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The Evolving Role of Private Equity in the Medical Aesthetics Sector

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INTRODUCTION

Private equity investors have been interested in the healthcare space for decades but somewhat recently became interested in Medical Aesthetics (MedSpa). The business landscape was highly fragmented, with founders and owners largely lacking the business acumen to scale and take advantage of the strong growth headwinds. PE firms were initially attracted to Dermatology as an off-shoot of the physician practice roll-up, but quickly recognized the explosion in MedSpas with their focus on elective treatments, many of which did not require a licensed dermatologist. The MedSpa sector has highly attractive investment criteria including: low reimbursement risk (most services are 100% discretionary and paid out of pocket), limited number of active consolidators, strong recurring revenue stream opportunities, and projected industry growth.

FIRST A FEW BASICS:

Private Equity Funds: Defined

Private equity funds are investment vehicles focused on acquiring privately held companies. As of mid-2021 there were over 18,000 active private equity funds in the United States, according to SEC data . Further, by analyzing data from Pitchbook and other sources, these funds invest in excess of $100B per quarter into U.S. businesses . Recently, there has been tremendous growth among the lower middle market firms that are willing to acquire smaller companies.

Private equity investments typically take shape as either a buyout or an infusion of growth capital, with the distinction being the intended use of the funds and the percentage of a company acquired. Most transactions are structured as buyouts.

In these deals, the buyer acquires control of a company – at least 51% but oftentimes 75% or more – and the sellers or key managers retain a minority ownership position going forward. These deals in turn can be classified as either a platform investment or an add-on acquisition, largely based on the size and strategy of the investment.

Types of Private Equity Deal Structures

A platform investment is the firm's initial investment in a specific industry. Platform investments must meet stringent requirements and be of a certain size; lower middle market funds look for companies with at least $3M in EBITDA (earnings before interest, tax, depreciation, and amortization), stable cash flows, recurring revenue, and a promising outlook for the industry.

Add-on investments are acquisitions by these platform companies. There tend to be fewer requirements for add-on acquisitions, as size can be less relevant as long as the add-on is synergistic with the portfolio company.

Growth capital investments, on the other hand, also result in the creation of a new platform but can be structured as either control or non-control (minority) investments. Further, whereas in a buyout the majority of the cash component is distributed to the sellers, many growth capital investments are structured to fund growth and not pay out the sellers as in a traditional sale.

Types of Private Equity Buyers

The market for MedSpa acquisitions largely involves three categories of buyers:

01 Pure strategic buyers: groups lacking a private equity sponsor

02 Private equity platforms: groups aggressively pursuing add-on acquisitions, like MedSpa Partners or Advanced MedAesthetics Partners

03 New private equity entrants: groups seeking to capitalize and build their own platform

Typical Timeline for a Private Equity Acquisition

PE firms manage money for outside investors, known as limited partners ("LP"), for whom they ultimately need to generate a return on their investment. In order to pay LPs a return, firms need to liquidate their investments. Typically, a firm will hold an investment for 5-7 years, growing it rapidly during this time. Eventually, they will sell the company to another PE firm or a strategic buyer.

The Attributes Attracting PE to the Medical Aesthetics Industry

The industry attracts PE investment because there is close alignment with criteria common to PE firms high-performing investment criteria. One key reason: MedSpa clinics have a high degree of recurring revenue with little to no reimbursement risk. Another reason: high profit margins.

In addition, the $17 billion global MedSpa industry is projected to enjoy significant growth through 2033. According to Market.us, the global MedSpa industry is projected to grow at a CAGR of 13.2% between 2024 and 2033. Couple this with the highly fragmented landscape with an estimated 90% of MedSpas independently owned, makes this an industry ripe for consolidation.

The Attributes Attracting PE to a Particular Company

On a high level, below is a list of key attributes a MedSpa business must have to attract the attention of a private equity buyer:

- Experienced, capable leadership team
- Strong provider and staff retention
- Demonstrated historical growth and pipeline for future growth
- Organic and acquisition/de novo growth
- Diverse revenue and service mix
- Strong EBITDA margins

Investment Criteria

PE investors each have their own set of investment criteria. Typically, a company needs to generate at least $15M in revenue and $3M in EBITDA to be considered for a platform acquisition. However, a company may only need ~$1M in revenue to qualify as an add-on investment.

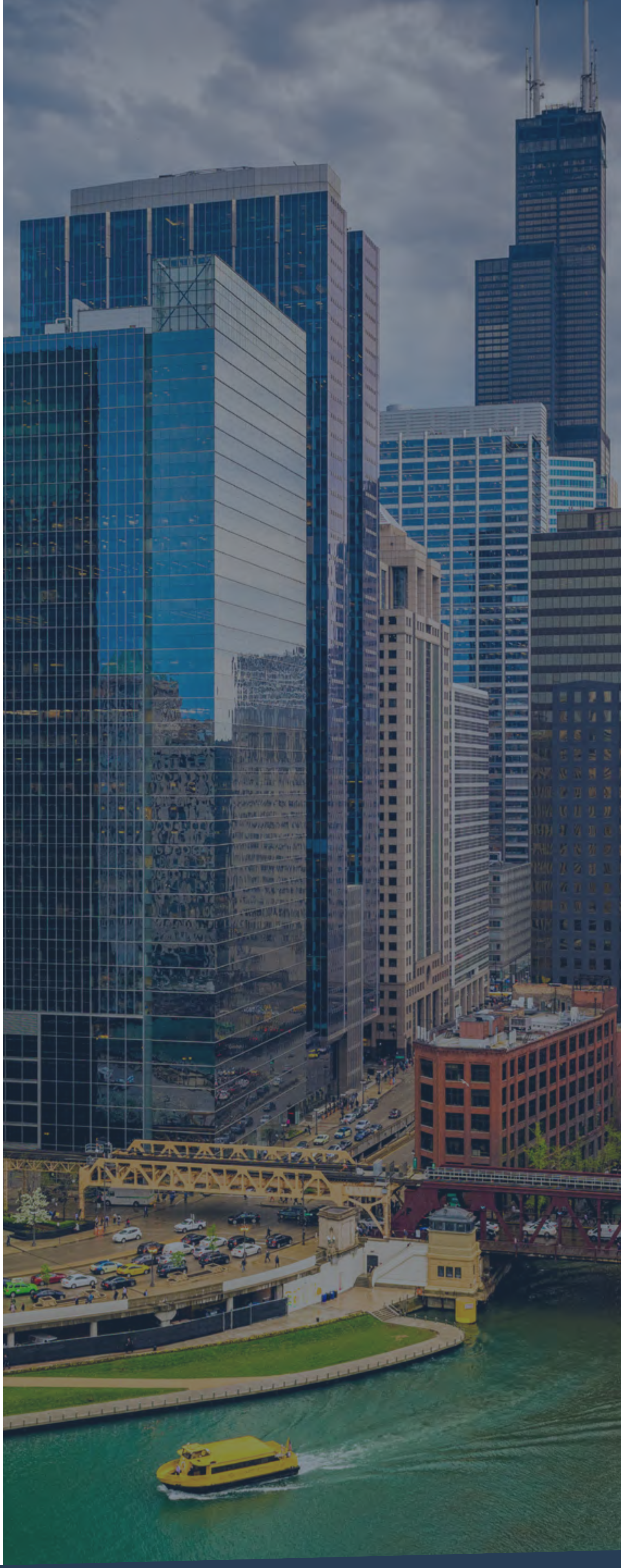
Investors are looking for stable revenue streams supplemented by organic and acquisition growth. Revenue mix is of particular importance and a delicate balance to ensure patient flow and appropriate reimbursement. Most investors shy away from practices with a high concentration of Medicaid reimbursement, but there are those that welcome the opportunity to invest in practices with a focus on this patient population.

Geography

Most investors prefer geographic concentration of practices when considering a platform investment but have little preference for specific areas of the country.

Market Segments

The MedSpa industry has grown alongside the growth of non-surgical aesthetic treatments which historically were traditionally offered by Plastic Surgeons. We've seen a distinct preference from investors towards MedSpas over plastic surgery offices not dissimilar from other healthcare spaces where investors initially focused on niche areas of a discipline. As the industry consolidates, it will be interesting to see if there is a move to bring all services, surgical and non-surgical, under one roof.



IMPACT ON COMPANY OWNERS

How Consolidation Drives Demand

Consolidation can create a more competitive market, and independent companies can expect increased competition when one or more large operators enter their markets. It also creates tremendous opportunity. The entrance of new players who have specific mandates to grow through acquisitions means that the demand to acquire may exceed the supply of companies for sale.

In other words, it becomes a seller's market.

When industries go through consolidation cycles, valuations increase as buyers compete with each other to purchase premier companies. Such cycles can last anywhere from 5-15 years, with owners who exit amidst the frenzy realizing massive premiums compared to the average valuations obtained during other cycles. Furthermore, the increase in the number of buyers in the market increases the options for a seller.

Platform vs Add-On

There are major differences between selling as a platform and as an add-on, well beyond any perceived financial distinctions. Even companies that fit the financial profile of a platform may find themselves transacting as an add-on.

The Case for Platforms

A platform investment nearly always requires the company to come with a CEO who retains a significant equity stake in the business going forward. In the lower middle market, that often means the owner is that CEO. How significant the equity stake must be will vary by the individual PE firm and the capital structure of the business prior to a transaction, but 20% or more is common. Not all sellers want to make this large of a commitment of either time or money. Over the last 12 months, we've seen the minimum rollover as high as 50% in recent transactions.

The upside, however, can be appealing. As with most investments, those who get in on the ground floor of something successful tend to reap the biggest rewards, and the same is true for those owners who create a new platform. Their rollover equity tends to appreciate more than that of any ensuing add-on.

The Case for Add-Ons

Add-ons, however, create a simpler path for the seller, as they likely involve a lower threshold for rollover and the potential for a shorter post-close commitment to the business. They may still be required to stay on for a few years if they are a significant clinical producer or instrumental to the functioning of the executive team, but that is usually a less intensive commitment than that made by one selling as a platform.

Selling to private equity tends to be glamorized, and not enough is written about just how challenging it can be to operate a business owned by private equity and report to a PE-controlled board of directors.

Great challenges can yield great rewards, but they can also result in great failures.

THE INFORMATION ASYMMETRY

The Information Asymmetry

First-time sellers face a significant disadvantage when selling to private equity or strategic buyers. There are a variety of reasons why, but it boils down to an information asymmetry between the seller and the sophisticated buyers on the other side of the table.

The main factors contributing to this information asymmetry are the opacity of the private capital markets and the relative lack of available information about private company transactions.

In such transactions, the more experienced buyer has access to proprietary off-market information about valuations, transaction structures, and deal terms that is only available to someone with vast transactional experience and an extensive network. They can leverage this information asymmetry to purchase companies for less money and on more favorable terms than if the playing field were leveled.

As a result, several sellers unknowingly accept a less-than-optimal offer.

The Value of an Advisor

An M&A adviser can generally help a seller identify and contact potential buyers, value the seller's business, negotiate with a potential buyer, and close a deal at a lower cost than the seller would incur on its own.

Several resources exist to support company owners in a sale, with the primary being M&A advisors. A sell-side M&A advisor acts as an exclusive advisor to the company owner, representing their interests in the transaction and managing the process from pre-sale planning through to closing. A qualified advisor has a broad base of transactional experience, in-depth knowledge of an industry, and an expansive network of contacts among relevant strategic buyers and outside investors. While some firms specialize exclusively in the MedSpa industry, company owners would be wise to retain a firm with broader expertise as they can draw from a larger network of potential buyers and contribute unique points of view to the process.

A sell-side M&A advisor will ensure that the company owner maximizes the sale process by eliminating the information asymmetry. Several studies have demonstrated that businesses sold through advisors receive higher prices than those sold by their owners , and the best firms align their incentives with their client's objectives to ensure all parties are focused on one goal.

One study analyzed nearly 5,000 transactions over 20 years and estimated that sellers who enlisted the guidance of an M&A advisor garnered valuation premiums of around 25%.

M&A MEDICAL AESTHETICS OUTLOOK FOR 2025 AND 2026

While we have seen a slowdown in transactions, it is an excellent time to sell a quality MedSpa group. There is an increasing number of PE firms investing in platforms, in addition to those platforms competing for add-ons. These market forces allow sellers to maximize value and choose a partner for reasons beyond economics.

The prospects over the next 12-18 months, and beyond, are very bright given the early stage of MedSpa consolidation. Transacting in the early stages of a consolidation can be very beneficial for those who have a longer work horizon or are considering a larger equity roll. We expect a seller's market for the foreseeable future, and most definitely for the next 3-5 years.

Eventually, the ratio of supply to demand will flip. In the United States, an estimated 40% percent of privately held companies are owned by Baby Boomers. All of these owners will retire someday, and most are counting on the sale of their company as both their exit strategy and a critical element of their retirement savings. There will be a significant increase in companies for sale over the next 5–15 years.

We expect to see significant competition for sellers, with buyers having multiple options in most markets as the supply of companies for sale exceeds demand. There will still be buyers, but the shift in the supply-to-demand ratio will put downward pressure on valuations.

This dynamic is great if you're planning to buy a company because your options will increase with each year. A company owner preparing for an exit, however, would be wise to evaluate supply and demand when determining when to sell, because those owners who sell at the beginning of this impending wave will achieve better results.

Quite regularly, Caber Hill Advisors fields inquiries from MedSpa groups eager to make add-on acquisitions or platform investments in the space. These frequent, ever-persistent queries just reinforce our main claim: it is a seller's market.

ABOUT CABER HILL ADVISORS

Caber Hill Advisors assists private company owners and prospective company buyers in the sale, purchase, or evaluation of a company, and has acted as the trusted advisor to hundreds of company owners across numerous healthcare sectors. Our team has in-depth knowledge of the MedSpa industry and close connections with its leading investors. The firm utilizes a proven process for selling companies, bringing capabilities that are often only found at Wall Street investment banks to small- and medium-sized businesses.

Our clients are our best advocates.

Here is what Eric J. Roman, the Co-Founder of Carolinas Dentist had to say about Managing Director Maria G. Melone:

Don't consider doing this without a seasoned professional that's on your team. I'd make sure you have a strong trust relationship with the person you are working with – this isn't somebody that should just be simply transactional or somebody just trying to get a deal done, this person is trying to get you to an outcome and experience inside of your life; you should have a really great idea about what you want to see as different in your life after the transaction, have a sense of what you are going to be doing next and maybe having a [advisor] that can help you discuss that process and discuss what this might look like on the other side of the rainbow because anybody can get a deal done, it takes a lot more skill and a lot more knowledge and wisdom to get you to a really great outcome for your future, this isn't the end of your life, it's the beginning of a new phase.

- Eric J. Roman, Co-founder of Carolinas Dentist

I would recommend working with the Caber Hill team for 3 primary reasons: it's an exceptional team, the resources they have at their disposal are top-notch; their support, their intention is to help you get what you want not to assure that they simply get a transaction done; the depth of their connections, they know absolutely every potential buyer in this industry and people that are thinking about doing it – you need that level of knowledge, experience and connection if you want to get the most for your transaction .

- Eric J. Roman, Co-founder of Carolinas Dentist

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