

A Promising Recovery from the Pandemic Shutdown

Private Equity Investment and Consolidation Strategies in Ophthalmology

State of the Market August 2020

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Preface

A View After the Shutdown

Physicians First white papers are designed to provide a clearer picture of M&A activity in the market verticals where we focus.

We return with this updated white paper now because we believe the COVID-19 fog has cleared enough to allow us to provide a view of the market and its likely future direction. Of course, no one can know the future with certainty ... especially given what we've gone through the past few months ... but information and data is now emerging to allow a clearer view.

The future looks promising.

Recent Transactions

Physicians First is designed to provide exceptional investment banking services to specialty practices and ASCs. Our principals lead and manage every transaction from start to finish. That's why we are selective about who and how many we work with.

We partner with a wide range of practice specialties with anywhere from two to twenty plus physicians. Every client gets our personal attention. Despite the COVID-19 slowdown, our past year has been very successful. Since July of 2019 we have completed partnerships around nine businesses with eight more anticipated to close in 2020.

Closed Transactions



Transactions In Progress - 2020 Close Anticipated



Consolidation Strategies Underway in Ophthalmology

The PPM Management Company Strategy

The predominant private equity acquisition strategy is best defined as “Platform-Growth”. Executing this strategy with success requires the acquisition of a large practice or practices which act as a foundation. Those platforms are expanded through “Add-On” acquisitions of medium and small practices and ASCs within a geographic region.



We consider large practice acquisitions to be the key driver of market expansion and a primary indicator of future investment in medium and small practices in a geographic area. A platform practice is defined by a variety of factors, determined in part by the buyer’s preferences. Our market analysis simplifies this and considers the acquisition of practices with five or more physicians as “platforms”. We feel this is a strong indicator of overall platform acquisition activity.

The Physician-Owned Area Consolidation

We see an increasing number of physician-owned practices combine to form larger practices to reap the rewards of scale, and perhaps, complete a larger future transaction.

Physicians First offers specialized services for groups pursuing this strategy. These include strategic consulting, transaction advisory, and unique financing solutions.

The Participation Investment Strategy

A handful of buyers are engaged in what we call a “Participation” strategy – one with less emphasis on geographic density. They seek to acquire strong practices with less regard to geography and are often willing to enter a new area through a smaller acquisition.

Private Equity and Physician Seller End Goals

Improved Patient Care, Revenue Growth, Profit Improvement

In order to gain a return on their investment, PE firms look to improve operations and grow their portfolio companies through organic and inorganic initiatives, ideally driving a much higher valuation and EBITDA multiple when the portfolio company is sold (usually in 5-7 years).

Principal areas for organic growth include referral networks, physician recruiting, contract negotiations and revenue cycle and cost containment initiatives. Managers may also invest in practices via capital improvement projects - additional lanes, new technology or construction of a surgery center. Each investment will present unique opportunities, such as combining multiple practices under a single umbrella for reimbursement purposes. Investors will leverage their size, financial resources, and human capital expertise to achieve desired growth outcomes.

Inorganic growth comes through the acquisition of ophthalmology and optometry practices, ambulatory surgery centers, and other complementary businesses. Investors provide capital and leverage physician knowledge and relationships to identify and pursue appropriate opportunities.

Physician Autonomy

Importantly, most physicians will be surprised by how hands-off these investors are when it comes to day-to-day practice operations. They are rarely interested in physician schedules and local management issues, believing instead that these things are best handled by the physicians themselves and their local management teams. This emphasis on growth and improvement rather than operational change means that physicians can continue to focus on their patients while a well-funded partner works to grow and perpetuate their practice.

Successful Recapitalization at Higher Multiples

Many firms offer physician sellers the opportunity to “roll over” equity into the acquiring company, thus investing along side its other physicians and the PE firm. That equity may be sold in later transactions at a higher value (or EBITDA multiple). This strategy allows physicians to participate in the gains private equity firms achieve.

Positive Recapitalization News

Partners Group Buys FFL's EyeCare Partners for \$2.2 Billion

A highly successful ophthalmology recapitalization just occurred in December of 2019 when Partners Group Holding AG acquired EyeCare Partners, adding one of the largest U.S. ophthalmology and optometry services groups to its portfolio of healthcare investments.



At the time of the transaction, EyeCare Partners was reportedly valued at \$2.2 billion including debt. At that valuation, the transaction carries a multiple of about 16x based on EyeCare Partners reported adjusted EBITDA of approximately \$135 million.

The deal results in the exit of the PE firm FFL Partners after five years of building a successful eye care portfolio company. FFL made its first optometry investment in 2015 and grew to include significant ophthalmology acquisitions in Missouri, Illinois, Alabama, Kentucky, Kansas and Michigan.

Under San Francisco-based FFL's ownership, EyeCare Partners revenue grew at a compounded rate of 65% through organic and inorganic initiatives over the last five years. During that time, EyeCare Partners grew to 435 locations from 63.

According to PE Hub (December 16, 2019), "Partners Group claims victory for FFL's EyeCare Partners in \$2.2 bln deal"

State of the Market

The Effects of COVID-19

The shutdown resulting from the COVID-19 pandemic disrupted a consolidation wave moving into its eighth year, progressing through the usual stages of development. Prior to the shutdown, we believed the ophthalmology consolidation wave was maturing to a more stable and predictable phase of network expansion. Now, as we emerge from the shutdown, transaction progress to-date and the return of cataract elective surgery suggests the ophthalmology M&A market will begin to return to its former strength in Q4 2020.

Positive Signals

Prior to COVID, analysis suggested that many of the large platform practices open to a transaction with private equity had already done a deal. Geographies had been established and networks were being built through add-on acquisitions.

Now, how quickly operations return to pre-COVID levels will be the key to determining market demand and transaction multiples. Ophthalmology has shown strong elective surgery resilience following the shutdown, which will serve to fortify it as a recession and pandemic resistant healthcare investment. In addition, the hardships created by the shutdown and more demanding operating requirements will convince previously reluctant physician owners to seriously consider a sale. These factors point to a future increase in deal activity.

We also have identified areas with great opportunity but little activity to date, such as Texas and multiple areas on the West Coast. We expect to see increased activity here in 2021 including large platform acquisitions.

Cautionary Signals

There are now at least 29 firms invested in ophthalmology, all in various stages of integration, infrastructure buildout, and organic/inorganic growth initiatives. The fact that 21 firms have not closed a transaction in the last six months shows the impact of the shutdown as many pause or rethink their strategies. New investments are gaining favor and may cause funds to refocus on other priorities like Home-Based Healthcare and Hospice. As a result, we expect that at least one "sponsor-to-sponsor" merger will occur in late 2020 or early 2021.

The Market Return

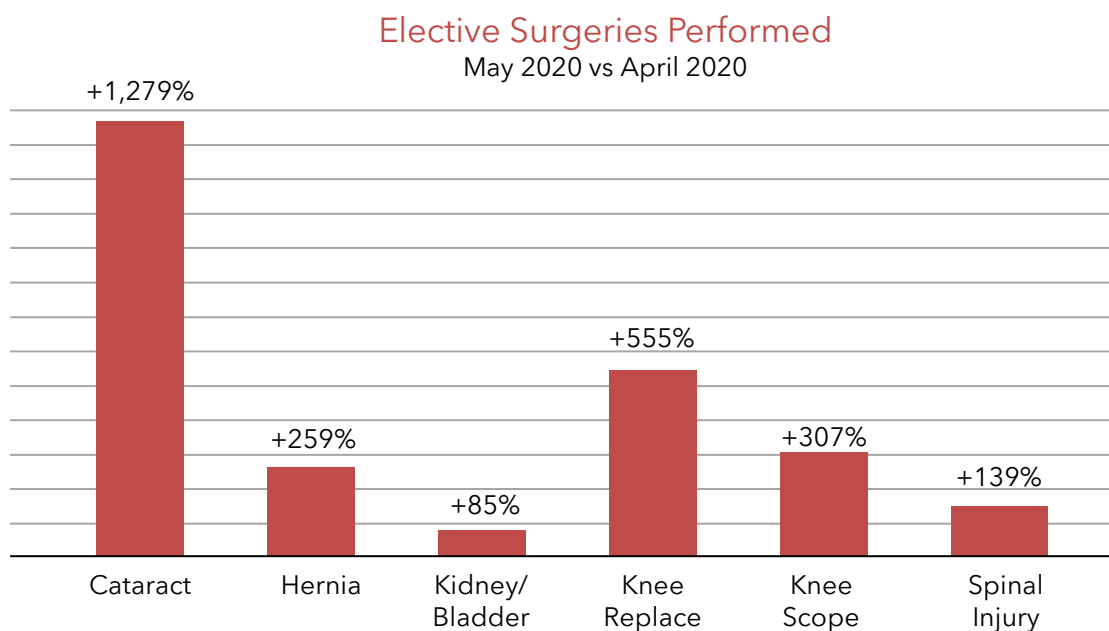
We expect a resurgence of PE/ophthalmology acquisition beginning in the 4th quarter. It is possible transaction activity could reach historical highs at the end of 2020 and into 2021 as deal activity resumes and networks continue to be built out. We also hear a consensus that EBITDA multiples have reached their peak and that most investors are proceeding cautiously with new deals.

Underlying Market Catalysts

A Promising Post-COVID 19 Recovery

Key factors can underly market performance and signal future direction. As of now, the most important factor surrounding the ophthalmology consolidation market is the speed and magnitude of a return to pre-COVID operations and revenue generation.

As our stay-at-home orders began to lift and the economy began to open, May of 2020 provided a key data point to gauge that recovery. As can be seen below, ophthalmology ranked #1 in resilience with elective cataract surgeries up 1,279% from April 2020. The speed and magnitude of that return far outpaced other elective surgeries.



Source: Jason Krantz, CEO Definitive Healthcare, Three Unexpected Healthcare Industry Trends in 2020 - June 24, 2020

Emerging Retina-Only Network Creation and Development

A second underlying catalyst to acquisition activity came in the way of a new emphasis on retina-only networks. Retina is considered a unique specialty within ophthalmology, often operating as a stand-alone entity versus a part of a general ophthalmology practice.

Some PE firms have worked to integrate retina into their ophthalmology network as a key patient service, but that approach has been limited. Now, a new retina-only network approach is being pursued by two firms. If successful, this approach may lead to a significantly higher number of retina deals in the next few years.



PPM Dashboard

*Definition: A **dashboard** is a graphical user interface that provides at-a-glance views of key performance indicators (KPIs) to provide a clearer understanding of business or market activity.*


The following key performance indicators help provide an unbiased numeric view of the marketplace. It is a useful tool that tracks key data points to understand market dynamics.

We use this data in context with other input we receive in our day-to-day dealings. Properly designed, a dashboard can provide a numeric picture of market strength and direction.

Beginning the first quarter of 2017, our dashboard signaled Expansion – characterized by consistent new firm entries and deals in new geographic areas. In late 2019 the market signaled a transition to Network Growth, characterized by consistent add-on acquisitions and expansion into strategic areas. Now, the dashboard shows the market has paused as the effects of COVID-19 are worked through.

Key Signals in 2020 .. A Strong Start Awaiting Recovery

- Acquisition of 5+MD practices matched the all time high for a quarter with 12 in Q1.20.
- Four new PE firms entered ophthalmology in Q1.20, the highest since Q2.17.
- Four New Geographic Areas (NGA) have been entered to-date in the 2020 calendar year.
- Q2.20 acquisitions fell to the lowest level since the consolidation started in 2016.
- 21 of 29 PE firms (72%) had no acquisition in the last 6 months.

	2018				2019				2020			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3*	Q4
Number of New PE Firms Entering The Ophthalmology PPM Sector	3	2	2	2	1	2	1	0	4	0	0	
Total Acquisitions	19	10	14	29	10	18	20	16	19	6	4	
Platform Acquisitions (5+ MD)	10	6	3	12	5	7	8	3	12	1	2	
Add-on Acquisitions	9	4	11	17	5	9	12	13	7	5	2	
Number of New Geographic Areas (NGA) Entered through Acquisition	4	2	2	3	2	8	5	0	3	0	1	
Number of Firms Closing an Acquisition in the Quarter	10	6	8	14	9	12	9	8	11	2	4	
Number of Firms Invested with No Acquisition in the Last Six Months	2	3	7	4	4	7	10	12	14	14	21	
Management Company Recapitalizations								1				

Note: Data Scorecard data is based on publicly available records and information provided to us by acquiring firms with authorization to publish.
*Q3 2020 data is through August 4, 2020

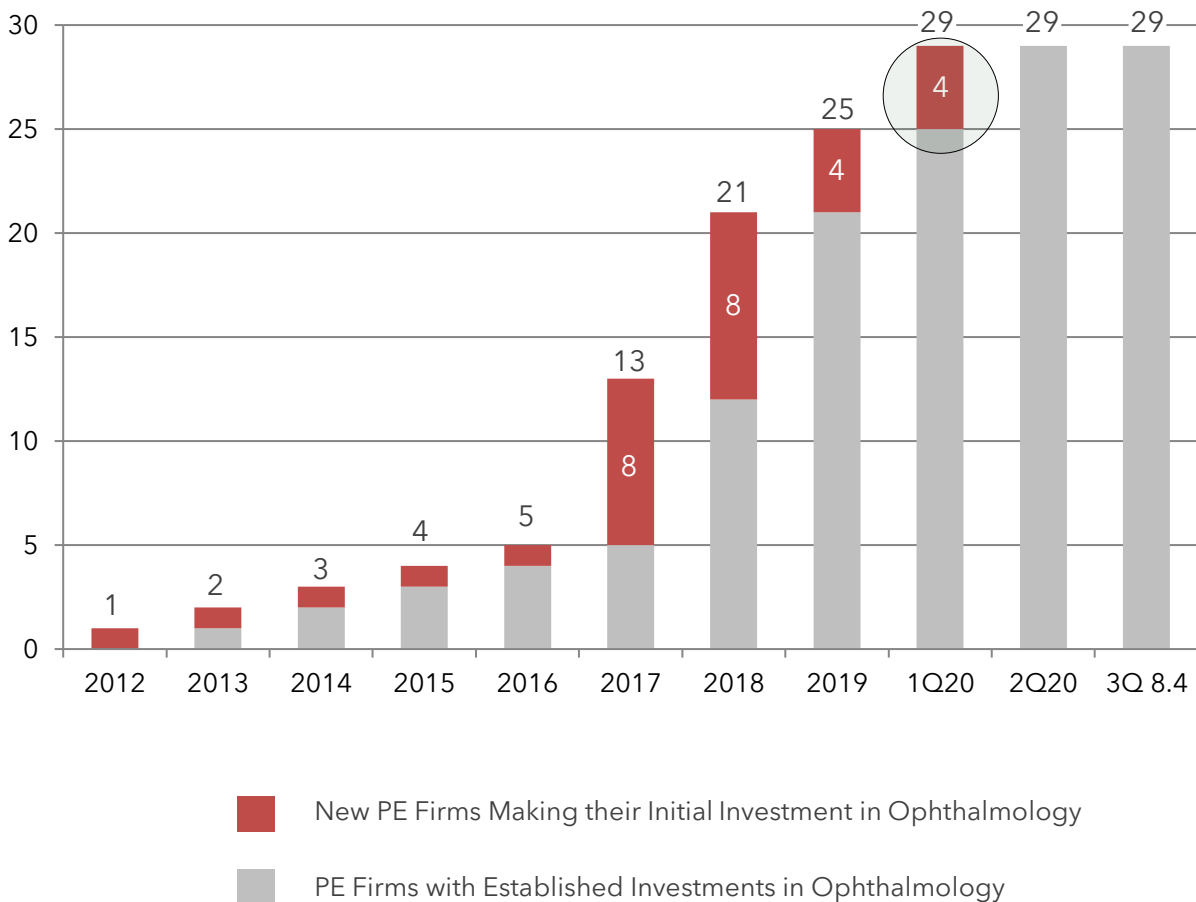
Investor Attraction – From Hot to Cold

For any business, entering a new market is a big decision. The key drivers to that decision are saturation and profit potential. When a market has high profit potential and low competitor saturation, new entries are attracted. This is clearly exhibited by the large number of new PE firms entering ophthalmology in 2017 and 2018.

In the first quarter of 2020, four new PE firms entered ophthalmology matching the highest ever. 2020 was off to a fast start. Since then, no new firms have entered ... the first time that has occurred since the consolidation began in 2012.

In addition, as previously noted on the dashboard, deal activity has cooled dramatically with 21 of 29 firms making no acquisitions in the last six months.

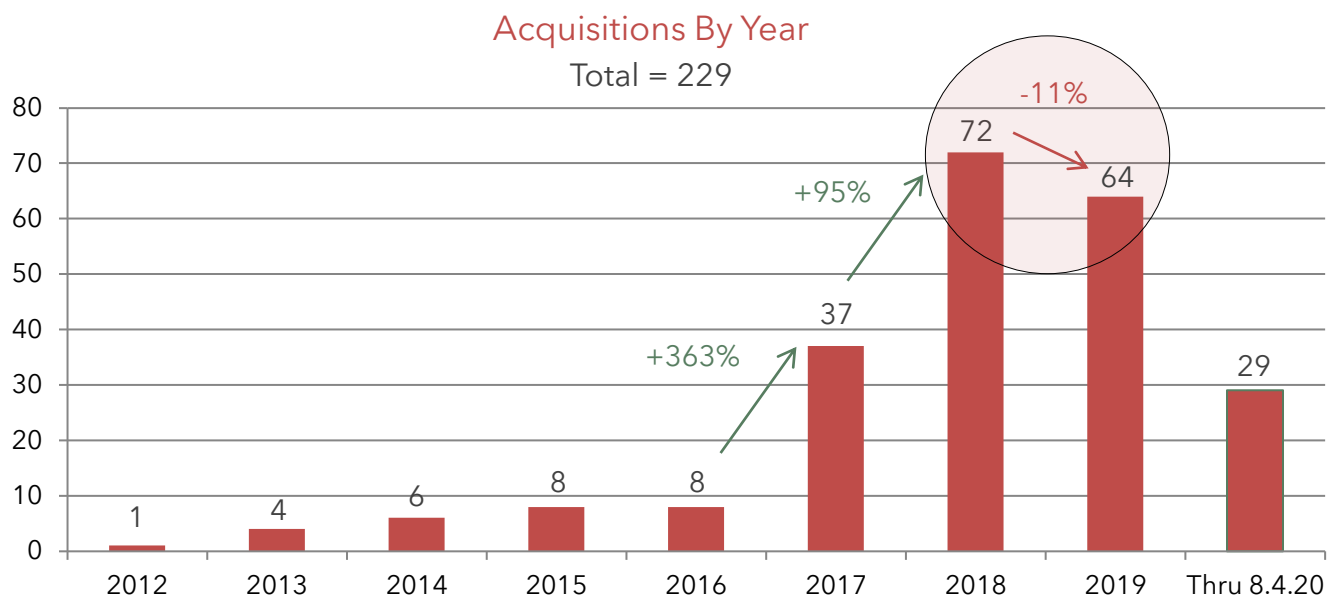
PE Firms Investing in Ophthalmology



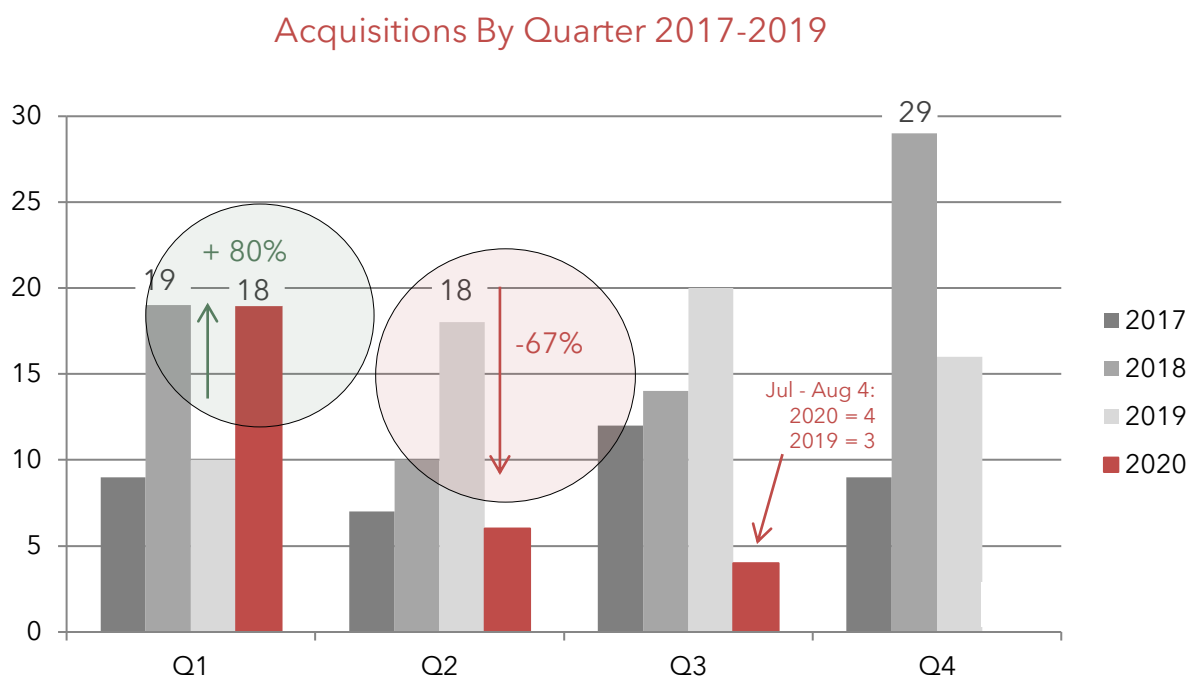
Acquisition Activity Works Through the Shutdown

We expected the tremendous growth in acquisition volume experienced in 2017 and 2018 to eventually slow. That happened in 2019 as the consolidation process matured into a more stable growth phase with actual acquisitions down 11% from 2018.

Acquisitions for the 2020 calendar year through 8/4 count only 28, made up of a relatively strong first quarter followed by a historically low second quarter.



Early indicators point to a return to more normal deal numbers in the third quarter. Although only one month into the third quarter, 2020 acquisitions are ahead of same time 2019.

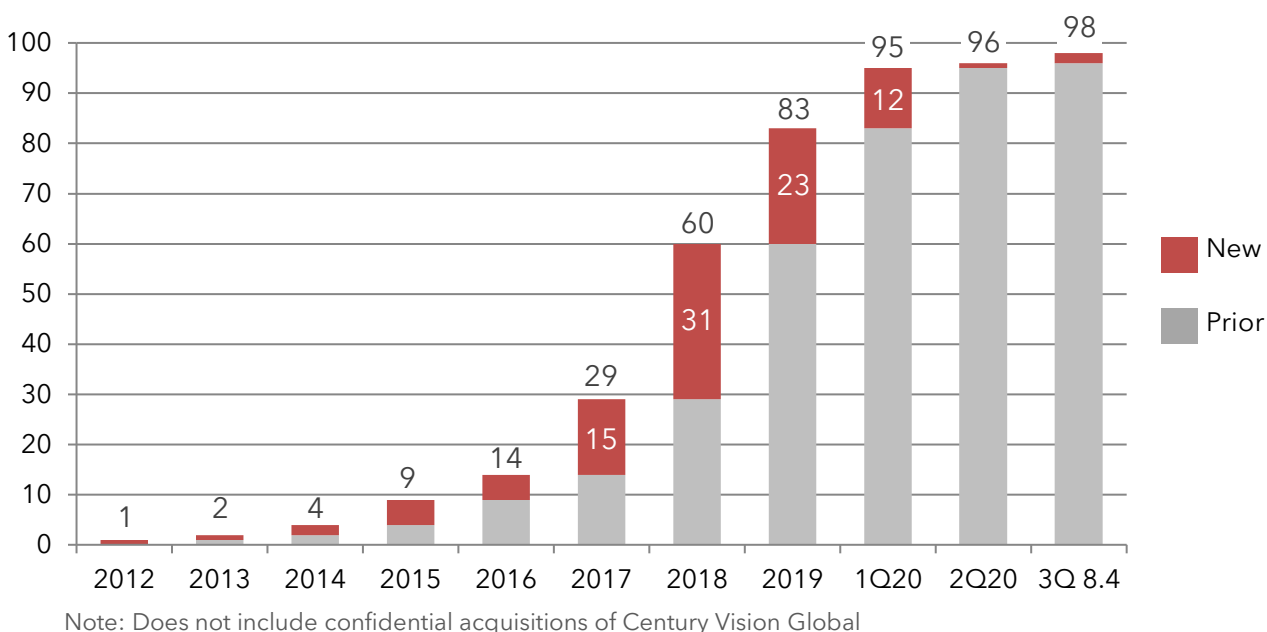


Large Practice Acquisition Activity

We consider large practice acquisitions to be the key driver of market expansion and a primary indicator of future investment in medium and small practices. Based on our experience, those expansion drivers can be identified as practices with five or more physicians.

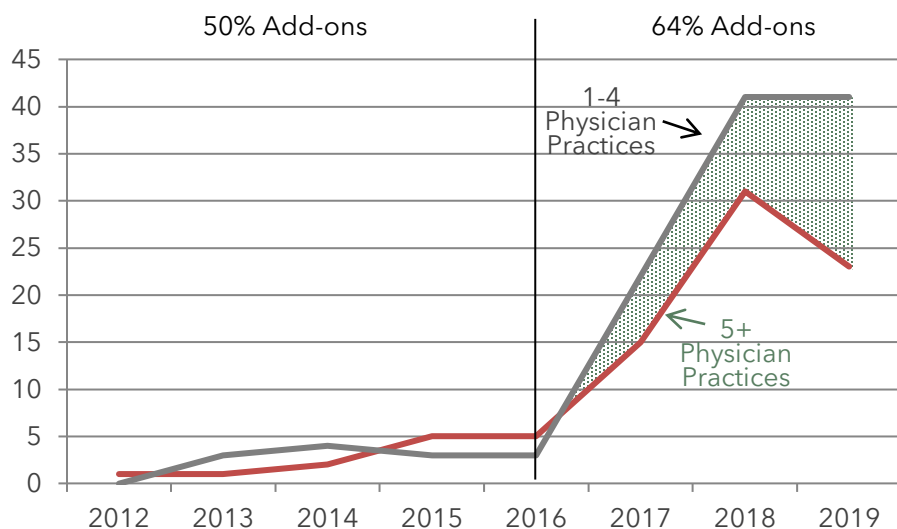
2020 got off to a fast start with 12 large practice acquisitions in the first quarter, then fell abruptly due to COVID-19. Total large practice acquisitions of 98 represent 43% of total ophthalmology acquisitions to-date.

Acquisitions of 5+ Physician Practices

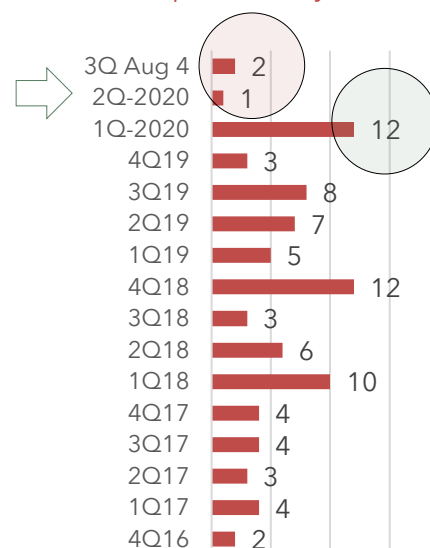


Pre-COVID, the market was moving more strongly toward network building. We expect this trend to continue but do see growth prospects in recent large practices acquisitions, new geographies and retina.

Pre-COVID: Market Moving to Network Building



5+ Acquisitions by Quarter



Geographic Targeting and Development

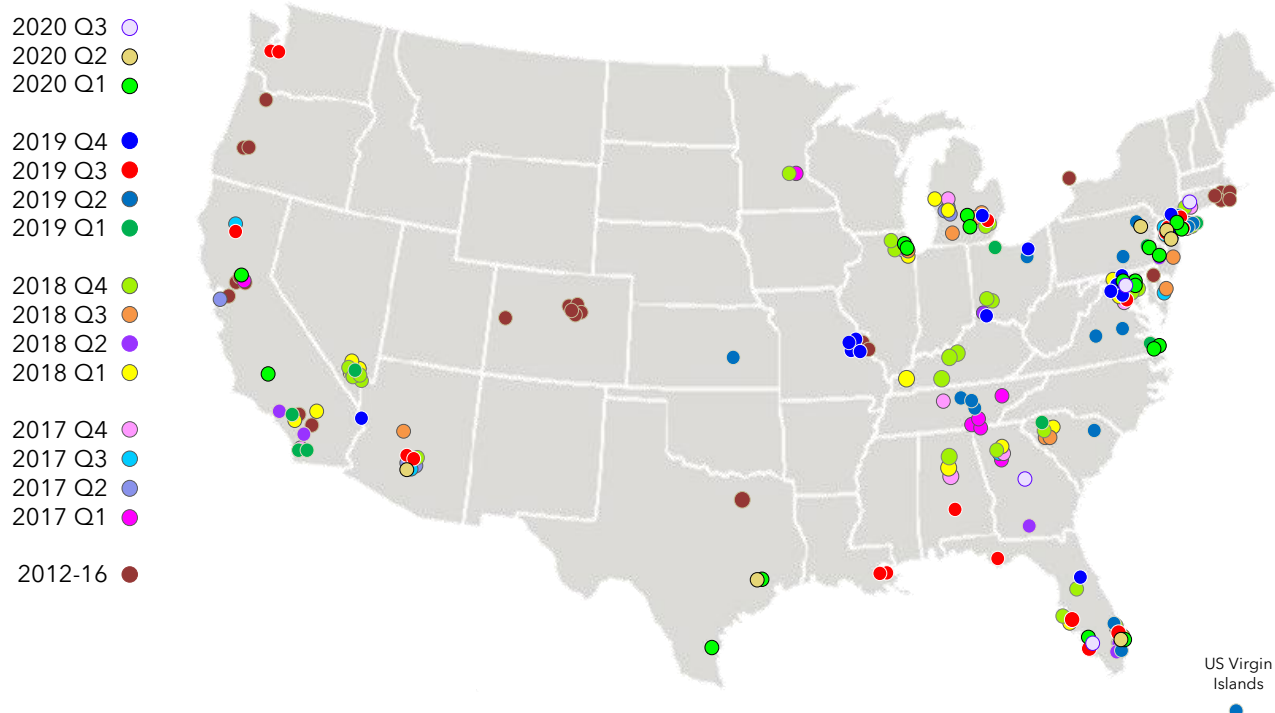
2020 through August 4 activity is shown below in the following areas:

- Macon, GA (NGA)
- Baltimore, MD (3)
- Boca Raton, FL (2)
- Chicago, IL (2)
- Ft Myers, FL (2)
- Houston, TX (2)
- New York, NY (2)
- Virginia Beach, VA (2)
- Allentown, PA
- Bakersfield, CA
- Corpus Christi, TX
- Jackson, MI
- Lansing, MI
- New Brunswick, NJ
- Newark, NJ
- Phoenix, AZ
- Philadelphia, PA
- Sacramento, CA
- Scranton, PA
- Washington, DC
- Waterbury, CT

Despite all the events taking place in the first quarter of 2020, the total of nineteen acquisitions represents the third highest level of quarterly deals since the ophthalmology consolidation began. More importantly, 12 of those deals were for large practices which signal future add-on activity. In addition, four new geographic areas (NGA) were entered in Texas, California and Georgia.

Overall activity has been heaviest in the Eastern United States, with the Southeast, Mid-Atlantic, Northeast, and much of the Midwest seeing very competitive acquisition markets - even for small and medium practices. Southern California has also become more active, but the Central US appears more in its initial stages - with several major acquisitions in different geographies without a lot of "fill-in" activity.

Ophthalmology Practice & ASC Acquisitions 2012 - August 4, 2020



This map provides a visual summary of private equity/ophthalmology consolidation activity beginning in 2012. Each dot represents a practice acquisition. Multi-location practices are shown with only one dot.

Opportunity Areas – Open Geographies

Several key geographies have experienced little or no private equity investment yet offer compelling opportunities.

Eastern Midwest

West Pennsylvania through most of Illinois is relatively open. Yet, many opportunities exist here including ASC acquisitions in non-CON states. Hospital dominance can make some of these markets more challenging.

TOLA

Large, highly populated, and fast-growing, Texas presents an excellent opportunity market. We expect several large acquisitions going forward as investors find the right physician partners. Surrounding states of Oklahoma, Louisiana and Arkansas offer opportunity as well.

Northern California and the Pacific Northwest

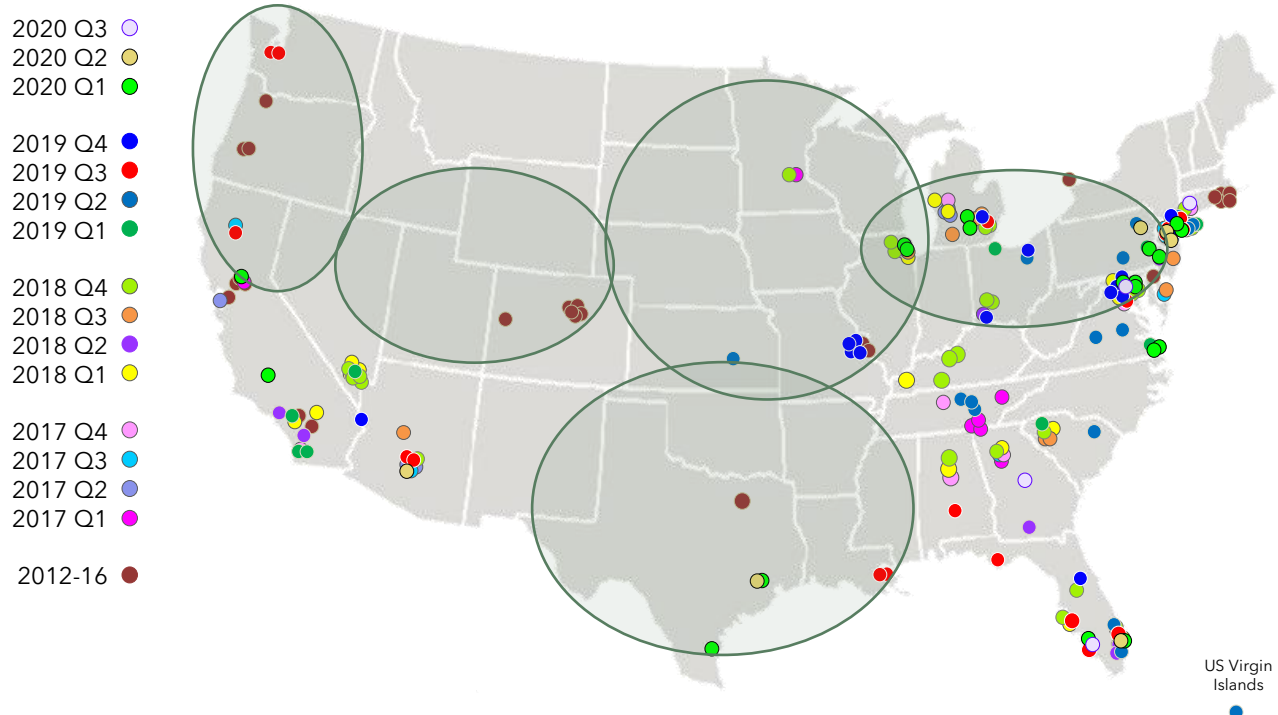
An investor could be very successful in Northern California through effective partnership with the many small practices there. The Pacific Northwest is home to some large players that could be initial platform investments.

Central Midwest and Mountain Regions

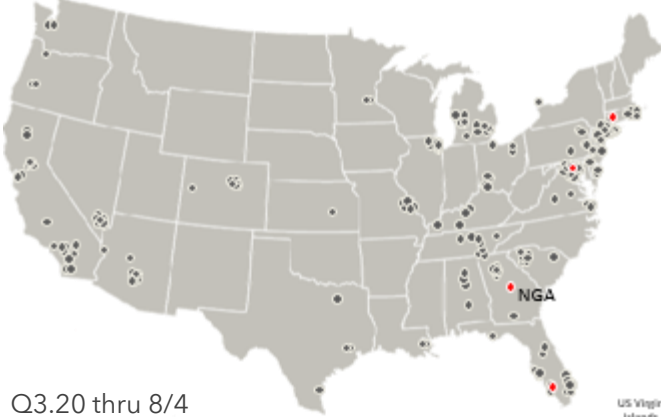

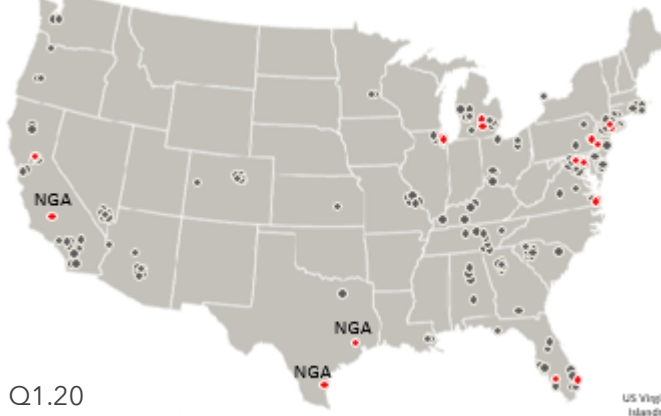

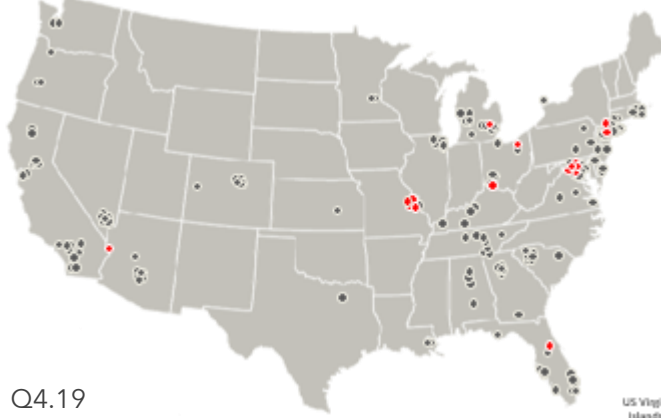

Though less concentrated, these areas are generally stable and offer strong opportunities for investors willing to work over a greater footprint. Building scale through add-ons here may prove challenging.

Ophthalmology Practice & ASC Acquisitions

2012 – August 4, 2020



Geographic Investment Highlights – Last Four Quarters

 <p>Q3.20 thru 8/4</p>	<ul style="list-style-type: none"> • One New Geographic Area (NGA) entered this quarter ... EyeSouth Partners enters Macon, Georgia • Prism Vision Group strengthens its presence in Baltimore/Washington acquiring The Retina Group of Washington (30 physicians) • Refocus acquires second practice in Connecticut with purchase of OptiCare Eye Health & Vision Centers in Waterbury, CT (7 physicians) • Quigley Eye Specialists strengthens its position in Ft Myers, Florida with first add-on acquisition in Prendiville Facial Plastic Surgery (1 physician)
 <p>Q2.20</p>	<ul style="list-style-type: none"> • EyeCare Partners closes four acquisitions in the second quarter of 2020 with an emphasis on Retina: <ol style="list-style-type: none"> 1. Arizona Eye Institute & Cosmetic Laser Center of Phoenix (3 physicians) 2. Vitreous Retina Macula Specialists of New Jersey, Somerset, NJ (2 physicians) 3. The Retina Clinic - Mine Hill, NJ (Newark - 1 physician) 4. Patel Retina - Carks Summit, PA (Scranton - 1 physician) • EyeSouth makes two acquisitions: <ol style="list-style-type: none"> 1. Coastal Eye Associates, Houston (8 physicians) 2. Mitchell Refractive, Boca Raton (1 physician)
 <p>Q1.20</p>	<ul style="list-style-type: none"> • Three New Geographic Areas (NGA) Entered • Webster Equity Partners enters ophthalmology forming Retina Consultants of America by acquiring 5 large retina practices in CA, TX, FL, and NY • New Harbor Capital enters ophthalmology acquiring Quigley Eye Specialists of Southwest FL (8 physicians) • MoonSail Capital enters ophthalmology forming Ocular Partners acquiring two large Chicago practices • KKR rebrands Covenant Physician Partners and purchases Texas Eye Care Network <div data-bbox="852 1407 1477 1512">  </div>
 <p>Q4.19</p>	<ul style="list-style-type: none"> • Partners Group acquires EyeCare Partners from FFL Partners for a reported \$2.2 Billion • No New Geographic Areas entered this quarter • Vision Innovation Partners strengthens Maryland network with four new acquisitions • Midwest Vision Partners acquires platform practices in Flint MI and Cleveland, strengthens Midwest presence • CEI Vision Partners acquires 2nd Cincinnati platform (11 physicians) • Vision Integrated Partners acquires four in St Louis <div data-bbox="974 1890 1323 1963">  </div>

10 Key Takeaways

... From this mid-2020 State of the Market white paper:

1. The end goal objectives of early investors in ophthalmology have been achieved through successful recapitalization at high EBITDA multiples. Once the pandemic effects are behind us that will bolster continued development by participating investors.
2. Four new private equity firms began investing in the ophthalmology space in the first quarter of 2020, the highest quarterly influx of investors since the second quarter of 2017 when the consolidation was in its fastest growth period.
3. The ophthalmology acquisition market got off to an unusually fast start in 2020 but fell victim to the pandemic shutdown. In general, deals in process slowed or paused and new deal generation fell dramatically.
4. Ophthalmology has shown very strong elective surgery resilience following the shutdown, which will serve to fortify it as a recession and pandemic resistant healthcare investment.
5. Hardships created by the shutdown and more demanding operating requirements will convince previously reluctant physician owners to seriously consider a sale.
6. A new retina-only network approach is being pursued by two new firms. If successful, this approach may lead to a significantly higher number of retina deals in the next few years.
7. As we emerge from the COVID-19 shutdown, transaction progress to-date and the fast return of cataract elective surgery suggests the ophthalmology M&A market will begin to return to its former strength in 4Q 2020.
8. It is possible transaction activity could reach historical highs at the end of 2020 and into 2021 as deals activity resumes, networks continue to be built out and new geographies are entered.
9. There is a growing consensus that EBITDA multiples have reached their peak and that most investors are proceeding cautiously with new deals.
10. New healthcare investments are gaining favor and may cause investor funds to be refocused to other priorities like Home-Based Healthcare and Hospice.

PHYSICIANS FIRST

Healthcare Services Investment Bankers

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Physicians First provides investment banking services focused exclusively on specialty medical practices, healthcare services and ambulatory surgery centers.

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Additional information and resources are available at www.physiciansfirst.com

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Notes

This image shows a full page of blank, lined paper. It features approximately 20 horizontal blue or grey lines spaced evenly apart, typical of notebook paper. The lines extend across the entire width of the page, leaving small margins at the top and bottom. There are no vertical lines, text, or other markings on the page.