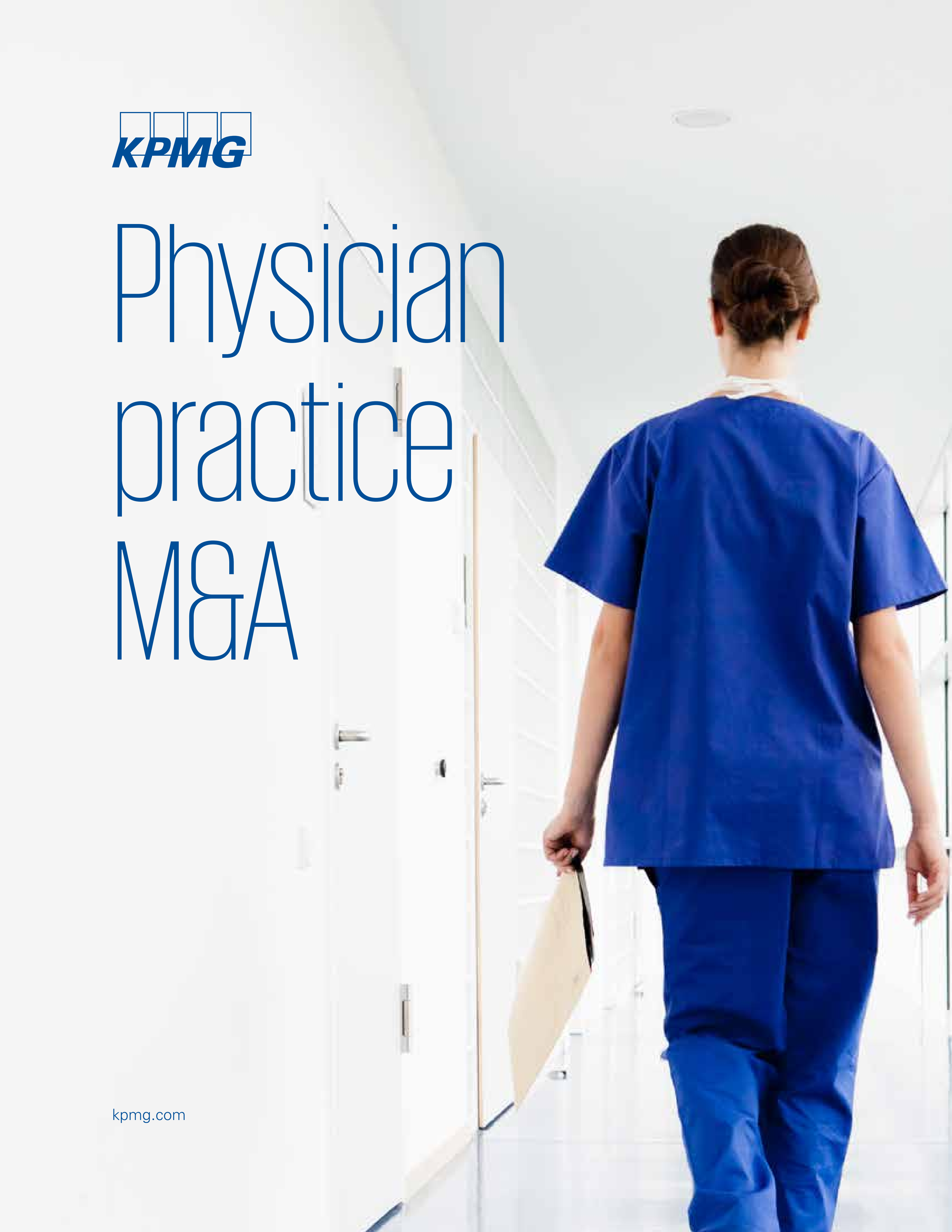

Physician practice M&A

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Contents

Physician practice M&A: What you need to know about partnering with PE sponsors

The healthcare services industry is rapidly evolving as providers seek to provide better outcomes, lower costs and create a better patient experience.

Government mandates are creating uncertainty for traditional reimbursement mechanisms (i.e., fee for service) and market realities pertaining to expected budgetary issues are pushing nonprofit, private, and for-profit entities to move toward a value-based care scheme. As a result, it's not surprising that large national payors and health systems have experienced significant consolidation for almost a decade since the implementation of the Affordable Care Act. That leaves independent physician practices at a crossroads as they face the reality that future changes may impact their traditional way of doing business. Independent physician practices must determine how to compete in an increasingly consolidated payor and health system market, and in many cases, are partnering with investors across the country.

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Physician practice groups in nearly every specialty are being approached by local health systems (strategic entities) and private investors or private equity (PE) sponsors (financial entities) to provide strategic options for shareholders. Besides providing a monetization event for shareholders, there are other reasons for independent physician groups to pursue a strategic option other than remaining independent. As practices join other entities they're able to realize cost savings, command more respect when negotiating with payors, expand service offerings, and move into to new geographies. Key themes contributing to PE sponsors' interest in physician practices include:

Noncyclical business model

There is a low correlation between physician practice revenue and economic trends.

Macro-level trends

There is a growing aging population and focus on patient treatment in lower-cost outpatient settings.

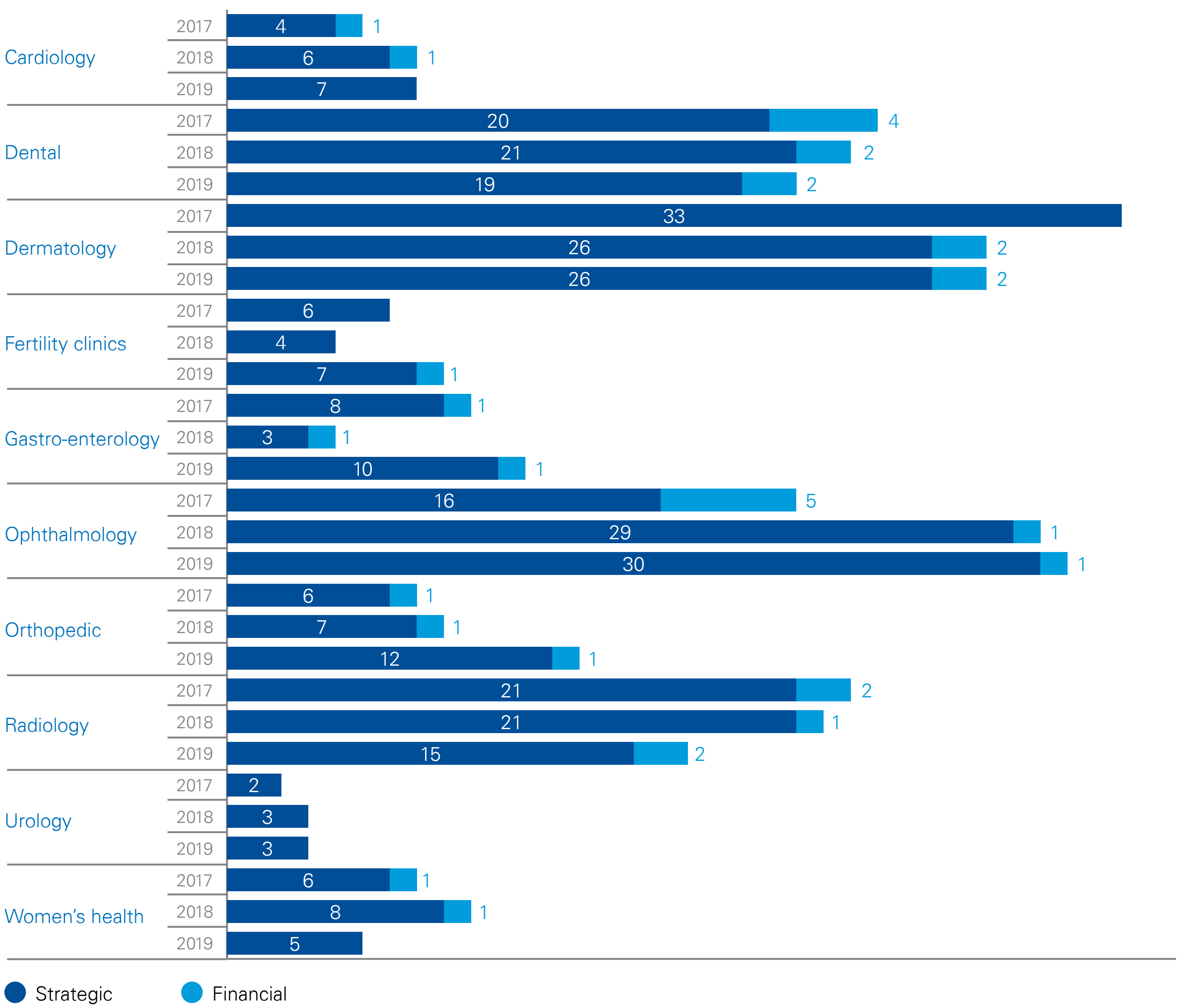
Fragmented market

The highly fragmented nature of physician practices is favorable to the "platform and add-on" strategy PE sponsors typically utilize.

Physician practice M&A activity in 2019

In 2019, deal activity remained high as both strategic and financial entities continued to invest in physician practices, but the more recent trend is for financial entities to be the likely partners for physician practices.

Physician M&A activity



In the current volatile healthcare merger and acquisition transaction market, it's likely that independent physician practices with more than 15 providers (i.e., physicians, nurse practitioners, physician assistants, etc.) have already been or will be contacted by several potential investors expressing interest in creating a strategic option, including acquiring the practice. This may raise many questions for the practice owner: What's next for my practice? What is my practice worth? When is the right time to consider a strategic option? What does a sale transaction look like? Knowing the answers to these questions will prepare you to make an informed decision and help yield optimal results.

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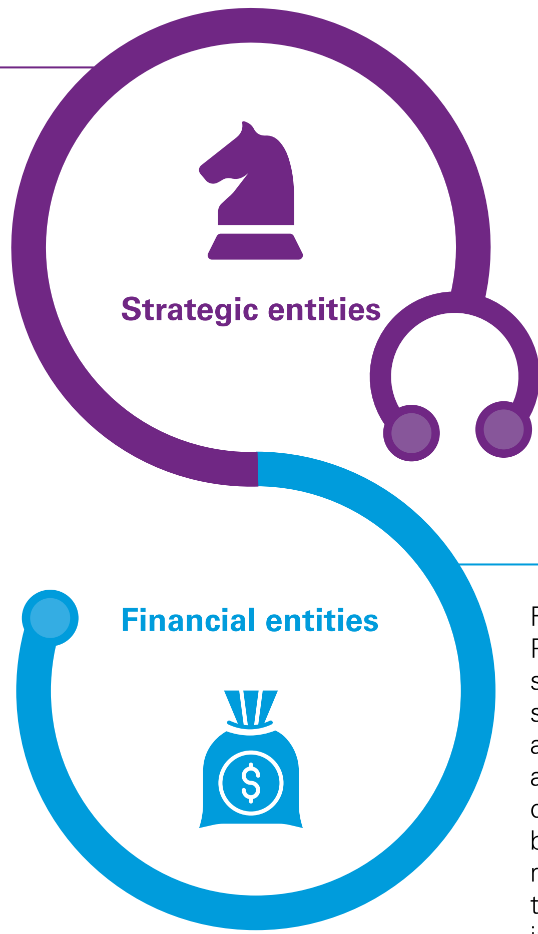
Who are the parties interested in physician practices?

There are two types of parties interested in partnering with a physician practice: strategic entities and financial entities.

Strategic entities are ambulatory surgery centers, hospitals and health systems, and other physician practice groups. These groups are typically looking to partner with (including acquiring) practices as a means of expanding their network and improving patient access, referral, and retention; providing ancillary services; increasing specialties provided; gaining size and negotiation advantage against the government and payors; and enhancing their competitive standing.



Financial entities are typically PE sponsors that are backed by significant capital resources. PE sponsors can use their operational and financial resources as well as growth-oriented expertise to consolidate operations, implement back-end efficiencies, and allocate resources towards new services, technologies, or offerings that improve the patient experience.

What is a PE sponsor trying to achieve when they partner with a physician practice?

PE sponsors have recognized that investments in physician practices can yield strong returns on investments. PE sponsors typically partner with physician practices by taking a majority or minority ownership stake in the physician practice and are typically looking to:

- Partner with a stand-alone practice that has a functional central business office (known as a platform company).
- Pursue "add-on" acquisitions by acquiring similar, smaller practices in the same region as their initial platform investment.
- Implement best practices across the businesses, optimize revenue cycle, and institute a business development function.
- Build a network of several practices that are about two to three times the size of their initial acquisition. After a three- to-five-year hold period, they will look to sell all or a portion of this larger, more operationally efficient group of practices to a larger private equity fund or strategic operator.

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What should you think about if you're contemplating taking on an investment partner?

The decision to pursue a strategic option can be difficult. Whether you are looking to pursue a transaction today or in the future, there are a number of questions to keep in mind. Below is a list of questions for physician practice shareholders to consider:

How do I determine if the time is right to consider a strategic alternative?

— Does my company have solid financial performance, consistent over the years, demonstrated with supporting financial statements?

— Do my fundamental operations have the potential to benefit from the additional resources that would result from consolidation?

— Has my practice demonstrated an ability to manage risk and achieve a differentiated and sustainable service offering?

How do I find the right partner who aligns with my practice's culture and vision for growth?

What kind of changes will be made to my business?

Do I want to stay involved in the transition of my company?

— How long will I have to continue working?

— What will be my role in the new company?

— What will be the plan for my eventual exit?

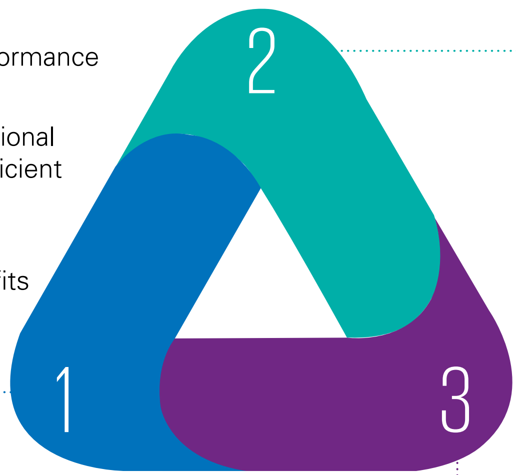
How do I determine the value of my company?

How can you maximize value of the physician practice?

A physician practice has many moving pieces that ensure it operates efficiently and provides the best possible care. In preparation, a physician practice can focus on critical elements that are key areas of focus for valuation. These include financial performance, opportunities for growth and synergies and differentiation in the market.

Strong financial performance is demonstrated by:

- Consistently growing top-line performance year over year
- Implementing fundamental operational practices that are effective and efficient
- Demonstrating strong underlying profitability through the ability to consistently distribute excess profits to shareholders.



Opportunities for growth and synergy are demonstrated by:

- Possibility of adding additional ancillary service lines
- Showing operational similarities between your practice and potential investment partner
- Using similar technologies and software as those used by potential investment partners, or the ability to quickly adopt these tools.

Differentiation in the market is demonstrated by:

- Specialized focus/expertise that sets the practice apart from competitors
- Scarcity value which occurs when there's a high demand but a lack of service providers in the region
- Strong patient base and referral network.

What does a strategic partnership process look like?

The process can take around 9 months to complete. The key steps are:

— Preparing marketing materials

— Marketing the practice

— Soliciting potential partners to make proposals

— Negotiating and driving the process to a successful closing.

All the while, each party to the process will have a chance to perform due diligence to assess quantitative and qualitative factors of a potential transaction.

Transaction timeline

1 Preparation (1–2 months)

— Develop strategy

— Identify target partner

— Prepare marketing materials

2 Marketing (4–6 weeks)

— Contact buyers and deliver marketing materials

— Deliver offer process instructions

3 Initial offers and diligence (3–4 weeks)

— Receive initial offers

— Select and invite buyers for in-person meetings

— Conduct initial due diligence

— Deliver second-round offer process instructions

4 Final offer and closing (2–3 months)

— Collect second-round offers

— Select final buyer and enter exclusivity

— Conduct final due diligence

— Negotiate final deal terms and transaction documents

— Close transaction

The items below help to further explain some key steps in the transaction process.

Preparation

Develop a strategy

Define your end goal of an M&A transaction and collect the necessary documentation including financial data that will be key in creating a compelling story for your practice.

Identify target partners

Compile a list of potential partners and begin outreach to these individuals. These potential partners are typically investors that have a history of investing in similar businesses or have an explicit interest in pursuing a physician practice strategy.

Marketing

Contact buyers and deliver marketing materials

Interested potential partners will agree to a nondisclosure agreement (NDA), which will allow you to share key information about your business via a confidential information memorandum (CIM). A CIM is a detailed document that includes business overview, industry trends, operational data, growth opportunities, and detailed financial information (historical and projections).

Initial offers and diligence

Receive initial offers and negotiate terms

Host in-person meetings with buyers and on-site visits. Offers will be received and select companies will move on to the second round of offers.

Conduct due diligence

Potential buyers conduct research and analysis to ensure that they have a holistic understanding of the state of your practice, from financial statements to inventory, real estate, and patient information.

Final offer and closing

Negotiate final deal terms

Negotiate on areas that you and the buyer did not initially agree upon, and sign the purchase agreement.

Close transaction

How will I be affected after the closing of a transaction?

As you transition from the role of a practice owner, clinician, and administrator to a role more focused on clinical care, your responsibilities and organizational structure may change. While every transaction is different, there are some common themes:

Compensation

Shareholders will receive a lump sum for the sale of the practice, retain some ownership in the new organization, and receive a market-based salary.

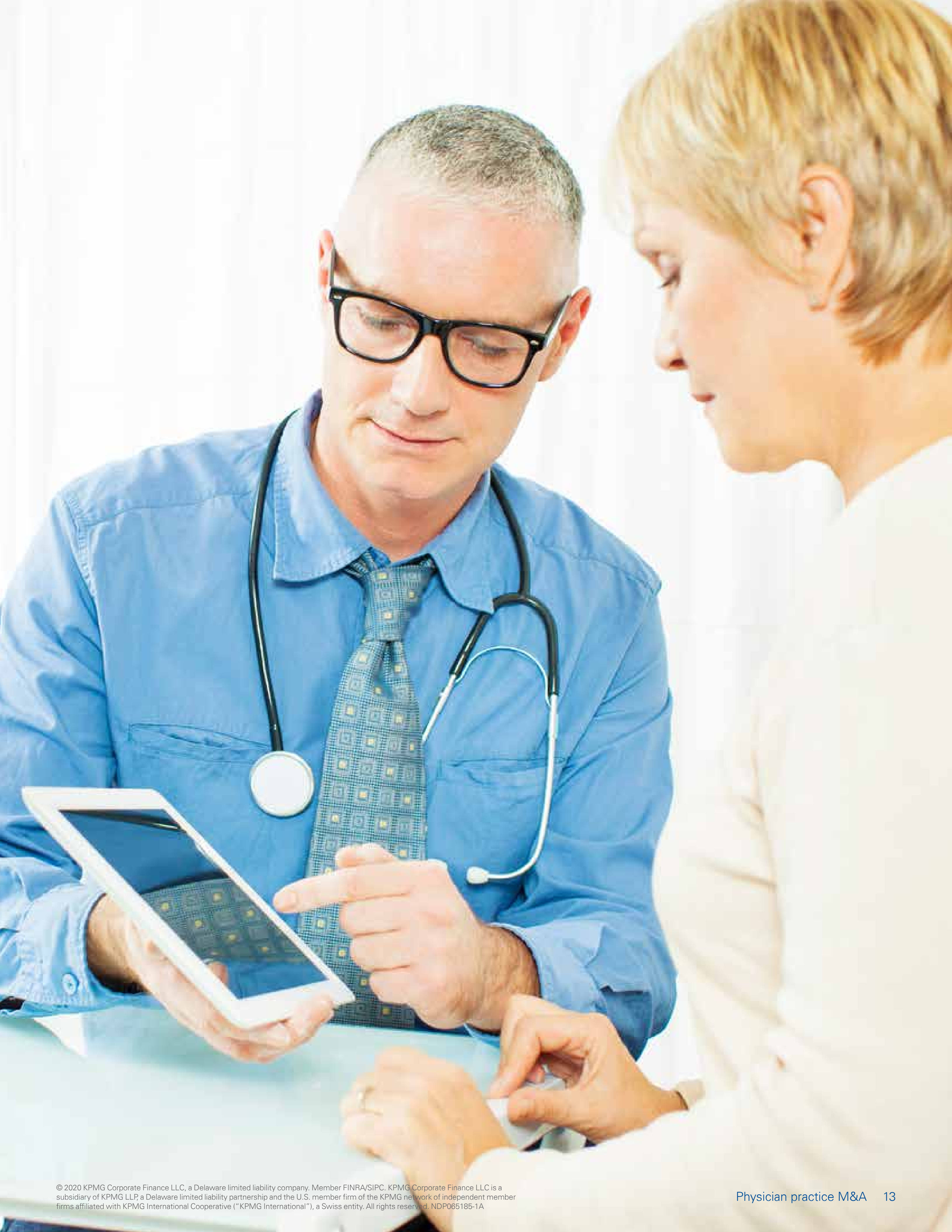
Responsibilities

Shareholders will be able to focus more on clinical care rather than operational and managerial administrative tasks.

Transition and culture

The ultimate buyer will augment existing staff and processes that are in place and leverage new strategies of their own to continue to grow the practice.

Given the changing healthcare marketplace, consolidation of physician practices is likely to continue. For practice owners, understanding your options and taking a preemptive position in the planning process can yield better results not only in terms of valuation, but also the qualitative aspects of a transaction.



Key takeaways

As you weigh your options for a strategic partnership, consider the following:

1

Take steps to increase valuation by focusing on strong financial performance, and identify opportunities for synergies with a future partner and ways to show that you're differentiated in the market.

2

Understand the partnership process before you are approached by private equity sponsors.

3

Establish a common understanding among stakeholders of what your desired results of a partnership would be.

How we can help

KPMG Corporate Finance LLC's healthcare services investment banking team understands that the decision to pursue a strategic partnership is a significant decision. We guide physician practice stakeholders through each step of the process, from deciding whether to pursue a partnership, and understanding the value drivers to executing a transaction.

We're able to answer questions and provide you with objective insights on how to efficiently execute a deal that aligns with your goals and objectives. We understand the healthcare landscape and how to differentiate your practice. We offer actionable insights and guidance while managing the transaction from start to finish. Our decades of transaction experience allow us to navigate complex transactions, our pulse on the dynamics within the healthcare industry help us maximize value, and our relationships with private equity sponsors and strategic buyers are critical for getting your practice in front of more interested parties.

If you would like to begin a discussion around what your options for a strategic partnership could look like, and to better understand how to maximize value during the process, please contact a member of our team.

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KPMG Corporate Finance LLC

The global Corporate Finance practice of KPMG International's network of independent member firms was ranked the #1 M&A middle-market adviser globally for the past 20 years by Refinitiv, based on number of completed transactions.

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