

Driving Value With an Investment Bank

*Why working with a partner can lead to
the best outcomes*

Introduction

With increased costs, razor-thin profit margins, and lower reimbursement rates, physician owners are finding it increasingly difficult to grow and scale their practices. Add to that the move to value-based care and new technologies, and it's no surprise that private equity continues to fuel M&A trends in healthcare and drive a wave of deals.

In 2022, private equity raised fresh capital of **\$343.1 billion**.¹ Volumes remained steady between May 2022 and May 2023, with 1,661 deals valued at **\$85.2 billion**. And experts say, with enough dry powder allocated for healthcare, these trends will continue.²

Physicians spend most of their careers working to build their practices, so when they decide they're

ready to sell, the business decision is one of the most important they'll ever have to make. While the benefits are clear—autonomy, cash up front, secondary monetization, and growth—the path to close the deal is often rife with obstacles.

While some physician owners try to execute the transaction on their own, they almost always open themselves up to a myriad of risks. At the same time, those who consider an investment banking partner may be concerned about the investment and wonder whether a partnership is really worth it. Weighing the risks and benefits of both options is critical to ensure the best outcomes.

Risks of Selling Solo

Physician owners who attempt to manage a deal on their own risk a lower valuation, less than optimal terms, or a deal that falls through.

LOWER VALUATION

A common misconception among physician owners who try to manage the transaction on their own is that every buyer is going to analyze their financials the same way. This line of thinking can often leave them vulnerable to a lower valuation.

The truth is that they only get one chance to make a strong first impression. Before sharing data or talking valuation with buyers, there is a lot of due

diligence that needs to be performed upfront, including determining how to position the practice, thinking through cash flow adjustments, and exploring growth opportunities. Simply sharing historical financials can be a significant missed opportunity to present their business in an optimal way and receive the highest possible valuation.

LACK OF COMPETITIVE PROCESS

If physician owners are only talking to potential buyers who knocked on their door, they're not seeing the entire market, and there's no way they can feel confident that they got the best price—or even an average price. Even for those who engage

with credible buyers, without a thorough auction process and true competition, sellers risk missing out on potentially better deals.

SUBOPTIMAL TERMS

One of the most commonly overlooked areas of a transaction are the financial and non-financial terms. For example, physician owners may not know to negotiate fair and reasonable vesting schedules or inquire about the partner's commitment to invest in future growth and income repair of the practice.

A DECLINE IN PERFORMANCE

When physician owners attempt to sell on their own, they're often unprepared for the amount of time and commitment that's required— typically 6 to 12 months, on average. When their focus is shifted away from running the business, the potential buyer may lower the initial offer, forcing them to sell at a lower price. Or they may have to wait to get the business back to a solid place.

GOVERNANCE AND SOCIAL CHALLENGES

Challenges are inevitable with every M&A transaction regardless of how straightforward they are, and without a partner who is a skilled negotiator, navigating and solving them can be impossible. Governance and social challenges in the existing and prospective partnership are common. They may include discussing fair splits among partners, how to involve and retain employed physicians, and what governance rights owners should expect to maintain at the practice.

THE DEAL COULD FALL THROUGH

Most buyers don't have the experience to know whether they should be patient and work through issues that come up or walk away. A fully-marketed process with strong cover bids gives buyers a credible option to exit, which can provide significant leverage for sellers to get higher bids.

STRESS AND ANXIETY

M&A is a complex, high-pressure process that requires knowledge and expertise that most physician owners lack. Plus, those who attempt to manage the transaction on their own are ill-prepared to work with private equity firms, top-notch lawyers, accountants, and other consultants. The stress associated with the deal is likely to add to the [burnout physicians are already experiencing](#).³

Benefits of Working With an Investment Banker

Working with a firm allows physician owners to leverage knowledge, expertise, and credibility they wouldn't otherwise have on their own.

INDUSTRY EXPERTISE

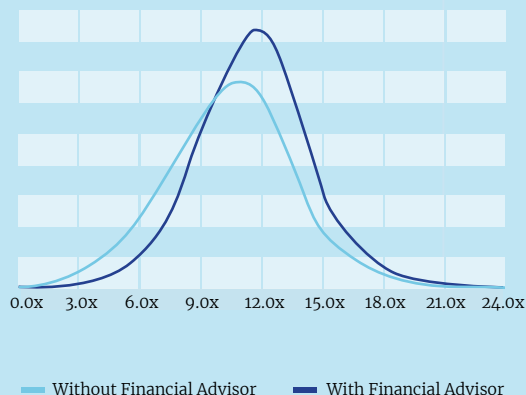
Healthcare transactions are complex, and understanding the regulatory and compliance requirements requires a partner with specialized industry knowledge, expertise, and experience.

Investment bankers who specialize in healthcare can provide a comprehensive understanding of the current market trends and the regulatory environment. They are uniquely positioned to accurately assess the value of the practice, find the right buyers who are willing to pay a fair price, and are equipped with strong negotiation techniques.

Plus, research shows that individual investment bankers who have more experience with deals are associated with higher acquisition returns and post-acquisition operating performance, particularly for acquirers in complex and more opaque industries.⁴

Business owners who work with investment banks achieve transaction values 1.5x EBITDA higher than average.

DEAL MULTIPLES WITH AND WITHOUT SELL-SIDE FINANCIAL ADVISOR



| | Without Financial Advisor | With Financial Advisor |
|----------------------|---------------------------|------------------------|
| Mean EBITDA Multiple | 10.2x | 11.7x |
| Standard Deviation | 2.88 | 2.59 |
| Observations | 1,600 | 2,716 |

MAXIMIZED VALUE

As skilled negotiators, investment bankers can help physicians get the best possible price for their practice and structure the deal in a way that minimizes tax liabilities and maximizes the financial benefits for the sellers.

Investment bankers build a financial model that ensures proper treatment of normalizing adjustments and the quantification of growth opportunities, providing a robust financial picture for potential buyers.

Additionally, a strong *multiple* isn't enough. Healthcare transactions are considered a hybrid with *trailing* earnings, a historical and a steady state component, and *forward* earnings, a projected growth component. When both types of earnings are prepared and presented in a credible manner, the overall valuation will be increased. Investment bankers understand how to dig into the numbers and best position the practice for optimal outcomes.

POSITIONED FOR A HIGHER VALUATION: TRAILING AND FORWARD EARNINGS

With a trailing multiple of 14x and a forward multiple of 10x, the overall valuation is \$70,000,000.

| LAST 12 MONTH TRAILING EARNINGS CALCULATION | | FORWARD EARNINGS CALCULATION | |
|---|--------------------|----------------------------------|--------------------|
| Last 12 Months Trailing Earnings | \$4,500,000 | Adjusted Trailing Earnings | \$5,000,000 |
| Add Backs | | Projected Items | |
| Non-Recurring Expenses | \$250,000 | Ancillary Ramp Up | \$1,000,000 |
| One Time Costs | \$250,000 | New Producer Ramp Up | \$1,000,000 |
| Adjusted Trailing Earnings | \$5,000,000 | Adjusted Forward Earnings | \$7,000,000 |
| Trailing Multiple | 14x | Forward Multiple | 10x |

CREDIBILITY

Representation by an investment banking partner lends credibility to the transaction and prevents lowball offers. Potential buyers understand there's a competitive process at play and the seller is committed to seeing the deal through.

ACCESS TO A LARGE NETWORK OF BUYERS

With a broad network of contacts, including private equity firms, strategic buyers, and other investors, investment bankers can quickly identify potential buyers. The large network also encourages a competitive bidding process and drives a higher valuation, allowing sellers to feel confident that they received the right price and financial and non-financial terms.

CONFIDENTIALITY

Maintaining confidentiality among physicians, board of directors, attorneys, accountants, and other stakeholders is critical to any M&A transaction. If sensitive information such as reimbursement rates are leaked, the valuation could be affected. Physician owners may also not want their patients, staff, and competitors to know about their plans. By facilitating non-disclosure agreements (NDAs) and screening potential buyers, investment bankers ensure the strictest level of confidentiality is maintained.

A FASTER AND SMOOTHER PROCESS

Challenges are bound to arise, but working with an experienced investment banking partner can ensure issues are resolved, deadlines are adhered to, and the process moves forward without pulling sellers away from running their businesses.

Investment bankers can also help sellers navigate challenges that come up after letters of intent (LOI) are executed before the close. These may include unexpected physician departures and financial, legal, or regulatory issues that were unearthed during the due diligence process.

CONTROL AND GOVERNANCE

A good investment banker will help owners focus on areas of value to them outside of the purchase price and can advise on what to expect and how to best negotiate post-deal governance rights. Different buyers (hospital systems and strategic buyers vs. private equity platform buyers) might offer different levels of autonomy. An investment banker can help owners prioritize their goals and flush out with buyers decisions around the business of the practice and patient care well before a deal closes.

CASE STUDY

Merritt's Fully Marketed, Competitive Process Nets 48% Higher Offer for Practice

THE CHALLENGE

A physician practice that decided to run a sale process on its own received 5 letters of intent (LOI) with a wide range of valuations and deal terms. Uncertain about how to evaluate the offers, they engaged with Merritt to review the LOIs and advise on next steps.

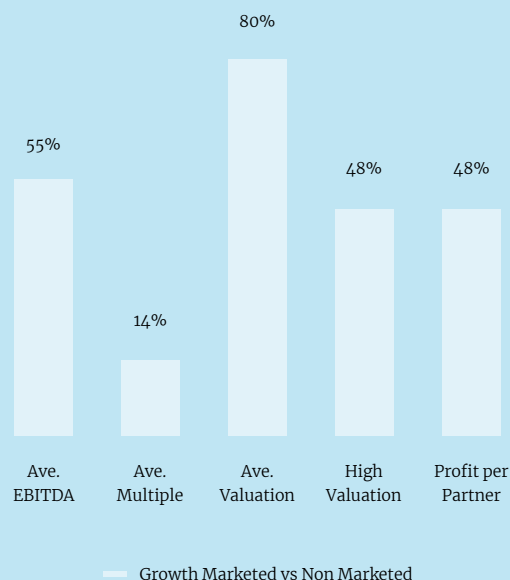
[Read the full white paper on Selling a Medical Practice.](#)

ILLUSTRATION: NON-MARKETED PROCESS VS. BANKER-LED MARKETED PROCESS

Marketed deal value added 48% (\$30MM) to the Enterprise Value. Enhanced valuation was driven by both better analysis & presentation of financials and by offering a competitive bidding process.

| | Non-Marketed/ No Banker | Marketed/ Banker |
|---------------------|----------------------------|---------------------|
| Buyer Ave. EBITDA | \$3.8MM | \$5.9 |
| Buyer Ave. Multiple | 11.7x | 13.3x |
| Ave. Valuation | \$44MM | \$79MM |
| High Valuation | \$62MM | \$92MM |
| Per Partner (10) | \$6.2MM | \$9.2MM |

PRE VS. POST MARKETED TRANSACTION GROWTH



What To Look For in an Investment Banking Partner

Whether it's a partnership with another group, selling an interest in your business, or growing through an acquisition, the right partnership matters. Here are some areas to consider.

- **HEALTHCARE PRACTICE EXPERTISE:**

Look for a firm that has a team of professionals who have experience in both investment banking and healthcare operations, specifically developing and running facilities. Partners with this specialized background have an understanding of regulatory and compliance standards and are able to more easily navigate challenges than partners without the same expertise.

- **EXTENSIVE NETWORK:** The partner you work with should have a broad network of relationships in hospitals and health systems, healthcare organizations, strategic firms, private equity, and industry leaders across the U.S.

- **PROVEN RESULTS:** When evaluating potential partners, it's important to have an understanding of the firm's process and strategy and ensure their vision is aligned with yours. The firm should also be able to demonstrate compelling financial and non-financial outcomes for past clients.

About Merritt Healthcare Advisors

Merritt Healthcare Advisors ("MHA") is focused exclusively on representing owners of middle-market healthcare businesses that are considering strategic options, whether it is selling an interest in their organization, creating a new partnership, or growing through acquisition. MHA is unique in that we are the only firm that combines an investment banking background with actual "owners" experience that comes from developing and managing our own healthcare facilities. We have used this experience to successfully complete more than \$5 billion in transactions on behalf of our Clients. As the industry's leading Mergers and Acquisitions ("M&A") firm, our proven process and extensive buyer network enable us to help our Clients realize the absolute best financial and non-financial outcomes. The Principals of Merritt acted in their capacity of licensed investment banking agents of Burch & Company, Inc., member FINRA/SIPC. For additional information about Merritt Healthcare Advisors, please visit www.merrittadvisory.com.

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Request a meeting with Merritt

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¹ PitchBook. (2023, January 12). 2022 Annual US PE Breakdown. <https://pitchbook.com/news/reports/2022-annual-us-pe-breakdown>

² PwC. (n.d.) Health services: US Deals 2023 midyear outlook. <https://www.pwc.com/us/en/industries/health-industries/library/health-services-deals-outlook.html>

³ Medscape. (2022 January 21). Physician Burnout & Depression Report 2022: Stress, Anxiety, and Anger. <https://www.medscape.com/slideshow/2022-lifestyle-burnout-6014664?af=1>

⁴ Chemmanur, T., Ertugrul, M., & Krishnan, K. (2019). Is It the Investment Bank or the Investment Banker? A Study of the Role of Investment Banker Human Capital in Acquisitions. *Journal of Financial and Quantitative Analysis*, 54(2), 587-627. doi:10.1017/S002210901800073X