OUTPATIENT PHYSICAL THERAPY

INDUSTRY OVERVIEW

Many industry pundits refer to the late 1980s as the “Golden Age” of the Physical Therapy Rehabilitation (PT) industry. However, despite today’s many challenges including billing complexity, utilization review, revenue cycle management and stagnant reimbursement rates, Capstone views M&A in PT as one of the most attractive sectors in healthcare. The industry is benefiting from an aging population intent on maintaining an active lifestyle as well as commercial carriers and government health programs emphasizing patient outcomes and value-based medicine. There is a growing recognition among stakeholders that PT is an effective yet affordable treatment option that can minimize the need for surgery and medication.

Publicly traded players are receiving robust valuations including U.S. Physical Therapy (12.4x EBITDA) and Select Medical (10.8x), which provides the currency and impetus to make accretive acquisitions of privately held businesses. Attractive industry dynamics coupled with a highly fragmented sector is also attracting strong PE investment. Welsh, Carson, Anderson and Stowe; Great Point Partners; Sterling Partners; Celerity Partners and Harvest Partners are just a few of the PE firms that made major platform investments in PT in the past three years.

M&A OVERVIEW

The proverbial stars continue to align in the PT industry, driving heightened M&A activity from both strategic suitors and PE investors. Fiscal 2015 was another record setting year with the number of announced transactions totaling 118 (CapIQ). As industry players look to improve margins by leveraging infrastructure and systems, gain market share and expand geographic reach, we expect industry consolidation to remain at heightened levels in 2016.

PE-backed physical therapy companies have continued to expand their footprint through add-on acquisitions at a brisk pace. Leading the way in 2015 were ATI Physical Therapy (KRG) and Professional Orthopedic and Sports Physical Therapy (Great Point), with six acquisitions apiece. The acquisition of Premier Physical Therapy & Wellness established Professional as the largest provider of outpatient physical therapy services in the Northeast, while ATI’s acquisition of Olympic PT added nine clinics in Washington and expanded their total to 470 clinics nationally. Pivot Physical Therapy (CI Capital and InTandem Capital) and Physiotherapy Associates (Court Square Capital) have also been quite active, each completing four add-ons in 2015.

Notable platform investments in 2015 included WCAs co-investment with Select Medical in the acquisition of Concentra, Inc. for roughly $1.1 billion, Celerity Partners recapitalization of 360 PT Management and Pharos Capital’s majority stake in MOTION PT. These transactions follow 2014 PE platform investments in Results Physiotherapy (Sterling Partners) and Athletico (Harvest Partners). Athletico subsequently acquired Accelerated Rehabilitation Centers in December 2014, creating of the largest physical therapy providers in the Midwest with over 330 locations.
GROWTH DRIVERS

While the PT industry experienced modest growth from 2010 to 2015, it has entered a new era of growth and is expected to increase by 3.6% annually to become a $34.6 billion sector by 2020. U.S. Physical Therapy (the only public pure play ORF provider) anticipates the outsourced rehab market could grow at +5% over the same period. Growth within the ORF and IRF sectors are largely being fueled by the aging US population, healthcare reforms and the recognized benefits of rehabilitation services.

- **Positive Patient Outcomes** – The benefits of PT are extensive as it enables patients to regain active lifestyles while avoiding the financial burdens, complications and side effects associated with surgery and medication. According to the American Physical Therapy Association, “physical therapy has proven as effective as surgery for meniscal tears and knee osteoarthritis, rotator cuff tears, spinal stenosis and degenerative disk disease, among other conditions.” According to MediRisk, when using physical therapy for lower back pain, as the first management strategy rather than advanced imaging referral, there are up to 72% fewer costs associated with care. As commercial carriers and government sponsored healthcare programs attempt to reign in escalating healthcare costs, efficacious cost-effective treatments such as PT should continue to benefit.

- **Patient Protection and Affordable Care Act** – According to Obamacarefacts.com, as of September 2015, an additional 17.6 million people have received healthcare coverage since the enactment of the PPACA in March of 2010. Additionally, Gallup reported that the percentage of adults who were uninsured dropped from 18% in the third quarter of 2013 to 11.4% in the second quarter of 2015. The PPACA guidelines for minimum essential health-benefits also includes coverage for rehabilitation services.

- **CMS Funding** – According to IBISWorld’s April 2015 US Physical Therapy Rehabilitation Report, Centers for Medicaid and Medicare Services account for nearly 50% of total industry revenue. For inpatient rehab providers, CMS has been the proverbial double edged sword. With Medicare funding averaging 63% among the top three IRF companies combined with the ballooning 65+ demographic, IRFs will not soon wean their reliance on CMS funding. However, notwithstanding reimbursement risks, Medicare in particular has provided stability to the industry as a greater portion of rehabilitation centers are treating patients covered by CMS programs. In fact, CMS increased its therapy cap amount again for 2016 to $1,960 (up from $1,940 in 2015 and $1,920 in 2014) and extended the current $3,700 Medicare cap exceptions for medical necessities through December 31, 2017.

Outpatient rehab providers, on the other hand, are far less dependent on CMS funding with Select Medical reporting 10% of their outpatient rehab revenues coming from Medicare and U.S. Physical Therapy sites 25%. While outpatient rehab centers are also experiencing growth from the aging and active population, ORFs are seeing an increase in patients participating in competitive athletics and casual physical activities.
Competitive Landscape

Physical Therapy is a $29 billion industry (IBISWorld Industry Report, April 2015) consisting of outpatient rehabilitative facilities (ORF) and inpatient rehabilitative facilities (IRF) offering physical, occupational and speech pathology services. ORFs constitute the lion’s share of the rehabilitation market generating annual revenues of $19 billion and this sector is projected to grow at an annual rate of +5% over the next five years (U.S. Physical Therapy industry overview). The outpatient rehabilitation sector is highly fragmented with the three largest players controlling only 8.3% of the market share and 13.1% of the facility base. While there are a few national companies, the industry predominantly consists of small to medium regional providers with annual revenue of slightly over $1 million per center.

<table>
<thead>
<tr>
<th>Outsourced Rehabilitation Facilities</th>
<th>Industry Relevant TTM Revenue ($000)</th>
<th>% of Market Share Revenue</th>
<th>Number of ORF Facilities</th>
<th>% of Market Share Facilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Select Medical</td>
<td>808,860</td>
<td>4.3%</td>
<td>1,023</td>
<td>6.4%</td>
</tr>
<tr>
<td>Physiotherapy Associates</td>
<td>450,000</td>
<td>2.4%</td>
<td>561</td>
<td>3.5%</td>
</tr>
<tr>
<td>USPh</td>
<td>324,000</td>
<td>1.7%</td>
<td>506</td>
<td>3.2%</td>
</tr>
<tr>
<td>Total Top Three Market Leaders</td>
<td>1,582,860</td>
<td>8.3%</td>
<td>2,090</td>
<td>13.1%</td>
</tr>
<tr>
<td>All Other ORFs</td>
<td>17,417,140</td>
<td>91.7%</td>
<td>13,910</td>
<td>86.9%</td>
</tr>
<tr>
<td>Totals</td>
<td>19,000,000</td>
<td>100.0%</td>
<td>16,000</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Physiotherapy Associates revenue data source: CapIQ as of 2010.
ORF facility figures from U.S. Physical Therapy November 2015 Investor Presentation
ORF industry market size from U.S. Physical Therapy website
## OUTPATIENT PHYSICAL THERAPY: SELECT M&A TRANSACTIONS

<table>
<thead>
<tr>
<th>Date</th>
<th>Target</th>
<th>Acquiror</th>
<th>Target Business Description</th>
<th>Enterprise Value (mm)</th>
<th>EV / LTM</th>
<th>Revenue</th>
<th>EBITDA</th>
</tr>
</thead>
<tbody>
<tr>
<td>11/04/15</td>
<td>PT Healthcare</td>
<td>Watchstone</td>
<td>Operates physiotherapy and rehabilitation clinics in Canada.</td>
<td>$28.8</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>10/07/15</td>
<td>Bradley &amp; Monson Physical Therapy</td>
<td>MOTION PT</td>
<td>Offers physical therapy, massage and independent fitness work-out services in New York City.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>10/06/15</td>
<td>The Hammonds Centre</td>
<td>Physiotherapy Corporation</td>
<td>Provides physical therapy services in Macon, Georgia.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>10/01/15</td>
<td>Excel Therapy</td>
<td>Physiotherapy Corporation</td>
<td>Offers physical therapy services in Alabama.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>09/22/15</td>
<td>Marino Therapy Centers</td>
<td>BenchMark Rehabilitation</td>
<td>Provides outpatient rehabilitation services at three locations in the Long Island/Queens area.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>09/22/15</td>
<td>Performance Rehab</td>
<td>PT Solutions</td>
<td>Provides physical therapy and rehabilitation services in Florida.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>09/10/15</td>
<td>NYSportsMed Orthology</td>
<td></td>
<td>Operates four sports medicine, physical therapy and athlete performance improvement clinics in New York City.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>09/01/15</td>
<td>Three Physical Therapy Practices</td>
<td>Professional Orthopedic &amp; Sports</td>
<td>Provides physical therapy and rehabilitation services at six locations in the Long Island/Queens area.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>08/26/15</td>
<td>Therapy Plus of Wisconsin</td>
<td>Physiotherapy Corporation</td>
<td>Offers physical and occupational therapy services through seven clinics in Southwest Wisconsin.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>08/20/15</td>
<td>Sports and Spinal Physical Therapy</td>
<td>Orthology</td>
<td>Provides physical therapy services in Washington, D.C.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>08/15/15</td>
<td>360 PT Management</td>
<td>Celerity Partners</td>
<td>Provides physical therapy services managing eight outpatient clinics throughout the Phoenix-metro area.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>08/01/15</td>
<td>Premier Physical Therapy</td>
<td>Professional Orthopedic &amp; Sports</td>
<td>Offers physical therapy services at thirteen locations in New York and Connecticut.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>07/20/15</td>
<td>Olympic Physical Therapy</td>
<td>ATI Physical Therapy</td>
<td>Operates nine physical therapy facilities in the Puget Sound region.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>07/15/15</td>
<td>Advanced Center for PT</td>
<td>PHOENIX Rehabilitation</td>
<td>Provides outpatient orthopedic and sports rehabilitation services in Virginia.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>07/02/15</td>
<td>Athletic Advantage</td>
<td>Pivot Physical Therapy</td>
<td>Offers physical therapy services in North Carolina.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>07/01/15</td>
<td>South Bay Sports &amp; PT</td>
<td>Professional Orthopedic &amp; Sports</td>
<td>Provides physical therapy services in New York.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>07/01/15</td>
<td>Four Location PT Practice</td>
<td>US Physical Therapy</td>
<td>Operates four outpatient physical therapy clinics.</td>
<td>$6.1</td>
<td>1.1x</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>06/25/15</td>
<td>MOTION PT</td>
<td>Pharos Capital</td>
<td>Provides physical therapy in Brooklyn, Manhattan and Long Island with 10 locations.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>06/25/15</td>
<td>STAR Physical Therapy</td>
<td>MetroSportsMed</td>
<td>Provides physical therapy services.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>06/01/15</td>
<td>Concentra</td>
<td>Select Medical and WCAS</td>
<td>Offers urgent care, occupational medicine, physical therapy, primary care and wellness programs.</td>
<td>$1,055.0</td>
<td>1.1x</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>05/22/15</td>
<td>Proaxis Therapy</td>
<td>ATI Physical Therapy</td>
<td>Operates 25 physical therapy clinics in Colorado, North Carolina and South Carolina.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>05/19/15</td>
<td>Body Werks Physical Therapy</td>
<td>ATI Physical Therapy</td>
<td>Provides physical therapy and individual movement analysis services at 16 clinics in Indiana and Illinois.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>05/01/15</td>
<td>Three Location PT Practice</td>
<td>US Physical Therapy</td>
<td>Offers physical therapy services.</td>
<td>$6.9</td>
<td>2.0x</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>
Capstone Partners has successfully advised on a number of transactions in the health & medical products and services industry. These transactions are shown below. Capstone’s experience in the sector provides us with insight into the valuable attributes and likely valuation of target companies, the active buyers in the industry and the nuances of transactions in the space.
THE OUTPATIENT PHYSICAL THERAPY TEAM

Mark Surowiak, Director
msurowiak@capstonellc.com • (215) 854-4063

Mark is a Director in the Philadelphia office, supporting the management of the Atlantic Region. Previously, Mark served over 10 years as a senior investment banking professional in Morgan Stanley Smith Barney’s Capital Strategies Group. Over his career, Mark has focused on developing deep credentials and expertise in the sale and recapitalization of privately held businesses. Prior to investment banking, Mark enjoyed a career in the social services field. Mark is a graduate of Illinois State University with a BS in Business Administration. He is a Series 7 and 63 Registered Securities Representative.

Eric Williams, Managing Director
ewilliams@capstonellc.com • (215) 854-4065

Eric serves as Managing Director and Head of the Atlantic Region for Capstone. Prior to Capstone, Eric was responsible for managing the Eastern region for Morgan Stanley Smith Barney’s Capital Strategies Group and its predecessor, Citi Capital Strategies. Eric has more than 20 years of experience managing strategic sale assignments and leveraged recapitalizations for owners of privately held companies. He is head of Capstone’s Health and Medical practice and has successfully completed over 100 transactions in a wide range of industries including pharmaceutical outsourcing, health care services, medical device, contract manufacturing and education and training. In 2013, he received the “M&A Deal of the Year” M&A Advisor award for his work on the acquisition and majority recapitalization of Invo HealthCare Associates, Inc. and in 2014 was awarded both “M&A North American Middle Market Deal of the Year” at the M&A Atlas Awards and “Cross Border Deal of the Year” from the M&A Advisor for his work on the sale of T-DOC Company LLC. He has also executed complex cross-border transactions with foreign buyers based in London, Germany, Sweden and Switzerland. He graduated cum laude from the University of California and is a Series 24 Registered Securities Principal.

Daniel Schultz, Director of Business Development
dschultz@capstonellc.com • (617) 619-3368

Dan oversees Capstone’s national business development and industry coverage activities, working closely with current and prospective clients of the firm on matters related to corporate sales, recapitalizations, mergers & acquisitions and growth financings. In his role, Dan is able to deliver specific market intelligence to clients regarding M&A, financing, strategic, industry and competitive trends. Prior to spearheading the firm’s business development and market initiatives, he was a Vice President in Capstone’s M&A group, managing numerous successful transactions across a variety of industries. Dan also gained hands-on transaction experience as an investment banker at Headwaters MB. He started his career with Ernst & Young’s National Professional AABS practice in New York and later worked in Assurance and Advisory Business Services in the Denver office. Dan received a BE in Biomedical Engineering with a Business Minor from Vanderbilt University. He earned an MBA and a Master of Accountancy from the Daniels College of Business at the University of Denver.
CAPSTONE’S OFFICE LOCATIONS

BOSTON
176 Federal Street
3rd Floor
Boston, MA 02110
(617) 619-3300

CHICAGO
200 South Wacker Drive
Suite 3100
Chicago, IL 60606
(312) 674-4531

LONDON
42 Brook Street
London W1K 5DB
United Kingdom
+44 (0) 203 427 5068

LOS ANGELES
23046 Avenida de la Carlota
Suite 600
Laguna Hills, CA 92653
(949) 460-6431

NEW YORK
41 Madison Avenue
31st Floor
New York, NY 10010
(212) 634-0855

ORANGE COUNTY
23046 Avenida de la Carlota
Suite 600
Laguna Hills, CA 92653
(949) 460-6431

PHILADELPHIA
1515 Market Street
12th Floor
Philadelphia, PA 19102
(215) 854-4063

SAN DIEGO
12707 High Bluff Drive
Suite 200
San Diego, CA 92130
(858) 926-5950

SILICON VALLEY
228 Hamilton Avenue
3rd Floor
Palo Alto, CA 94301
(650) 319-7370

TAMPA
1550 W Cleveland Street
Suite 10
Tampa, FL 33679
(813) 251-7285

ABOUT CAPSTONE PARTNERS

Capstone Partners LLC is a premier investment banking firm dedicated to serving the corporate finance needs of middle market business owners, investors and creditors. The firm provides M&A, corporate restructuring, private placement and financial advisory services. Headquartered in Boston, Capstone has offices in Chicago, London, Los Angeles, New York, Orange County, Philadelphia, San Diego, Silicon Valley and Tampa with an international presence that spans 450+ professionals in close to 40 countries.

For more information about our expertise, please visit www.capstonellc.com