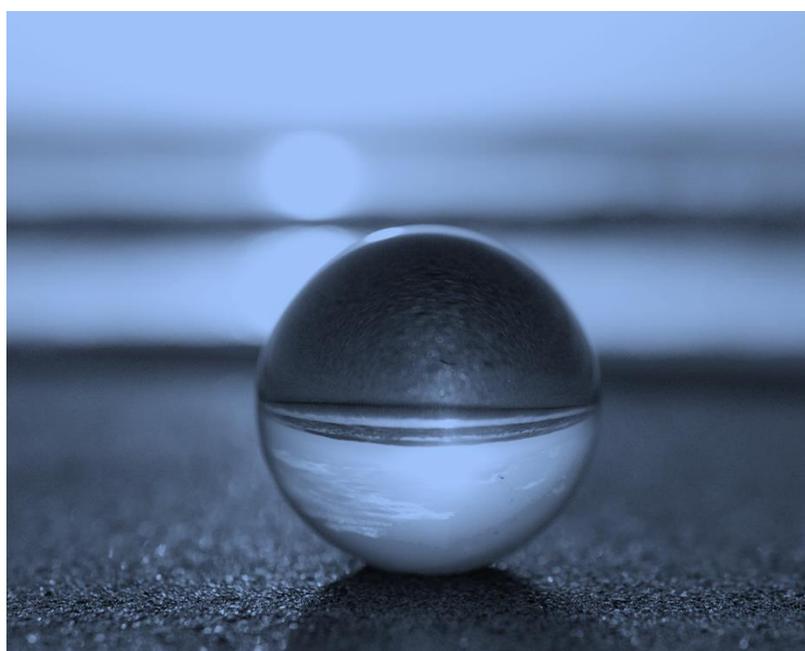


FOCUS

Investment Banking

Healthcare Team

PRIVATE EQUITY INVESTMENT AND CONSOLIDATION STRATEGIES IN GASTROENTEROLOGY



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

January 2020

WHITE PAPER

- 2 Physician Owner Specialization
- 4 Consolidation Strategies Commonly Employed
- 5 The End Goal for Private Equity and Physician Sellers
- 6 Successful Recapitalizations
- 7 Private Equity Investors in Gastroenterology
- 8 PPM Dashboard
- 9 Analytic and Comparative Methodology
- 10 Market Fundamentals
- 11 Overview of Participating Private Equity Firms
- 12 Acquisition Activity Analysis
- 14 Geographic Targeting & Development
- 15 Quarterly Investment Highlights
- 16 Key Takeaways / 2020 Outlook

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Physician Owner Specialization

Our Services .. New Highs in 2019

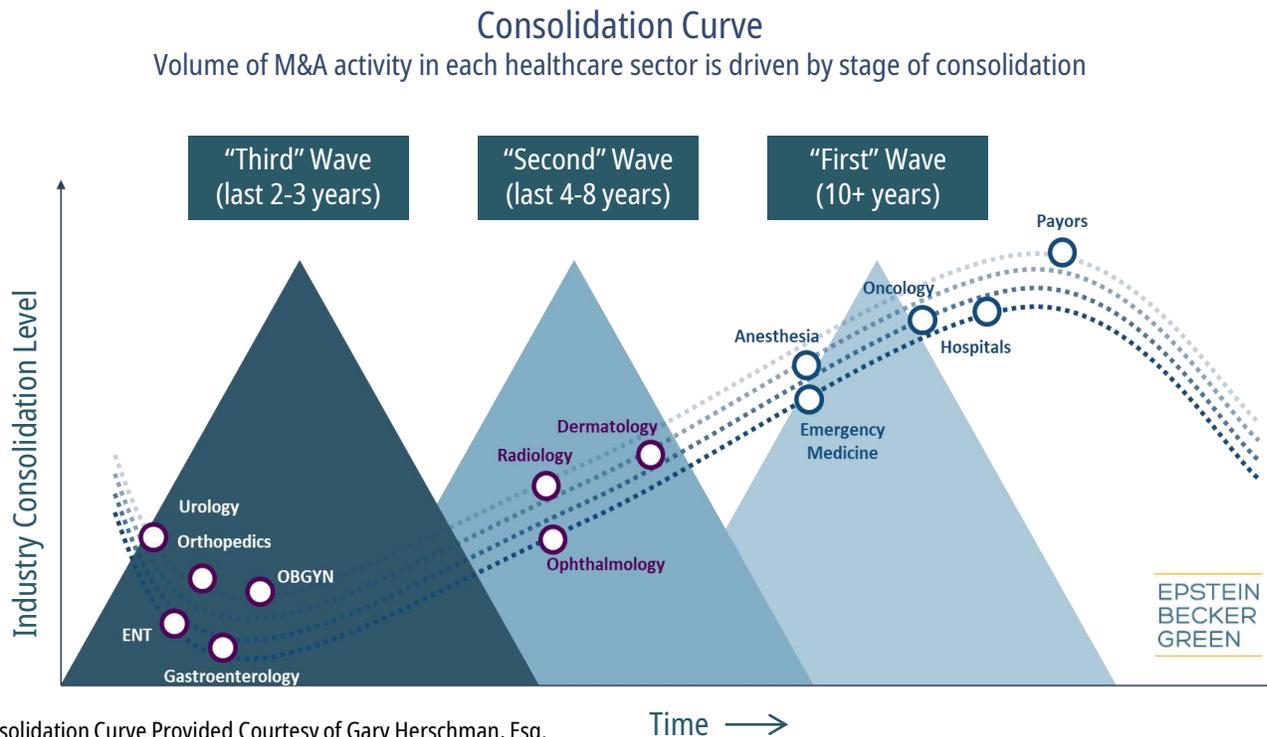
FOCUS Healthcare specializes in investment banking services focused on mergers & acquisitions involving clinicians. We represent physician groups in transactions with private equity and ASC management company investors across the United States. The demand for our services hit new highs in 2019. Since July of 2019, we have had seven successful closings and have eight additional businesses under Letter of Intent as we begin 2020.

We are a leading expert on this market and its participants. This White Paper is designed to share those 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 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.

Since July of 2019 we have closed transactions for seven clinical businesses and have eight businesses under LOI.

Transactions Closed

04

Specialty
Medical
Practice
Closings



03

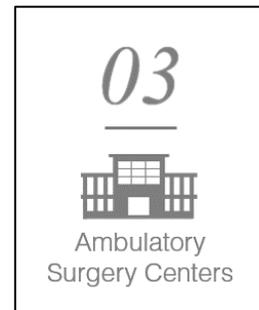
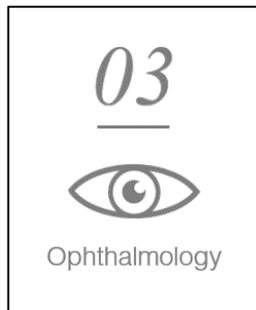
Ambulatory
Surgery Center
Closings



Transactions In Progress – 2020 Close Anticipated

08

Businesses
Under Letter
of Intent



Specialty Consolidation Strategies

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 ten or more physicians. We feel this is a strong indicator of overall platform acquisition activity.

The Physician-Owned Area Consolidation

We are seeing an increasing number of physician-owned practices combine to form larger practices to reap the rewards of increased market coverage, expansion of services, consolidated investment and operating cost efficiencies. This approach can create the most lucrative selling opportunity for physician owners.

Physicians pursuing this strategy are aware of the potential to sell to private equity in the future at favorable multiples. However, the challenge of running a practice while pursuing consolidation is very demanding and prohibitive for most physicians.

We offer specialized services for groups pursuing this strategy. These include strategic consulting, transaction advisory, and unique financing solutions. Please contact us for more information.

The Participation Investment Strategy

A handful of players 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.

The End Goal for Private Equity and Physician Sellers

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. They will also invest in practices via capital improvement projects - perhaps additional offices, 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 gastroenterology 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, if ever, 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.

Recapitalization Examples - Ophthalmology

The ophthalmology consolidation is about four years ahead of gastroenterology with two successful recapitalizations to-date providing an example of end-goal achieved:

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 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 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"

Harvest Partners Buys Varsity's EyeCare Services Partners

In May of 2017, Harvest acquired Varsity's majority ownership interest in ESP. Since its founding in May 2014, the company had scaled to 46 practice locations and seven ambulatory surgery centers across California, Colorado, Delaware, Illinois and Maryland at the time of this acquisition.



The existing management team was chosen to continue to lead ESP and retained a significant stake in the company. Harvest Partners said, "ESP is exactly what we look for in a partner company. It is an undisputed leader in a burgeoning business model where there are few sizeable players. There is a clear path for growth as an aging population will require more and better services in eye and vision care."

According to Harvest Partners Press Release (May 22, 2017), "Varsity Healthcare Partners and Harvest Partners Announce Recapitalization of EyeCare Services Partners"

Private Equity Investors in Gastroenterology

Private equity firms usually create a subsidiary Practice Management Company within their portfolios to acquire and manage gastroenterology practices and ancillary businesses. Most transactions include some equity ownership in that parent management company.

The combination of the private equity firm names and the new practice management company names can be confusing and is simplified below.

Private Equity Firm	Gastroenterology Management Company
	
	
	
	
	<p data-bbox="678 1528 922 1644">Non- Acquisition Strategic Partnership To Form Management Platform</p> 
	

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 brings data into the quest to understand complicated 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.

Audax Private Equity (Gastro Health) was the sole PE investor in gastroenterology from 2016 through the third quarter of 2018, building a presence in Florida. Since that time, five new PE firms have entered. Acquisition activity has accelerated steadily with a major uptick in the fourth quarter of 2019.

Significant Fourth Quarter Acceleration Signals:

- A new high of seven platform acquisitions.
- New Geographic Area entries have doubled in each of the last three quarters of 2019. Total NGAs entered in the third and fourth quarters alone exceed all expansion activity occurring in the prior eight quarters.
- Four firms closed an acquisition, the highest ever in one quarter.
- Add-on acquisition activity increased quarter to quarter for the first time since Q2 2017.

	2016		2017			2018				2019			
	Q1	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Number of New PE Firms Entering Gastroenterology PPM Sector	1	0	0	0	0	0	0	0	2	0	1	1	1
Total Acquisitions	1	1	3	1	1	0	0	2	2	1	2	4	10
Platform (10+) Acquisitions	1	0	0	0	0	0	0	1	2	0	2	3	7
Add-on Acquisitions	0	1	3	1	1	0	0	1	0	1	0	1	3
Number of New Geographic Areas (NGA) Entered through Acquisition	1	0	0	1	0	0	0	1	2	0	2	4	8
Number of Firms Closing an Acquisition in the Qtr.	1	1	1	1	1	0	0	1	2	1	2	3	4
	Gastro Health Executed All Acquisitions from 2016 – Q3 2018												
Number of Firms Invested with No Acquisition in the Last 6 Months	0	0	0	0	0	0	1	0	0	0	2	1	1
Management Company Recapitalizations	0	0	0	0	0	0	0	0	0	0	0	0	0

Note: Data Scorecard data is based on publicly available records and information provided to us by acquiring firms with authorization to publish.

Data Analytics and Comparative Methodology

We work hard to advise and manage individual transactions with excellence, but we also feel it is very important to understand the overall “state” of the market. To do that we leverage our day-to-day interactions with buyers and sellers along with data analytics and comparative methodology.

Data Analytics

Our team follows all acquisition activity across the U.S. to track and analyze what is happening within a very complex market. We then roll-up that detailed information to create overall market statistics that can be analyzed to better understand overall activity and trends. Those analytics follow in the coming pages.

Comparative Approach

We also know that there is nothing better than a roadmap when viewing a market travelling through a cycle, which is what these healthcare specialty/private equity consolidations are doing. Understanding the path taken by previous consolidations gives us perspective and insight into current conditions and helps us anticipate future developments.

For gastroenterology, we are fortunate to have ophthalmology as a predecessor that is only four years ahead. That provides a fresh roadmap that allows us to compare the gastroenterology market activity to what previously happened in ophthalmology under virtually the same market and economic conditions. For example, how does the acquisition activity in year four of the gastroenterology consolidation compare to year four of the ophthalmology consolidation?

This multi-faceted approach to market understanding helps us anticipate risk and opportunity for ourselves and our clients.

Market Fundamentals

Gastroenterology vs Ophthalmology

When doing comparative analysis, it is important to understand the similarities and the differences between the two specialties when viewing their market fundamentals from the buyer's perspective. We consider these factors in our evaluation and outlook.

Key Similarities and Differences

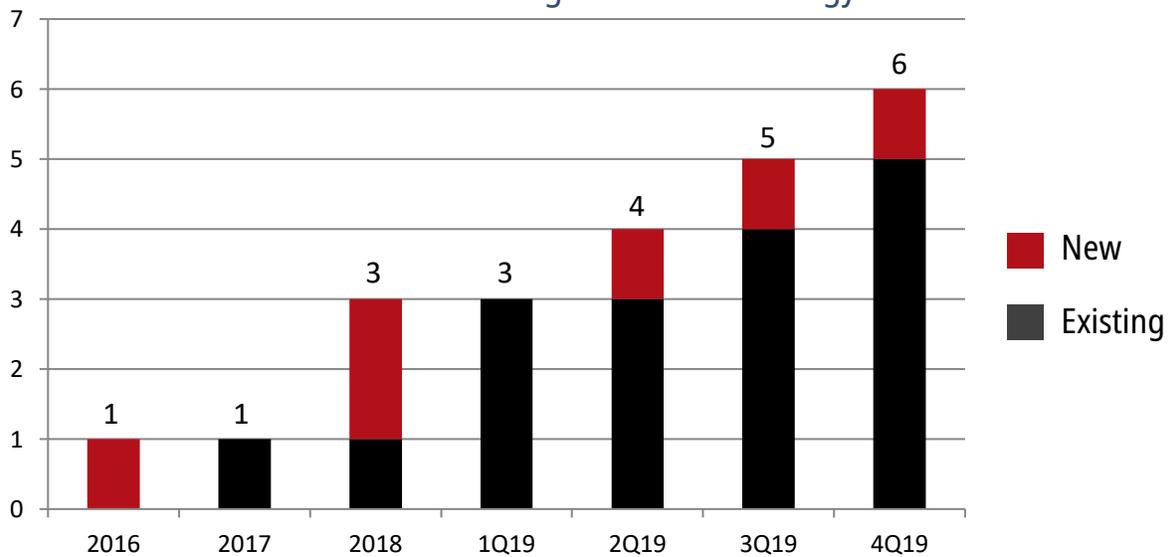
1. The services of both specialties are largely age-driven and experiencing strong demand due to the current population makeup (cataracts, colonoscopy screening, etc.).
2. Future population aging patterns favor an increasing demand for both specialties.
3. The average age of a gastroenterology patient is younger than the average ophthalmology patient and as a result there is lower Medicare payment exposure in gastroenterology.
4. Referral Networks:
 - Gastroenterology referrals are primarily from Primary Care and as a result have more exposure to losing patients to hospitals and health networks.
 - Ophthalmology referrals are primarily from Optometry with some Primary Care and as a result have more exposure to private players.
5. Practice Size:
 - There are a higher number of very large physician groups in Gastroenterology and as a result there are more markets where one group dominates.
 - The ratio of smaller practices (Add-ons) to larger practices (Platforms) is very similar between gastroenterology and ophthalmology. Therefore, gastroenterology presents a high level of consolidation opportunity.
6. Market Size by Physician:
 - Based on physician count, gastroenterology is approximately 40% the size of ophthalmology.
 - This makes it more attractive to private equity investors because it is easier to consolidate a key market presence.
7. Ambulatory Surgery Centers:
 - There are many strong gastroenterology surgery centers available for potential acquisition.
 - Amsurg and similar management companies have made early inroads into investment in gastroenterology ASCs, thus limiting acquisition options in some geographic areas.

Overview of Participating Private Equity Firms

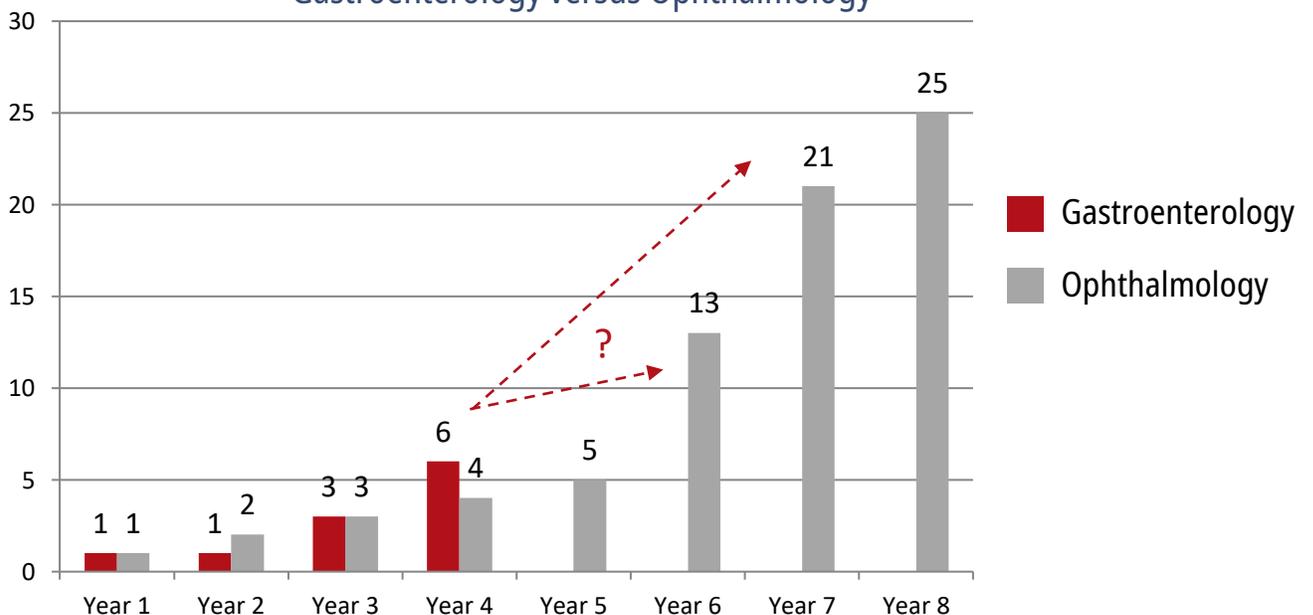
For any business, entering a new market is a big decision. The key drivers to that decision are saturation and profit potential. When a market has high profit potential and low competitor saturation, new entries are attracted. This is clearly exhibited by the increase in PE firms entering gastroenterology in 2018 and 2019.

The number of PE firms investing in Gastroenterology grew faster than ophthalmology in year four of the consolidation lifecycle. This comparative analysis foreshadows two possible growth trajectories. Given the unique makeup of gastroenterology in terms of physician size, market coverage and acquisition opportunity, we believe a significant number of new PE investors will enter in 2020.

PE Firms Investing in Gastroenterology



PE Firm Entry
Gastroenterology versus Ophthalmology

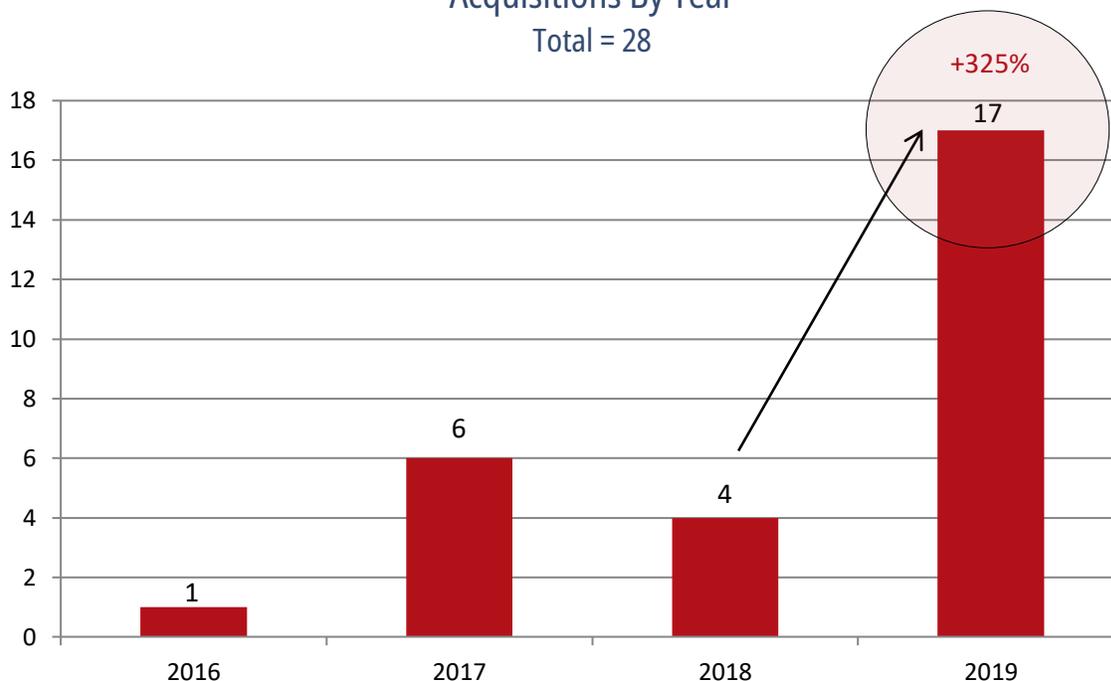


Acquisition Activity – Was 2019 the Tipping Point?

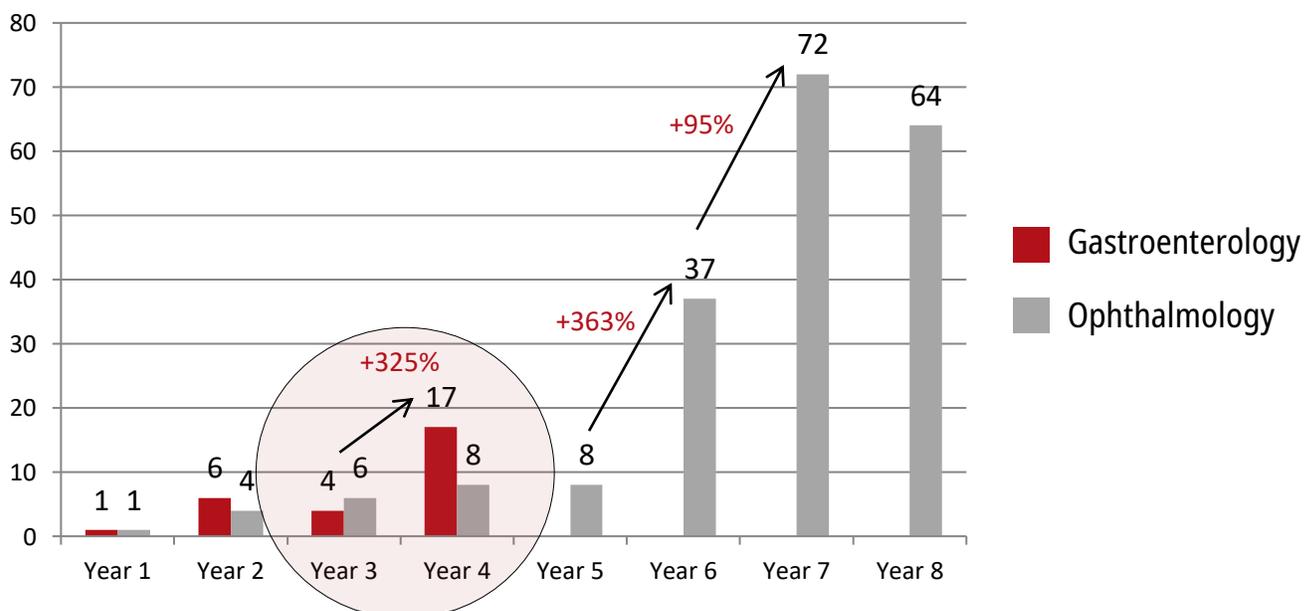
We saw very strong growth in acquisition volume in the 2019 calendar year following three years of relatively low activity. That increase, along with the expected increase in PE firm participation, suggests the consolidation has reached a tipping point that signals a significant surge in activity by firms already invested as well as those considering entry. We believe the rush is on to secure strong platform acquisitions and important add-on practices in key geographic areas.

Acquisitions By Year

Total = 28



Acquisition Life Stage Gastroenterology versus Ophthalmology

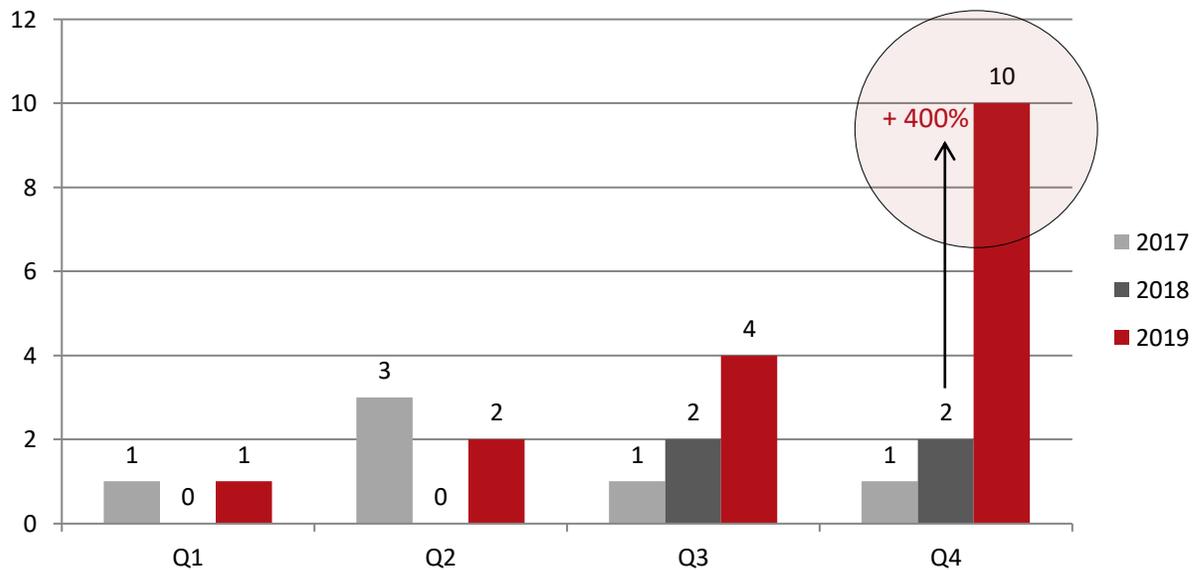


The Big Move to Platform Acquisitions

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, we define those as practices with ten or more physicians.

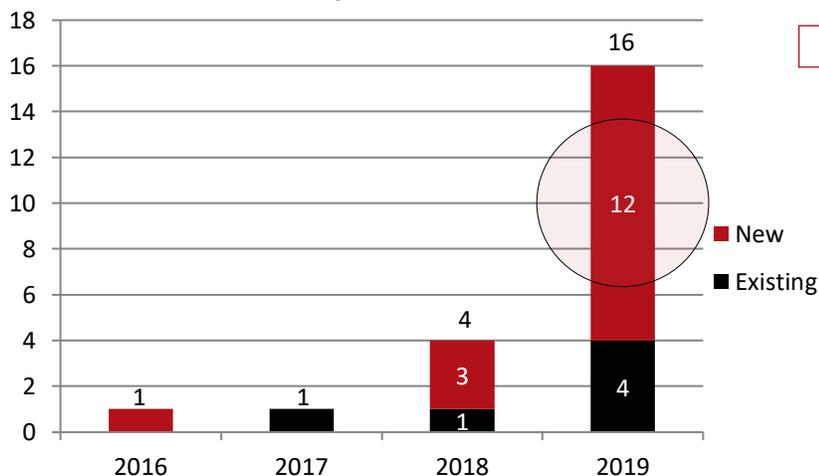
In the third and fourth quarter of 2019, A total of 14 gastroenterology practices were acquired, up 250% versus the same period in 2018. Fourth quarter acquisitions alone were up 400%.

Acquisitions by Quarter

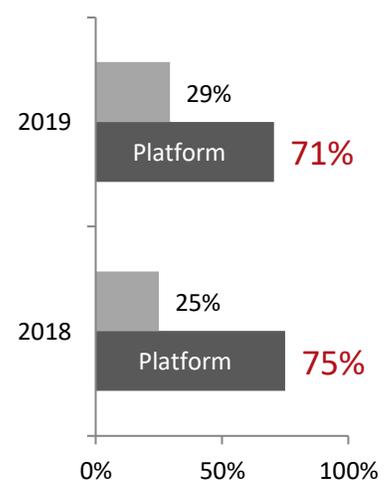


Two key factors provide a view of current and future consolidation speed: 1) the acquisition of platform practices of 10 or more physicians and 2) the geographic footprint of those acquisitions. Gastroenterology platform acquisition exploded in 2019 when platform acquisitions tripled all platform activity for the prior three years. In the last two years, platform acquisitions have dominated the transaction mix at over 70%.

Acquisition of Platform Practices (10+ Physicians)



% Platform vs. Add-on



Geographic Investment Highlights by Quarter

 <p>Q4.19</p>	<ul style="list-style-type: none"> • Eight New Geographic Areas (NGA) Entered • Varsity Healthcare Partners enters gastroenterology with platform investment in Peak Gastroenterology Associates Colorado Springs, CO (25 Physicians/NGA) • Seven new platform acquisitions made • Gastro Health becomes second investor in Washington DC area acquiring Gastroenterology Associates of Northern Virginia (18 Physicians) • Gastro Health makes largest acquisition in Q4, Arizona Digestive Health in Phoenix AZ (50 Physicians/NGA) 
 <p>Q3.19</p>	<ul style="list-style-type: none"> • Four New Geographic Areas (NGA) Entered • Physicians Endoscopy enters gastroenterology with strategic partnership in Capital Digestive Care Washington, DC (55 Physicians/NGA) • GI Alliance acquires Illinois Gastroenterology Group in Evanston, IL (45 Physicians/NGA) • Gastro Health acquires Puget Sound Gastroenterology in Seattle, WA (24 Physicians/NGA) 
 <p>Q2.19</p>	<ul style="list-style-type: none"> • Two New Geographic Areas (NGA) Entered • Amulet Capital enters gastroenterology with platform investment in Regional GI, Main Line Gastroenterology Associates and Digestive Disease Associates in Philadelphia, PA (64 Physicians/NGA) • Gastro Health acquires Southeast Gastro in Birmingham, AL (20 Physicians/NGA) 
 <p>Q1.19</p>	<ul style="list-style-type: none"> • Gastro Health completes add-on acquisition of Giles Gastroenterology Center (dba Gastroenterology Specialists) in Orlando, FL (3 Physicians)

Key Takeaways / 2020 Outlook

1. The end goal objectives of the current wave of specialty practice consolidations have been proven out by recent ophthalmology recapitalizations at high EBITDA multiple. This is attracting new investors and continued development by participating investors.
2. Key indicators and analysis suggests the U.S. gastroenterology consolidation wave is entering a significant acceleration phase.
3. Given the unique makeup of gastroenterology in terms of physician size, market coverage and acquisition opportunity, we believe a significant number of new PE investors will enter the gastroenterology market in 2020.
4. Analysis shows the gastroenterology consolidation has reached a tipping point that signals a significant surge in activity by firms already invested as well as those considering entry. We believe the rush is on to secure strong platform acquisitions and important add-on practices in key geographic areas.
5. Two key factors provide a view of current and future consolidation speed: 1) the acquisition of platform practices of 10 or more physicians and 2) the geographic footprint of those acquisitions. Gastroenterology platform acquisition exploded in 2019 when platform acquisitions tripled all platform activity in the prior three years. Importantly, those acquisitions occurred across a wide footprint throughout the United States.
6. In 2020, we believe there will be a significant increase in prospecting activity around the fourteen platform practices acquired in the 2019 calendar year as well as new geographies yet to be entered.

Contact

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

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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.

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