FOCUS
Investment Banking

Healthcare Team

THE PHYSICIAN'S GUIDE TO PRIVATE EQUITY TRANSACTIONS

Investment Banking and Advisory Services

FOCUS Investment Banking LLC is a leading Investment Bank with specialized healthcare services expertise, concentrating on providing highly tailored services to middle market and larger organizations in this sector:

- Mergers & Acquisitions Advisory
- Corporate Development Consulting
- Strategic Partnering & Alliances
- Capital Financing, Debt & Equity
- Corporate Valuations

June 2021

WHITE PAPER

Eric J. Yetter
Managing Director and Healthcare Team Leader

J. Andrew Snyder
Managing Director Healthcare Team

Physician Owner Specialization

Our Services .. At the Forefront of Physician Owned Transactions

FOCUS Healthcare specializes in investment banking services focused on mergers & acquisitions involving clinicians. We represent physician groups in transactions with private equity and ASC management company investors across the United States.

We are a leading expert on this market and its participants and one of the most active advisors in the industry. This White Paper is designed to share our insights with you – physician owners with valuable practices and ASCs contemplating their own transactions with private equity.

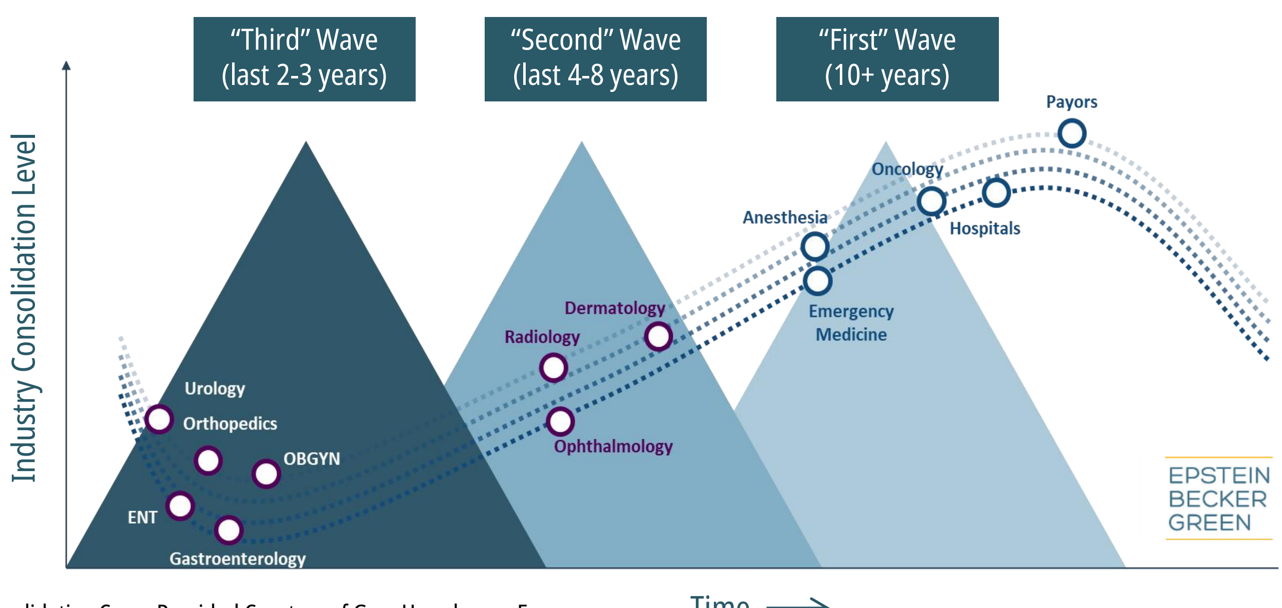
As former operators, we understand the unique attributes of specialty practices and surgery centers. We invest our time and money in the best data available and our partners constantly track transaction activity, conduct independent research, and analyze critical issues. We represent physicians every day and leverage the resulting experience and relationships to benefit our clients.

We Specialize in Second and Third Wave PPM

We focus on the emerging second and third wave sectors across the full spectrum of physician practices.

Consolidation Curve

Volume of M&A activity in each healthcare sector is driven by stage of consolidation



Consolidation Curve Provided Courtesy of Gary Herschman, Esq.
Epstein Becker & Green, P.C.

Recent Transactions

Our services are designed to provide exceptional investment banking services to specialty practices and ASCs across a wide range of practice specialties.

Despite the “pause” created by the COVID-19 pandemic, our partner engagements have remained strong. Since July of 2019 FOCUS Managing Directors have completed nine transactions for a combined 16 clinical businesses.

Closed Transactions

Eye Center of Texas ACQUIRED BY EyeSouth Partners	McCoy Vision ACQUIRED BY SEES Group	CWC Emergent Care Center ACQUIRED BY Women's Care Enterprises	Vista Surgical Center ACQUIRED BY Surgery Partners
Rosenbaum Eye & Laser Center ACQUIRED BY Midwest Vision Partners	Olympia Eye Clinic ACQUIRED BY NVision Eye Centers	Carroll Vision Center ACQUIRED BY Vision Innovation Partners	Valley Eye Institute ACQUIRED BY CVP
CWC OB/GYN Offices ACQUIRED BY Women's Care Enterprises	UBEC Surgery Center ACQUIRED BY CVP	Carroll County Surgery Center ACQUIRED BY Vision Innovation Partners	Olympia Eye Surgery Center ACQUIRED BY NVision Eye Centers
Virginia Beach Eye Center ACQUIRED BY CVP	Center for Total Eye Care ACQUIRED BY Vision Innovation Partners	CWC Surgical Center ACQUIRED BY Women's Care Enterprises	Valley Eye Surgery Center ACQUIRED BY CVP

Selling Your Medical Practice

Private Equity Investment in Physician-Owned Specialty Practices

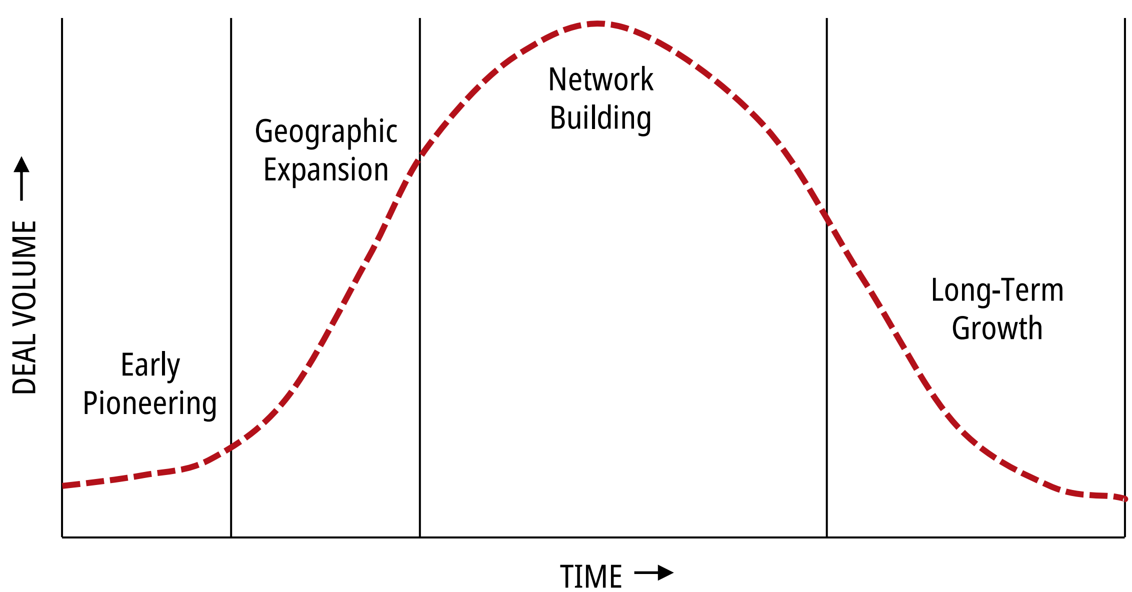
Medical practices of all types have been consolidating rapidly for the past decade or more. Transaction volume declined in 2020 mainly due to the COVID-19 pandemic, which created uncertainty and left prospective buyers and sellers focused on managing and maintaining their existing businesses. But activity accelerated in the fourth quarter and has continued into 2021.

> We now expect 2021 will set a new high for completed transactions in this 10-year consolidation wave, driven in part by proposed changes in capital gains and other taxes that will encourage medical professionals to sell now before those changes become effective.

Practices looking to sell should assume that roughly 80% of the transaction value will be taxed as a capital gain, so an increase in capital gains tax rates will have a significant impact on final returns. Sellers should therefore carefully consider the advantage of doing deals under current favorable capital gains rates.

The Consolidation Life Cycle

Most industries have experienced consolidation waves at different times. Within healthcare services, ambulatory surgery centers and hospitals have been consolidating for decades and are in a more stable maintenance phase. Urology practices, by contrast, are in the early part of this consolidation life cycle. A number of pioneering practices, such as MidLantic Urology Partners in Philadelphia, The Urology Group In Cincinnati and Genesis Healthcare Partners of San Diego, have recently joined with financial sponsors and started to make acquisitions.



Selling Your Medical Practice

Geographic Expansion

Geography can play a significant role in the speed and timing of consolidation. This is driven by the traditional supply-and-demand characteristics of a given market. Of course, consolidation can only occur if there are interested buyers. Private equity firms use many factors to determine their most desirable markets and the speed of their growth and expansion. Once markets are chosen, prospective buyers first look for large "platform" practices they can build around, with smaller "add-on" practices later. Some markets develop earlier in the consolidation curve and some later.

Network Building

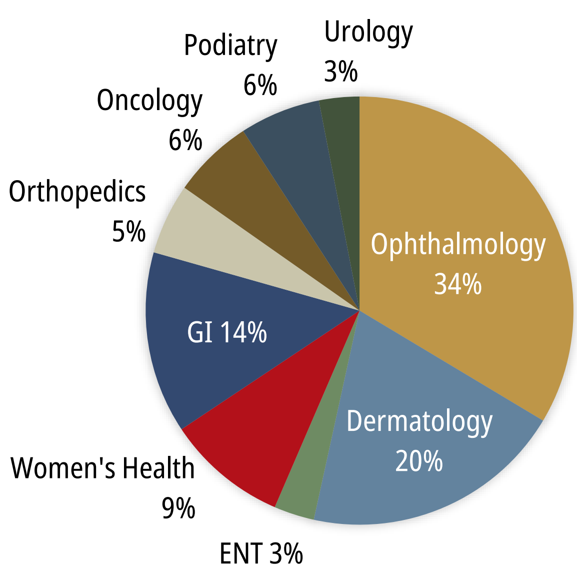
Dermatology and ophthalmology are each in the Network Building phase. This phase is generally characterized by many deals with a decreasing average deal size. That is because most large platform practices have already chosen their financial partners and are now pursuing small and medium add-on acquisitions.

As those deals continue, average deal size continues to decrease. For example, as ophthalmology transitioned from the Geographic Expansion phase to the Network Building phase, acquisition activity became more heavily weighted towards 1-4 physician "add-on" practices. Overall, we expect strong new platform and add-on activity in 2021.

Deal Volume and Size Implications

Generally, most transactions are completed as specialties move through the geographic expansion and network building phases of the curve. Dermatology and Ophthalmology have been in those phases the last several years. The 2020 deal volume across key specialties is shown below.

We expect a significant increase in total medical practice deal volume as the many pioneering and geographic expansion specialties enter the network building phase. In 2021 and beyond, additional platforms will be created, develop infrastructure, and pursue add-on acquisitions. For example, we believe investments in gastroenterology may accelerate to mirror what has occurred in ophthalmology.



When is the Best Time to Sell?

There is no set answer, but here are some things you should consider.

- The most entrepreneurial groups tend to enter financial partnerships earlier in the consolidation process. These early adopters enjoy certain advantages, including more influence over company culture. They also have the greatest equity appreciation potential.
- Physicians who partner later in the cycle will have gained more information about the buyer spectrum. They may take on less risk by joining a more established platform with an experienced management team and developed infrastructure.
- Demand for strong physician partners, and thus valuations, can be highest at any point in the curve depending on individual buyer's goals.
- When to sell is ultimately a case-by-case decision. We recommend that qualified groups review their options with a qualified investment banker.

Determining Which Buyer is Best

Many physicians make the mistake of quickly entering into negotiations with a buyer that contacts them directly. Indeed, it can be tempting to take a warm, unsolicited offer instead of stepping into a structured marketing process with multiple buyers. However, groups that take that route often shortchange themselves in terms of transaction terms, choice among buyers, and economy in getting the deal done. Bringing in a professional advisor can help solve those problems.

Consider selling a home. Most physicians would not accept an unsolicited offer from a couple who knocked on their door. Instead, they would put their home on the market with a professional agent who would field offers from multiple buyers in a competitive environment. These sellers trust their advisor and the market to develop the most competitive price.

> The same principal applies when selling a business – only the terms are more complicated, the stakes are higher, and the buyers are much more sophisticated.

When thinking about an ideal buyer, we recommend that physicians consider the following factors:

1. The buyer's business approach and reputation. How is the buyer viewed in the physician community? What is their approach to operating practices?
2. The buyer's financial strength. Do they have a sophisticated management team and financial (private equity) partner? Are their operations healthy? What is their overall likelihood of success?
3. The individual deal terms. What is the purchase price and deal structure? How is consideration paid? What are the legal terms of the deal?
4. The employment terms. Is the employment contract agreeable in terms of working schedule, compensation, non-compete, and other key items?

In a competitive process, sellers often have a choice between a handful of top candidates. The goal is to consider the above factors, weigh the pros and cons, and make a choice among the suitors. Experienced financial and legal advisors can help selling physicians make this sometimes-difficult choice.

What is Private Equity?

Private equity is the practice of raising a pool of money and investing it in private companies. Many if not most PE investments involve total or controlling interest in the companies they acquire, although PE firms also make debt or minority equity investments. In the latter, PE firms do not control the businesses they invest in and instead act as more passive investors.

Under Corporate Practice of Medicine (CPOM) laws, non-physicians are restricted from controlling a medical practice. Patient care must remain in control of the physicians; therefore, the legal owner of the practice must remain a physician. To comply with CPOM regulations, PE firms form a Management Services Organization (MSO) which legally acquires all the operating assets within the physician practice. This is also commonly referred to as the “friendly PC ” model. The practice stays under physician ownership as a legal entity while the MSO takes control over the administrative and management side of the practice.

> Most investors in physician practices are lower middle-market PE firms. These firms often create investment strategies around a medical specialty and then build companies to execute on that strategy. Generally, these companies will eventually be sold to larger investors.

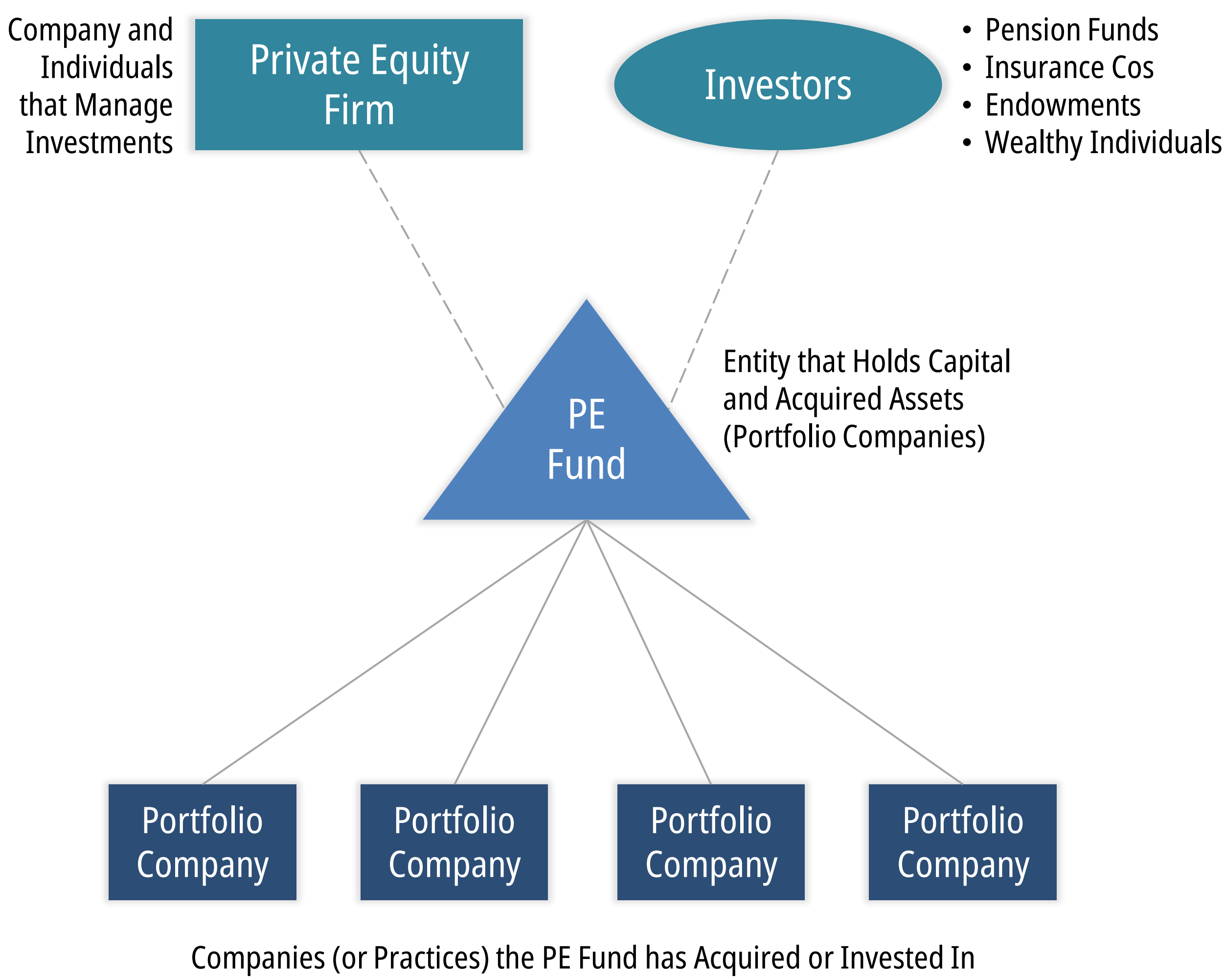
How Private Equity Firms Do Business

At their core, PE firms follow four steps:

1. Raise Capital

PE firms need money to acquire companies. The first step, then, is to raise funds from external financial sources called Limited Partners (LPs). Typically, these investors are retirement funds, endowments, insurance companies, and wealthy individuals. PE firms look for large chunks of capital and target large investors. Regulations and capital requirements tend to restrict all but the wealthiest individuals from investing directly in PE funds.

PE firms and their leaders are almost always investors in their own funds.



How Private Equity Firms Do Business

2. Source, Diligence and Closed Transactions

Once the PE firm has money to work with, it can start identifying potential target companies to invest in. Developing investment ideas and starting a dialogue with target companies is called Sourcing. PE firms typically have areas of interest and expertise where they are comfortable and excited about investing. For example, a particular PE firm might specialize in ophthalmology.

Prospective deals come from several sources—investment bankers, referrals, and direct outreach. Investment banks typically run an auction process consisting of multiple rounds where various PE firms place bids for the company. After each round, firms drop out, get rejected, or advance, until only the best deals remain.

Once a potential deal is negotiated and a letter of intent is signed, the investment team at the PE firm conducts an extensive due diligence process that evaluates the target company, including its finances and operations, strategy, management team, risk factors, and future sale potential. PE firms utilize outside advisors to assist with diligence, including attorneys, specialized accountants, insurance experts, and others.

Once due diligence is complete, the parties draft and circulate transaction documents. Terms are negotiated and financial and legal deal components finalized. When everything is ready, the transaction is formally closed.

3. Grow

In order to increase the return on their investment, PE firms look to grow their portfolio companies so that they are more valuable when sold. Rather than taking a direct role, such as stepping in as CEO or COO, PE firms typically control their investments from the board level and provide advice and support on day-to-day operations, strategy, and financial management. They often build company-level management teams to accelerate the company's growth.

The PE firm's involvement depends heavily on how large a stake it has in the company. If the firm takes a sizeable percentage of the equity, it will likely take a more active role in managing the newly acquired company. Conversely, the smaller the stake, the smaller the PE firm's role.

4. Sell

Private equity's ultimate objective is to exit investments at a profit. Firms aim to sell off their stakes in the companies they own after three to 10 years. Specific timing depends on the larger market environment and numerous strategic circumstances.

Although we often hear about large corporate acquisitions and initial public offerings, the typical private equity sale in the medical space is to a larger PE firm. That new firm picks up the ball and works to continue growing the company.

The Private Equity Life Cycle

Private equity-backed consolidations follow a life cycle pattern similar to that of medical practices, beginning with pioneering, then accelerating through greater adoption. A period of high activity persists until supply is diminished or interest changes. Finally, a maintenance period follows at a lower, more predictable activity level.

The length and volume of activity will vary due to factors such as specialty characteristics, economic conditions, insurance coverage and government regulations. Earlier life cycle investments are centered in larger platform practices, with later investment moving toward smaller add-on practices.

The total number of specialized PE-backed platforms also tracks the consolidation life cycle. Ophthalmology and dermatology have the most platforms, though PE firms may be entering other specialties more regularly.

Private Equity Economics

PE firms earn money for their investors by acquiring businesses and selling them later at a profit (usually by growing them before sale). Investor return will depend on the blended performance of the investments within the portfolio.

Investors pay PE firms for initiating and managing the fund's investments. PE firms are paid in two ways: 1) management fees and 2) performance fees.

Management fees are usually calculated based on the fund's assets. For example, the PE firm might be paid 2% for managing a $100 million fund (or $2 million per year). Those management fees are used to pay PE professionals' salaries and cover other overhead.

Performance fees are based on the fund's investment performance. They are an incentive that encourages PE funds to discover and nurture the best investment ideas. When funds do well (relative to a pre-determined hurdle rate), PE firms earn a percentage of that excess performance.

Competition

Private equity investing is highly competitive. Money is actively flowing into private equity from other asset classes, giving firms more money to invest. New firms are launching their first funds. All of this means there is a large amount of capital seeking a limited number of strong companies and investment ideas.

As a result, sellers of high-quality healthcare assets have a choice among buyers, and leading PE firms must establish a strong investing track record to differentiate themselves from numerous competitors.

Sometimes, PE firms can avoid a competitive investment banking process by reaching out directly to business owners and closing deals "off-market." Many PE firms have created in-house business development teams to accelerate this strategy as the market becomes more competitive.

A qualified investment banking firm can help you navigate the PE landscape and help you find the right PE partner for your firm.

EBITDA - The Core of Valuation

EBITDA - earnings before interest, taxes, depreciation, and amortization—is the primary way of valuing most private businesses. Alternatives such as multiples of revenue, asset value, or discounted cash flow are less common.

The simplest way to calculate EBITDA is to start with your practice's reported net income. This allows adding items on top of that net income to get to EBITDA, and then adjusted EBITDA (see below).

EBITDA = Earnings Before Interest, Taxes, Depreciation, and Amortization

Calculating EBITDA is a key negotiating point in medical practice transactions. That is because applying a "multiple of EBITDA" is by far the most common and most favored approach in private equity transactions with medical practices.

In its most simplistic form, a valuation is calculated as follows:

EBITDA x EBITDA Multiple = Valuation

Calculating Adjusted EBITDA for Medical Practices

Generally, however, Adjusted EBITDA is the favored method among transaction professionals for valuing medical practices. That is, EBITDA adjusted for certain key items, including owner compensation and non-recurring items.

Adjusted EBITDA = EBITDA +/- Owners' Normalized Compensation and non-recurring items

A further, sometimes merited wrinkle is Pro-Forma EBITDA, which estimates financial performance in a particular future time period that includes certain catalysts and events during that period. For example, a practice may have recently hired a new doctor who is ramping up. In that case, pro forma adjusted EBITDA might account for her expected production.

Pro-Forma EBITDA = Adjusted EBITDA +/- Reasonable Future Items

Step 1
Calculate EBITDA

EBITDA	
Reported Net Income	$1,000,000
Plus EBITDA Adjustments:	
Interest	20,000
Taxes	-
Depreciation	50,000
Amortization	0
EBITDA	$1.070,000

Step 2
Make Adjustments

ADJUSTMENTS	
Compensation Adjustment	$222,000
Non-Recurring Items:	
Legal (New Partner Buy-in)	30,000
IT Consulting	50,000
TOTAL ADJUSTMENTS	$302,000

Step 3
Add It Up

ADJUSTED EBITDA	
EBITDA	$1,070,000
Plus Adjustments	302,000
ADJUSTED EBITDA	$1,372,000

How Multiples Are Determined

An EBITDA multiple isn't chosen because of any specific rule. Buyers value a business – and choose its EBITDA multiple – based on its current and future assets and operations. How strong is the current business? Are there compelling growth opportunities? Can a buyer make operational changes to increase profitability? When consolidation is ongoing – as it is with medical practices – the buyer also looks at how a business fits with other companies in its portfolio.

Different buyers assign different values to a company, even when all prospective buyers are looking at the same information. That is one of the primary duties of the sell-side investment banker – to create a competitive bidding process among a group of highly-qualified and interested buyers. That process, combined with data-rich marketing materials, helps unearth value and encourage buyers to bid high.

> It's important to understand that the EBITDA multiple and EBITDA itself are heavily negotiated

The Components of Value

The total value of a transaction is often paid in several ways. The largest portion is most often cash up front, with smaller amounts in fees, earnouts, escrows, and rollover equity investment.

At the end of the day, a valuation often looks like this:

Fees

All sellers incur certain fees in completing a transaction. These are often paid directly to the relevant service providers out of proceeds at closing. The major fee categories for sellers are the investment banker, attorneys, and accountants.

Earnouts

Some transactions include an earnout or similar delayed payment. Essentially, an earnout is a portion of the purchase price that is held back and paid once certain conditions are met. For example, an earnout in a medical practice deal could be released and paid to the seller once an additional physician is hired.

Escrows

Almost all transactions include escrow accounts, the two key types being indemnity escrow and adjustment escrow. Like earnouts, these amounts are held back and paid once certain conditions are met. The indemnity escrow may be released once the key indemnity period has passed without incident. Its purpose is to provide the buyer security if the seller breaches certain indemnities, as outlined in the purchase agreement.

Rollover Equity

Instead of taking payment in cash, sellers often reinvest some of their transaction proceeds in the acquiring company. This is called Rollover Equity, because equity is effectively being "rolled over" into the new company. This equity represents an ownership interest in the new company. The intention is for that equity to become more valuable as the new company grows, and the equity can be converted into cash when and if the company is sold at a later date.

In a physician practice acquisition, the transaction proceeds are usually given to the physician sellers as a blend of cash and rollover equity. A reasonable baseline for this blend would be to expect 70% cash and 30% rollover equity. For example, in a $10 million acquisition, the physicians would receive $7 million in cash up front and $3 million in rollover equity.

While some physicians prefer to receive as much cash as possible in a transaction, equity in the new company can yield high returns within a one-to-five-year window post-transaction. Every investment carries risk, and physicians should pursue the deal structure most aligned with their risk preference.

The Components of Value

Ancillary Businesses

It has also become common in medical transactions to create “ancillary pools” where buyer and sellers split income from ancillary businesses on negotiated lines. For example, selling gastroenterologists might retain 30% of the profits from their anesthesia business, effectively “selling” 70% of its pre-transaction profitability. There is a lot of variety around acquisitions of ancillary businesses, including ambulatory surgery centers, endoscopy and infusion suites, catheterization labs, and more. Some buyers will purchase 100% of these assets while others will acquire a controlling 51% ownership.

Ancillaries can provide sellers with an opportunity to make the most of a transaction based on their individual situation. An experienced investment banker can help sellers structure a deal around their ancillaries in a way that provides maximum value – both from the purchase price and post-transaction distributions.

Getting Associate Physicians to Buy In

Changing Ownership Dynamics

Medical practices across the country are faced with the challenge of securing the next generation of physician partners. Historically, practices brought in associates soon after residency or fellowship on a long-term path to partnership. Although partnership was never guaranteed, it was expected to both reward physician loyalty and, more importantly, ensure practice continuity.

Practice ownership dynamics have changed substantially over the last 30 years. Running a medical practice has become more complicated and expensive, with additional regulatory burdens, complex reimbursement programs, and more. Time and again, we hear from senior physician partners who are struggling to convince the next generation of associates to buy in as a partner.

More mid-career physicians are electing to remain employed, preferring a predictable work schedule and the security of employed compensation. They are uncomfortable with the debt they would assume in a practice buy-in, and in many cases don't want to take on administrative responsibility.

Education Debt Acts as a Deterrent to Buy-In

A significant factor is the rising cost of education. According to recent studies, the average medical school debt is over $215,000 and up to 89% of medical school students graduate with educational debt. Rising education costs are leaving new physicians with an unprecedented amount of debt. Furthermore, subsequent residencies and fellowships do not produce high enough salaries to begin paying down debt. This results in a graduating physician cohort that will carry education debt into their late thirties and beyond. This financial uncertainty makes the next generation of physicians hesitant to take on additional debt for buying into a partnership stake of the practice. These doctors would rather focus on seeing patients and increasing productivity.

For them, private equity-backed operators have created an attractive solution.

Getting Associate Physicians to Buy In

Solution: Private Equity's New Approach

Through private equity partnerships, current physician partners are receiving high valuation multiples while simultaneously solving ownership continuity problems. Centralized administrative resources will take over general day-to day management and grow the practice while allowing partners and associate physicians to stay focused on patients.

Importantly, these transactions are not depriving associate physicians of partnership opportunities down the road. Private equity acquirers are finding unique ways to provide important and attractive partnership opportunities to younger physicians when they're ready.

Many groups set aside a portion of the transaction price for associate equity buy-in to the global company. Associates subsequently have an ownership stake in the new company and can participate in the financial growth alongside selling physicians and private equity partners.

This solution keeps younger physicians incentivized to maintain or increase personal production and ensure continuity of their existing productivity. Additionally, they are freed from the administrative responsibilities that were traditionally expected in past partnership transitions.

> Private equity partnerships are bridging the gap in generational views of practice ownership by allowing all physicians to stay focused on patients and clinical healthcare while providing a way to benefit from any increase in the value of the practice.

Next Steps: Getting a Deal Done

Medical practice transactions are highly complex and difficult to negotiate and execute. Sellers who are serious about a deal should work with advisors uniquely geared to handle the challenges common to these deals.

FOCUS Investment Bankers offers an investment banking process designed to deliver great outcomes to doctors embarking on the most important and complex transactions of their lives.

To learn more about our healthcare investment banking services or to discuss your specific situation with no obligation please feel free to call:

Eric Yetter
FOCUS Managing Director and Healthcare Team Leader
Direct: 615-477-4741

We are happy to share our knowledge and help you understand your options. All conversations are strictly confidential.

Legal Disclaimer/Other Disclosures

This report is for informational purposes only and does not constitute an offer, invitation, solicitation, or recommendation to buy, sell, subscribe for, or issue any securities and shall not form the basis of any contract with FOCUS Investment Banking, LLC. This report was prepared exclusively for the benefit and internal use of the person or company to whom it is directly addressed and delivered (including such recipient's subsidiaries, the "Company") in order to assist the Company in evaluating, on a preliminary basis, the feasibility of a possible transaction or transactions and does not carry any right of publication or disclosure, in whole or in part, to any other party. This report is for discussion purposes only and is incomplete without reference to, and should be viewed solely in conjunction with, the oral briefing provided by FOCUS Investment Banking, LLC ("FOCUS"). Neither this report nor any of its contents may be used for any other purpose without the prior written consent of FOCUS.

The information in this report is based upon FOCUS estimates and reflects prevailing conditions and our views as of this date, all of which are accordingly subject to change. In preparing this report, we have relied upon and assumed, without independent verification, the accuracy and completeness of information available from public sources. In addition, our analyses are not and do not purport to be appraisals of the assets, stock, or business of the Company or any other entity. FOCUS makes no representations as to the actual value which may be received in connection with a transaction or the legal, tax or accounting effects of consummating a transaction. FOCUS does not render legal or tax advice, and the information contained in this communication should not be regarded as such. The information in this report does not take into account the effects of a possible transaction (or transactions) involving an actual or potential change of control, which may have significant valuation and other effects. The information in this report is confidential.

If you are not the intended recipient or an authorized representative of the intended recipient, you are hereby notified that any review, dissemination or copying of this report is prohibited.

Copyright Notice

3353 Peachtree Road, NE | Suite 1160 | Atlanta, GA 30326