GPB CAPITAL

Healthcare/Physical Therapy Strategy

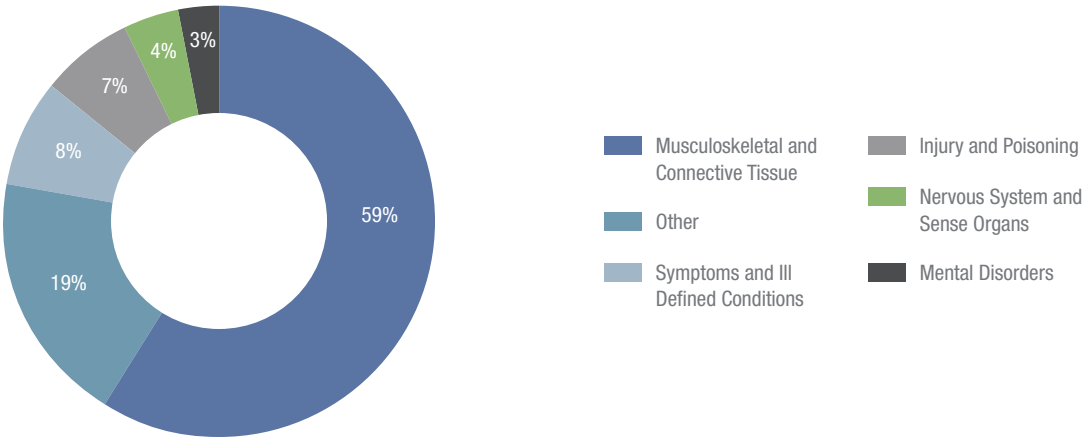
Market Overview

The domestic physical therapy industry is a $34 billion market which is expected to grow 1.5% per year, driven by a set of underlying diagnoses, an aging population, improving therapist utilization rates and increased insurance coverage.[1]

The physical therapy industry is comprised of inpatient and outpatient rehabilitation delivery models which provide care to patients with a variety of conditions, including musculoskeletal disorders, sports injuries, neurological disabilities, speech and audiology impairments, and general orthopedic injuries, as can be seen in Figure 1 below. Approximately 60% of revenue generated in the industry is driven by orthopedic rehabilitation.[2] Outpatient rehabilitation clinics offer cost-effective outcomes through their services, especially when compared to inpatient rehabilitation services. Freestanding outpatient rehabilitation clinics represent a $14 billion market and are highly fragmented with over 21,000 clinics dispersed across the country.[3] The top 20 largest players in the industry represent about 25% of the total freestanding clinics in the U.S., with independent operators (operating between one and four clinics) comprising a majority of the market.[4]

Figure 1

Physical Therapy Product and Service Segmentation



Source: IBISWorld, IBISWorld Industry Report 62134: Physical Therapists in the US, April 2017.

1 IBISWorld, *IBISWorld Industry Report 62134: Physical Therapists in the US*, April 2017.
2 IBISWorld, *IBISWorld Industry Report 62134: Physical Therapists in the US*, April 2017.
3 Cantor Fitzgerald, *GPB Capital Discussion Materials*, November 2017.
4 Cantor Fitzgerald, *GPB Capital Discussion Materials*, November 2017.

Over the last five years, the physical therapy industry has grown at an annualized rate of 2.8%, to $33.6 billion in annual revenue.[5] In 2017, the industry grew 1.8% due to a rapidly growing elderly population, as this class of population generally requires more physical rehabilitation services to address their chronic illnesses. Over the next five years, the industry is expected to grow at a slightly lower 1.5% annually to $36.2 billion in annual revenue, driven by demand for physical therapy due to healthcare reforms focusing on value-based care and keeping non-critical patients out of hospitals.[6] Moreover, as hospitals seek to lower readmission rates to receive incremental Medicare reimbursements, many facilities will provide or outsource more preventive services for patients with post-hospital care, including physical therapy.

There are several macro trends within the U.S. that have increased the demand for rehabilitation:

Aging U.S. Population: There are over 8,000 Baby Boomers turning 65 daily and 21.7% of the domestic population is expected to be over the age of 65 by 2040.[7] The elderly population typically has a high prevalence of chronic illness and other health ailments, leading to strong demand for rehabilitation services which promote wellness.[8] With an increasing focus on cost containment in healthcare systems, most government sponsored programs and commercial carriers are shifting focus to value-based reimbursements. This shift is advantageous to physical therapy, as it is viewed by payers as a highly cost-effective approach for rehabilitating a rapidly aging population.

Rising Obesity Rates: The obesity epidemic costs an estimated $147 to $210 billion annually in otherwise preventable healthcare spending.[9] According to newly released findings from the Centers for Disease Control and Prevention, nearly four in ten U.S. adults have a body mass index classifying them as obese. Adult obesity rates have continued to increase steadily since the turn of the century, rising from 30.5% in 1999 – 2000 to 39.6% in 2015 – 2016, a record high.[10] It is empirically more economical to invest in preventative programs and clinical treatments for obesity, such as physical therapy, that promote physical activity and healthy nutritional habits, rather than in invasive surgical or reactionary medical approaches.[11]

5 IBISWorld, *IBISWorld Industry Report 62134: Physical Therapists in the US*, April 2017.
6 IBISWorld, *IBISWorld Industry Report 62134: Physical Therapists in the US*, April 2017.
7 Capstone Partners, *Outpatient Physical Therapy Q1 2017*, March 2017.
8 IBISWorld, *IBISWorld Industry Report 62134: Physical Therapists in the US*, April 2017.
9 The National Bureau of Economic Research, *The Medical Costs of Obesity: An Instrumental Variables Approach*, October 2010.
10 Forbes, *U.S. Obesity Rates Have Hit An All-Time High*, October 2017.
11 PubMed Central, *Effectiveness of interventions targeting physical activity, nutrition and healthy weight for university and college students: a systematic review and meta-analysis.*, April 2015.

Domestic Employment Growth: A steady rise in employment rates over the last decade has increased demand from employers for occupational health and injury prevention services.[12] Providers and health maintenance organizations (HMOs) seeking to reduce the burden of healthcare cost delivery are increasingly switching to outpatient rehabilitation, especially for the treatment of short-term disabilities and/or musculoskeletal injuries which could occur in the workplace.

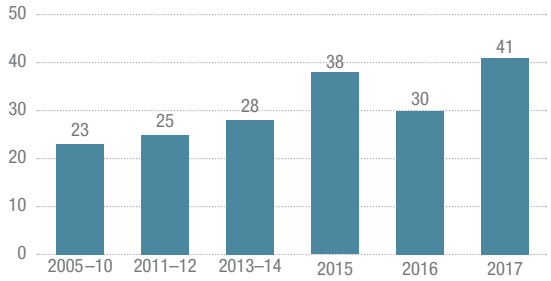
Regulatory Tailwinds: For almost two decades, Medicare payments related to physical, speech or occupational therapy were subject to arbitrary caps set by Congress, limiting a patients' ability to afford a full course of rehabilitation after suffering from chronic or musculoskeletal injury. In February 2018, Congress enacted a permanent solution by eliminating the hard cap on outpatient physical therapy services under Medicare Part B, which will increase rehabilitation patient volume nationwide, as patients are able to afford longer courses of treatment.[13] Additionally, the Patient Protection and Affordable Care Act (PPACA) requires a minimum essential health benefits package to include rehabilitation services and since 2015, small companies with 50 or more full-time employees have been required to provide health insurance to their employees or face a penalty.[14]

The aforementioned factors have led to increased interest from institutional private capital and a marked increase in sponsor and strategic activity within the physical therapy space. There are currently 15 public and/or sponsor-backed physical therapy aggregators in the space.[15] The largest groups by clinic count are Select Medical (NYSE: SEM), US Physical Therapy (NYSE: USPH), ATI Physical Therapy (Advent International), Athletico Physical Therapy (BDT Partners) and Upstream Rehabilitation (Revelstoke Capital). The remainder of aggregators have been increasingly active in recent years, quickening the pace of consolidation in the industry. As can be seen in Figure 2 below, since 2011 there have been over 160 announced add-on acquisitions, but only three significant consolidations. These add-on acquisitions tend to be smaller deals, which has left space in the market for new and disruptive consolidators to grow.[16]

Figure 2

Add-On Acquisition Velocity

(Number of PT Deals Announced)



Source: Livingstone Partners, *Upstream Acquires Drayer; Alters Physical Therapy Landscape*, January 2018.

GPB Capital Acquisition Strategy

GPB Capital will seek to acquire 100+ profitable outpatient physical therapy centers and provide capital, as well as operational assistance, to these clinics. GPB Capital will aim to drive operational efficiencies by consolidating the back-office functions, such as recruiting, revenue cycle management, credentialing, advertising and insurance procurement, across its footprint of owned physical therapy centers. GPB Capital intends to acquire clinics in the 4x – 7x EBITDA range and work to create value through increased operational efficiency, as well as through an aggregation premium.

12 Reuters, *U.S. economy grows at fastest pace in more than two years*, December 2017.
13 WebPT, *What's Going On with the 2018 Therapy Cap?*, February 2018.
14 IBISWorld, *IBISWorld Industry Report 62134: Physical Therapists in the US*, April 2017.
15 Capital IQ Market Data, April 2018.
16 Livingstone Partners, *Upstream Acquires Drayer; Alters Physical Therapy Landscape*, January 2018.

Why Physical Therapy?

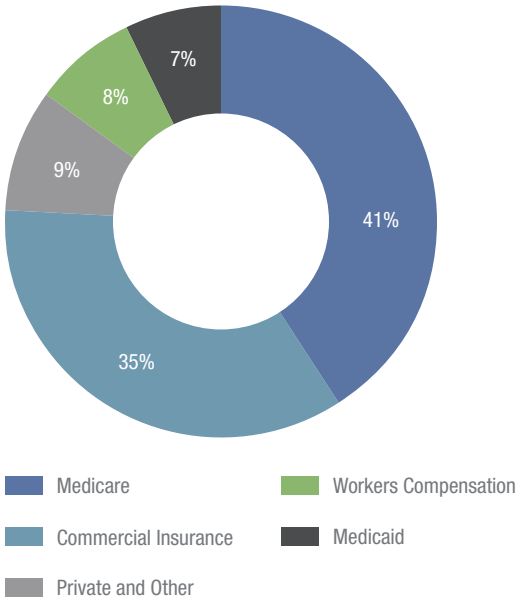
GPB Capital's overarching philosophy is to seek to acquire companies with strong, consistent cash flows and proven management teams that operate in recession resilient industries with defined barriers to entry. GPB Capital has targeted the physical therapy industry because it demonstrates certain qualities that are consistent with the four fundamental criteria laid out below:

Strong, Consistent Cash Flows

The physical therapy industry has historically generated healthy profit margins driven by an asset-light business model and high operating leverage, resulting in stable and consistent cash flow. The average industry profitability was 12.9% in 2017, which is materially higher than other industries within the healthcare services sector.[17] Consolidation of physical therapy practices may also provide GPB Capital the opportunity to identity operational efficiencies and integrate clinical services into a unified infrastructure.

Figure 3

2017 Physical Therapy Payor Segmentation by Type



Source: IBISWorld, *IBISWorld Industry Report 62134: Physical Therapists in the US*, April 2017.

Recession Resilient

In seeking to provide consistent cash flow throughout the economic cycle, GPB Capital targets industries that have historically demonstrated recession resilient traits. Physical therapy has exhibited demand inelasticity during times of economic turmoil, driven primarily by two contributing factors: the necessity-based nature of rehabilitation services and by the industry's reliance on government payers for a significant portion of revenue through reimbursements. Consumers are less likely to cut healthcare spending during recessions and over the past three recessions national healthcare expenditures, as a percentage of GDP, have increased.[18] As seen in Figure 3, in 2017 48% of industry revenue generated for physical therapy services were derived from reimbursement by government payers.[19] The proportion of industry revenue generated from government reimbursements is significant and assists in insulating companies from changes in discretionary income throughout an economic cycle.

17 IBISWorld, *IBISWorld Industry Report 62134: Physical Therapists in the US*, April 2017.
18 Business Insider, *Healthcare spending in the US just did something that rarely happens outside a recession*, December 2016.
19 IBISWorld, *IBISWorld Industry Report 62134: Physical Therapists in the US*, April 2017.

Defined Barriers to Entry

By focusing on industries with defined barriers to entry, GPB Capital is able to target companies that have a certain level of protection from revenue and profit erosion by new competitors. There exists a high level of government regulation in the physical therapy industry. Therapists operating at both inpatient and outpatient facilities are required to be licensed by the state in which they practice. To be licensed, therapists must pass an accredited program, a licensing exam, and must possess a master's degree in physical therapy from an accredited institution.[20] Additionally, certain states require both inpatient and outpatient facilities to have a certificate of need (CON). A CON is an endorsement required to be obtained prior to the construction of a new facility. CON-related legislation is aimed at controlling the establishment of redundant facilities to curtail rising healthcare costs. State licensing requirements and legislation such as CON requirements create strong barriers to entry for potential physical therapy operators.

Proven Management Teams

In most cases, GPB Capital will seek to acquire a majority interest in a company, generally 60% to 80% of the target company, while keeping existing owners and management in place to run the operations. Given the increasing level of government regulation and oversight in the physical therapy industry, it is of the utmost importance to partner with proven and capable operators. GPB Capital will focus on partnering with management teams and operators that have demonstrated an ability to run profitable companies throughout the economic cycle. GPB Capital will then provide these operators with the guidance and capital needed to execute on our shared objectives.

20 IBISWorld, *IBISWorld Industry Report 62134: Physical Therapists in the US*, April 2017.

GPB Capital

GPB Capital is a New York-based alternative asset management firm focusing on acquiring income-producing private companies. GPB Capital provides their portfolio companies with the strategic planning, managerial insight and capital needed to enable strong businesses to work towards the next level of growth and profitability. GPB Capital seeks to take advantage of the large opportunity in the private U.S. middle-market by seeking to acquire companies that have a track record of current and sustainable yield, are recession resilient, have proven operating partners/ management teams and are in industries which have high barriers to entry. GPB Capital's strategies include, but are not limited to, Automotive Retail, Technology-Enabled Services, Debt Strategies, Waste Management, and Special Situations.