NEW INVESTORS 'OPTI-MISTIC'

Private Equity Banks on Optical's New ROI

BY MARGE AXELRAD AND JOHN SAILER

Call it 'Opti-mism.' The pace of new investment and acquisitions in the retail and optometric side of the U.S. optical business has been intensifying. In 2015, that pace picked up dramatically—and more deals are reportedly on tap for the remainder of this year and into the next—promising to essentially reshape the business in new ways, to realign and restructure the national regional, local optical retail landscape and the presence of vision care in the health care space as well.

Financial experts, retail executives and analysts specializing in optical agree that there has never been a better time to invest in the optical business. With decades of experience in the field, investors who have turned their sights toward the business of vision, say that right now there are especially unique conditions fueling private equity deals and consolidation. In conversations with *Vision Monday*, experts cited several factors all coming together to create this crescendo: the amounts of available investment money in all sectors, currently low interest rates, health care reform, opportunities for new optical platforms serving the evolving vision care needs of patients, the "good fundamentals" of optical and the steady need for vision correction solutions for patients of all ages.

MONEY AVAILABLE

"We are in a very favorable deal environment, probably the most favorable market for sellers I've ever seen in 30 years," said Mark Goodman, head of Consumer Investment Banking at Raymond James & Associates, one of the nation's leading investment banks. Goodman has over 30 years of experience advising private and public companies on capital raising and mergers and acquisitions. He and his team have worked with many premier consumer and retail companies and have completed a number of transactions for leading companies in the optical retail sector. He described the general deal-making environment today as "the perfect storm of private equity availabil-

NEW INVESTORS 'OPTI-MISTIC': A VM Series

Starting with this issue, *VM* begins a Special Series exploring the recent influx of private equity capital into the optical business and the multimillion dollar deals (and in one case, billion dollar deal) being made in the sector. With access to record amounts of available money and health care reform encouraging consolidation, this "perfect storm" shows no signs of stopping as mergers and acquisitions continue their pace.

This first installment explores the private investors' perspective about optical. Watch for part 2 in the Sept. 14 edition of *VM*, which will take the optical retailer/ECP point of view and also explain what they need to know about the current climate and factors to consider. *VM* is anticipating that future stories might explore specific new platforms, the brands and businesses they are building to reach modern consumers and patients and also look into the impact of these new investors' approach to the optical market landscape. *VM* welcomes your comments and ideas, please let us know at maxelrad@jobson.com and jsailer@jobson.com. ■

ity and credit availability than ever before." Goodman pointed to financial market reports estimating that there is some $400 billion to $500 billion of "undeployed private equity" out there.

Goodman observed, "Following the huge debt crisis of 2008, and the nature of the recovery that followed, combined with low interest rates, the ability to leverage deal value is significant. There are tremendous amounts of cash and banks are anxious to put capital out there. When the economy is doing reasonably well, as it is now, and lenders feel positive, they are willing to lend at a much higher level in terms of loans to cash flow ratio."

That means, Goodman and others point out, that valuations, as a multiple of EBITDA, which is how all private equity deals are generally measured, can be higher, too. All of this means that those looking to sell may be in a position to negotiate higher prices for their practices.

Chris Harris, of FFL Partners, the group which has been visibly active this year in the optical sector with deals with Eyemart Express and Clarkson Eyecare, among others, said, "We raise money from limited partners' foundations, endowments, and so forth, and those limited partners are looking for rates of return. Private equity is an asset class where people can generate higher returns, no question."

Anne Kavanagh is managing member of Kavanagh Consulting, L.L.C. a consultancy that provides M&A, financing, strategic advisory and business development services to the optical industry, as well as a broad array of health care and retailing clients. In a presentation this past spring at the National Association of Vision Care Plans (NAVCP) meeting, she pointed out, "U.S. equity markets have reached an all-time high. The 2014 IPO market was the most active in over a decade, with the highest level of mergers and acquisitions in that time. The mergers and acquisitions market for specialty health care is particularly robust because the Affordable Care Act makes it necessary to increase scale and efficiency while reducing cost."

"Healthy deals, like the ones we've seen in our field most recently, bring ever increased interest and focus on the optical category."

Reade Fahs
CEO, National Vision, Inc.

About the current climate favoring deals in various sectors, Kavanagh added, "The retail/consumer side is driven by the dollars available (from the consumers, dollars for them to spend), and health care reform requires more efficiency and a lower cost structure."

Most private equity/investment experts agree that they evaluate economics and management talent, too, as fundamental considerations. When a company can demonstrate sustainable EBITDA growth potential, the investors, owners and management teams will be in a position to optimize their exit. And, yes investments need to present a "viable exit strategy," either among strategic or other financial buyers. Those holding periods are typically plus or minus five years, all agree.

OPTICAL'S APPEAL

The deals the U.S. optical industry is seeing today are often the result of years of study, discussions and exploration by the major private equity firms and those specialists who work with them. Hunter Puckett is managing director and general counsel, HPC Puckett & Co, a firm founded by his father, Tom Puckett, in 1983. With extensive family and business background in the optical industry, the company is unique in its knowledge, legal and financial perspective about the optical space.

The privately held merger and acquisition advisory firm takes on the role as an exclusive sell-side advisor. In 2014, the firm closed 16 optical sector merger and sale transactions. This year, the firm opened 2015 with more than 20 optical entities under exclusive retainer, the Pucketts said.

Hunter Puckett observed, "Optical is unique, combining both medical and consumer retail, and while this combination can make the sector more complex, it can also make it especially attractive to investors right now."

Tom Puckett said, "At HPC we strive to maximize the value of our clients' business while at the same time creating a structure that aligns the owners' current and future needs with those of the purchasing partner going forward."

Noted Hunter Puckett, "We work with clients, many over a period of years, to determine what's best

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Private Equity Likes Optical's ROI

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for them, what they really envision for the future. We ask our clients, 'In a perfect world, what's best for you?' it sounds like an easy question, but it's really not. We're a family business and understand that many entrepreneurs and vision groups out there are family businesses. We try to bring their expectations and disciplines in line with what the investors are looking for, too. But clearly the interest in this space is higher than ever right now."

Raymond James' Goodman concurred, "Analysts are particularly interested in the optical industry for the higher profits they can expect to generate relative to certain other health care sectors. They like the high gross margins in the business."

The business of vision is also attractive to investors because of its inherent ability to remain profitable even during economic downturns. "They also like the resilience of the sector more so than other retail sectors," added Goodman, "because it's a need-to-have item as much as a want-to-have item."

Another factor affecting the vision market's desirability is the aging population and its need for more eyecare services and eyewear. "The aging population is also a driver of demand," Goodman said.

FFL's Harris, whose father was an independent ophthalmologist, also commented, "In the world of health care, optical is attractive for a variety of reasons since it's at the intersection of health care and retail. You have interesting aspects of both that make optical better than health care and better in many ways than traditional retail. It's also kind of 'recession-resistant.'" Harris noted, "From peak to trough, we observed that there was not as much of a dip as other retailers in other sectors took during the last recession."

Several years back, Harris acknowledged, P/E firms that might have looked at optical didn't seem to understand it, tending to want to view it only in comparison to other "known" sectors. "To those unfamiliar with it, optical can just seem different and weird. It's been fragmented, true, but there are many real opportunities and value to uncover from it."

Kavanagh added, "All boats are now rising in this economy. But even in a down economy, optical is viewed more favorably than other retail sectors, both on the value side, and the higher-end."

When asked about the unique nature of the optical market, with its medical aspects, the influence of managed vision care, doctor ownership and state regulations, Goodman said, "The complexity of this market requires private equity firms to take more time to investigate, to get their hands 'dirtier' in the optical side of the business than they typically have to do in other more familiar segments. Some might regard that as a bit of a barrier to entry, there is indeed a learning curve to understand this business."

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Hunter Puckett
Managing Director and General Counsel, HPC Puckett & Co.

However, some elements of that complexity could be viewed as a positive. For example, although navigating many managed vision care plans is challenging even for those intimately familiar with operating an optical practice, it could also be seen as a kind of bonus. Noted Kavanagh, "Managed care can act as a marketing tool; it helps reduce the cost of marketing dollars for many in the optical sector, relative to other conventional retailers," for example.

Scott Werry, of Altas Partners, the Toronto-based firm involved in this month's acquisition, with Quebec's Caisse de Depot et Placement (CDPQ) known as La Caisse, of Capital Vision Services LP/MyEyeDr. from its previous equity partner, Monitor Clipper, told *VM* that the firm had been studying the field for a number of years. He remarked, "We take a longer term orientation to investing, and it's our goal to be a stable capital partner with the companies we invest in. We were drawn to the optical market because of its opportunity for growth, and we believe that the doctor-driven model in particular has much potential, particularly in such a fragmented market."

Reade Fahs, CEO of National Vision, Inc. pointed out, "National Vision was public until August 2005 when we were bought by Berkshire Partners, which purchased us and America's Best at that time. And we enjoyed an incredibly positive relationship with our partners. National Vision really enjoys working in a private environment, especially because the private equity firms we've been associated with have been very long term in their orientation; operating with them is not like being a public company, having to live quarter to quarter and take a shorter view."

In March of 2014, National Vision, the fourth largest optical retailer in the U.S., was purchased by the KKR Group, in a deal estimated by financial news sources as valued in excess of $1 billion. KKR's Nate Taylor, said at the time, "NVI has a bright future ahead of it, and we are excited to partner with this proven management team on its next chapter of growth. Through its broad store base and leading e-commerce platform, the company is poised to benefit from the growth in this highly attractive value segment of the optical industry. As NVI continues to grow, we also look forward to supporting its important social mission."

Of the current investment climate, Fahs said, "Healthy deals, like the ones we've seen in our field most recently, bring ever increased interest and focus on the optical category."

That view was acknowledged by Drew Schelzo, operating partner at Acon, and acting CEO of Refac

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Who's Who and What's What in Investing

Accredited Investor:
Investors who are financially sophisticated with a reduced need for protection, as defined by Regulation D of the Security and Exchange Commission (SEC), these investors can include individuals, banks, insurance companies, employee benefit plans and trusts. Accredited investors must earn $200,000 individually or $300,000 jointly during each of the last two years and expect that to continue; have an individual or net worth of $1 million; and be a general partner, executive officer, director or a related combination.

Acquisition Accounting:
How assets, liabilities, non-controlling interest and goodwill of the company being acquired must be reported by the purchasing company on its consolidated financial statement. International standards require that one company be the "acquirer" and one company be the "acquiree" for all business combinations, even if a new company is created.

Acquisition Adjustment:
Also known as goodwill (see below), the difference between the price paid for an acquisition and the net original cost of the acquired company's assets. This premium paid above the acquired company's book value is based on intangible assets such as good customer relations, brands, patents, and other intangibles.

Adjusted Book Value:
This reflects a company's true fair market value after liabilities, including off-balance sheet liabilities, and adjusted assets. While not often an accurate assessment of a profitable company's operating value, adjusted book value is most often used to value companies facing liquidation, bankruptcy or sale due to financial distress.

Angel Investors:
The opposite of venture capitalists, angel investors are usually family and friends who use their own finances as seed money or for ongoing support. Focused on the success of a business rather than earning a profit from their investment, angel investors usually base their investment on the person rather than the viability of the business.

Consolidated Financial Statement:
This aggregated look at the combined financial statements of a parent company and its subsidiaries help measure the status of an entire group of companies rather than just a single company.

Dry Powder:
The amount of money available for investment or operations from highly liquid marketable securities such as treasuries or other fixed income investments

Due Diligence:
The care taken before entering into an agreement to confirm all of the material facts related to a potential investment. This could be performed by the buyer reviewing financial records and anything else related to the sale and by the seller to gauge the buyer's ability to make the purchase.

EBITDA:
The most important metric when buying and selling. Specifically, Earnings Before Interest Tax Depreciation and Amortization, EBITDA is meant to determine the true value of any given business.

Fairness Opinion:
Usually compiled by investment bank analysts for key decision makers, the fairness opinion is a report that evaluates the facts of an acquisition to determine the fairness of the acquisition price.

Goodwill (see also Acquisition Adjustment):
A subjective valuation based on intangible assets such as good relations with customers and employees, brands, patents and other intangibles. This is the amount above the book value of the acquired company. Companies acquired at less than their book value are deemed as having negative goodwill.

Institutional Investor:
Institutional investors are non-bank individuals or organizations—such as pension funds, endowment funds, insurance companies, commercial banks, mutual funds and hedge funds—that trade in dollar amounts that are large enough so that they qualify for preferential treatment and lower commissions.

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Investment Bankers:
Individuals who work for financial institutions involved with raising capital and who may also provide advice related to mergers and acquisitions.

Investment Horizon:
The amount of time an investor plans to hold a specific investment.

Leveraged Buyout:
Using a significant amount of borrowed money in the form of loans or bonds to make an acquisition, usually with a ratio of 90 percent debt to 10 percent equity. The assets of the company being acquired are often used as collateral along with those of the purchasing company. This enables companies to make large acquisitions without committing a lot of capital.

Multiple:
Determined by measuring one metric by another to determine some aspect of a company's financial status, a multiple can show how much investors will pay per dollar of earnings.

Private Equity:
Equity capital that is not quoted on a public exchange, private equity comes from retail and institutional investors and funds that invest directly into private companies for acquisitions and also for other purposes such as expanding working capital, purchasing new technologies, or strengthen a balance sheet. Private equity investments often demand long holding periods to allow for a turnaround of a distressed company or a liquidity event such as an IPO or sale to a public company. Private equity usually consists of accredited and institutional investors. Private equity investors often prefer making a majority investment in order to maintain control. Sometimes partnering for large acquisitions, private equity investors work toward improving the finances of the acquired company in order to resell at a higher value.

Retail Investor:
Also known as an individual or small investor, retail investors are individuals who buy and sell securities for their personal account and not for another company or organization.

Valuation:
The process of measuring a company 'or assets' current value using a variety of subjective and objective techniques such as analyzing a company's management or capital structure, future earnings or asset market value.

Roll-Up Merger:
A roll-up merger (also known as a "roll up" or a "rollup") occurs when investors (often private equity firms) buy companies in the same market and merge them together. Roll-ups combine multiple small companies into something larger to be able to enjoy economies of scale. Private equity firms use roll-ups to rationalize competition in crowded and/or fragmented markets and to combine companies with complementary capabilities into a full-service business.

Target Firm:
A company which is the subject of a merger or acquisition attempt.

Venture Capital:
Institutions, such as pension funds, or wealthy individuals become limited partners with venture capitalists by retaining their services to invest their money. For example, a pension fund might hire a venture capitalist to invest $10 million of their money with the hopes of realizing several times that in return from a high performing start-up. These investors typically expect to see a return on their investment within ten years.

Sources: Financial market sources, Investopedia (Investopedia.com) and other investment specialists.

Recent Optical Retailer Acquisitions and Private Equity Investments

A number of major deals have taken place within the last five years:

Date	Investor	Transaction
March 2011	ACON Investments	acquires Refac Optical Group (including U.S. Vision subsidiary) from Palisade Capital Management affiliate
April 2011	Brazos Private Equity Partners, LLC	makes significant investment in Vision Source L.P.
December 2012	Monitor Clipper Partners	acquires minority share in MyEyeDr.
September 2013	FYidoctors	acquires Vision Source's Canadian assets and operations
October 2013	Refac Holdings and main subsidiary U.S. Vision	acquires Nationwide Vision
December 2013	New Look Eyewear Inc.	acquires Vogue Optical Inc.
January 2014	MyEyeDr.	acquires Doctors Vision Center brand and corporate locations
February 2014	MyEyeDr.	acquires Lord Eye Center
February 2014	Thomas H. Lee Partners, L.P.	acquires 1-800 CONTACTS from WellPoint, Inc.
March 2014	KKR	acquires National Vision Inc. from Berkshire Partners
August 2014	New Look Eyewear Inc.	acquires certain optical assets of Optic Direct Inc. doing business under the Greiche & Scaff banner
September 2014	Clarkson Eyecare	acquires Thoma & Sutton
September 2014	Luxury Optical Holdings (owned by investment firms aPriori Capital Partners and Goode Partners, LLC)	acquires Robert Marc Eyewear
November 2014	FFL Partners	makes growth investment in Eyemart Express
November 2014	FYidoctors	acquires Marchand Giguère Group
December 2014	MyEyeDr.	acquires Eye Care Associates in North Carolina
April 2015	FFL Partners	completes growth investment in Clarkson Eyecare, Inc.
May 2015	MyEyeDr.	acquires The Hour Glass and South East Eye Specialists
July 2015	Clarkson Eyecare	acquires EyeCare Associates and Pinnacle Optical LLC of Alabama
July 2015	Essilor of America	acquires Vision Source from Brazos Private Equity Partners, LLC
August 2015	Altas Partners and Caisse de dépôt et placement du Québec	invests with management to acquire MyEyeDr./Capital Vision Services

Source: Vision Monday. Chart information valid as of presstime.

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Optical, acquired four years ago, which operates U.S. Vision and Nationwide Vision. "I would say the climate is not any different than three or four years ago. We've seen some high profile deals and there can be somewhat of a herd mentality when it comes to private equity; firms will look at deals and say 'Oh, maybe they are onto something.'"

Schelzo pointed out, "The fundamentals that we saw four years ago are the same as they are today—the industry has strong fundamentals, demographics, the aging population creates good demand, it is still a very fragmented industry, private equity firms are investing to consolidate and fold them up. The margin profile is very strong in eyecare, making it attractive.

"But the other thing going on in the retail industry, in general, is the challenge from the internet, the challenge put on brick and mortar, but you don't really see that on the retail side in optical as much as you do in general merchandise, for example. You need brick and mortar stores in optical—even Warby Parker is opening stores—this makes people feel that brick and mortar is secure in optical. What tends to work in brick and mortar is specialty, and optical fits that profile, it is a medical device with consultative selling. There is a solid reason for people to come into the store and buy. They may be able to look up something on the web or buy something for a lower price, but they're not going to buy that way with their eye health."

Doug Barnes, Jr., CEO of Eyemart Express, which is currently operating 170 stores and will be expanding after the investment of FFL Partners earlier this year, noted, "At a time when many people are viewing Warby Parker and asking what might they do in the future, we feel so strongly that it's the private practice doctor, new efficiencies, the in-office and in-store opportunities for vision care which is the real up side."

In addition to the expansion planned for Eyemart Express, which it acquired this year, FFL Partners acquired Clarkson Eyecare, which it purchased in

2014. The firm has also, this summer, acquired EyeCare Associates (ECA), a 19-office optometry practice in Alabama and Pinnacle Optical LLC, a full-service wholesale lab in Alabama.

Anthony Nunn, president of Clarkson Eyecare added, echoing a view shared by others said, "It's also, frankly, more difficult to be an independent OD today than 15 to 20 years ago. The demands on each independent or regional group is increasingly more complex and burdensome. ODs coming out of school are less focused on ownership and more on lifestyle options as well as their eye doctor focus. Many are saddled with debt. This results in reduced exit options for older ODs, too."

Another retail executive pointed out, "In today's competitive retail environment, it can be expensive to invest in new systems and support structures in a business." And, Nunn added, "It's increasingly difficult to keep up with the investments and requirements for ICD-10, EMR, and compliance with health insurance companies. Our approach is looking for practices that are more medically based."

Today, both sides are being influenced to seek consolidation, resulting in a flurry of acquisition activity. On the practice owner side, increased regulation and competition, challenges staying up-to-date with technology, and a desire to leave management challenges behind in order to focus on the patient, are all encouraging them to give up running the business, cash out their own equity yet stay involved with seeing patients.

On the investor side, record amounts of money available at low interest rates, health care reform encouraging efficiencies that come from economies of scale, and practice owners looking to rollover their businesses are all coalescing to form an environment friendly toward acquisition and consolidation.

Combined, the current acquisitive landscape helps answer the question that Kavanagh said every CEO must be asking, "How do I stay relevant?" The proof is in the private equity, putting its money, and lots of it, into optical. ■

A Unique Player: Why American Optical Services Lost Its Bet on Optical

LAS VEGAS—Based in the gambling capital of the U.S., American Optical Services (AOS) lost its bet on consolidation . . . and brought a number of successful optical businesses down with it. Judging from the many successes private equity firms have experienced in the sector, this failure was not due to the market itself, which remains robust, but resulted from poor planning, mismanagement and other factors, according to many of the investors and retailers spoken to by *VM*.

Formed in 2009 with a buying team and a group of seven regional managers reporting to COO Erica Perreira, AOS began acquiring and overseeing the operations of practices across the country with Pierre Keyser as president and CEO. Some were retail-oriented eyewear businesses, while others were ophthalmology or optometric medical model practices.

Why did AOS fail? According to a statement released by the parent company when it filed for bankruptcy in 2014, "The liquidity crisis that precipitated the filing was the culmination of various factors including a non-strategic acquisition strategy, unsustainable costs of practice integration, electronic medical records implementation and general mismanagement." In addition, "upon the discovery of significant accounting irregularities, the board of managers launched an investigation, which led to the termination" of the company's former CEO, Pierre Keyser, and former COO, Erica Perreira.

Unlike other successful investments in the sector in which synergies were exploited or optical chains were rolled up based on their geographic proximity, AOS was all over the map, acquiring locations haphazardly with no thought toward how the whole could equal more than the sum of its parts.

"Significant accounting irregularities" proved too much for the company. AOS went bust and filed for bankruptcy protection on Friday, June 20, 2014.

Those that had been paid up front already had the money they were due for the businesses that they had sold to AOS, but others who had accepted payment plans from AOS were stuck and had to wait until the company proceeded through bankruptcy protection to find out what they would receive, as *VM* reported.

Turnaround executive Thomas J. Allison was named CEO, and he began a process of restructuring that involved categorizing the operation's practices into three silos—those that needed to be closed due to their profitability levels, those that would be sold at auction and those that were placed into "keepwell" operation to remain open, offering their previous owners the opportunity to buy their practices back from AOS within 60 days.

Currently, private equity investors and retailers VM spoke to point to the failure of AOS as a lesson to eyecare professionals, reinforcing the advice financial consultants have for those seeking an exit strategy by selling out to private equity and other investors making acquisitions—be sure to vet the buyer and any transaction before agreeing to anything, especially a deal that involves payment plans versus money up front. There are plenty of successful deals happening in the optical sector, as evidenced by the chart on page 46, and there are surely to be many more.

jsailer@jobson.com