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## PE firms may bite deeper into the dental industry

By [Michael D. Brown](#) Updated 05:35 PM, Aug-06-2014 ET

The vagaries of Medicare and Medicaid reimbursements are leading private equity firms interested in investing in healthcare to gravitate to dental service organizations, or DSOs, which don't depend on such payments and which exist in what's largely a fragmented industry.

"The dental space, in particular, is an interesting space because of the direct payment model and their lack of ties to federal government reimbursements," said [Donald Moody](#), partner at [Waller Lansden Dortch & Davis LLP](#). "Medicare doesn't typically cover dental and a lot of people don't have Medicaid coverage, so their dental expenses tend to come out of pocket."

According to Moody and other industry sources, a number of private equity-backed consolidators could be poised for initial public offerings in 2014 or 2015.

Industry sources point to two major IPO prospects in the next few years. One is [Smile Brands Group Inc.](#), an Irvine, Calif.-based operator of general dental and orthodontic practices that is backed by New York PE firm [Welsh, Carson, Anderson & Stowe](#). The other is [Ontario Teachers Pension Plan](#)-backed [Heartland Dental Care Inc.](#), which was acquired in a 2012 auction featuring the likes of [Kohlberg Kravis Roberts & Co. LP](#), Apax Partners LLC and [Madison Dearborn Partners LLC](#). Ontario and Welsh Carson officials didn't return calls.

"Those are the only DSOs of any scale that could be taken public," said a source who asked not to be named.

"Not many [companies] have the scale that it makes sense to take public. I think you really need to have at least \$100 million in cash flow to be considered a real candidate."

The source said that Pacific Dental Services, also based in Irvine, also fits the bill as a potential IPO candidate but that its owner, Stephen Thorne, isn't interested in an exit. Thorne couldn't be reached for comment.

The \$100 million cash flow threshold, however, may be a difficult one for most companies in the dental industry because it's so fragmented. So while the IPO opportunity may not exist for too many PE firms right now, those firms do have the chance to consolidate the dental sector some more.

For example, while it hasn't been mentioned as an IPO candidate, one other PE-backed consolidator is

**Midwest Dental Holding Co.** The Mondovi, Wis.-based company was acquired in April 2011 by **San Francisco**-based private equity firm **Friedman Fleischer & Lowe LLC** for undisclosed terms. **Thoma Cressey Equity Partners Inc.** led a recapitalization of **Midwest Dental** in May 2007 and purchased all of its interests from **Svoboda Collins LLC** before selling out to Friedman four years later.

"In the past you have seen some regionality but you are seeing more consolidation now," said Moody, who worked with Thoma Cressey, now Nashville PE firm **Cressey & Co. LP**, on its sale of Midwest Dental in 2011. "Midwest Dental is one that you have seen grow geographically and will continue to do so."

Since being acquired in 2011, Midwest Dental has quietly consolidated a number of practices through transactions involving small practices consisting of one or two dentists across the country.

"The Midwest monicker has become a real misnomer," added another source.

Another middle-market PE firm that is taking advantage of the fragmented dental industry is Detroit's Huron Capital Partners, which has invested in two separate dental practice management companies in the past year.

In July 2013, Huron invested an undisclosed amount in Palmetto, Fla.-based Dynamic Dental **Partners Group**, and on Jan. 23, the firm inked its first add-on deal when it acquired Personal Dental Care of Richmond, Va.

In June, Huron formed Detroit-based Spring & Sprout Dental Holdings LLC, its second dental practice management operation.

Huron said it intends to add bulk to Spring & Sprout, which operates pediatric dentistry and orthodontic practices, through acquisitions.

"Our acquisition strategy for those businesses is pretty similar," said Huron partner Nick Barker. "Spring & Sprout was our second dental practice business. We plan to help both grow in tangential states to where they are currently operating and in other markets where it makes sense."

Barker said the pool of potential acquisitions for Dynamic, which is focused on general dentistry, is far greater than the breadth of targets Spring & Sprout can go after because of regulations for pediatric dentistry, which include a two-year residency requirement.

He said both Dynamic and Spring & Sprout will also target states with historically stable Medicare reimbursement rates, with Georgia next up on the list for Dynamic.

While Barker declined to say how much his firm paid for Spring & Sprout and Dynamic, as well as the Personal Care bolt-on deal, multiple sources said that PE firms tend to shell out between 3 to 5 times Ebitda for one- or two-dentist practices, while larger networks with more infrastructure can pay between 8 and 12 times Ebitda.

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