



## Q2-2011 DENTAL SERVICES INDUSTRY UPDATE

### Market Update

Deal activity in the dental services industry this quarter remains consistent relative to Q1-2011 as private equity (PE) buyers continue to seek growth investments, while strategic buyers look to expand through acquisitions.

Consolidation in the dental services industry is currently driven by several factors: dentist demographics, dental education costs, and technology change. Aging dentists are looking to either retire or redirect their focus to increased patient care thereby selling their practice to buyers with management in mind. Increased costs in dental education are preventing graduates from buying into new or existing offices, leaving older dentists fewer exit opportunities. This trend gives way for financial and strategic buyers to consolidate dental business in their existing practices. Increased costs associated with technology changes will also slow industry growth and prompt consolidation. With suiting a practice costing investors more than \$300K to \$500K, groups with more capital and leverage (such as dental practice management companies) can assume the costs more easily over a broader revenue base.

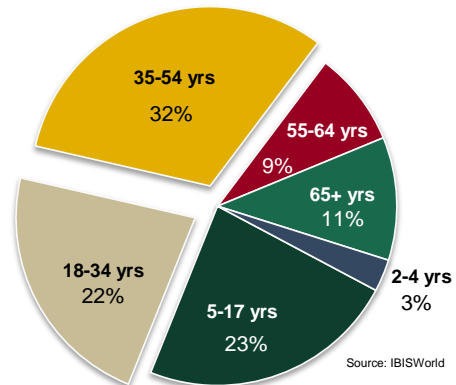
Specifically looking into the PE side, consolidation is also driven by excess capital that has yet to be deployed. With overhang capping at roughly \$376 billion, financial buyers have not invested all the capital they have raised from 2004 to 2008. Investment horizons of PE funds typically span five to seven years; with that investment window closing, PE firms are more actively seeking investment opportunities, and the dental services sector has been identified as an attractive space for acquisitions. Audax Group, Ares Management, and Welsh, Carson, Anderson & Stowe are among the many PE groups invested in dental practice management organizations. With that in mind, competition in the financial buyer market continues to remain fierce, which can drive higher valuations.

### The Dental Services Macro Environment

The chart below illustrates the dental services market revenue breakdown by age group. Dental offices receive 54% of their sales from the adult population of 18 to 54 years of age. According to Census Bureau data, revenues generated in dental employer firms (ie. businesses with less than 500 employees) come from 45% private insurance, 44.8% out of pocket, 4.1% Medicaid, and 0.8% Medicare. More than 75% of this revenue funds dental examinations, radiographs, caries treatments, and oral hygiene procedures, where examinations and radiographs each make up 20% of total industry revenue.

In an environment where government funds account for less than 5% of the industry revenue, average profit margins make up approximately 17.3% of revenue. The industry is expected to grow at an annualized rate of 3.5% to \$130 billion until 2016, largely based on healthcare reform boosting the number of insured in the US. The aging population is expected to grow at an annualized rate of 3%, which will benefit dental groups focused on age-related cosmetic services.

Market Segmentation by Age Group  
(Revenue)



### NOTEWORTHY TRANSACTIONS

Month	Acquirer	Target Company	Details
May 2011	Friedman Fleischer & Lowe, LLC	Midwest Dental, Inc.	Friedman Fleischer & Lowe, LLC, a middle-market private equity firm, completed its purchase of a majority stake in Midwest Dental, Inc., a leader in dental practice management. The details of the transaction were not disclosed. Midwest Dental is one of the largest dental practice management companies in the United States, with more than 80 dental practices across the United States. The Company provides centralized management, administrative and financial services to practices that deliver a full suite of general dentistry services, including restorative, diagnostic and preventative procedures. Midwest Dental's senior management is investing alongside FFL, and will continue to manage the business in the future. FFL will provide Midwest Dental with the financial backing necessary to capitalize on new market opportunities as well as share its extensive experience in healthcare services with the newly acquired company.
<b>Announced Transactions</b>			
May 2011	Coast Dental Services, Inc.	Community Dental Services, Inc.	Coast Dental Services, Inc. has agreed to acquire the assets of Community Dental Services, Inc., doing business as SmileCare Dental Group. Financial terms were not disclosed. Community Dental is a California licensed dental management organization operating 57 dental practices in CA, NV, and TX. Founded in 1977, the company employs 1,200 staff members that includes 130 dentists. All SmileCare dental centers will continue to operate under the SmileCare brand upon the final approval by the California Department of Managed Health Care for this transaction. The acquisition will make Coast Dental Services the fifth largest dental provider in the US with 182 affiliated practices and 2,200 employees.