



## Smart Money: Outpatient Investment Opportunities Worth Pursuing

The ongoing transformation of traditional healthcare — including the adoption of value-based and/or retail models — has compelled providers to restructure practice locations, medical affiliations and processes in order to maintain profitability without ceding market share, care quality or convenience.

With larger healthcare systems acquiring physicians' groups and onboarding personnel as salaried employees, many enterprising physicians/entrepreneurs have instead sought to join forces with or have launched smaller, more specialized outpatient practices covering the likes of vein care, dermatology, physical therapy, urgent care and other treatments. By allowing providers to maintain their independence while leveraging specialization, these models are expected to gain momentum in the years to come.

Many segments have already piqued the interest of private equity and other strategic investors. In the first of a multipart *Executive Insights* series on outpatient opportunities, we look into current outpatient trends and, based on L.E.K. Consulting's work within the field, highlight a number of "hot topic" practices that come up for discussion frequently.

### Growth Factors

For its high-level analysis, L.E.K. applied a number of key metrics in an effort to assess the relative appeal of each segment (see Figure 1). These include:

- **Market size:** Estimate of segment's current revenues per year
- **Market growth:** Projected annual segment rate of growth
- **Payment type/reimbursement exposure:** Indication of whether payments are predominantly in the form of cash versus reimbursement from commercial payers versus government payer reimbursements, or a combination thereof
- **Fragmentation:** Proxy for the extent to which scaled entities compete in and own significant share within the segment, as well as for feasibility of anticipated future acquisition opportunities
- **Level of investment maturity:** Historical PE activity within the space, including whether assets have already been vetted, purchased and/or professionalized
- **Point of sale:** Patient acquisition paradigm — e.g., whether a segment primarily offers elective procedures marketed through direct-to-consumer advertising, or medically necessary services requiring PCP network/specialist referrals
- **Impact of scale:** Degree to which scale (number of single-entity-owned units) produces significant operating leverage and competitive advantage

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Figure 1  
Outpatient practices: Relative attractiveness for investment

Indicative

#	Type of clinic / center	Total market size	Market growth CAGR (2015-2020)	Reimbursement exposure	Degree of fragmentation	Investment maturity	Point of sale	Economies of scale	Competitive intensity
1	Dermatology	Medium	Medium	Medium	Medium	Medium	Referrals	Medium	Low
2	Vein care	Low	Medium	High	Medium	Low	DTC / Referrals	Medium	Medium
3	Fertility	Low	Medium	Low	High	Medium	DTC / Referrals	Medium	Medium
4	Dental	High	Medium	Medium	High	High	DTC	High	Medium
5	Physical therapy	High	Medium	High	High	Medium	Referrals	Medium	Medium
6	Urgent care	High	Medium	Medium	Medium	High	DTC	Medium	High
7	Chiropractic	Medium	Low	Low	High	Medium	DTC / Referrals	Low	Medium
8	Ambulatory surgery centers	High	Medium	High	Medium	High	DTC / Referrals	High	High

Attractiveness of metric     Positive     Intermediate     Drawback

Source: L.E.K. intellectual property, survey and analysis

- **Competition:** Level of competitive intensity/sophistication among existing providers, including adjacent segments such as hospital/health system-owned entities, etc.

Based on these factors, the following healthcare segments are considered attractive from both an operator and an investor standpoint:

**Dermatology physician practice management (PPM).** These firms offer attractive back-office support, competitive compensation and improved work/life balance, making them a stronger value proposition than stand-alone or smaller group practices. With strong demand fundamentals, a significant imbalance between high demand and limited supply of doctors, and a shift in the mix of doctors' mindsets toward greater work/life flexibility, this segment has become quite attractive as well as active.

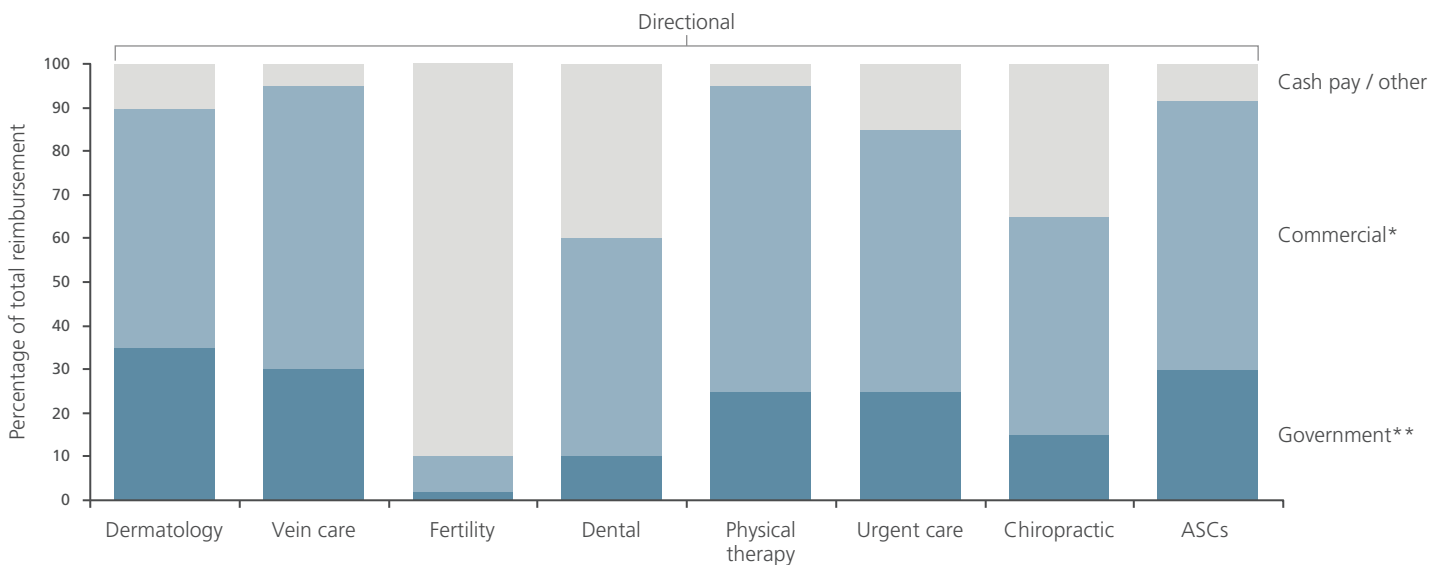
**Dedicated vein care centers.** These facilities bring significant economies of scale through reduced procedure times and marketing/referral efficiencies, as well as improved physician

training and recruitment, to a clinical field that continues to have strong demand fundamentals, albeit in a moderately sized market.

**Fertility clinics.** A consortium of reproductive endocrinologists and other specialists who provide fertility medications as well as a range of assisted reproductive technology (ART) services. Fertility is somewhat unique in that outcomes are relatively transparent, any given "cycle" is more likely to fail than succeed (and patients know that) and the vast majority of payments are in cash. Demographic and cultural undercurrents bolster the fundamentals in this otherwise moderately sized market.

**Dental service organizations (DSOs).** Offer dental practitioners such benefits as immediate debt reduction, increased security and reduced business stress. The "corporatization" of dental practices has been underway for a while, but the size and fragmentation of the market overall provide an extensive glide path for this category.

Figure 2  
Reimbursement sources of key market segments



Note: \*Commercial includes workers' compensation \*\*Government includes Medicare and Medicaid as well as Medicare Advantage and Managed Medicaid  
Source: Bureau of Labor Statistics, Becker's Hospital Review, Medscape, and L.E.K. research and analysis

**Physical therapy practices.** These management firms partner with experienced local physical therapists (who hold an equity stake) and offer administrative services such as accounting, purchasing, IT and HR, as well as sales and marketing.

**Urgent care clinics (UCCs).** A convenient, lower-cost ER alternative covering a range of routine episodic care, diagnostic, screening and occupational medicine services. While the market itself is large, sophisticated investors have been working in this space for some time. UCCs can fill a unique niche, but they must contend with competition not only from other UCCs but also from other provider settings catering to a similar set of patient needs.

**Chiropractic centers.** Multichain practices include standard chiropractic procedures and processes as well as back-office administration, sales and marketing support. The space remains cash-oriented and highly fragmented.

**Ambulatory surgical centers (ASCs).** Offer a select number of diagnostic and preventive surgical procedures with the goal of maximizing operating efficiency and productivity. In addition to robust demand fundamentals, ASCs have benefited from, and will likely continue to benefit from, the growing need for lower-cost alternative settings for surgical care of lower-acuity

patients. ASCs can also be a strong strategic fit for several other provider segments.

Several segments seem particularly well-positioned to outperform in the years ahead. For instance, both physical therapy and urgent care currently rank among the largest practices within healthcare, and are expected to maintain a significant rate of growth going forward. Given the challenges of reimbursement processing, certain segments with a higher proportion of cash-paying clients — among them fertility, chiropractic and dental service organizations — are also poised to benefit (see Figure 2). Of particular note are those with both above-average growth potential and cash-based payers, such as fertility clinics, urgent care facilities and DSOs. Other attributes include level of competitive intensity (L.E.K. sees ample opportunity for incoming dermatologists, for example) and extent of investor uptake (vein care remains relatively under-penetrated at present).

In the first of this multipart series, we examine three segments with above-average growth potential: dermatology, dental care and physical therapy.

**Dermatology physician practice management (PPM).** Though relatively small in size, the market for dermatology PPMs is

# Executive Insights

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nonetheless poised to expand in the years ahead, as aging boomers become more vigilant about cancer screenings while also taking advantage of sophisticated cosmetic services (the latter expected to drive revenues going forward). The PPM model represents a solid value proposition for providers — perhaps not surprisingly, nearly 40% of dermatologists surveyed indicated a willingness to join a PPM group over the near term. The market ostensibly has room to grow, with as many as 60% of practitioners still working independently, and the largest PPM group employing only around 230 dermatologists.

Furthermore, large portions of the country experience significant wait times (e.g., three to five weeks) to schedule an appointment with a board-certified dermatologist. Fragmentation remains high but is expected to gradually decline as more physicians become PPM affiliated. Additionally, EBITDA margins in the vicinity of 20% appear strong enough to help offset any future declines in reimbursement. While industry experts are not aware of any specific risks regarding a decrease in reimbursement, there remains a downside risk of reimbursement cuts, given projected increases in procedure volumes and current dermatologist margins.

**Dental service organizations (DSOs).** Another segment with room to move, at present DSOs account for just 10% of the estimated \$110 billion annual U.S. dental care market, and could possibly double in size by the start of the next decade, according to L.E.K. Cash payments represent a sizable portion (40%) of the market, while Medicaid, CHIP and Medicare Advantage payments are likely to increase as employer-sponsored coverage wanes, which could put added pressure on pricing/margins over the long haul.

Benefits include the ability to scale information technology and to offer dental recruits more flexible work schedules and loan support, among other perks. Of the 70 scale DSO practices currently operating in the U.S., the 20 largest account for only some 5% of the total market. DSOs have long been targeted by private equity interests (leading DSO InterDent, for instance, has been PE-owned since 2000), with investor activity on the increase since the start of the decade.

**Physical therapy (PT).** With an estimated 200,000 U.S. practitioners across 16,000 clinics, physical therapy dominates all domestic outpatient rehab spending (accounting for roughly 90 cents on the dollar, according to L.E.K. research). Easily accessible for incoming practitioners, PT remains highly fragmented, with 60% of the market consisting of startups and the largest firms holding no more than 6% market share. Though clinics primarily rely on commercial insurance for payments (75%, compared with a scant 5-6% of cash payers), PT, like dermatology, caters to a vast boomer population as well as needy younger clients, and is expected to benefit as healthcare delivery continues to shift toward a lower-cost, high-quality provider model, and the Affordable Care Act (ACA) makes it easier for patients to qualify for covered services.

## Conclusion

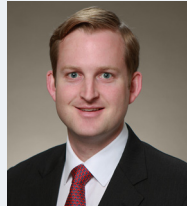
As the healthcare market continues its current evolution, providers are expected to increasingly move toward newer, more cost-effective operational models that promote autonomy by allowing healthcare professionals/entrepreneurs to take advantage of scale efficiencies. In upcoming installments, L.E.K. will explore additional outpatient service models, ranging from freestanding emergency departments to ophthalmology/optometry and ob-gyn practices, which also have the potential to gain traction while drawing investor interest in the years ahead.

## About the Authors



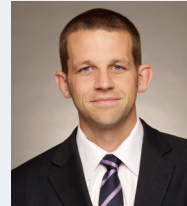
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## About L.E.K. Consulting

L.E.K. Consulting is a global management consulting firm that uses deep industry expertise and rigorous analysis to help business leaders achieve practical results with real impact. We are uncompromising in our approach to helping clients consistently make better decisions, deliver improved business performance and create greater shareholder returns. The firm advises and supports global companies that are leaders in their industries — including the largest private and public sector organizations, private equity firms and emerging entrepreneurial businesses. Founded more than 30 years ago, L.E.K. employs more than 1,200 professionals across the Americas, Asia-Pacific and Europe. For more information, go to [www.lek.com](http://www.lek.com).