

Private Equity and the Dermatology Industry

The dermatology market has long stood out as an attractive space for private equity (PE) firms due to its continuous year-over-year revenue growth rate, and an expected 2023 CAGR of 13.4%, showcasing the potential for substantial returns [3]. Driven by rising demand for specialized skincare services and advancements in treatments, the industry is experiencing a robust growth trajectory due to PE's interest in the sector's potential for generating substantial returns and its proven resilience in the face of economic fluctuations (e.g., COVID-19).

The dermatology market's allure lies in its promising market dynamics, including opportunities for consolidating practices, leveraging economies of scale, and optimizing operational efficiencies. Additionally, the growing consumer awareness and emphasis on skin health have contributed to a robust and expanding market demand. With relatively favorable reimbursement structures, evolving regulations, and technological advancements supporting the sector, PE firms are keen to invest in dermatology practices and capitalize on their growth potential.

Industry Overview

Since 2011, the dermatology sector has witnessed robust market activity and this trend shows no signs of slowing down. According to Pitchbook's analysis of transaction activities and deal flows in the dermatology space, there were 134 private equity transactions recorded between 2020 and 2022, indicating a strong and consistent demand for investment when compared to the 171 transactions between 2017 to 2019. However, it is important to note these figures only include transactions that are strictly related to dermatology practices and do not include med spas or other aesthetic services. Additionally, even with the significant deal flow in the space, the market remains highly fragmented with no single participant owning 1.0%+ of the total market [3].

The growth and stability of the dermatology industry is fueled by several factors. First, the market itself is highly fragmented, as outlined above. Additionally, the industry benefits from an aging population with over 69% of dermatology patients being over the age of 40 [2]. Considering this age group accounts for 47.9% of the entire U.S. population in 2020 (U.S. Census Bureau), the demand for dermatological services is poised to rise. Moreover, the limited number of board-certified dermatologists further amplifies the favorable supply/demand dynamics [2]. Another driving force is the increased awareness of skin health due to more individuals recognizing the importance of early detection and treatment. For instance, skin cancer affects approximately 9,500 Americans daily with annual treatment costs estimated at \$8.1 billion [6]. Consequently, the robust demand for dermatological services persists and ensures the industry's continued growth.

Reimbursement Trends

It is interesting to note that while the demand and activity within the space are undoubtedly high, the Medicare reimbursement rates have decreased by roughly 10% between 2011 and 2021. In a peer-reviewed study published in 2022, doctors found management codes and both procedural and evaluation experienced an average decline in reimbursement over the span of 10 years. Out of the 20 codes tested, 15 had a higher average decrease in reimbursement [4]. However, it is important to mention the author also noted that this decrease is in line with similar trends observed in other medical specialties, albeit to a lesser extent.

A separate study on reimbursement rates between 2000 to 2020 further supports and confirms the overall decrease in reimbursement rates. This study identifies the decline was primarily attributable to changes in valuation by the relative-value scale update committee and healthcare policy changes aimed at reducing reimbursement. Additionally, the authors emphasized that reimbursement for other healthcare sectors experienced more significant decreases. For example, emergency medicine experienced a decrease of 29% over the same period [5].

Investment Considerations and Value Creation Opportunities

Private equity firms can add significant value to dermatology practices by streamlining administrative functions, leveraging their business expertise, and capitalizing on marketing and cross-selling opportunities.

By consolidating practices to include the currently untapped cosmetic sub-industry, PE firms can utilize fresh capital pools. This can create platform companies to capture more market share and scale administrative tasks which allow dermatologists to focus on patient care. However, aligning goals between physicians and PE partners and maintaining long-term practice stability are essential considerations.

Recent Dermatology-Focused PE Transactions

D1 Investor: GarMark Partners | Operator: The Dermatology Specialists | May 1, 2023

GarMark Partners was founded in 1997 as a mezzanine investment firm and is headquartered in Stamford, Connecticut. GarMark provides junior debt and structured equity capital to middle-market companies with over \$1.4 billion of capital invested across their entire portfolio, and over \$685.0 million is within the healthcare space. GarMark's goal is to employ flexible investment strategies that encompass a wide range of transaction types along with deep expertise in investing across the capital structure to achieve long-term business success. GarMark has completed three investments related to the healthcare industry, including dermatology, pediatrics, and nutrition.

The Dermatology Specialists (TDS), located in New York, New York, was founded in 2019 and is now the largest dermatology practice in New York City. The practice specializes in both medical and cosmetic treatments in the field of dermatology with over 30 locations across Manhattan, Brooklyn, Queens, the Bronx, and Long Island.

D2: Investor: ACE & Company | Operator: MedSpa Partners | April 1, 2023

ACE & Company (ACE) was founded in 2005 and is headquartered in Geneva, Switzerland. With over \$1.7 billion of assets under management across over 150 companies worldwide, ACE's goal is to leverage its relationship with top investment firms, corporate partners, and entrepreneurs to provide private investors with exceptional investment opportunities and solutions. ACE has completed six investments related to the healthcare industry, including healthcare IT, dermatology, pediatrics, and laboratory services.

MedSpa Partners (MSP), located in Toronto, Canada, was founded in 2019 and is the operator of an acquisition platform intended for medical aesthetic clinics. The platform acquires medical spas and cosmetic dermatology clinics. MSP focuses on providing support in areas such as clinic management, marketing, business intelligence, legal, and others to enable its acquisition partners to achieve their goals and create valuable customer experiences.

Outlook and Conclusion

The dermatology market is poised for continued growth with favorable industry trends offering significant opportunities for building and scaling platforms. However, the scarcity of board-certified dermatologists may pose challenges in initial hiring and retention. Adding cosmetic services to complement medical-surgical dermatology is expected to unlock untapped growth potential. As mergers and acquisitions reshape the landscape of dermatological care, these activities will drive advancements in patient care, fostering innovation, and unlocking new avenues for growth.

Sources

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