as investors bring an institutional mindset to smaller, physician-owned practices around the country, the financial aspects of the orthopedic market are becoming more sophisticated and efficient.

The goal of any PE transaction is to increase the company's value and then sell it within five to seven years. In the orthopedic space, M&A is the overwhelming option, as regional competitors eye acquisitive growth to expand geographically. In 2021, for example, Colorado-based Sisters of Charity of Leavenworth Health System acquired Montana Orthopedics, and Tuckahoe Orthopaedic Associates, a 50-year-old practice based in Virginia, sold itself to the Bon Secours Health System in Maryland. Those market dynamics show no signs of slowing, and we expect 2022 to record similar deals in other parts of the country. Successful orthopedic practices are valuable assets to hospitals and health systems, and health systems are known to aggressively bid for those practices when they come to market—boosting their value in the process. Well-run practices are also valuable targets of PE-backed orthopedic practices, as financial sponsors vie to expand their platform companies through acquisitive growth.

Orthopedics PE deal count by type



Source: PitchBook | Geography: US | *As of December 31, 2021

Most active PE investors in orthopedics since 2005

Investor	Deal count*
Shore Capital Partners	42
Waud Capital Partners	21
Altaris Capital Partners	17
Great Point Partners	17
Gryphon Investors	16
KRG Capital Partners	14
Water Street Healthcare Partners	12
TPG	11
Ridgemont Equity Partners	10

Source: PitchBook | Geography: US | *As of December 31, 2021

*Methodology

All datasets are sourced from PitchBook, and all traditional healthcare industry codes correspond to existing industry codes for healthcare in the PitchBook Platform. Orthopedics-specific data is derived from a combination of keywords and a primary industry code tag to identify companies within the orthopedics space. These datasets include orthopedic practices and platforms, surgery centers, orthopedic rehabilitation providers, physical therapy, device companies and other orthopedic product manufacturers.

Select 2021 transactions

In January 2021, Trivest Partners acquired Bluegrass Orthopaedics, a Kentucky-based practice founded in 1992. Trivest plans to give the practice a national presence.

In January 2021, OrthoCincy acquired Wellington Orthopaedic & Sports Medicine, an Ohio-based practice founded in 1968.

In February 2021, Spire Orthopedic Partners, which is backed by Kohlberg & Company, acquired Orthopaedic Associates of Manhasset, based in upstate New York.

In March 2021, Sisters of Charity of Leavenworth Health System acquired Montana Orthopedics, based in Montana and founded in 2001.

In April 2021, Trinity Hunt Partners, a Texas-based private equity firm, bought out Los Angeles Orthopaedic Surgery Specialists, a 14-year-old practice based in Los Angeles.

In April 2021, Bon Secours Health System purchased Tuckahoe Orthopaedic Associates, founded in 1972 and headquartered in Virginia.

In July 2021, Tucson Orthopaedic Institute was acquired by Orthopedic Care Partners, a portfolio company of Varsity Healthcare Partners. Based in Arizona and founded in 1993, Tucson Orthopaedic Institute's 33 physicians and eight clinic locations will be folded into OCP's platform, which now employs more than 100 physicians.

American Orthopedic Partners is a new national orthopedic practice formed by Stone Point Capital in June 2021. AOP will recruit orthopedists while letting them keep control of—and grow—their practices.

In late 2021, Welsh, Carson, Anderson & Stowe acquired Resurgens Orthopaedics, a Georgia-based practice. Founded in 1986, Resurgens employs almost 100 physicians and aims to grow its national footprint under WCAS.

Key trends to watch in 2022

More investors are entering

We expect a surge in the number of investor platforms in the orthopedic space to gain momentum in 2022. The healthcare market is even attracting nonmedical players, including Google, Amazon, and Walmart. Furthermore, the 2018 tie-up of Aetna and CVS reflects a broader push into vertical interests and vertical integration across industries and healthcare channels.

Telehealth legislation

Telehealth technology has been available for years, but it took a global pandemic for telehealth to become a mainstream, accepted, sought-after practice among doctors and patients alike. Legislative adjustments will become critical signals for investors, particularly for laws around reimbursement.

The impact of genetic medicine

Genetic medicine will greatly affect how we care for disease, and holistic care models will become paramount moving forward.

Q&A with Dana L. Jacoby and Gary W. Herschman

Please share your thoughts on 2021 PE deal activity—specifically what drove it and whether the orthopedic market can expect more of the same in 2022.

A few basic metrics are driving PE deal activity across all specialties, including orthopedics. First, there is approximately $2.3 billion in dry powder looking for investment opportunities. This unprecedented amount drove much of the activity in 2021. Second, the average physician age in the US is 56. Many physicians are looking at retirement, an ownership transition, or a work/life rebalance; the orthopedic specialty is particularly hard-hit with retirees. Coupled with COVID-19 burnout, this fact has catalyzed and drawn forward the "change of life" conversation. A third major factor was a concern about the potential new capital gains and taxation laws, which haven't happened yet. However, other regulations continue to pressure specialties including orthopedics. The ever-changing policy landscape around payor reimbursement and fee schedules continues to complicate the practice of medicine.

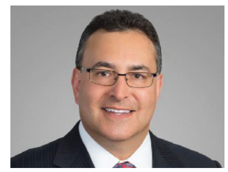
Many orthopedists are seeking to monetize the value of their practice ownership due to strong demand and currently high valuations. Although it often isn't, a physician's ownership share in their group should be recognized as a meaningful asset in their personal wealth. Pursuing a transaction with an investor allows physicians to partially cash out the true value of their practices (usually 70% to 80%) and retain the balance in rollover equity, which gains value as the investor's equity grows in value and is realized in whole or in part upon the investor's exit from the platform. This is much more lucrative than retiring and receiving a generally modest buyout of their interest in the practice—in accordance with the terms of their Shareholder, Buy-sell, or Operating Agreement—which doesn't equate to the true value of the practice or constitute a material asset in their personal wealth portfolio.

Moreover, in light of all of the challenges and future uncertainties in the rapidly transforming healthcare marketplace, joining a larger organization has many advantages that increase the likelihood of physicians being able to continue to prosper in the future, such as: greater access to capital for growth of ancillaries, ASCs, new offices, EMR, and data analytics, among others; experienced corporate executives to manage regulatory changes and navigate challenges in their local markets; economies of scale via consolidated back-office functions such as billing, HR, IT, and compliance; and cost savings through group purchasing.

The orthopedic market will continue to see significant PE activity in 2022, although some things will likely change. The failure to pass the Biden tax changes has given the market time to breathe, but it still could happen in the coming Congress or after the midterm elections. Doctors are still looking at retirement, and private practice will continue to become more difficult. More mergers, acquisitions, and consolidations will happen between platforms, hospitals, and specialty groups, which makes competing as an independent orthopedic practice more challenging. And there is that incredible amount of dry powder still out there.

There were eight PE-backed orthopedic platforms in 2020. As of year-end 2021, there are 16, including Welsh Carson.

Dana L. Jacoby
CEO
Vector Medical Group



Gary W. Herschman
Board of Directors
Member of the Firm
Epstein Becker Green

Further, several of the existing platforms added on new practices in 2021 to continue their growth trajectories.

Some PE deals were expedited to clear the December 31, 2021, deadline, but others were behind in diligence, needed additional time to close, or were delayed for tax reasons until Q1 2022. For these reasons, we expect 2022 to be another banner year for orthopedic group consolidation and to exceed the robust transaction volume during 2021.

What company characteristics are investors looking for in the current orthopedic market? Have those characteristics changed over the past two years, or even over the past year?

Not much has changed in this regard over the past two years. Investors still are looking for a solid orthopedic platform that demonstrates the foundation of disciplined financial and managerial decisions. Specifically, the practice is more valuable when it has a well-honed patient care system, a well-managed corporate infrastructure, well-planned payer strategies and contracts, and initial success in value-based care initiatives. The leadership should be experienced, and they should have an articulate vision for growth. Finally, it is impossible to say enough about the importance of a practice's culture. Following any transition, whether PE, a merger with another practice, or joining a hospital organization, the culture of the practice drives future success. Weak leadership and culture seriously undercut the value, and the future revenues are much riskier. Those timeless elements are critical to any practice.

Putting aside financial investors, what is motivating the corporate M&A market, either from strategic competitors or from hospitals trying to expand into the orthopedic market?

The orthopedic market has some unique characteristics that make it attractive to acquisitions by hospitals and other strategic players. Orthopedics has always been a revenue stream for hospital systems, but the structure has changed and created a tremendous opportunity. In this regard, although historically focused on acquiring PCPs and employing PCPs in their service areas, hospitals—and large national strategic companies, such as Optum—are increasingly purchasing specialty practices. This poses a real threat to the referral sources of orthopedic practices that remain independent and is causing them to consider their strategic options to best position themselves for survival and success. Both hospital systems and national healthcare companies are fierce competitors in bidding on orthopedic groups undergoing sale processes.

Moreover, ambulatory surgical centers (ASCs) have proliferated due to their financial success and the trend toward providing a majority of surgical care in an outpatient setting. Consequently, hospitals, orthopedic platforms, and outside investors are all recognizing the value of owning an ASC.

Furthermore, orthopedic practices provide the largest menu of ancillary services as compared with other specialties. In addition to ASCs (which are the most lucrative), other important and profitable orthopedic ancillary services include: physical, occupational, and hand therapies; imaging; orthopedic urgent care; office-based procedures, such as pain management and other injections and biologics; durable medical equipment, orthotics, and prosthetics; and occupational health.

Combined, these market developments and the aging Baby Boomers make orthopedics a stellar investment candidate. This is because of the growing number of musculoskeletal issues that occur among an aging population. In the US, retirees are more active, and they are living longer. Thus, the demand for orthopedic services from joint replacements to injuries and repairs is increasing.

What dynamics are affecting orthopedic practice valuations?

It is difficult to overstate the importance of payer contracts, value-based care, strong leadership metrics, and both dependable and diversified revenue in the valuation process. Investors are looking for consistent, nearly guaranteed revenue following a transaction. Insecure practice revenue is risky and may reduce the value of the practice. Another important consideration that accompanies consistent operations and financial considerations is the amount of competition within the sector. Increasingly, smaller groups are forced to compete with conglomerates and hospital systems. PCP groups often dictate the referral process. These factors will affect the quality of earnings going forward and decrease the value of an unprepared practice. The other traditional elements remain critical: leadership, culture, vision, growth, infrastructure, and management.

For prospective investors, what questions or issues need to be considered before investing in the current orthopedic market? Beyond infusing capital into these companies, what kinds of organic or inorganic growth initiatives are vital to competing in the current market?

The largest concern for investors is picking a solid platform group with strong financial performance, experienced leadership, a good culture, and a strategic vision. Having a good advisory team and subject matter experts involved at the outset of an investment, during the growth period, and upon exit is critical for prospective investor success.

Opportunities abound for organic and inorganic orthopedic growth in the coming years. Expanding the service offerings within the practice is a brilliant start. For example, in addition to providing a prosthetic replacement, what is being done to assist with physical and exercise therapies? Some basic growth strategies include recruiting new subspecialists and other surgeons, opening new offices and service locations, and acquiring smaller practices in the region. We are also exploring other avenues of experience and service previously unseen in the medical industry, such as referral programs, satisfaction surveys, and VBC metrics. Yet another area of organic growth is in enhancing a practice's complement of physician extenders who can expand the practice's capabilities, provide quality, coordinated, and hands-on patient engagement, and allow the physician to focus on the higher-value procedures.

Outside the practice, several different ways exist for an orthopedic platform to acquire additional market share. One example is direct contracting with local or regional employers, so that a company encourages all employees to use the services of the orthopedic platform. The critical element here is creativity in rethinking provider-patient interactions.

Physician group M&A market trends

The emergence of investment interest from new buyers such as vertically integrated payers/strategic buys and private equity firms/financial sponsors has expanded the strategic options available to healthcare providers

Hospitals/Health Systems

Pros

- *Referral network*
- *Guaranteed compensation*
- *Stronger clinical operational knowledge and capabilities*
- *Geographic congruency*

Cons

- *Least favorable financial considerations*
- *Potential lack of value-based arrangements*
- *Lack of equity ownership opportunity*

Payers/Strategic Players

Pros

- *Increased access to strategic data and technology infrastructure*
- *Greater access to population health capabilities*
- *Risk and shared savings arrangement expertise*
- *Attractive financial considerations*

Cons

- *Decreased clinical and operational autonomy, compensation guarantee*
- *Potential lack of cultural alignment*

Private Equity

Pros

- *Performance incentives*
- *Entrepreneurial growth-driven model*
- *Upfront cash consideration and potential "second bite at the apple"*

Cons

- *Potential lack of operational and/or specialty-specific experience*
- *Potential decreases to guaranteed compensation in lieu of upfront cash consideration and future equity appreciation opportunities*

Vector Medical Group, LLC conducts project management, client leadership insights, and market research for industry, community-based medical groups, health systems, and associations. Vector Medical Group is the preeminent leader in creating synergies between investors and healthcare provider groups with seamless, strategic, trademarked solutions. As an intersection between investors and healthcare leaders, we work to integrate with any health industry business at any facet of its life cycle. We work with C-Suite executives and senior leadership to drive business performance and outcomes based on combining healthcare and shareholder value. Our global experience allows us to assist organizations with change management and affords shareholders streamlined solutions across all departments. **With over 20 years' experience and an unprecedented lens of the insight across the ever-changing healthcare marketplace, there is no better option than Vector Medical Group.**

Epstein Becker & Green P.C. is one of the top healthcare law firms in the country, with 150 health law attorneys in 16 offices who advise medical groups, healthcare facilities and businesses, pharma and medical devices companies, and investors in all of the foregoing, in connection with mergers, sales and acquisitions, as well as the many regulatory and compliance issues that are essential in connection with their operations. The firm's healthcare attorneys have been particularly active over the last 10 years in representing a wide spectrum of physician groups and ASCs in strategic transactions, including the following specialties: ENT, OBGYN, Orthopedics, Neurosurgery, Podiatry, Urology, Retina, Ophthalmology, Cardiology, Primary Care, Gastroenterology, Dermatology, Plastic Surgery, Dental, Fertility and Pain Management.