

Navigating the Boom: Legal and Structural Realities of Private Equity in Cosmetic Medicine

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The market for corporate investment in medspas, dermatology, and cosmetic practices remains one of the most active sectors in healthcare private equity (PE). Driven by high cash-pay revenue, fragmented markets, and strong consumer demand, PE funds continue to aggressively roll up clinical practices.

However, transitioning from an independent, physician-owned practice to a PE-backed platform is a rigorous legal and financial undertaking. Sellers who understand the mechanics of valuation, corporate preparation, and transaction structuring are best positioned to maximize value while protecting their post-closing interests.

1. Valuation and EBITDA Considerations

Private equity transactions are fundamentally driven by a multiple of the practice's Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA). For independent cosmetic practices, calculating a true "adjusted EBITDA" is the first critical hurdle.

- **The Valuation Gap:** Small, single-site medspas may command multiples of 4x to 6x EBITDA, whereas larger, multi-location dermatology platforms can command 10x to 14x+ EBITDA.
- **Normalizing Adjustments:** To find true EBITDA, the seller's financial team must add back personal expenses run through the business, one-time legal fees, and above-market owner salaries.
- **The Provider Compensation Adjustment:** The most significant adjustment involves replacing the owner's current draw with a market-rate salary or commission structure (e.g., 20–25% of personal net collections). Because this reduces EBITDA, balancing pre-sale cash flow expectations against the ultimate transaction multiple is a delicate legal and financial calculation.

2. Preparing for Due Diligence: Corporate Books and Records

PE buyers conduct exhaustive due diligence. Discovery of corporate or regulatory non-compliance mid-transaction can result in severe purchase price reductions or deal termination. Sellers must get their corporate house in order before signing a Letter of Intent (LOI).

- **Corporate Structure and Governance:** Buyers will review all historical organizational documents, meeting minutes, and equity issuance records. Missing stock certificates, unrecorded transfers, or unsigned operating agreements must be remediated.
- **Regulatory Compliance:** Due diligence will heavily scrutinize federal Anti-Kickback Statute (AKS) compliance, HIPAA data privacy protocols, and state law "fee-splitting" prohibitions.
- **Licensing and Credentialing:** Every provider—physicians, mid-levels, estheticians, and laser technicians—must have up-to-date licenses, proper oversight agreements, and documented certifications for the specific devices they operate.

3. The Quality of Earnings (QofE) Analysis

Relying on internal QuickBooks files or standard tax returns is insufficient in a PE transaction. Buyers will commission a third-party accounting firm to perform a Quality of Earnings (QofE) analysis. Forward-thinking sellers often commission a “sell-side” QofE before going to market.

- **Cash vs. Accrual Accounting:** Many cosmetic practices operate on a cash basis. A QofE converts these financials to accrual-based accounting (GAAP) to accurately match revenues with the period in which the services were actually performed.
- **Deferred Revenue Management:** Medspas frequently sell gift cards, packages, and membership subscriptions. A QofE analyzes how deferred revenue is tracked. Money collected up front for a cool-sculpting package cannot be recognized as earnings until the treatment is rendered, which significantly impacts closing-day working capital calculations.

4. The Heavy Lift of Disclosure Schedules; Interplay with Indemnification and Escrow

The Disclosure Schedules are arguably the most labor-intensive legal component of the definitive asset or stock purchase agreement, and they are inextricably linked to the transaction’s indemnification framework and escrow mechanics. Together, these three elements form the backbone of post-closing risk allocation between buyer and seller.

- **The Risk Allocation Function of Disclosure Schedules:** The disclosure schedules serve as the exceptions to the seller’s representations and warranties. For example, if a purchase agreement states “the seller is not a party to any material contracts over \$X in annual expenditure,” the disclosure schedule must list every single lease, vendor agreement, and software license that exceeds the applicable threshold. If an item is omitted and later causes a loss, the buyer can claim a breach of the seller’s representations and seek indemnification — making the completeness of these schedules a critical predicate to the entire indemnification framework.
- **The Scope of Disclosures:** For cosmetic practices, these schedules require an exhaustive cataloging of all medical devices (and whether they are leased or owned), employee census data, active litigation, patient complaints, and historical regulatory audits. Preparation requires weeks of dedicated administrative effort.
- **Escrow as a Security Mechanism:** To ensure the seller’s indemnification obligations are more than a contractual promise, buyers in cosmetic M&A transactions typically require that a portion of the purchase price — commonly **5% to 15%** — be deposited into an escrow account at closing, held by a third-party escrow agent. The escrow fund serves as the buyer’s readily accessible source of recovery for indemnification claims without needing to pursue the seller directly. Escrow terms are a significant negotiating point: sellers push for shorter hold periods and smaller escrow amounts to accelerate receipt of full consideration, while buyers seek longer hold periods (often 12 to 18 months, matching the general representation survival period) and larger reserves to account for claims that may not surface immediately after closing. In transactions involving rollover equity, the escrow negotiation can take on additional complexity, as the seller’s reinvestment in the platform may itself provide the buyer with a degree of comfort regarding the seller’s ongoing alignment.
- **Indemnification Mechanics:** The indemnification provisions in the purchase agreement establish the buyer’s primary remedy for post-closing losses arising from breaches of the seller’s representations and warranties. In cosmetic healthcare transactions, buyers typically negotiate for **special indemnities** covering known high-risk areas — such as undisclosed regulatory violations, malpractice claims, HIPAA breaches, or noncompliance with the Corporate Practice of Medicine doctrine — that survive beyond the general survival period and may sit outside the indemnification

cap. The scope of indemnification is often heavily negotiated, with key terms including survival periods (commonly 12 to 24 months for general representations, and longer for fundamental representations such as title, authority, and tax), indemnification caps (frequently 10% to 20% of the purchase price for general representations), deductible baskets or mini-baskets that set a threshold before claims become payable, and whether the indemnification obligation is the buyer's sole and exclusive remedy.

- **The Interplay — Schedules, Indemnification, and Escrow:** These three elements operate as an integrated risk-allocation system. The disclosure schedules define the baseline of what the seller has represented as true; the indemnification provisions create the contractual right to recover when those representations prove inaccurate; and the escrow ensures a funded source from which the buyer can satisfy those claims. A gap in any one element weakens the others — incomplete schedules undermine the basis for indemnification claims, narrow indemnification terms limit the buyer's recovery even when a breach is clear, and an undersized or short-duration escrow may leave the buyer without a practical remedy if the seller lacks sufficient assets or becomes difficult to locate post-closing. For this reason, experienced counsel in cosmetic healthcare transactions negotiate these provisions as a package rather than in isolation, calibrating the size of the escrow fund, the breadth of the indemnification obligations, and the specificity of the disclosure schedules to achieve a coherent allocation of post-closing risk.

5. Typical Transaction Structures

Because of state-level healthcare regulations and the PE desire to align incentives, cosmetic M&A transactions utilize highly sophisticated corporate structures.

The PE-Backed MSO Model

Most states enforce the Corporate Practice of Medicine (CPOM) doctrine, which prohibits non-physicians from owning medical practices or employing doctors. To bypass this, transactions are structured using a Management Services Organization (MSO) model. **Click [here](#) to view the model.**

The MSO buys the non-clinical assets of the practice (real estate, brand, technology, IP) and provides administrative services (billing, marketing, HR) to the clinical entity in exchange for a fair-market-value management fee. The clinical entity remains technically owned by a licensed physician compliant with CPOM laws.

The MSO model, however, is under heightened scrutiny. State legislatures and medical boards are increasingly looking past the form of MSO arrangements to evaluate whether the licensed physician owner actually controls the practice. California, for example, enacted legislation (SB 351), effective January 1, 2026, that prohibits private equity groups and hedge funds involved with physician and dental practices from interfering with providers' professional judgment or controlling key aspects of the practice—such as coding and billing decisions, payer contracting,

and the hiring and firing of clinical staff—and limits the enforceability of certain non-compete and non-disparagement provisions. Oregon has adopted even more restrictive limits on MSO ownership and control of professional corporations, and medical boards in other states are using existing CPOM and fee-splitting authority to discipline physicians who lend their licenses to management-driven structures.

Recent enforcement activity illustrates the risk. Regulators have disciplined physicians who served as nominal owners of professional corporations while a non-physician operator and its management company effectively controlled the practice and divided its revenue on a percentage basis—an arrangement regulators view as impermissible fee-splitting. Regulators have also pointed to physician owners and medical directors who were not meaningfully involved in supervision, chart review, or

treatment protocols, as well as reliance on remote, third-party patient examinations that were not adequately documented in the patient record. The lesson for PE sponsors and sellers is that regulators are focused on whether money and clinical oversight actually move the way the MSA says they do—and whether that can be proven. Although, generally, no statute imposes a residency requirement, regulators in a growing number of states increasingly view in-state, proximate supervising physicians as a practical indicator of genuine oversight.

In response, a growing number of MSOs are moving away from “medical director matchmaking” and investing in technology-enabled infrastructure designed to make the MSA operational and auditable. On the financial side, “flow of funds” platforms deposit clinical revenue into a practice account—typically directly through the point-of-sale payment gateway—from which the MSO’s fair-market-value management fees, eligible practice expenses, and debt service on any MSO-to-practice loans are debited according to the MSA’s service schedule, while supervising physicians invoice the practice monthly for clinical services, with each transaction recorded in an audit ledger. For example, some platforms route patient payments through integrated point-of-sale systems into a practice account to which both the practice and the MSO have defined access rights, record any working-capital loans from the MSO to the practice as documented debt with scheduled repayment, and automatically debit management fees and other eligible expenses in accordance with the MSA. On the clinical side, some MSOs are integrating good faith examination workflows directly into the practice’s electronic health record, creating a documented chain of custody from examination to treatment rather than relying on third-party clearance services. For PE buyers, these systems can materially strengthen due diligence and post-closing compliance—but technology is not a substitute for a properly structured arrangement. Management fees generally should still reflect fair market value for services actually rendered rather than a percentage of practice revenue, and the physician owner must exercise real control over clinical decisions.

Rollover Equity

Buyers rarely pay 100% cash at closing. Instead, physician-owners are typically required to “roll over” 10% to 30% of their equity into the parent MSO. This ensures the founding providers remain incentivized to grow the broader platform, tying a portion of their wealth to a future “second bite of the apple” when the PE fund sells the consolidated platform to a larger fund.

Reduced Compensation Post-Closing

To maximize the EBITDA multiple at closing, sellers often agree to a lower post-closing compensation structure for their clinical work. While this yields a higher upfront payout, the physician must legally balance this against their required production quotas and lifestyle expectations post-closing.

Restrictive Covenants and Non-Competes

PE buyers are purchasing goodwill and patient loyalty. Consequently, purchase agreements will contain robust non-compete and non-solicitation covenants. These typically bar the selling physicians and key extenders from practicing cosmetic medicine within a specific geographic radius (e.g., 10 to 25 miles) for a period of 3 to 5 years post-closing.

6. Other Critical Transaction Considerations

- **Transfer of Control for Medical Devices:** Many laser and cosmetic device manufacturers require hefty transfer fees to transition software licenses and service contracts to a new corporate owner. The allocation of these costs must be negotiated early.
- **Tail Insurance:** Sellers are almost universally required to purchase “tail” medical malpractice and

cyber-liability insurance policies to cover any claims arising from pre-closing incidents.

- **Key Employee Retention:** The value of a med-spa often rests on star estheticians or nurse injectors. Buyers will frequently condition the deal on these key employees signing new, restrictive employment agreements prior to closing.

Conclusion

Sell-side transactions in the cosmetic medicine sector offer extraordinary financial liquidity, but they demand rigorous legal navigation. By proactively aligning corporate records, undergoing a sell-side financial analysis, and structuring the MSO framework carefully, practices can protect their clinical integrity while capitalizing on peak market valuations.

This article is general in nature and does not constitute legal advice. If you have legal questions, please consult the author, Mark Opara (mopara@sb-kc.com) at 816.265.4140 or any of the other attorneys in Seigfried Bingham's Health Care Law service group, or your regular contact at Seigfreid Bingham at 816.421.4460.