Comments on Proposal to Amend Rules 3-05 and 8-04
Bill Korn, Chief Financial Officer

(NASDAQ Global Market: MTBC)
Background on MTBC

• MTBC is a healthcare information technology company that provides proprietary web-based solutions and business services to healthcare providers
• Emerging growth company and smaller reporting company
• IPO on Nasdaq in July 2014
• 15 acquisitions over the last six years … all asset purchases

<table>
<thead>
<tr>
<th>Significant Acquisitions Requiring 8-04 Financial Statements</th>
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<tbody>
<tr>
<td>July 2013 Metro Medical Management Services, Inc.</td>
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<tr>
<td>July 2014 Omni Medical Billing Services, LLC</td>
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<td>Practicare Medical Management, Inc.</td>
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<td>CastleRock Solutions, Inc.</td>
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<td>July 2015 SoftCare Solutions, Inc.</td>
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<td>October 2016 MediGain, LLC</td>
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<td>July 2018 Orion Healthcorp, Inc.</td>
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<td>April 2019 Etransmedia Technologies, Inc.</td>
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Revenue

($ in millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue</th>
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<tbody>
<tr>
<td>2013</td>
<td>$10.5</td>
</tr>
<tr>
<td>2014</td>
<td>$18.3</td>
</tr>
<tr>
<td>2015</td>
<td>$23.1</td>
</tr>
<tr>
<td>2016</td>
<td>$24.5</td>
</tr>
<tr>
<td>2017</td>
<td>$31.8</td>
</tr>
<tr>
<td>2018</td>
<td>$50.5</td>
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Objective

• Provide investors with useful information to make informed investment decisions without:
  – Spending shareholder money unnecessarily on information that doesn’t help them
  – Limiting investment opportunities for smaller reporting companies
  – Limiting exit choices for private companies without audited financials

• Challenges:
  – Significance tests based on the size of the acquirer disproportionately increase the transaction costs for smaller companies
  – Tests that don’t distinguish between asset purchases and stock purchases require production of financial statements that aren’t relevant to the buyer
  – Repeated inclusion of Rule 3-05 financial statements long after a transaction closes and the seller has exited creates the need for representations that may be difficult and unreasonable for anyone to make
1. Eliminate Repeated Filing of Rule 3-05/8-04 Financials

- The proposal no longer requires separate acquired business financial statements *once the business has been included in the registrant’s post-acquisition financial statements for a complete fiscal year*
  - Today there is a convention that 9 months can be considered one year for some purposes
  - Once a seller has exited a business, it is difficult to get them to sign representation letters when they have no basis to know what might have changed
  - But the buyer can’t represent to the auditor events before the acquisition
  - Ideally the Form 8-K should include the auditor’s *evergreen* consent to the Form 8-K financial statements being incorporated by reference in future registration statements, with no further consents or rep letters needed
  - Alternatively, limit the requirement to include Rule 3-05 or 8-04 financial statements to 3 or 4 *complete quarters* (even if they span 2 fiscal years)
2. Encourage Carve-out Financial Statements when Appropriate

- Carve-out financial statements are permitted when less than the full business is acquired, but *many auditors find these difficult to audit*
  - For *asset purchases*, the only value to investors is the *operations actually acquired*, and *any assets and liabilities acquired*, not the full balance sheet
  - Much work goes into creating opening balance sheets and reconstructing prior years’ equity amounts, which has *no significance in an asset purchase*
  - Valuing *intangibles and goodwill from prior acquisitions* also has no value to investors (these just get eliminated with the new acquisition)
  - *Allocating overhead* which isn’t acquired adds no value to investors
- I would encourage *carve-out or partial financial statements for all asset purchases*
  - If a situation couldn’t be audited, I would rather see *partial financial statements reviewed*, as long as they match the assets actually acquired
  - The proposal uses the term “tested subsidiary,” so stock deals were the primary focus
3. Revenue Test may be better for Smaller Reporting Companies

- The proposal mentions revenue tests, but doesn’t go far enough
  - It mentions businesses with “annual recurring revenues,” without defining the term
    - I would simplify, saying “two or more years of revenue”
  - For a business whose net income is small, or which flips from positive to negative after an acquisition based on amortization of acquired intangibles, anything divided by income close to $0 is significant
  - I would modify the smaller reporting company standard (Rule 8-04) to rely on a revenue test, and let Rule 3-05, for larger companies, use the smaller of the two tests
  - For situations where an income test is used, I would:
    - Use pre-tax income before extraordinary items, since that better predicts the future
    - Eliminate goodwill impairment and amortization of intangibles from target company financial statements, since these get eliminated after acquisition
4. Investment Test Using Aggregate Worldwide Market Value

• Using *aggregate worldwide market value* makes sense
  – I would compute the value on the *date of the transaction*, to make it more comparable
  – Since Rules 3-05 and 8-04 only apply to public companies, their value should be easy to ascertain on any day (unless the acquirer is pursuing an IPO, in which case their market value may be hard to prove, and the current methodology of using total assets is more reasonable)

• But why consider only the value of common equity?
  – I would include the *value of all equity*, as long as its market value can be ascertained
  – If preferred stock is listed, or is convertible into listed securities, it seems just as relevant
5. Pro Formas should include Management Adjustments

- **Management Adjustments** would make Pro Forma financial statements more relevant in many cases
  - The question is how to get auditors to sign off on some adjustments, or include in comfort letters to underwriters, when they are *based on management’s assessment of the future*, not auditable actions taken in the past
  - Guidance should explicitly say that these adjustments need to be justified by management, but since there will need to be management judgement, this needs to be presented in a way which doesn’t complicate the auditor’s *comfort letter* ... or else companies may feel it is easier to omit such adjustments
  - Adjustments will be easier to justify for acquirers with a history of repeated acquisitions
Summary

• The SEC’s efforts to streamline Rule 3-05 and 8-04 financial statements will make the playing field more level.
• Many smaller reporting companies don’t have the resources or the patience to deal with these audits, and as a result, their shareholders, and the investors in private companies looking to exit, lose opportunities.
• Analysts and investors don’t care about past performance of acquisition targets … they want to understand the impact the investment would make on the acquiring company.
• Eliminating the system which requires repeated consents from an auditor would eliminate frustration and confusion of who can represent prior periods:
  – The buyer, who wasn’t present and has no firsthand knowledge of the period audited.
  – The seller, who is no longer involved, and knows nothing more than the last time they signed a management rep letter.
• The SEC’s proposal is a good step forward, but these few tweaks might make it even better.
Thank you!

Bill Korn
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